Trinidad and Tobago

Heritage & Stabilisation Fund

Quarterly Investment Report

January – March 2015

Central Bank of Trinidad & Tobago

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EXECUTIVE SUMMARY

Despite the optimism surrounding the US economic outlook for 2015, data for the first quarter of the year reflected a slowdown in activity. Durable goods orders declined in February, suggesting that companies remain cautious given the headwinds from the strengthening US dollar and restrained global demand. In addition, growth in the manufacturing sector slowed while consumer spending disappointed as US retail sales declined over the quarter. Although the inclement weather may have played a role in reducing output in the first quarter, markets remain hopeful that the economy will regain momentum during the second half of the year.

On the policy front, the Federal Reserve (Fed) as widely expected removed its reference to being "patient" in beginning to tighten its monetary policy. The Fed conveyed that they would not be "impatient" in raising rates and re-iterated that the normalization path would be very gradual. Following the most recent meeting of the FOMC, the consensus for the first rate increase shifted from June to September.

During the first quarter, economic conditions in the Euro Area appear to have stabilized and have entered a more sustained cyclical recovery, amid low oil prices, lower bond yields and a weaker currency. At the same time, concerns over a Greek exit from the Euro Area heightened as uncertainties re-emerged over Greece's financing needs.

In terms of monetary policy actions, the European Central Bank (ECB) began a much anticipated Asset Purchase Program (APP) on March 9th, which is expected to be carried out until September 2016 or until the ECB sees a sustained adjustment to inflation consistent with its aim of achieving inflation rates below, but close to, 2 per cent in the medium term. The combined monthly purchases of public and private sector securities will amount to €60 billion. At the ECB's April 2nd meeting, the Governing Council announced that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility would remain unchanged at 0.05 per cent, 0.30 per cent and -0.20 per cent, respectively.

In the United Kingdom (UK) during the first quarter of 2015, data pointed to an expansion in both Manufacturing and Services in the UK. The HSBC Markit UK Composite rose to 58.8 in March from 56.7 in February and 55.4 in December. Meanwhile, unemployment was relatively unchanged during the quarter while inflation continued to decelerate. The decline in the inflation rate to more than one percentage

point below the 2 per cent target triggered a letter from the Governor of the Bank of England (BoE) to the Chancellor of Exchequer in February.

Against this backdrop, the BOE kept its benchmark interest rate unchanged and maintained the positions for the stock of purchased assets at £375 billion. The minutes from the Monetary Policy Committee (MPC) of April 8th and 9th revealed that all members agreed that this was the appropriate stance, although two members viewed the decision as finely balanced.

Japan emerged from its technical recession and returned to growth in the fourth quarter of 2014. The economy expanded at a tepid annualised rate of 1.5 per cent in the three months to December. While exports have increased due to the weaker Yen, domestic demand remains sluggish and business investment has been lackluster despite surging profits. Economic data for the first quarter of 2015 were mixed, indicating that Japan's recovery remains fragile.

On the monetary policy front, the Bank of Japan (BOJ) kept its policy rate unchanged in April and maintained its bond buying program at 80 trillion yen a year.

In the currency market, the US dollar continued to strengthen in 2015 appreciating for the ninth consecutive month in March, although not as strong compared with previous months. Dollar gains were somewhat suppressed by mixed US economic data, but continue to be supported by low global yields directing cash flows into the US economy. In addition, diverging monetary policy between the US and other advanced economics, particularly the Euro Area and Japan buoyed dollar strength. The British pound, the Euro and the Japanese yen all depreciated versus the US dollar during the first quarter of 2015, declining 4.87, 11.30 and 0.29 per cent respectively.

Despite some volatility during the quarter the US fixed income market added positive returns, as the demand for safe haven assets persisted following continued speculation about the Fed's interest rate hike, declining oil prices and ongoing negotiations in Greece. The broader fixed income market, as measured by the Barclays Capital US Aggregate Bond index, returned 1.61 per cent over the quarter compared with a return of 1.79 per cent in the fourth quarter of 2014. The 10-year US Treasury yield declined to 1.88 per cent by the end of the quarter from 2.17 per cent at the end of the previous quarter. Yields on UK 10-year Gilts and German 10-year bunds also fell over the period while 10-year Japanese Government Bond yields rose modestly.

US equities had a volatile quarter in the three months to March. For the first time in a year and half, US equity markets underperformed its global peers as a strong US dollar hurt performance. The S&P returned 0.44 per cent by the end of the first quarter, after declining 3.10 per cent in January and then rebounding 5.49 per cent in February. Non-US developed equities, as measured by the MSCI EAFE (USD) reversed fourth quarter losses and returned 4.19 per cent over the three months to March. Aggressive quantitative easing from the ECB and BoJ drove European and Japanese equities to deliver strong gains over the quarter.

The HSF investment portfolio earned 2.29 per cent for the quarter ended March 2015, compared with an increase of 2.25 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 March 2015, the net asset value of the HSF was US$5,779.4 million, an increase from the US$5,653.9 million reported at the end of December 2014.

Contribution to Quarterly Return
For the period Jan – Mar 2015
/per cent/

	SAA Weights	Portfolio Weights as at 31-Mar-2015	Weighted Return HSF	Weighted Return Benchmark
Composite Portfolio	100.00	100.00	2.29	2.25
US Core Domestic Fixed Income	40.00	37.08	0.65	0.65
US Core Domestic Equity	17.50	22.48	0.48	0.40
Non US Core International Equity	17.50	18.70	0.97	0.96
US Short Duration Fixed Income	25.00	21.74	0.17	0.23

NB: Differences in totals are due to rounding.

Comparative Quarterly Returns
For the Quarters ended Sept 2014 – March 2015
/per cent/

	3 Month Weighted Return as at 31-Mar-2015		3 Month Weighted Return as at 31-Dec-2014		3 Month Weighted Return as at 30-Sept-2014	
	HSF	**Bench-mark**	**HSF**	**Bench-mark**	**HSF**	**Bench-mark**
Composite Portfolio	2.29	2.25	2.25	1.63	-0.48	-0.73
US Core Domestic Fixed Income	0.65	0.65	0.57	0.71	0.06	0.07
US Core Domestic Equity	0.48	0.40	1.68	1.22	0.22	0.19
Non US Core International Equity	0.97	0.96	-0.08	-0.42	-0.74	-0.97
US Short Duration Fixed Income	0.17	0.23	0.08	0.12	0.00	-0.01

Comparative Financial Year to Date Returns
For the periods Mar 2014 & Mar 2015
/per cent/

	Financial Year to Date Return as at 31-Mar-2015		Financial Year to Date Return as at 31-Mar-2014	
	HSF	Bench-mark	HSF	Bench-mark
Composite Portfolio	4.60	3.92	5.47	4.00
US Core Domestic Fixed Income	1.22	1.36	0.74	0.68
US Core Domestic Equity	2.17	1.62	2.69	2.13
Non US Core International Equity	0.89	0.54	1.89	1.12
US Short Duration Fixed Income	0.25	0.35	0.09	0.03

SECTION 1 – INTERNATIONAL ECONOMIC ENVIRONMENT

United States

The United States (US) economy returned to a more sustainable pace of growth in the fourth quarter of 2014 as Gross Domestic Product (GDP) grew at an annualized rate of 2.2 per cent compared to 5.0 per cent in the third quarter. This movement reflected a widening trade gap and a slowdown in business investment. However, during the first quarter of 2015, economic data signalled a further loss in momentum as manufacturing activity slowed throughout the quarter, the pace of growth in industrial production waned and the expected boost in retail sales as a result of lower oil prices failed to materialise. Despite the overall improvement in labour market conditions over the quarter, where nonfarm payrolls increased by almost 200,000 per month and the unemployment rate declined to 5.5 per cent in March from 5.6 per cent in December, there is little evidence to suggest that households are eager to spend. Instead, consumers may have decided to pay down debt and shore up savings given the increase in personal savings rate to 5.8 per cent in February from 4.9 per cent two months earlier.

On the price front, the headline rate measured negative 0.1 per cent on a year-on-year basis to March 2015 compared with 0.8 per cent in December. This trend mainly reflected the sharp decline in the energy component of the index which fell 18.3 per cent in the twelve months to March. Meanwhile, core inflation increased steadily to reach 1.8 per cent over the same period.

Amidst wide expectation for monetary policy tightening in the US by mid-2015, the Federal Reserve's (Fed) removal of the word "patient" from its March policy statement caused increased anxiety among investors. However, the Fed, clarified that removing the reference to its patient stance does not imply that it will become "impatient" to raise rates and re-iterated that the normalization path would be very gradual. Following this clarification and the less than favourable economic data, the market consensus for the first rate increase has shifted from June to September. Furthermore, the minutes revealed that there was a wide dispersion among FOMC participants regarding the exact timing. While "several participants" considered June, a couple members suggested that the first rate hike may not occur until 2016. Given the level of uncertainty, volatility is forecast to increase as markets closely watch economic indicators to determine how it might impact the decisions of a data dependent Fed.

Euro zone

In the fourth quarter of 2014, the Euro Area economy modestly expanded 0.3 per cent compared with growth of 0.2 per cent in the third quarter. Domestic demand, particularly household expenditure continued to be the driver of growth while gross fixed capital investments and a positive external balance helped the economy's "lift-off." Conversely, inventories weighed down growth. The strength of recovery remained uneven across member states of the Euro Area. Spain led growth over the first quarter, followed by Germany and Italy. During the first quarter of 2015, economic conditions in the Euro Area appeared to have stabilized and have entered a more sustained cyclical recovery, amid low oil prices, lower bond yields and a weaker currency. The Composite Purchasing Managers Index for the Euro Area expanded to 54.0 in March compared with 53.3 in February and 51.1 in December 2014, with both services and manufacturing sectors showing continued improvement. Manufacturing factory output accelerated in Germany, Italy and Spain while the French economy continued to linger in contractionary territory. France's manufacturing sector contracted further in March with production and new orders declining.

At the same time, concerns over a Greek exit from the Euro Area heightened as uncertainties re-emerged over Greece's financing needs. With mounting debt facing the economy and payments due, an agreement was struck in February between Greece and its creditors to extend the existing bail-out package by four months in order to avoid potential financial collapse under the conditions of economic reform. However, as the reform deadline approached, Greek Finance Minister Varoufakis announced that it would not be possible to meet the requirements, reneging on the conditions and facing default on future debt obligations including its May 1st and May 12th International Monetary Fund (IMF) payments. In addition, The Greek treasury admitted that the government was unable to pay its bills including salaries and pensions. Against this backdrop and efforts by the ECB, deterioration in risk sentiment toward Greece has not spilled over to the other Euro Area countries so far.

The Euro Area labour market improved, on aggregate, in the first quarter as unemployment gradually declined from elevated levels. The unemployment rate fell to 11.3 per cent in February from 11.4 per cent in January and December. At the country level, besides positive developments in Germany's labour market, unemployment in Spain edged up marginally over the quarter while Italy's joblessness rate fluctuated. Italy's unemployment rate retreated to its December 12.6 per cent

reading in February, down from 12.7 per cent in January. Meanwhile, Spain's unemployment rate rose to 23.8 per cent over the quarter, up from 23.7 per cent in December. By the end of the quarter, Spain had the second highest unemployment level in the Euro Area, behind Greece at 26.0 per cent in January, down from 26.8 per cent in December.

On the price front, Euro Area deflationary pressures eased over the first quarter. Euro Area inflation rose to -0.1 per cent in March compared with -0.3 per cent and -0.2 per cent in February and Decemberrespectively. Meanwhile, inflation excluding energy and food maintained a stable path, at 0.6 per cent in March compared with 0.7 per cent in February and December. Looking at the main contributors of Euro Area inflation, food, alcohol and tobacco prices edged up marginally but the sharp decline in energy prices continued to suppress the inflation rate.

On the monetary policy front, the European Central Bank's (ECB) highly anticipated QE program was prominent in news headlines around the world. The ECB began the Asset Purchase Program (APP) on March 9th and it is expected to be carried out until September 2016 or until the ECB sees a sustained adjustment to inflation consistent with its aim of achieving inflation rates below, but close to, 2 per cent medium term. The APP will not include any European Government Bonds (EGBs) and Supra-Sovereigns (SSA) that yield below the ECB's deposit facility rate of -0.2 per cent. In addition, it will encompass euro-denominated investment-grade securities issued by Euro Area governments and Agencies and European institutions. The combined monthly purchases of public and private sector securities will amount to €60 billion.

At the ECB's April 2nd meeting, the Governing Council announced that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility would remain unchanged at 0.05 per cent, 0.30 per cent and -0.20 per cent respectively.

United Kingdom

The United Kingdom (UK) fourth quarter GDP growth rate increased to 0.6 per cent, up 0.1 per cent from its previous estimate but down from 0.7 per cent in the third quarter. Over the fourth quarter, a net trade balance and private consumption contributed positively to growth amid low energy prices, a subdued inflationary environment and an increase in exports of manufactured goods. In contrast, government spending and business investment waned over the period as the manufacturing sector had weakened in recent quarters. Over the first quarter, data pointed to an expansion in both Manufacturing and Services in the UK. The HSBC Markit UK Composite rose to 58.8 in March from 56.7 in February and 55.4 in December.

In the broader labour market, February's jobless rate declined slightly to 5.6 per cent from its 5.7 per cent reading in December and was broadly in line with expectations. Weak pay growth, however, contributed to inflationary weakness in the market. Growth in Average Weekly Earnings ex-bonus (year-on-year) in February was 1.8 per cent, slightly up from 1.7 per cent in December.

The Consumer Price Index (CPI) remained unchanged in March and February at 0.0 per cent down from 0.5 per cent in December. The main drags on inflation were clothing and gas prices while upward contributions to inflation came from food and motor fuels. Meanwhile, CPI ex-energy and food trended downward in the three months to March. By end March, CPI ex-energy and food was 1.0 per cent down from 1.2 per cent and 1.4 per cent in February and January respectively. The decline in the inflation rate to more than one percentage point below the 2 per cent target triggered a letter from the Governor of the Bank of England (BoE) to the Chancellor of Exchequer in February. The Governor explained that the already subdued inflationary environment was exacerbated by the unexpected adverse oil price shock which further depressed inflation. He explained that at the time, about one third of the deviation from the 2 per cent target was attributable to weak growth in domestic costs while the decline in oil prices contributed the majority of the remaining deflationary effect. The Governor concluded that despite the expectation that inflation would fall further in the coming months, it would be appropriate to set policy so that it is likely that inflation returns to its 2 per cent target within two years.

Against this backdrop, the BOE kept its benchmark interest rate unchanged and maintained the positions for the stock of purchased assets at £375 billion. The minutes from the Monetary Policy Committee (MPC) of April 8th and 9th revealed that all members agreed that this was the appropriate stance, although two members viewed the decision as finely balanced. "The actual path of the first rate rise was uncertain, and would depend on economic circumstances. The Committee's guidance on the likely pace and extent of interest rate rises was an expectation, not a promise." All committee members however agreed that "it was more likely than not that the Bank Rate would rise over the three-year forecast period."

Japan

The Japanese economy emerged from a technical recession in the fourth quarter of 2014 as the negative impact of April's sales tax hike faded and a weaker yen boosted exports. The economy expanded at a tepid annualised rate of 1.5 per cent in the three months to December 2014, compared with a contraction of 2.6 per cent in the third quarter.

Data released during the first quarter of 2015, suggests that the economic recovery remains fragile. Consumption continues to be constrained, with household spending falling for the 11th consecutive month in February, declining 2.9 per cent year on year. There were some improvements in retail sales and the labour market. The job-to-applicant ratio rose to the highest level in 20 years, increasing to 1.15 in February from 1.14 in December 2014. The unemployment rate however edged up to 3.5 per cent in February, compared with 3.4 per cent in December 2014.

Japan's inflation rate slowed further over the period. Consumer prices excluding fresh food and energy was 2.0 per cent in February compared to 2.1 per cent in December 2014. Excluding the effects of the sales tax increase, inflation was flat in February and is expected to stay around zero per cent in the months ahead.

At its April meeting, the Bank of Japan (BOJ) decided to maintain its bond buying program at 80 trillion yen a year. The BOJ introduced the possibility that core inflation could enter negative territory temporarily but was confident that longer-term inflation

expectations stayed intact. Governor Kuroda expects Japan's economy "to continue its moderate recovery trend" and attempted to talk down expectations for additional easing in the immediate future.

SECTION 2 – CAPITAL AND MONEY MARKET REVIEW

During the first quarter of 2015, markets were once again largely influenced by Central Bank policy actions. This as the ECB began its Asset Purchase Program (APP) of sovereign bonds and the US Federal Reserve (Fed) altered its forward guidance to potentially set the stage for its first rate hike, despite maintaining a decidedly dovish tone widely interpreted as an indication of a deferral of the anticipated hike to September or later. Against this backdrop, developed market government yields, with the exception of Japan, ended the quarter lower.

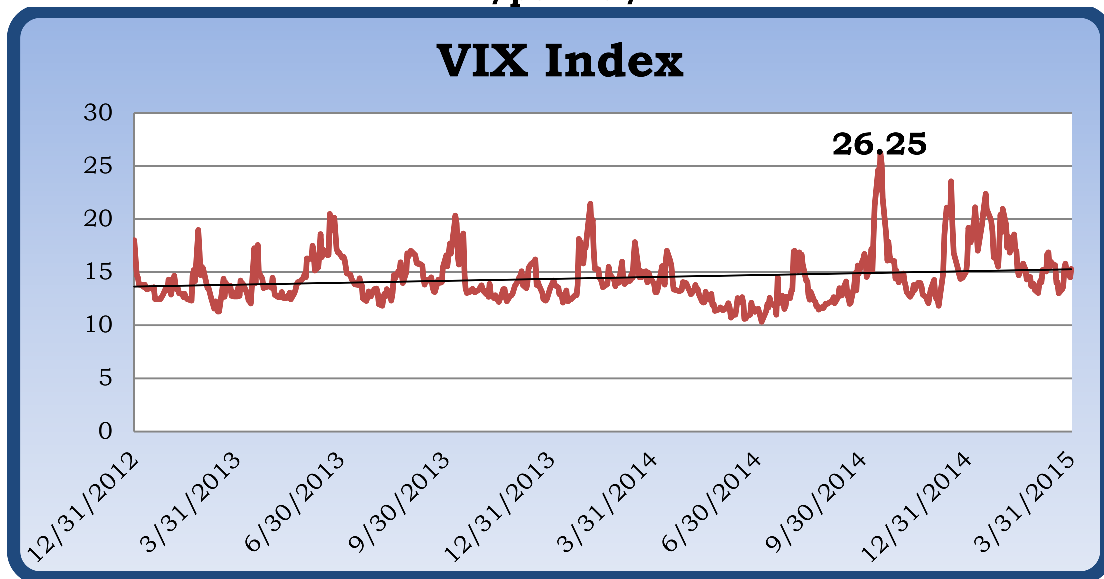
The US dollar continued to strengthen in 2015, appreciating for the ninth consecutive month in March, although not as strong compared with previous months. Dollar gains were somewhat suppressed by mixed US economic data, but continue to be supported by low global yields directing cash flows into the US economy.

US equity market returns were volatile during the first quarter of 2015, underperforming their developed market counterparts. Investors' risk appetite waned at times amid earnings headwinds related to US dollar strength and low energy prices in addition to concerns due to mixed economic data and valuation concerns. In the Eurozone, markets were buoyed by positive economic data in general despite the continued high levels of unemployment. UK equity markets were also negatively impacted by mixed data while Japanese stocks led the Pacific region despite disappointing data, partly due to the Government Pension Investment Fund's increased allocation to equities.

The Chicago Board Options Exchange Volatility Index (VIX), which is a proxy for investor anxiety and market risk, eased over the period, ending at 15.29 points, down from 19.2 points at the end of December. On a month-to-month basis, however, the VIX spiked in mid-January and early February, mainly due to the heightened anticipation about the Fed's statements regarding the first interest rate hike. During the quarter, the VIX reached a high of 22.39 on January 15th but retreated to levels below 20 thereafter, although it spiked again in early February. Despite market volatility earlier in the fourth quarter, the VIX averaged just 16.56, which was 1.14 points above the average of the prior quarter, but still continues to be well below crisis levels.

Figure 1

Market Volatility in the US
/points /



Source: Bloomberg

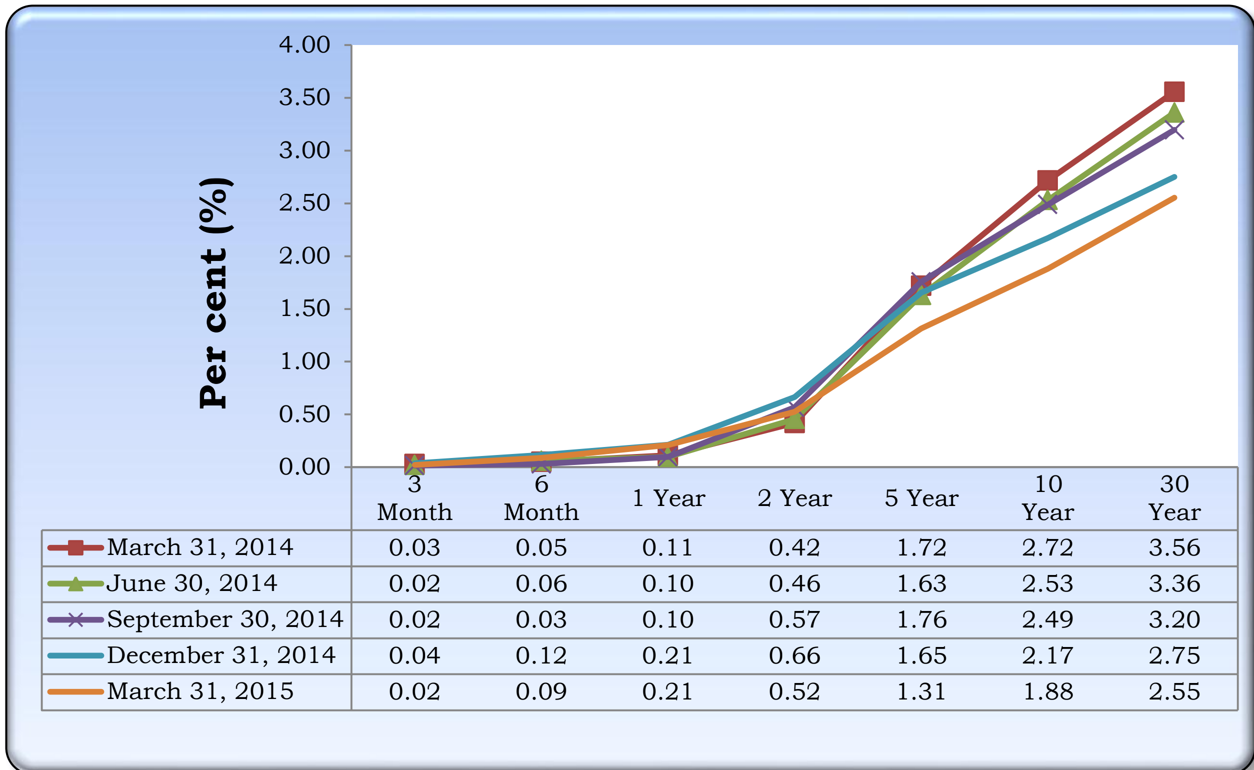
US Fixed Income

During the first quarter of 2015, there were bouts of rate volatility as markets attempted to decipher how various key economic metrics would affect the timing of the Federal Reserve's (Fed) impending rate hike. At the start of the year, safe haven flows resulting from the precipitous fall in oil prices placed downward pressure on rates, pushing the 10-year down to 1.68 per cent. Yields managed to reverse course in February as oil prices stabilized and markets focused on the positive implications of a strong employment report and a better than expected inflation print. Bonds continued to sell-off into the March FOMC meeting, amidst growing speculation that the Fed would no longer be "patient". The 10-year reached a high of 2.24 per cent but quickly retreated following the Fed's statement, which surprised markets given its dovish tone. The committee lowered its growth and inflation outlook for the US, indicating a much slower path to rate normalization and increasing the likelihood that first rate increase would not occur until later in the year. Yields fell across the curve as investors pushed expectations for the first interest rate increase from June to September.

In addition to central bank developments, yields were somewhat restrained due to the ongoing Greek bailout negotiations and disappointing US economic data. The curve

flattened over the three month period and the spread between the 2-10 year portion of the curve declined 13.7 basis points to 1.37 per cent.

Figure 2
US Treasury Yield Curve
/per cent/

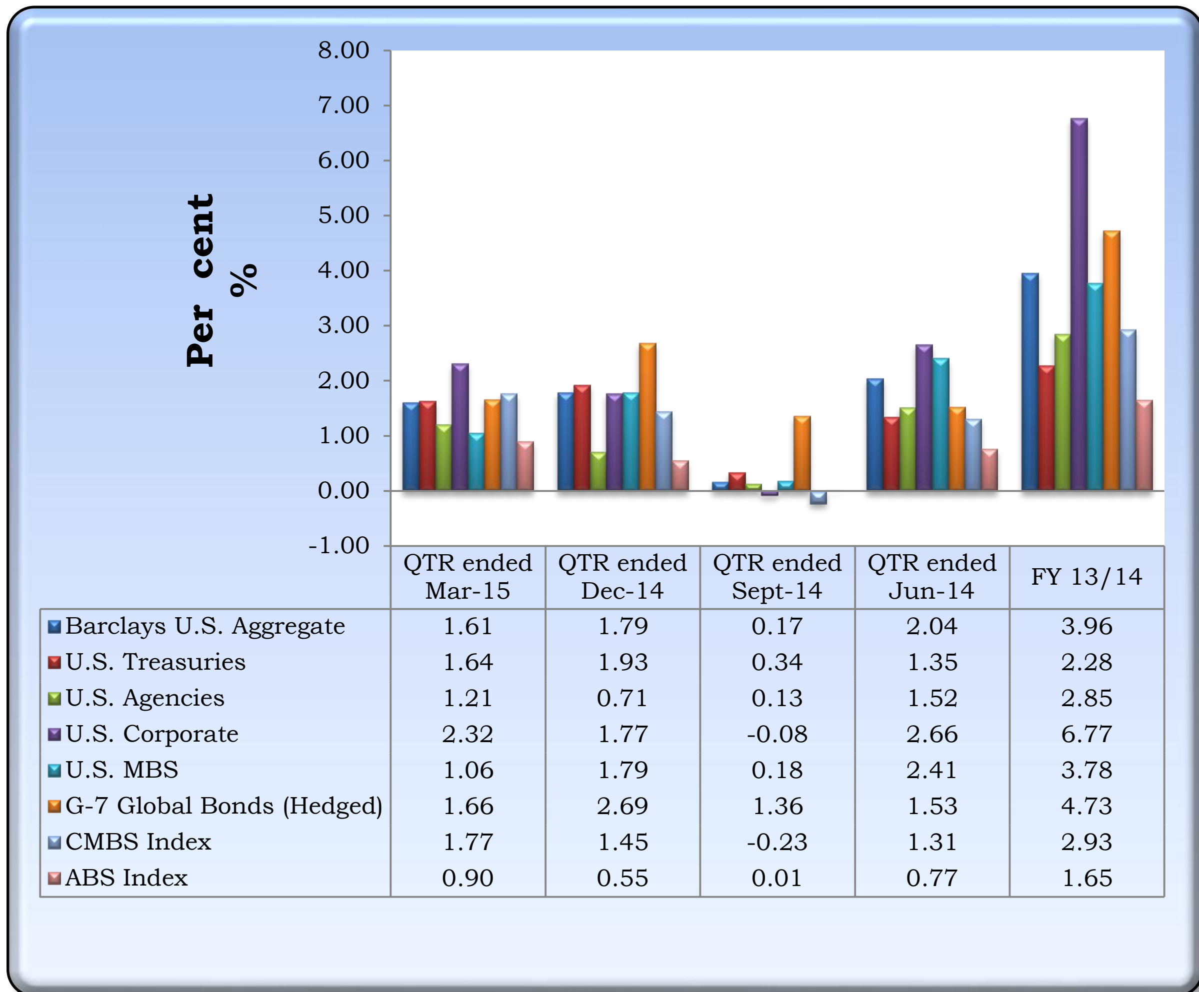


	3 Month	6 Month	1 Year	2 Year	5 Year	10 Year	30 Year
March 31, 2014	0.03	0.05	0.11	0.42	1.72	2.72	3.56
June 30, 2014	0.02	0.06	0.10	0.46	1.63	2.53	3.36
September 30, 2014	0.02	0.03	0.10	0.57	1.76	2.49	3.20
December 31, 2014	0.04	0.12	0.21	0.66	1.65	2.17	2.75
March 31, 2015	0.02	0.09	0.21	0.52	1.31	1.88	2.55

Source: Bloomberg

The broader US fixed income, as measured by the Barclays Capital US Aggregate Bond index returned 1.61 per cent over the first quarter. Spread sector performance was mixed. US Investment Grade corporate bonds outperformed like-duration Treasuries with consumer cyclical companies performing well, while metal and mining corporations lagged. However, in the mortgage market, Agency MBS underperformed similar duration Treasuries given the decline in rates, which could have a negative impact on prepayment speeds.

Figure 3
Returns on Fixed Income Indices
/per cent/



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

Source: Barclays Capital

Global Fixed Income Markets

Sovereign bonds rallied during the first quarter. In the Eurozone, yields moved lower in January as the European Central Bank (ECB) expanded its asset purchase program to include sovereign debt and pledged to grow its balance sheet by €60 billion monthly through September 2016. In March, there was additional impetus for rates to fall further. ECB President Mario Draghi indicated that the sovereign bond purchase program would include securities up to the deposit rate, which currently stands at -0.2 per cent. German 10-year bunds fell 35.8 basis points to 0.18 per cent and peripheral countries benefitted the most, with the Italian 10-year falling 63.8 basis points to 1.24 per cent.

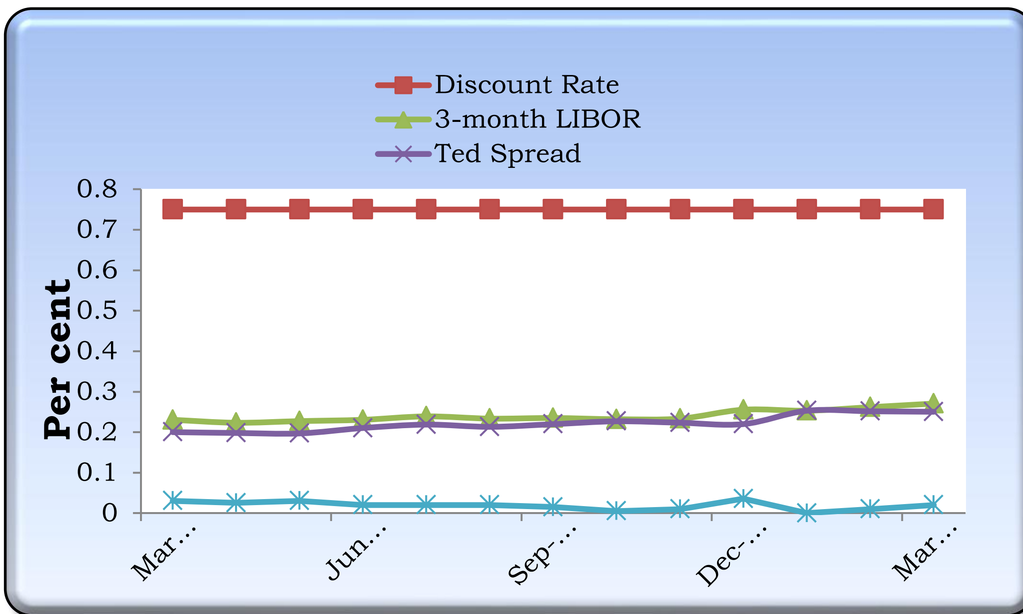
In the United Kingdom (UK), Gilt demand remained robust and a benign inflation outlook lent support for the Bank of England to delay the timing of the first rate rise; the 10-year fell 17.9 basis points to end the quarter at 1.58 per cent. In addition, political uncertainty surrounding the upcoming general elections in May and the lower growth outlook for the US, all weighed on yields.

Japanese bond yields rose modestly over the period, increasing 7.3 basis points to end at 0.40 per cent. Investors were somewhat reluctant to purchase bonds given the Bank of Japan's large presence in the market and the potentially negative implications for liquidity.

Money Market

Over the first quarter, US short-term interest rates edged up marginally driven by diverging monetary policies around the world. The Fed funds rate and Discount rate remained unchanged quarter-on-quarter although speculation about the Fed's first hike grew in January and February before simmering in March. The 3-month US Treasury bill rate fell in the 3 months to March. The 1-month and 3-month London Inter-Bank Offered Rate (LIBOR) increased marginally from 0.171 and 0.255 to 0.176 and 0.27 respectively. Spreads between the 3 month futures contracts for US Treasuries and Eurodollars also widened over the quarter by 0.14 per cent

Figure 4
US Money Market Rates
/per cent/



Source: Bloomberg

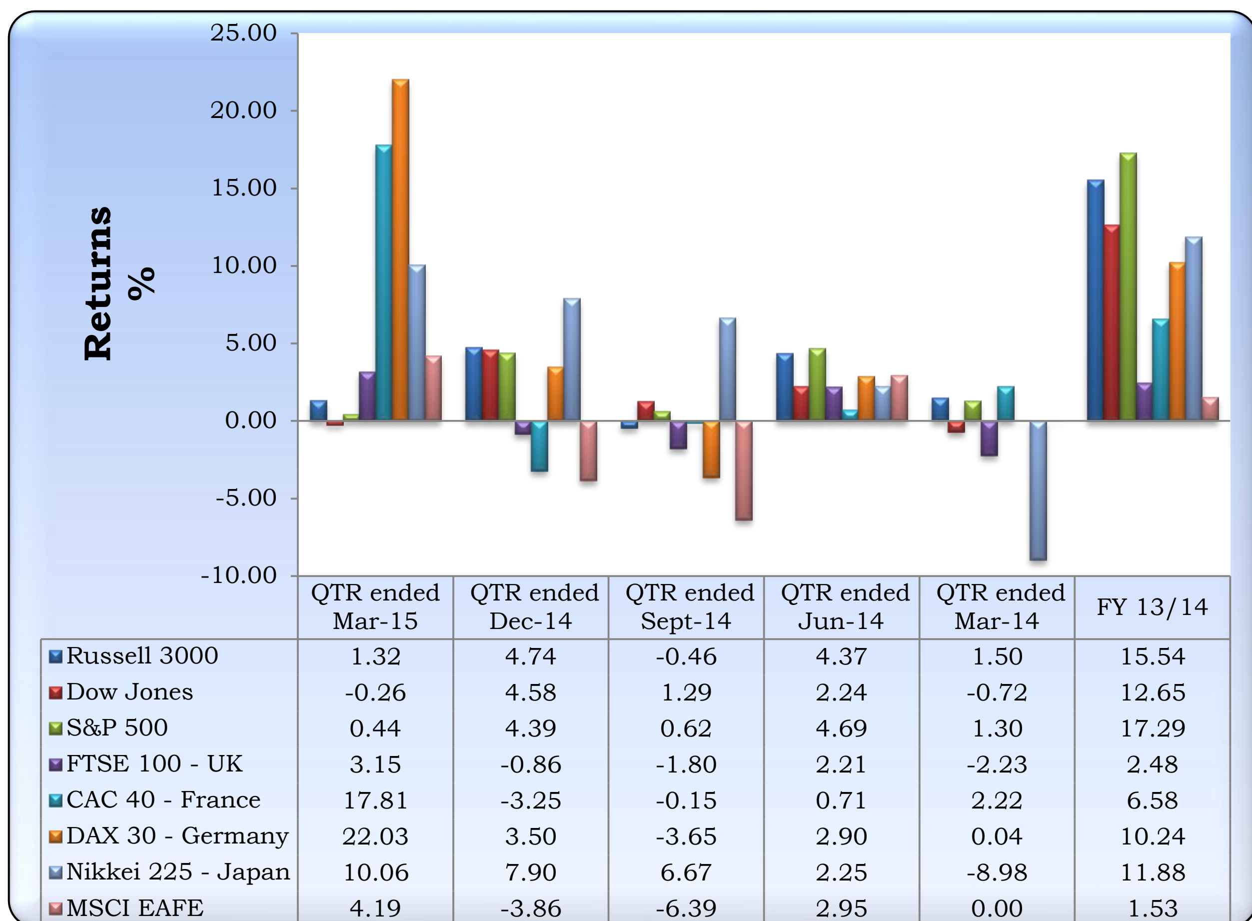
Equity Markets

US equities had a volatile quarter in the three months to March. For the first time in a year and half, US equity markets underperformed its global peers as a strong US dollar hurt performance. Additionally, according to exchange traded fund data, investors pulled money out of US equities in the first quarter while equity markets in the Euro zone, Japan and the UK experienced net inflows. The S&P returned 0.44 per cent by the end of the first quarter, after declining 3.10 per cent in January and then rebounding 5.49 per cent in February. Broadly speaking, the Financials, Industrials, Utilities and Energy sectors detracted from performance while Health Care and Consumer Discretionary supported modest returns.

Non-US developed equities, as measured by the MSCI EAFE (USD) reversed fourth quarter losses and returned 4.19 per cent over the three months to March. Aggressive quantitative easing from the ECB and BoJ drove European and Japanese equities to deliver strong gains over the quarter. In Europe, low oil prices and a weaker euro also helped stocks to rally, despite political and financial uncertainty in Greece. Germany's DAX and France's CAC 40 posted double digit returns, 22.03 per cent and

17.81 per cent respectively. In the UK, the FTSE 100 reversed fourth quarter's lag by adding 3.15 per cent in the first quarter despite increased uncertainty associated with the upcoming general election. In Japan, the Nikkei returned 10.06 per cent over the first quarter. In the three months to March, the Japanese economy has emerged from its technical recession supported by the BoJ's massive stimulus and mixed economic data.

Figure 5
Price Returns on Equity Indices
/Per cent/



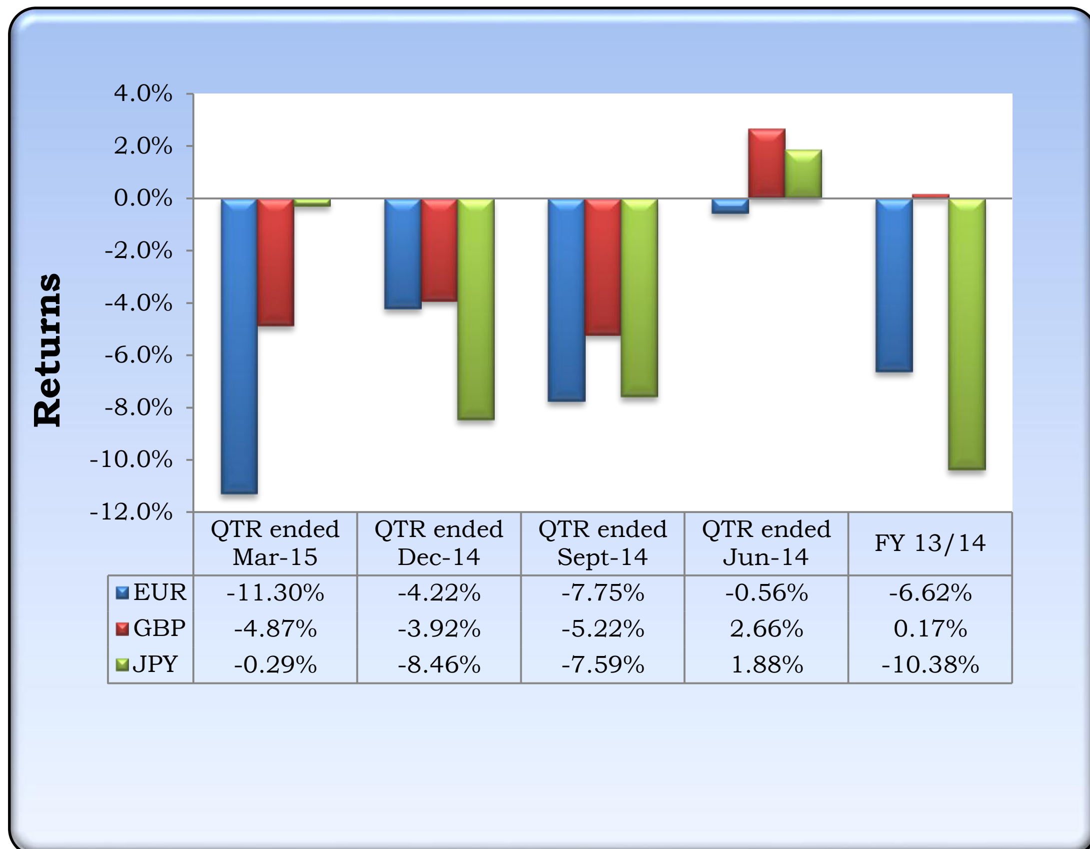
	QTR ended Mar-15	QTR ended Dec-14	QTR ended Sept-14	QTR ended Jun-14	QTR ended Mar-14	FY 13/14
Russell 3000	1.32	4.74	-0.46	4.37	1.50	15.54
Dow Jones	-0.26	4.58	1.29	2.24	-0.72	12.65
S&P 500	0.44	4.39	0.62	4.69	1.30	17.29
FTSE 100 - UK	3.15	-0.86	-1.80	2.21	-2.23	2.48
CAC 40 - France	17.81	-3.25	-0.15	0.71	2.22	6.58
DAX 30 - Germany	22.03	3.50	-3.65	2.90	0.04	10.24
Nikkei 225 - Japan	10.06	7.90	6.67	2.25	-8.98	11.88
MSCI EAFE	4.19	-3.86	-6.39	2.95	0.00	1.53

Source: Bloomberg

Currency Markets

During the first three months of 2015, the US dollar continued to strengthen against other major currencies, including the euro, pound and Yen. This trend mainly reflected a combination of factors including the stronger fundamentals of the US economy relative to other major countries and the divergence in monetary policy stance. Other contributing factors to currency movements over the period were political uncertainty in the UK and concerns about Greece's debt negotiation with the Eurogroup. While these conditions supported the strengthening of the dollar, increased signs of an improving European landscape emerged over in the quarter along with the market adjusting its expectation about the timing of the Fed's interest rate hike. These latter developments marginally slowed some of the US dollar gains as the euro, pound and Yen ended March 31 at €1.07, £1.48 and ¥120.13 versus the US dollar.

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



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

Source: Bloomberg

SECTION 3 – PORTFOLIO PERFORMANCE

Strategic Asset Allocation

During the period January to March 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 February 28, 2015, the US Core Domestic Equity mandate had an allocation of 22.65 per cent, or 5.15 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%*

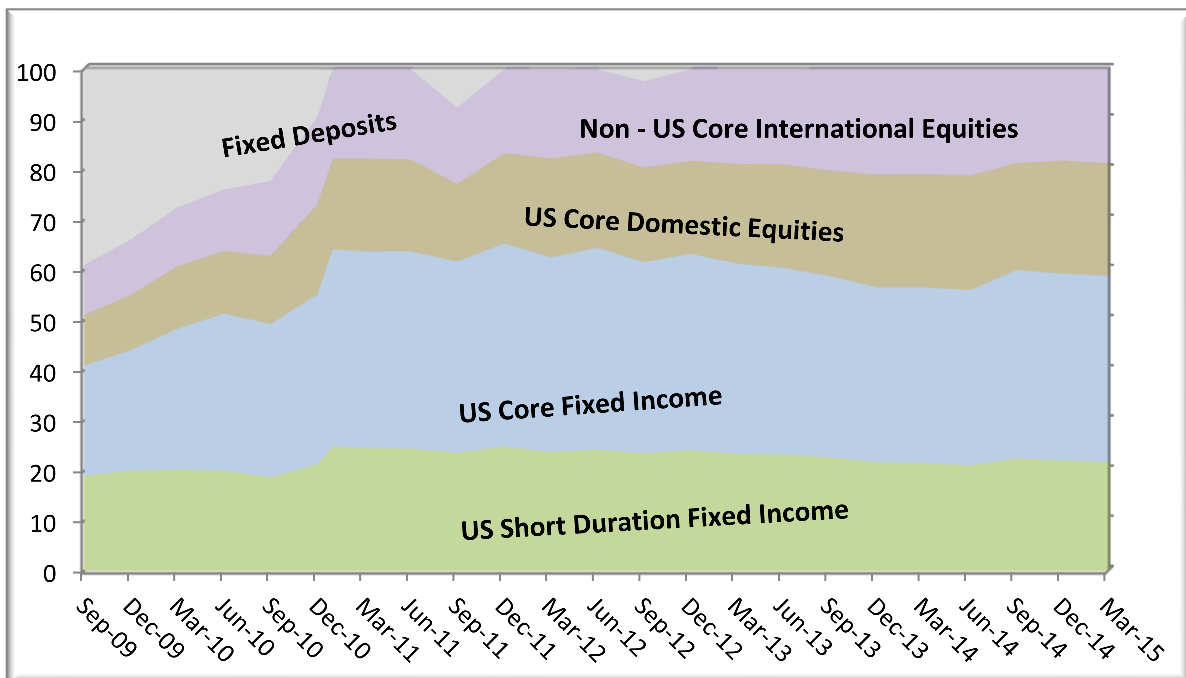
By the end of the quarter, the asset classes of the fund were within their permitted ranges. The asset class with the largest overweight was the US Core Domestic Equity mandate while the US Short Duration Fixed Income mandate had the largest underweight position.

The total net asset value of the Fund as at the end of March 2015 was US$5,779.4 million, compared with US$5,653.9 million at the end of the previous quarter. Of this total, the investment portfolio was valued at US$5,779.3 million, while the remaining portion (US$0.1 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 June 30, 2014 to March 31, 2015 are shown in Table 1, overleaf.

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

	Asset Class		Jun-14	Sep-14	Dec-14	Mar-15
		Target Weight SAA	Actual % of Fund	Actual % of Fund	Actual % of Fund	Actual % of Fund
Portfolio Weights	Cash	0.00	0.00	0.00	0.00	0.00
	US Short Duration Fixed Income	25.00	21.09	22.47	22.06	21.74
	US Core Domestic Fixed Income	40.00	34.93	37.52	37.26	37.08
	US Core Domestic Equity	17.50	22.87	21.33	22.50	22.48
	Non-US Core International Equity	17.50	21.12	18.68	18.17	18.70

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



Performance of the Investment Portfolio

For the first quarter of 2015, the HSF investment portfolio increased 2.29 per cent, compared with an increase of 2.25 per cent for the SAA benchmark[1]. This outperformance of 4 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 1.45 per cent, while the fixed income portion of the Fund contributed 0.83 per cent.

The **US Short Duration Fixed Income** portfolio increased 0.78 per cent during the first quarter of 2015, underperforming its benchmark, the Bank of America Merrill Lynch US Treasury 1-5 year index, by 13 basis points. This underperformance was attributed to the managers' short duration position relative to the benchmark which detracted from performance as yields declined over the quarter. The net asset value of this mandate as at March 31, 2015 was **US$1,256.6 million,** compared with US$1,247.1 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 1.76 per cent for the first quarter of 2015, outperforming its benchmark, the Barclays Capital US Aggregate Bond index, by 16 basis points. This relatively better performance was due to interest rate decisions and selection and allocation decisions with respect to spread products including commercial mortgage backed and asset backed securities. The net asset value of this mandate as at March 31, 2015 stood at **US$2,142.8 million** compared with US$2,106.5 million as at December 31, 2014.

The **Non-US International Equities** mandate rallied 5.33 per cent for the first quarter of 2015, compared with an increase of 5.46 per cent for its benchmark, the MSCI EAFE ex

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[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%).

Energy index. This underperformance was due to negative stock selection. The largest impact stemmed from holdings in the Materials, Telecommunications and Financials sectors. Additionally, stock selection in Japan and Denmark also detracted from performance. The net asset value of the Non-US Core International Equity mandate as at March 31, 2015 rose to **US$1,080.8 million**, from US$1,027.3 million at the end of December 2014.

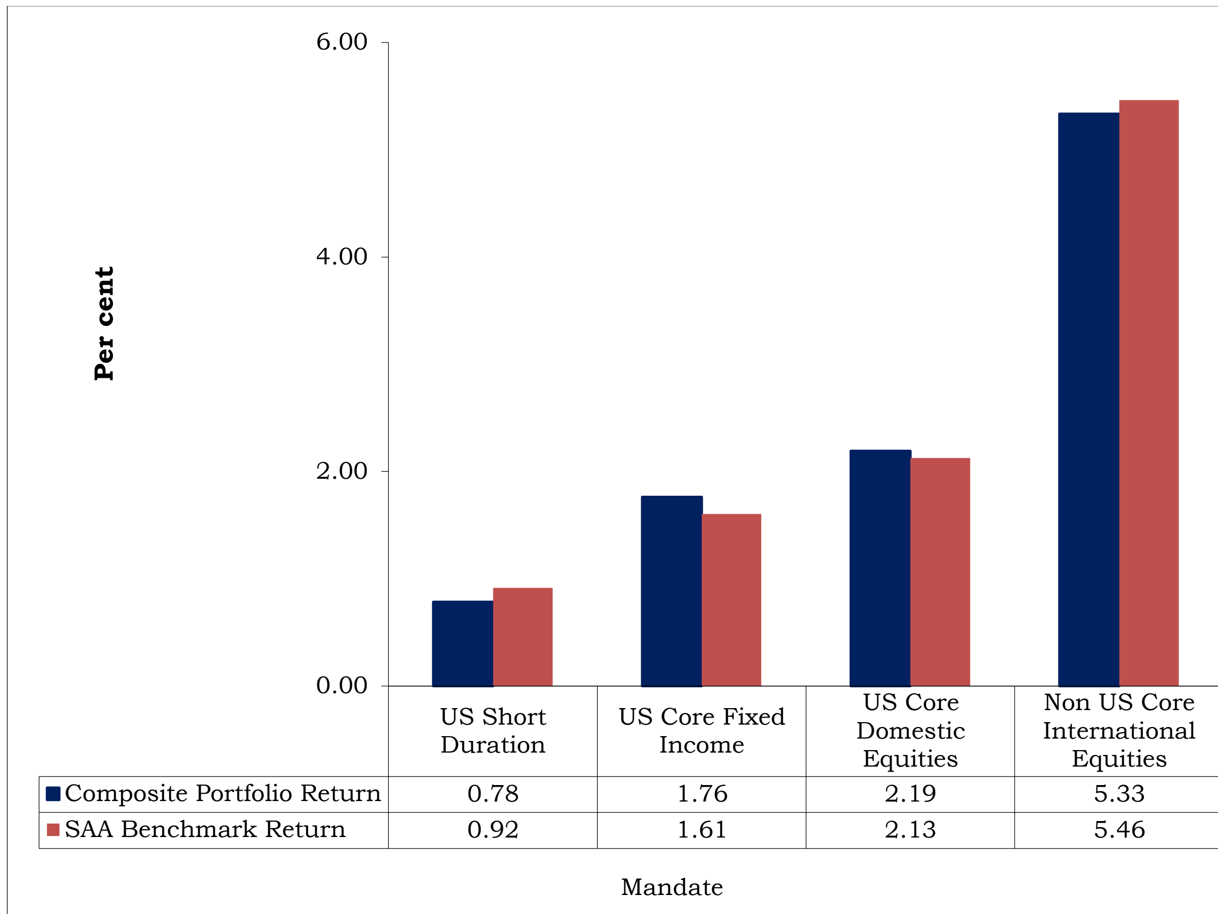
The **US Core Domestic Equities** mandate returned 2.19 per cent, compared with a benchmark return of 2.13 per cent. During the quarter both sector allocation and stock selection helped to drive outperformance. Stock selection in the Consumer Discretionary sector and allocations to the Technology and Health Care sectors provided the largest impact to positive excess returns. The net asset value of this mandate, as at March 31, 2015, was **US$1,299.0 million**, compared with US$1,272.1 million at the end of December 2014.

Table 2
Contribution to Quarterly Returns,
For the period Jan – Mar 2015
/per cent/

	SAA Weights	Portfolio Weights as at 31-Mar-2015	Weighted Return HSF	Weighted Return Benchmark
Composite Portfolio	100.00	100.00	2.29	2.25
US Core Domestic Fixed Income	40.00	37.08	0.65	0.65
US Core Domestic Equity	17.50	22.48	0.48	0.40
Non US Core International Equity	17.50	18.70	0.97	0.96
US Short Duration Fixed Income	25.00	21.74	0.17	0.23

NB: Differences in totals are due to rounding.

Figure 8
Absolute Returns by Asset Class
For the period Jan – Mar 2015
/per cent/



	US Short Duration	US Core Fixed Income	US Core Domestic Equities	Non US Core International Equities
Composite Portfolio Return	0.78	1.76	2.19	5.33
SAA Benchmark Return	0.92	1.61	2.13	5.46

SECTION 4 –COMPLIANCE AND PORTFOLIO RISKS

Compliance

As at February 28, 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 22.65 per cent, or 5.15 per cent above the SAA of 17.50 per cent. By March 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 3 below shows the Average Credit Quality of the US Short Duration and US Core Fixed Income Portfolios as at March 31, 2015.

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 March 31, 2015.

Table 4
Weighted Average Duration
/Years/

Mandate	Portfolio	Benchmark
US Short Duration	**2.40**	**2.66**
US Core Domestic Fixed Income	**5.25**	**5.19**

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 March 2015, 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
March	2.29	2.25	3.95	4.60	3.92	67.71	5.92	5.39	53.34

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

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

Valuation Date	Net Asset Value	Quarterly Income	Accumulated Surplus & Unrealized Capital Gains/Losses	Contributions
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	-

Appendix III
Summary Characteristics of Composite Benchmarks
Fixed Income Benchmarks

Key Characteristics	Barclays US Aggregate Index	Merrill Lynch 1-5 Index
Total Holdings	9,196	155
Coupon (%)	3.24	1.88
Duration (Years)	5.19	2.63
Average Life (Years)	7.72	2.71
Yield to Maturity (%)	2.07	0.79
Option Adjusted Spread (bps)	46	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	2,832	857
Earnings Per Share (EPS Growth 3-5y fwd)	11.1	9.71
Price Earnings (P/E fwd)	16.4	15.6
Price / Book (P/B)	2.9	1.89
Weighted Average Market Capitalization* (Bn)	$105	$59.6

*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.

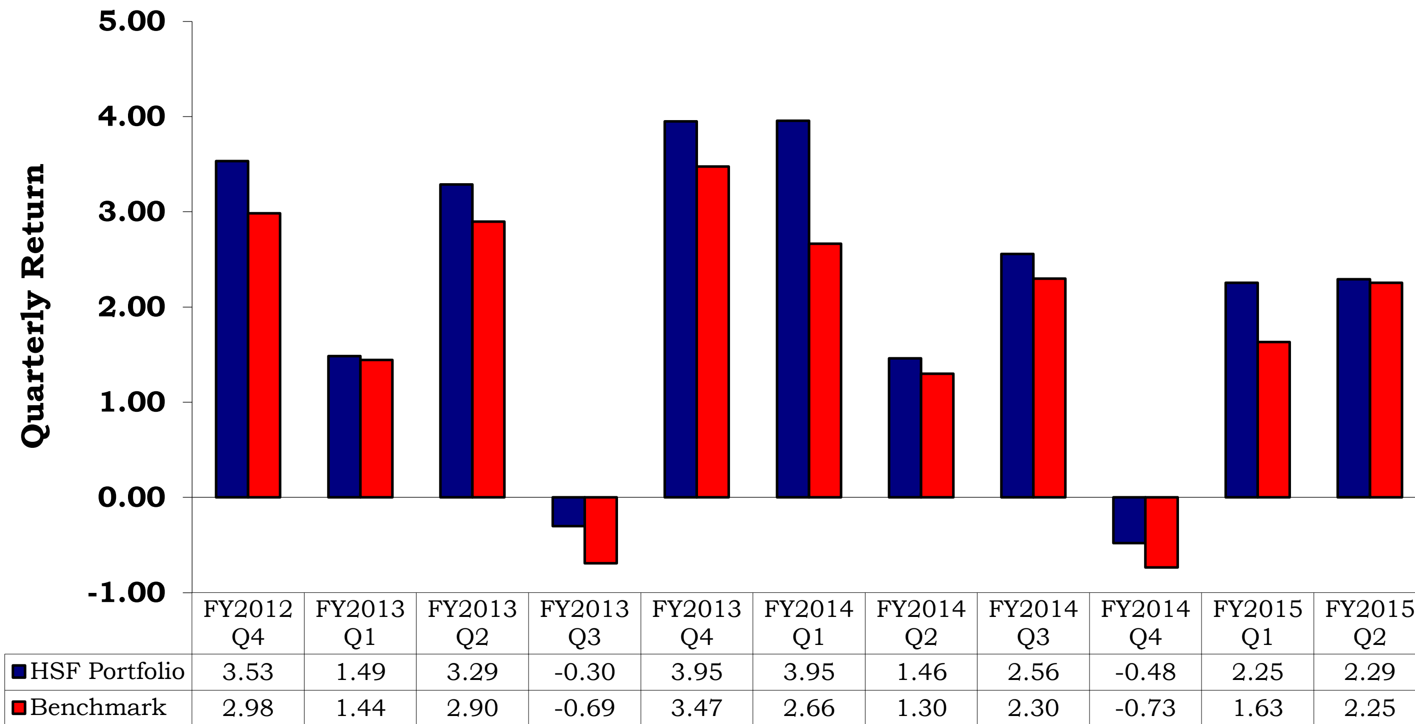
Appendix IV
Summary of the Fund's Net Asset Value by Mandate
/US$ Million/

	March 2014	June 2014	September 2014	December 2014	March 2015
Total Fund Value	**5,429**	**5,563**	**5,533**	**5,654**	**5,779**
Total Value of Equity	**2,359**	**2,446**	**2,213**	**2,299**	**2,380**
US Core Domestic Equity	1,225	1,272	1,180	1,272	1,299
Non-US Core International Equity	1,135	1,174	1,033	1,027	1,081
Total Value of Fixed Income	**3,070**	**3,115**	**3,319**	**3,354**	**3,399**
US Short Duration Fixed Income	1,169	1,173	1,243	1,247	1,257
US Core Domestic Fixed Income	1,901	1,942	2,076	2,106	2,143
Total Value of Cash or Cash Equivalents	**1**	**3**	**1**	**1**	**0**

NB: Differences in totals are due to rounding.

Appendix V
HSF Portfolio Quarterly Returns
/per cent/

Quarterly HSF & SAA Benchmark Returns



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

HSF Portfolio **Benchmark**