Trinidad and Tobago

Heritage & Stabilization Fund

Quarterly Investment Report

July – September 2015

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EXECUTIVE SUMMARY

Over the quarter ended September 2015, downside risks to global growth heightened amid a slowdown in the Chinese economy, Chinese equity market volatility and their impact on other emerging market economies and commodity prices. Actions by global central banks, particularly growing anxiety over the Federal Reserve's (the Fed) first rate hike, also moved markets. Accommodative monetary policies of the European Central Bank (ECB) continued to support markets in Europe, but were not adequate to offset global economic factors. Global growth remained on a positive trajectory during the third quarter despite a downward revision as estimated by the International Monetary Fund (IMF) in October. The IMF forecasted global growth for 2015 at 3.1 per cent, down from an estimated 3.3 per cent in July.

In the **United States (US)**, the economy gained momentum in the second quarter as GDP growth was recorded at 3.9 per cent annualized up from 0.6 per cent in the first quarter. However, economic data in the third quarter was mixed, which points to a more measured pace of growth in the quarter. The unemployment rate exhibited improvement in the third quarter, falling to 5.1 per cent at the end of September and into the Federal Reserve's full employment range, even though third quarter non-farm payrolls averaged 167,000 down from an average of 213,000 for the first six months of the year. Finally as expected, the Fed kept its monetary policy unchanged in its September policy meeting citing the need for further improvements in the labour market, to bolster its confidence in meeting its 2.0 per cent medium term inflation target.

In the **Euro zone,** growth slowed in the third quarter, as GDP rose 0.4 per cent compared to an upwardly revised 0.5 per cent expansion in the three months ending June. Economic growth was led by Germany, while growth in Spain, France and Italy declined. Unemployment continued to remain uneven across member states, while for the Euro zone as a whole, joblessness declined slightly from 11.1 per cent in June to 11.0 per cent in August. Like other major developed central banks, the ECB maintained its main policy rates. ECB President Draghi reiterated that monetary decisions continue to be data dependent and will be impacted by external factors such as the state of the Chinese economy.

The economy of the **United Kingdom (UK)** continued to exhibit positive growth trends during the quarter, as GDP grew 0.7 per cent compared with 0.4 per cent in the first quarter. The Bank of England (BoE) kept its benchmark interest rate and its stock of asset purchases constant and also continued to set monetary policy to meet its 2 per cent inflation target in the medium term, noting that this rate should influence inflation, unemployment and slack in the economy is a way that would be consistent with achievement of the 2 per cent in 2 years. By subtracting the transitory effects of oil prices, the BoE has concluded that there is still underutilized capacity in the UK economy.

In **Japan**, growth was somewhat volatile between the first and second quarters of the year, as the economy surged at an annualized rate of 4.5 per cent in the first quarter and subsequently contracted in the second quarter by 1.2 per cent annualized. Disappointing data from the third quarter thus far points to a potentially negative GDP reading for the period. The Bank of Japan decided to maintain its monetary policy at 80 trillion yen a year and continues to be optimistic about the outlook for the Japanese economy, with the BoJ governor stating that domestic demand will recover and help to offset the negative effects of China.

In **equity markets**, investor sentiment was skewed to the downside over concerns about the slowdown in the Chinese economy, Chinese market instability and its causal impact on commodity markets and global demand. Equity markets were also impacted by the actions of central banks, particularly the Fed as investors fixated on US economic data as indicators which may drive the first rate hike. Despite a July rebound across developed equity markets amid optimism over a resolution to the Greek debt crisis, all indices declined in the third quarter. The S&P 500 and the MSCI EAFE fell 6.94 per cent and 10.75 per cent respectively in the three months to September 2015.

Sovereign bond yields ended the quarter lower, as **bond markets** were in a risk-off environment due to concerns about Greece and China, which supported demand for safe haven assets. The US Treasury yield curve flattened over the quarter, even as the 2-year yield remained somewhat anchored by the Fed's view that the US economy is strong enough to withstand an increase in rates, albeit at a slower than initially anticipated schedule. The broader US fixed income market as measured by the Barclays Capital US Aggregate Bond index, returned 1.23 per cent for the quarter even though credit spreads widened. Asset backed and supranational securities managed to modestly outperform similar duration US Treasuries during the period.

The HSF investment portfolio lost 2.02 per cent for the quarter ended September 2015, compared with a decrease of 2.19 per cent for the Strategic Asset Allocation (SAA) benchmark. The Fund's exposure to equity securities detracted from absolute returns, offsetting the gains generated by the fixed income portfolio. 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$407.6 million was withdrawn from the two equity mandates and deposited with the two fixed income mandates as at the beginning of July 2015. At the end of September 2015, the net asset value of the HSF was US$5,665.1 million, a decrease from the US$5,774.9 million reported at the end of June 2015.

Contribution to Quarterly Return
For the period Jul 2015 – Sept 2015
/per cent/

	SAA Weights	Portfolio Weights as at 30-Sept-2015	Weighted Return HSF	Weighted Return Benchmark
Composite Portfolio	100.00	100.00	-2.02	-2.19
US Core Domestic Fixed Income	40.00	41.32	0.39	0.50
US Core Domestic Equity	17.50	16.58	-1.12	-1.10
Non US Core International Equity	17.50	16.16	-1.42	-1.74
US Short Duration Fixed Income	25.00	25.94	0.16	0.17

NB: Differences in totals are due to rounding.

Comparative Quarterly Returns

For the Quarters ended March 2015 – September 2015

/per cent/

	3 Months Weighted Return as at 30-Sept-2015		**3 Months Weighted Return as at 30-June-2015**		**3 Months Weighted Return as at 31-Mar-2015**	
	HSF	**Bench-mark**	**HSF**	**Bench-mark**	**HSF**	**Bench-mark**
Composite Portfolio	-2.02	-2.19	-0.02	-0.51	2.29	2.25
US Core Domestic Fixed Income	0.39	0.50	-0.56	-0.67	0.65	0.65
US Core Domestic Equity	-1.12	-1.10	0.10	0.06	0.48	0.40
Non US Core International Equity	-1.42	-1.74	0.44	0.11	0.97	0.96
US Short Duration Fixed Income	0.16	0.17	0.00	0.00	0.17	0.23

Comparative Financial Year to Date Returns

For the periods September 2014 & September 2015

/per cent/

	Financial Year to Date Return as at 30-Sept-2015		Financial Year to Date Return as at 30-Sept-2014	
	HSF	Bench-mark	HSF	Bench-mark
Composite Portfolio	2.47	1.13	7.65	5.60
US Core Domestic Fixed Income	1.05	1.18	1.59	1.57
US Core Domestic Equity	1.13	0.56	3.83	3.06
Non US Core International Equity	-0.11	-1.11	1.90	0.76
US Short Duration Fixed Income	0.41	0.53	0.21	0.16

SECTION 1 – INTERNATIONAL ECONOMIC ENVIRONMENT

United States

The United States (US) economy gained momentum during the second quarter of 2015. Gross Domestic Product (GDP) rose at an annualized rate of 3.9 per cent, following a more modest first quarter growth of 0.6 per cent. Activity in the second quarter was driven by a rise in personal consumption expenditures and non-residential fixed investment as well as a recovery in exports. During the third quarter, economic data was somewhat mixed and indicated that growth would be at a more measured pace in the three months to September. The Markit U.S. Composite Purchasing Manager Index nudged higher, rising from 54.6 in June to 55.0 in September. While the manufacturing sector was negatively impacted by the stronger U.S. dollar and the slower global growth outlook, activity in the service sector remained robust.

The labour market continued to gradually improve over the third quarter but lost some momentum as non-farm payrolls averaged 167,000 versus 213,000 in the first six months of the year. The unemployment rate fell from 5.3 per cent at the end of June to 5.1 per cent at the end of September. Though the labour market is nearing what the Fed considers full employment, earnings growth has been subdued. Average hourly earnings month on month was flat in June and though there was some gains in July and August, earnings stagnated again in September.

While consumer spending should be supported by the strengthening labour market and the generally weak inflationary environment, retail sales have yet to deliver steady gains. After resuming growth in July, spending weakened in August and September amidst the turmoil in financial markets and global growth concerns. Retail sales ex-Autos increased 0.40 per cent month on month in June but sales fell 0.30 per cent in September as sentiment may have negatively impacted consumer outlays. While part of the decline was attributed to lower gas prices, advances in automobiles, clothing and restaurant sales bode well for future consumption activity.

The Federal Open Market Committee's (FOMC) September meeting captured market attention throughout the period. As the meeting date approached, expectations for an interest rate increase waned and appeared unlikely given the turbulence in financial markets and somewhat weaker data releases in the US as well as internationally. Though the Fed decided to maintain its current monetary policy, the committee's comments managed to surprise markets as the reasons cited for its decision fuelled fears around

China's slowdown and the magnitude of its effect on global growth and inflation outlook. The Fed highlighted the need for "some further improvement in the labour market, to bolster its confidence that inflation will rise to 2.0 per cent in the medium term".

Inflation weakened further over the third quarter falling 0.20 per cent month on month in September, compared to a rise of 0.30 per cent in June. The decline in oil prices and the appreciation of the dollar weighed on prices but the impact is expected to be transitory. The Federal Reserve's preferred gauge of inflation, the Core PCE index, has hovered around 1.30 per cent during the first eight months of the year.

Markets were somewhat assured by various FOMC members who continued to believe that it would still be appropriate to increase rates at some point this year. However, recent labour and retail sales data have been somewhat disappointing and is expected to weigh on the Fed's decision to hike rates. Though December is regarded as the next likely meeting for an interest rate increase, there is mounting speculation that the Fed may need to delay its decision into the first quarter of 2016.

Euro Area

In the three months to September, real GDP in the currency bloc rose 0.4[1] per cent, which was below expectations and lower than the upwardly revised 0.5 per cent expansion for the quarter ended June 2015. Growth in the Euro Area continued to be led by Germany while growth in Spain, Italy and France declined. The Markit Euro Area Composite Purchasing Manufacturing Index (PMI), the leading indicator of business conditions and by extension, pace of economic growth, declined to 53.6 in September from 54.2 in June, but remained in expansionary territory. The Services PMI followed a similar pattern.

Other leading economic indicators however, pointed to a slowdown in the recovery over the quarter, particularly those related to inflation. Headline inflation[2] fell into negative territory at -0.1 per cent in September, compared with 0.2 per cent in June. Core

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[1] Seasonally adjusted real GDP growth for the quarter ended September 2015 was 0.4 per cent, according to Eurostat. Separately, the ECB lowered its September economic projections for the Eurozone for 2015, 2016 and 2017 to 1.4 per cent, 1.7 per cent and 1.8 per cent respectively.

[2] Inflation data used is measured by the Consumer Price Index and not the Eurozone's Harmonized Index of Consumer Price measure (HICP). HICP for the Eurozone was -0.1 per cent in September and 0.2 per cent in June.

inflation (inflation ex-food and energy), rose slightly to 0.9 per cent in September, from 0.8 per cent in June. Headline inflation continued to reflect the impact of the oil price decline which was only partially offset by higher prices in food and industrial goods.

Over the quarter, the Greek debt crisis faded into the background and the possibility of a "Grexit" diminished. In July, the Greek government and its European creditors struck a deal and Greece was granted a short term bridge loan totalling €86 billion, which was financed through the European Stabilization Mechanism. Greece was then granted a third and final bailout package in exchange for adherence to the package of austerity measures imposed by the International Monetary Fund and the other creditors. In August, Prime Minister Alexis Tsipras resigned and called a snap election which was held in September and resulted in his re-election.

Unemployment in the currency bloc fell to 11.0 per cent in August, from 11.1 per cent in June and continued to remain uneven across member states. In Germany, unemployment held steady at 6.4 per cent over the third quarter while unemployment in France, Italy and Spain printed 10.3 per cent, 12.4 per cent and 21.2 per cent respectively at the end of the second quarter. Joblessness in the Eurozone continued to be relatively high and of a structural nature unrelated to the traditional supply and demand dynamics of the labour force.

In monetary developments, the ECB maintained its main re-financing rate, deposit rate and lending rate at 0.05 per cent, -0.10 per cent 0.20 per cent respectively. According to ECB President Mario Draghi, the decision was based on a recent review of economic data and financial market analyses, in line with forward guidance, which indicated that the Eurozone continued on a "somewhat weaker economic recovery," as determined by GDP, inflation and inflation expectations and credit conditions. President Draghi indicated that monetary decisions continue to be data dependent and, more recently, impacted by renewed downside risks to the Eurozone, which include the Chinese economy and its spillover effects to emerging market economies, commodity prices and inflation.

Against this backdrop, President Draghi continued that the ECB's outlook for growth and inflation remain a cause for concern. However, he stated that it was "premature" to conclude whether external developments could have a long-lasting impact on the ECB's achievement of their 2 per cent medium term inflation goal. In the meantime, the ECB will continue to implement its asset purchase program of €60 billion monthly. However, the program may be extended past its current end date of September 2016. The ECB

President also stated that the Governing Council decided to increase the issue share limit of the public sector purchasing program from the initial 25 per cent to 33 per cent, subject to a "case-by-case" verification.

United Kingdom

The final print for second quarter GDP growth was 0.7 per cent compared with 0.4 per cent in the quarter ended March. The Bank of England (BoE) estimates that real GDP may increase 0.6 per cent in the third quarter, as the economy is approaching equilibrium between demand and supply dynamics, as judged by the central bank.

Recent data suggests a "gentle deceleration" in UK output growth since its peak in the beginning of 2014. According to the BoE, the outlook for growth remains characterized by improvements in domestic demand and a recovery in real income and productivity but remains constrained by the deterioration in global demand. The PMI Composite fell to 53.3 in September from 57.4 in June, driven by a similar decline in the Services PMI.

In the three months to September, UK labour market indicators have shown improvement. Unemployment fell to 5.4 per cent in September, its lowest post-financial-crisis reading, compared with 5.6 per cent in June. Average weekly earnings (3-month average) rose over the quarter while average weekly earnings (ex-bonus) held steady, indicative of progress, albeit gradual. Average weekly earnings rose 3.0 per cent in September, from a 2.8 per cent increase in June while average weekly earnings (ex-bonus) remained at 2.8 per cent quarter-on-quarter. Given this wage data, Governor Mark Carney judged that the possible slack in the labour market was being absorbed, but wages were still lower than would be consistent with the 2 per cent medium term inflation target.

Headline inflation in the UK fell to -0.1 per cent in September, compared with 0 per cent in June. Core inflation, however, rose to 1 per cent in September, from 0.8 per cent in June, which is indicative of an improvement in the domestic inflationary conditions in the UK. Notwithstanding this improvement, core inflation remained subdued, falling short of the 2 per cent medium term inflation target by 1 per cent. According to the third letter to the Chancellor of Exchequer, dated August 6th, around three quarter (3/4) of the deviations from the June inflation, which printed 0.0 per cent, were due to low contributions from energy, food and other imported goods while the remaining quarter was from possible slack in the economy. Meanwhile Governor Mark Carney was of the view that the appreciation in the sterling muted import costs resulting in negative contributions to inflation from imported goods. Moreover, he maintained that restrained labour costs have also contributed to the subdued inflationary environment, despite gradually rising wages.

In the minutes of the Monetary Policy Committee (the Committee) meeting ended October 6th, the Committee maintained its key interest rate at 0.5 per cent, based on an 8-1 majority vote. The committee also unanimously voted to maintain the stock of asset purchases at £375 billion. This decision was based on considerations of possible slack in the economy and the low inflation rate and thus, policy was set to ensure growth is sufficient to absorb the underutilized resources. In this way, the Committee also determined that the inflation rate would remain on track to achieve the 2 per cent target in 2 years. The Committee stated that it continues to monitor the global environment alongside domestic developments, which are tilted to the downside, in order to assess the outlook for inflation, growth and monetary policy. The BoE maintained that the path of rate increases is expected to be gradual and lower than in previous cycles, owing to the persistence of headwinds restraining economic growth.

Japan

The Japanese economy has struggled to sustain a positive growth trend. Japan emerged from a technical recession in the fourth quarter of 2014 and activity surged during the first quarter of 2015 at an annualised rate of 4.5 per cent. However, the economy contracted in the second quarter of 2015, shrinking at an annualised rate of 1.2 per cent. Weak capital spending and a drop in exports due to slowing demand from China hurt activity. Moreover, domestic demand continues to be subdued and has not yet recovered since the national sales tax increase in April 2014.

During the third quarter, disappointing economic data reflected a sharp deceleration in activity and increased speculation that GDP could potentially be negative for the period. There was growing evidence that the events in China continued to weigh on already tenuous activity during the three months to September. After recovering somewhat in June, industrial production fell in July and August month on month, and has been negative for 5 out of the 8 months. Moreover, export volume was flat in June but dropped in July and August before resuming growth in September at 0.6 per cent, as shipments to Europe and the U.S. helped to offset the fall in sales to Asia. Though economic data was mostly disappointing, household spending surged 2.9 per cent in August from the previous twelve months after falling in June and July. This is only the second positive reading for the year, but the Bank of Japan remains optimistic that domestic demand will recover.

The unemployment rate was flat from June to August at 3.4 per cent and the Jobs-to-Applicants Ratio nudged higher from 1.19 to 1.23 reflecting a modestly tighter labour market. Wage growth recovered from June but remained somewhat subdued. The average monthly cash earnings grew 0.40 per cent year on year in August compared to falling 2.5 per cent in June.

At the latest monetary policy meeting on October 7th, the BOJ decided to maintain its bond buying program at 80 trillion yen a year in an 8-1 majority vote. Despite negative growth in the second quarter, the BOJ indicated that the economy continued to recover moderately, while experiencing negative effects to exports and production from the slowdown in emerging economies. Inflation fell further over the third quarter. Over the previous twelve months, prices fell to 0.20 per cent in August from 0.40 per cent in June. Moreover, the inflation index ex-fresh food entered negative territory with prices declining 0.1 per cent in August versus gaining 0.10 per cent in June. Though inflation is likely to hover around 0.0 per cent due to the effects of falling energy prices, the BOJ Governor tried to downplay the need to expand its current quantitative easing program and remained optimistic that domestic demand will recover and help to offset the negative effects of China on exports.

The BOJ's next scheduled monetary policy meeting is October 30th during which the central bank will provide an update on its forecast for growth and inflation. Economic projections are widely expected to be downgraded and there is increasing pressure on the BOJ to expand its current stimulus package in an effort to address the deteriorating growth outlook.

SECTION 2 – CAPITAL AND MONEY MARKET REVIEW

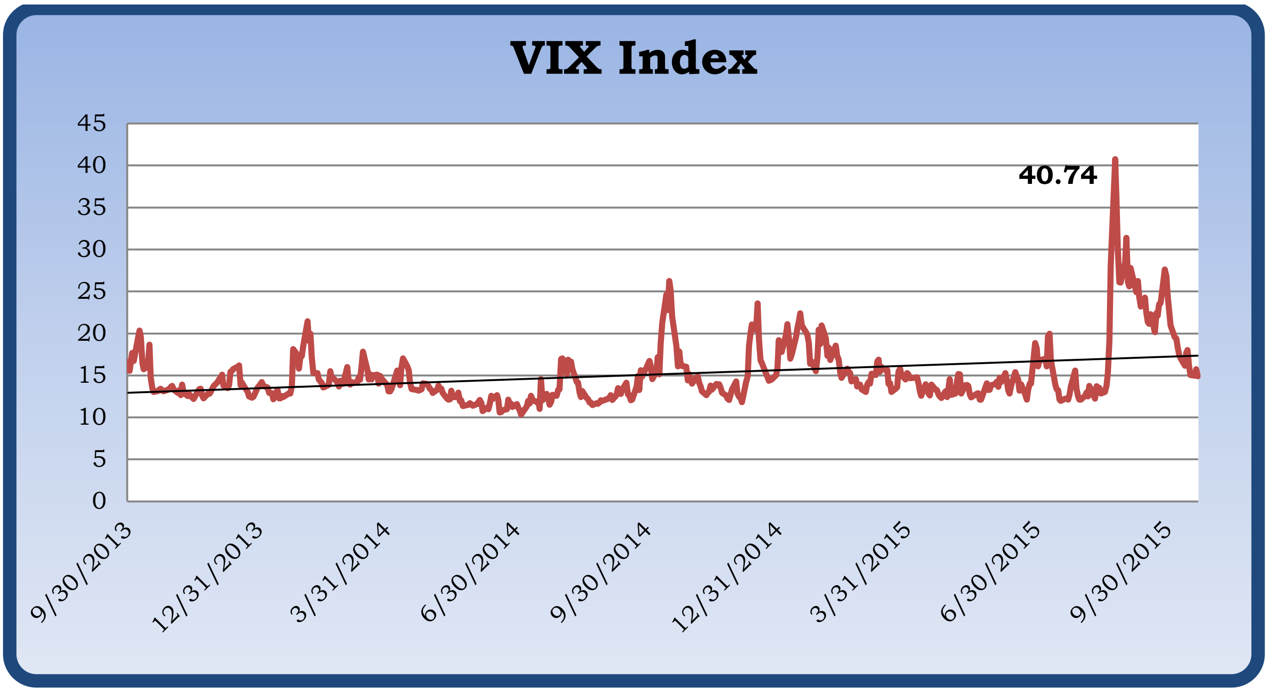
Over the quarter, international equity and bond markets were significantly affected by global headwinds as concerns about the Chinese economy and financial markets dominated headlines. Global bond markets were in risk-off mode, as most major sovereign bond yields declined during the quarter, with Italy and the US leading the way. In equity markets, performance was impacted mainly by concerns over the Chinese economy and to a lesser extent the timing of the Fed rate hike. Most major equity markets therefore declined over the quarter.

The Chicago Board Options Exchange Volatility Index (VIX), which is a proxy for investor anxiety and market risk, was relatively volatile during the third quarter of 2015 ending the period at 24.5 points, up from 18.23 points at the end of the second quarter of 2015. The VIX reached a high for the quarter of 40.74 points on August 24th, on account of the plunge in oil prices to US$ 38.09 per barrel, its lowest level post-global-financial-crisis, which was caused by escalating concerns about the slowdown in China.

Figure 1

Market Volatility in the U.S.

/points /



Source: Bloomberg

U.S. Fixed Income

During the third quarter, rates fell across the curve as investors sought the safety of U.S. Treasuries. Early in the period, yields recovered modestly as the threat of a Greek exit subsided. However, risk-off sentiment returned as lingering concerns around the magnitude of the slowdown in China were further exacerbated by continued turmoil in the local stock markets as well as the government's decision to devalue the Yuan[3]. While the events in China are expected to have relatively limited effects on the U.S. economy, the recent bout of global market volatility lowered the likelihood that the U.S. Federal Reserve (Fed) would have raised rates at its September FOMC meeting.

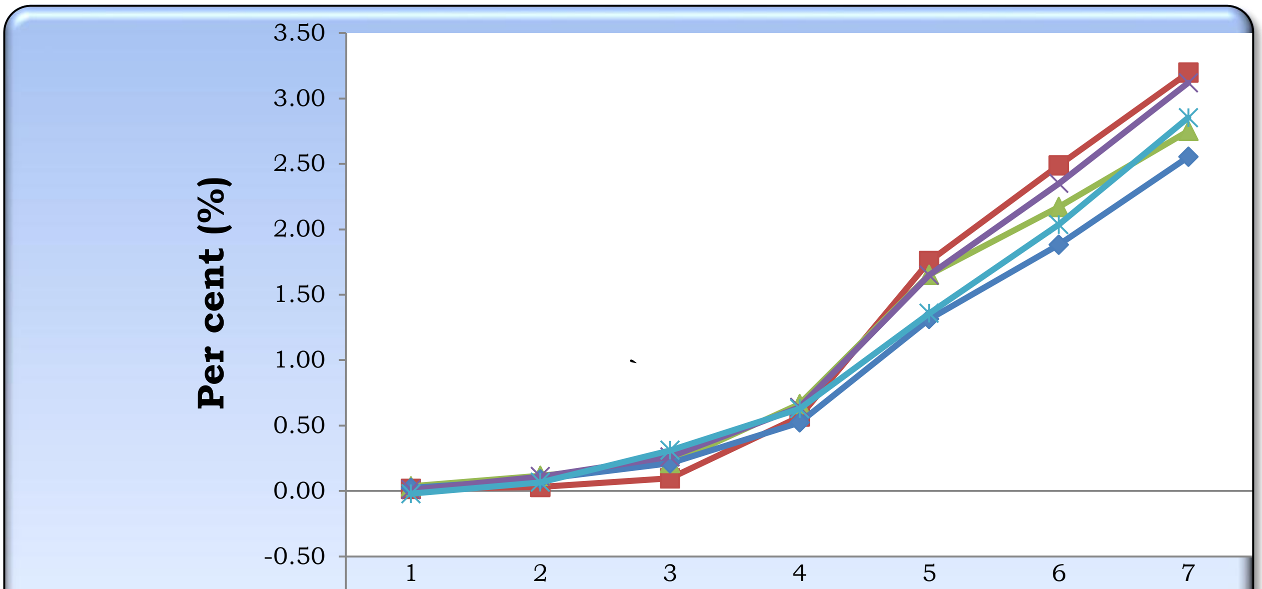
The yield curve flattened over the period and the spread between the 2 – 10 year portions of the curve fell 30.2 basis points to 140.7 basis points. The 2-year yield remained somewhat anchored by the view held by various Fed officials that the U.S. economy was strong enough to withstand a raise in rates, albeit at a slower than initially anticipated schedule. Rates on the longer-end of the curve fell as the sell-off in commodities and the slower global growth outlook dampened inflation expectations. The yield on the 10-year US Treasury fell 31.6 basis points to end the quarter at 2.038 per cent.

[3] In an effort to move towards a more market-based system to determine the Yuan's reference rate, the People's Bank of China (PBOC) changed the methodology on August 11th, 2015.

Figure 2

U.S. Treasury Yield Curve

/per cent/



	1	2	3	4	5	6	7
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
June 30, 2015	0.01	0.11	0.26	0.64	1.65	2.35	3.12
September 30, 2015	-0.02	0.07	0.31	0.63	1.36	2.04	2.85

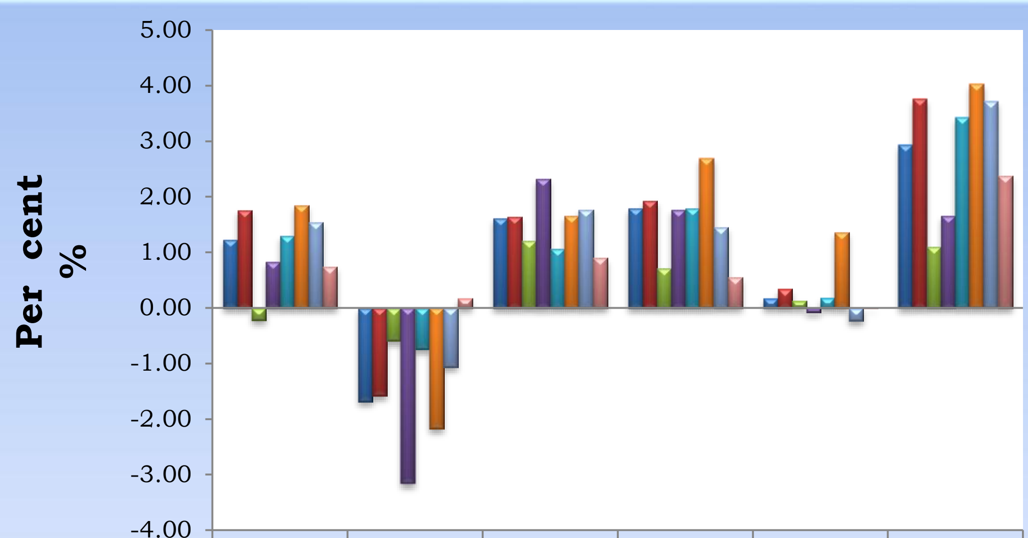
Source: Bloomberg

The broader US fixed income market, as measured by the Barclays Capital US Aggregate Bond index, returned 1.23 per cent over the third quarter. The risk-off environment driven by Greece and China hurt most spread products, however, asset-backed and supranational securities managed to post a modest outperformance versus similar duration US Treasuries. Credit spreads widened over the period as investors sought the safety of U.S. Treasuries; U.S. Corporate Investment Grade credit spreads increased 24.2 basis points to 169.2 basis points over the three months to September.

Figure 3

Returns on Fixed Income Indices

/per cent/



	QTR ended Sept-15	QTR ended Jun-15	QTR ended Mar-15	QTR ended Dec-14	QTR ended Sept-14	FY 14/15
Barclays U.S. Aggregate	1.23	-1.68	1.61	1.79	0.17	2.94
U.S. Treasuries	1.76	-1.58	1.64	1.93	0.34	3.76
U.S. Agencies	-0.22	-0.59	1.21	0.71	0.13	1.10
U.S. Corporate	0.83	-3.16	2.32	1.77	-0.08	1.66
U.S. MBS	1.30	-0.74	1.06	1.79	0.18	3.43
G-7 Global Bonds (Hedged)	1.85	-2.17	1.66	2.69	1.36	4.03
CMBS Index	1.54	-1.06	1.77	1.45	-0.23	3.72
ABS Index	0.74	0.17	0.90	0.55	0.01	2.38

Source: Barclays Capital

Global Fixed Income Markets

Global developed sovereign bond yields fell over the third quarter as concerns around Greece and China supported demand for safe-haven assets. In addition, the decline in commodity prices lowered inflation expectations and helped support lower rates. Risk-off sentiment drove yields lower in July and recovered in August only to drop further in September as the turmoil in the Chinese financial markets as well as growing signs of a more pronounced slowdown in the country sparked fears around the outlook for global growth and rising disinflationary pressures in an environment with already subdued pricing pressures.

In the United Kingdom, 10-year gilts fell 26.3 basis points to 1.76 per cent, while the 10-year German bund fell 17.7 basis points to 0.586 per cent. Early in the quarter, German bund yields fell as the outlook for Greece worsened following a missed debt payment to the IMF and there was growing uncertainty regarding whether the Syriza government would be able to reach an agreement with the country's creditors. In addition, European sovereign bond yields experienced additional downward pressure as the subdued inflation outlook increased the possibility that the ECB would explore extending its quantitative easing program.

Table 1

G-7 Generic Government 10 Year Yields

/per cent/

Country	**Generic Government 10 Year Yields**		**Change (basis points)**
	Sept 2015	**June 2015**	
US	2.037	2.353	(31.63)
UK	1.761	2.024	(26.30)
France	0.984	1.192	(20.80)
Germany	0.586	0.763	(17.70)
Italy	1.723	2.331	(60.80)
Canada	1.430	1.681	(25.10)
Japan	0.351	0.459	(10.80)

Source: Bloomberg

Money Markets

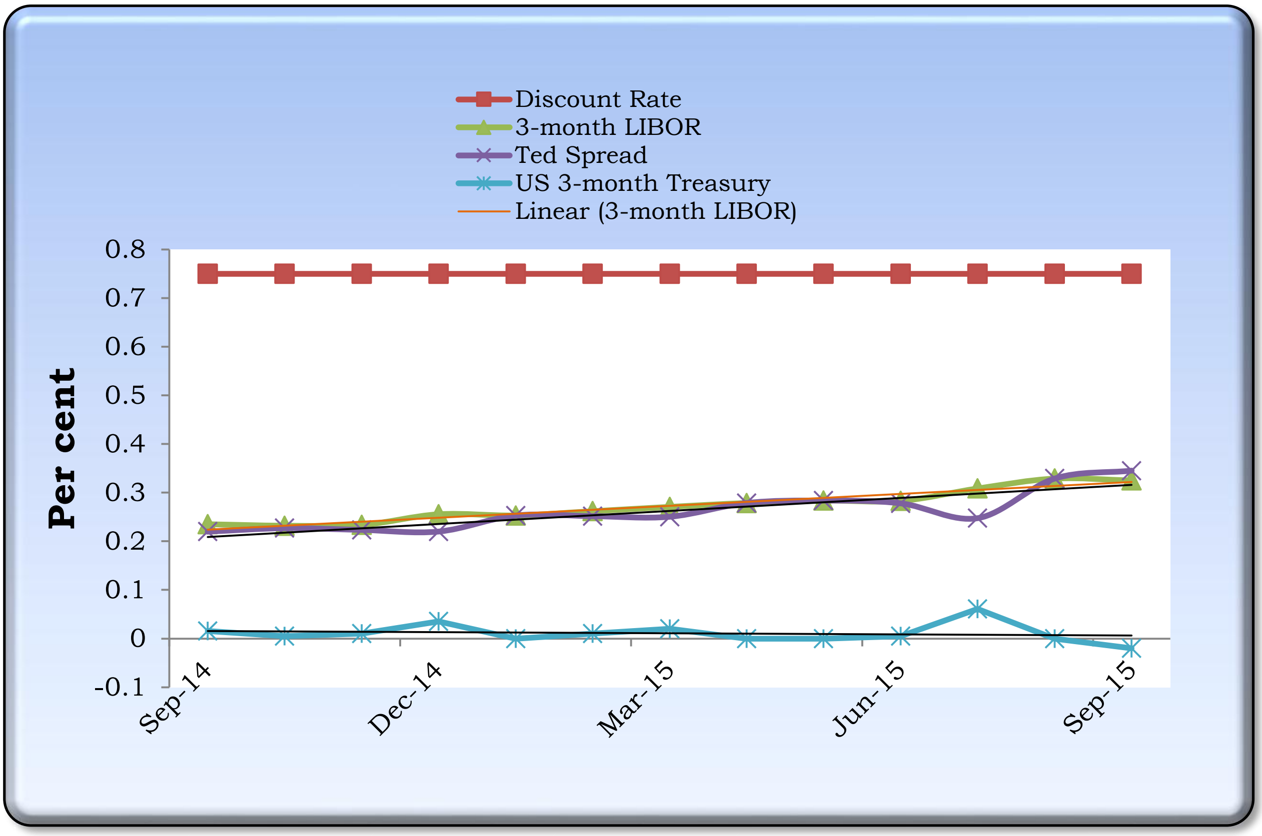
Short-term interest rates rose in general during the third quarter of 2015, with the exception of the 3-month US Treasury bill. The Ted Spread, which is an indicator of credit risk, rose 7 basis points over the quarter. This, as the increase in the 3-month London Inter-Bank Offered Rate (LIBOR), to 0.325 per cent from 0.283 per cent, offset the fall in the 3-month US Treasury bill rate, to -0.0203 per cent from 0.0051 per cent.

The 3-month US Treasury bill rate went into negative territory in the month of September, the first time since October 2011. Meanwhile, the discount rate and the Fed Funds rate held steady at 0.75 per cent and 0.25 per cent quarter-on-quarter and the 1-month LIBOR rose 0.007 per cent at the end of September, to 0.193 per cent from 0.187 per cent.

Figure 4

U.S. Money Market Rates

/per cent/



Source: Bloomberg

Equity Markets

Over the quarter, developed equity markets traded in correction[4] or bear market territory, as investor sentiment was impacted by heightened concerns over the slowdown in the Chinese economy, the unstable Chinese equity market and its spillover effects on global demand, emerging market economies and commodity prices. Expectations for the timing of the first Fed rate hike and US economic data also impacted investor sentiment over the quarter. The Greek debt crisis faded to the background during the third quarter, relative to the previous quarter, as a short term resolution was sought in the beginning of July. Developed equity markets struggled to maintain any positive momentum and by the end of September, Germany's DAX 30, Japan's Nikkei 225 and the MSCI EAFE were the worst performing equity markets over the quarter. Returns in US markets and the other European and Asian markets also declined, albeit to a lesser magnitude compared to the aforementioned countries *(See Figure 5)*.

In US equity markets, the Russell 3000 and S&P 500 declined 7.71 per cent and 6.94 per cent respectively with large cap stocks generally outperforming small cap companies. All sectors excluding Utilities detracted from performance over the quarter, with the Energy and Materials sectors leading the declines.

In non-US developed markets, the MSCI EAFE fell 10.75 per cent, as European and Japanese markets continued their sell-off, despite some encouraging economic data and continued support from expansionary monetary policies. In Europe, Germany's DAX 30 shed 11.74 per cent while France's CAC 40 lost 6.99 per cent. Elsewhere in Europe, London's FTSE 100 declined 7.04 per cent, mainly on account of energy price declines over the quarter, particularly on August 24th when the West Texas Intermediary (WTI) oil price troughed.

In Asian equity markets, Japan's Nikkei largely underperformed its developed market equity counterparts, with a decline of 14.07 per cent over the quarter. Despite relatively attractive valuations in Japanese stocks, Japan's equity market still continued to decline on account of soft economic data alongside disappointing Chinese financial market volatility and weak economic fundamentals.

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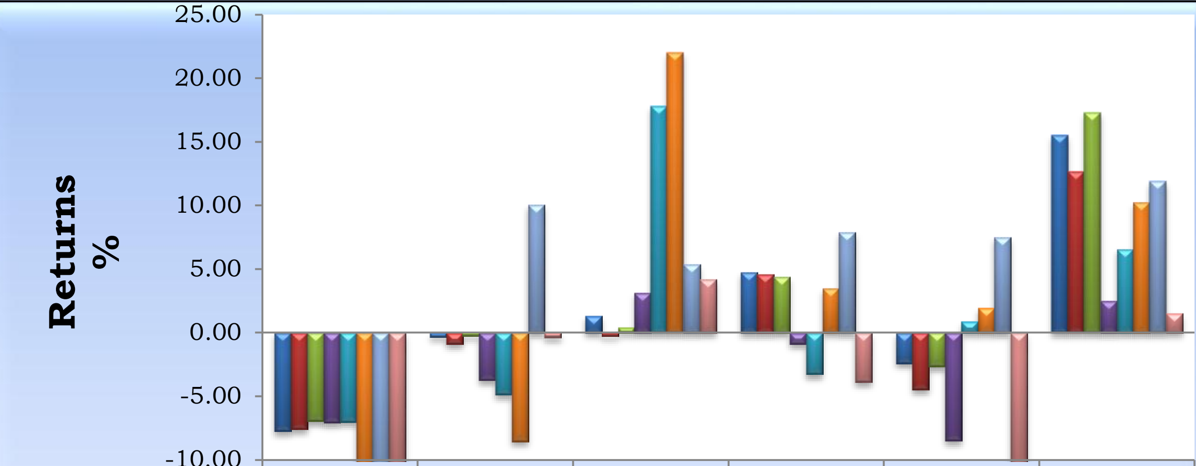
[4] approximately a 10 per cent decline from a previous high

Figure 5

Price Returns on Equity Indices

/Per cent/



	QTR ended Sept-15	QTR ended Jun-15	QTR ended Mar-15	QTR ended Dec-14	FY 14/15	FY 13/14
Russell 3000	-7.71	-0.34	1.32	4.74	-2.39	15.54
Dow Jones	-7.58	-0.88	-0.26	4.58	-4.45	12.65
S&P 500	-6.94	-0.23	0.44	4.39	-2.65	17.29
FTSE 100 - UK	-7.04	-3.72	3.15	-0.86	-8.47	2.48
CAC 40 - France	-6.99	-4.84	17.81	-3.25	0.88	6.58
DAX 30 - Germany	-11.74	-8.53	22.03	3.50	1.96	10.24
Nikkei 225 - Japan	-14.07	10.06	5.36	7.90	7.51	11.88
MSCI EAFE	-10.75	-0.37	4.19	-3.86	-10.92	1.53

Source: Bloomberg

Currency Markets

The U.S. dollar as measured by the US broad dollar index rose against a wide range of its trading partners but gains were at a more measured pace than those made earlier this year.

The euro ended the third quarter modestly higher against the U.S. dollar, appreciating 0.27 per cent. During the three months, the euro initially weakened as the ongoing debt negotiations in Greece and the uncertainty regarding the country's continued membership in the European Union weighed on sentiment. However, Greece and its creditors eventually agreed upon a third bailout package, which provided some stability to the region's outlook and supported a modestly stronger euro. The euro peaked in August as the turmoil in China's equity markets and the uncertainty over the government's ability to address the country's slower growth outlook, drove traders to derisk and exit their short positions, pushing the currency to a high of 1.1619. The euro retreated modestly toward quarter end as mixed messages from various ECB members sparked increasing speculation regarding whether the ECB would expand its Quantitative Easing program later this year.

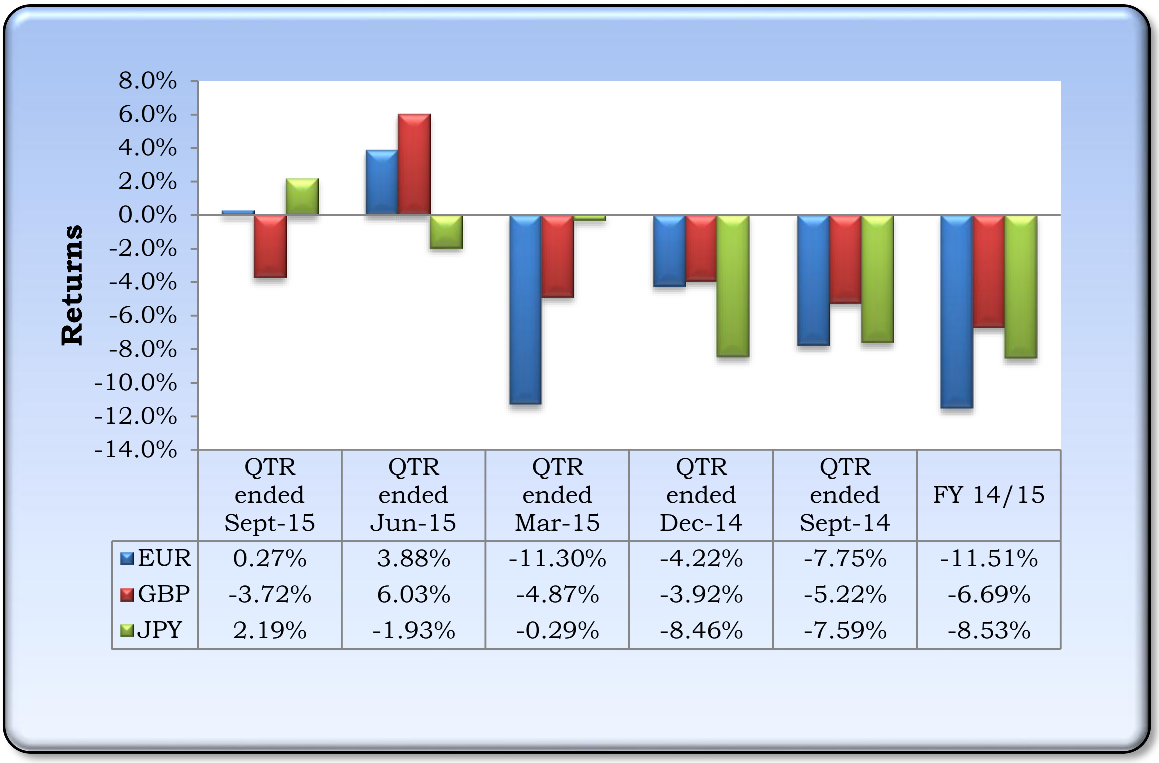
In the United Kingdom, the pound declined 3.72 per cent over the three months to September. The currency fell due to concerns around Greece early in the quarter and continued to experience weakness as economic data releases in the US and the UK, increased the likelihood that the Federal Reserve would tighten before the Bank of England.

In Asia, the outlook for the Japanese economy deteriorated as data releases pointed to a potential contraction in the third quarter. Moreover, Standard & Poor's lowered Japan's long-term credit rating one level from AA- to A+. Despite Japan's morose prospects and growing expectations that the Bank of Japan will need to eventually expand its stimulus program in order to achieve its inflation goals, the Yen appreciated 2.19 per cent over the three months to September. Safe haven flows stemming from the Greek debt crisis and heightened concerns around China's ability to successfully steer its slowing economy increased demand for safe haven assets such as the Yen.

Figure 6

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

/per cent/



	QTR ended Sept-15	QTR ended Jun-15	QTR ended Mar-15	QTR ended Dec-14	QTR ended Sept-14	FY 14/15
EUR	0.27%	3.88%	-11.30%	-4.22%	-7.75%	-11.51%
GBP	-3.72%	6.03%	-4.87%	-3.92%	-5.22%	-6.69%
JPY	2.19%	-1.93%	-0.29%	-8.46%	-7.59%	-8.53%

Source: Bloomberg

SECTION 3 – PORTFOLIO PERFORMANCE

Strategic Asset Allocation

During the period July 2015 to September 2015, the asset classes of the Fund deviated from their Strategic Asset Allocation (SAA) but their weights were all within the permitted (+/- 5 per cent) range. The approved SAA for the HSF investment portfolio is as follows:

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

Throughout the quarter, the two equity mandates carried underweight allocations relative to their SAA weights and these resulted from their weaker performance 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$407.6 million was withdrawn from the two equity mandates and deposited with the two fixed income mandates during the month of July 2015. By the end of the quarter, the asset class with the largest overweight was the US Core Fixed Income mandate while the Non-US Core International Equity mandate had the largest underweight position.

The total net asset value of the Fund as at the end of September 2015 was US$5,655.1 million, compared with US$5,774.9 million at the end of the previous quarter. Of this total, the investment portfolio was valued at US$5,654.4 million, while the remaining portion (US$0.7 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 December 31, 2014 to September 30, 2015 are shown in Table 2, overleaf.

Table 2

Portfolio Composition relative to the Approved SAA

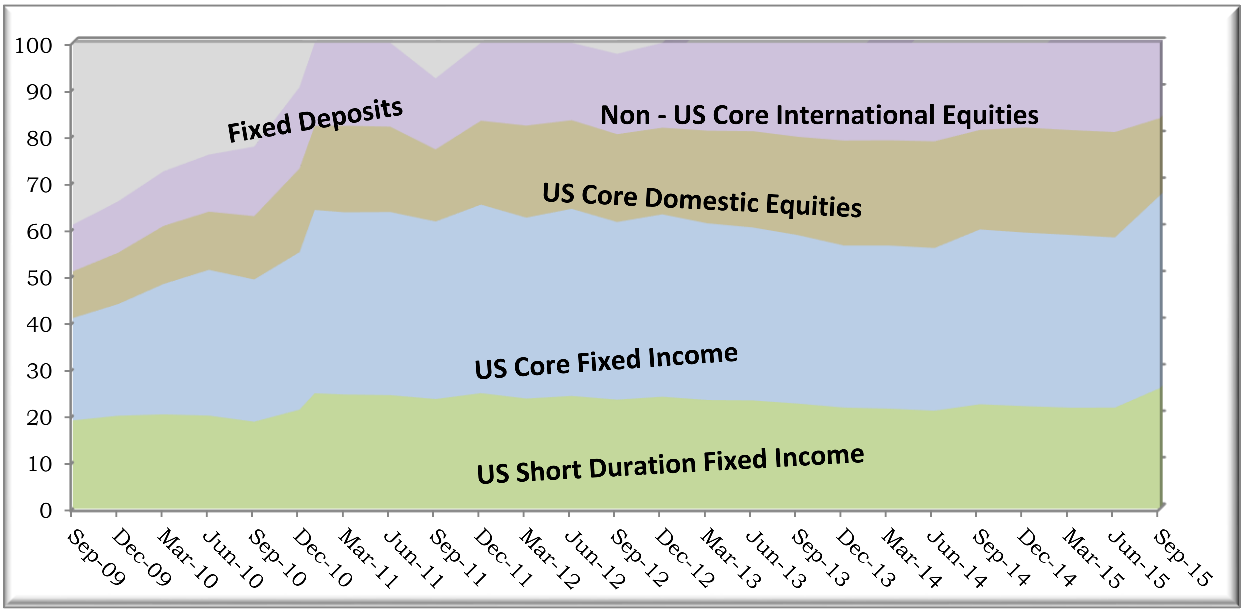
/per cent/

	Asset Class		***Dec-14***	***Mar-15***	***Jun-15***	***Sept-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	22.06	21.74	21.75	25.94
	US Core Domestic Fixed Income	40.00	37.26	37.08	36.53	41.32
	US Core Domestic Equity	17.50	22.50	22.48	22.58	16.58
	Non-US Core International Equity	17.50	18.17	18.70	19.13	16.16

Figure 7

Asset Composition of the HSF Portfolio

/per cent/



Performance of the Investment Portfolio

For the third quarter of 2015, the HSF investment portfolio decreased 2.02 per cent, compared with a decrease of 2.19 per cent for the SAA benchmark[5]. This outperformance of 17 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 detracted approximately 2.55 per cent, while the fixed income portion of the Fund added approximately 0.54 per cent.

The **US Short Duration Fixed Income** portfolio increased 0.62 per cent during the third quarter of 2015, underperforming its benchmark, the Bank of America Merrill Lynch US Treasury 1-5 year index, by 7 basis points. This underperformance was attributed to the portfolio's exposure to agency and non-US government bonds as spreads widened during the quarter, especially in August. Additionally, duration and breakeven inflation positioning negatively impacted performance as the portfolio had an underweight duration positioning during the quarter as yields declined and inflation protected securities lost value. The net asset value of this mandate as at September 30, 2015 was **US$1,466.7 million,** compared with US$1,255.8 million at the end of the previous quarter. A contribution of US$203.0 million was made in July 2015.

The longer duration fixed income mandate which consists of **US Core Fixed Income** securities, added 0.96 per cent for the third quarter of 2015, underperforming its benchmark, the Barclays Capital US Aggregate Bond index, by 28 basis points. This under- performance was due to interest rate and security selection decisions along with allocations to spread products in particular government agencies. Security selection, with respect to US Treasury Inflation Protected securities and agency mortgage securities, was a main detractor. The net asset value of this mandate as at September 30, 2015 stood at **US$2,336.6 million** compared with US$2,109.7 million as at June 30, 2015. A contribution of US$204.5 million was made in July 2015.

The **Non-US International Equities** mandate declined 8.26 per cent for the third quarter of 2015, compared with a decline of 9.87 per cent for its benchmark, the MSCI EAFE ex

[5] 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 outperformance was due to positive stock selection, country allocations and sector allocations in the portfolio. Stock selection provided the largest benefit to the portfolio from holdings in the Consumer Discretionary and Financials sectors. Additionally, country allocation in Japan and Ireland also added to performance. Sector allocations were positive in the Industrials and Telecom sectors. The net asset value of the Non-US Core International Equity mandate as at September 30, 2015 decreased to **US$913.5 million**, from US$1,105.0 million at the end of June 2015. US$107.8 million was withdrawn from this mandate in July 2015.

The **US Core Domestic Equities** mandate fell 6.56 per cent, compared with a decline in the benchmark of 6.33 per cent. During the quarter both sector allocations and stock selection hindered performance. Allocations to the Health Care and Producer Durables sectors were the largest detractors from performance. The net asset value of this mandate, as at September 30, 2015, was **US$937.6 million**, compared with US$1,304.2 million at the end of June 2015. US$299.8 million was withdrawn from this mandate in July 2015.

Table 3

Contribution to Quarterly Return

For the period Jul 2015 – Sept 2015

/per cent/

	SAA Weights	Portfolio Weights as at 30-Sept-2015	Weighted Return HSF	Weighted Return Benchmark
Composite Portfolio	100.00	100.00	-2.02	-2.19
US Core Domestic Fixed Income	40.00	41.32	0.39	0.50
US Core Domestic Equity	17.50	16.58	-1.12	-1.10
Non US Core International Equity	17.50	16.16	-1.42	-1.74
US Short Duration Fixed Income	25.00	25.94	0.16	0.17

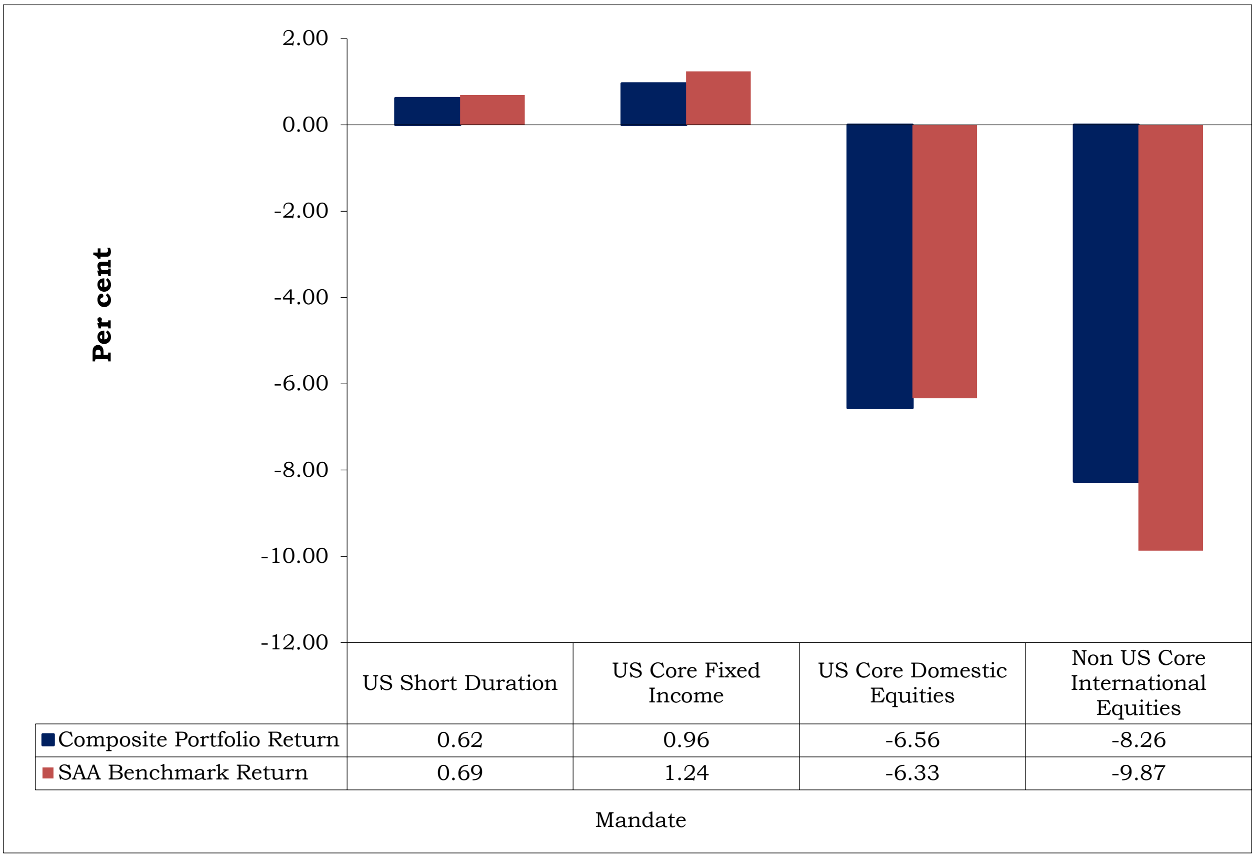
NB: Differences in totals are due to rounding.

Figure 8

Absolute Returns by Asset Class

For the period Jul 2015 – Sept 2015

/per cent/



	US Short Duration	US Core Fixed Income	US Core Domestic Equities	Non US Core International Equities
Composite Portfolio Return	0.62	0.96	-6.56	-8.26
SAA Benchmark Return	0.69	1.24	-6.33	-9.87

SECTION 4 – COMPLIANCE AND PORTFOLIO RISKS

Compliance

The investment guidelines for the US Core Domestic Equity Mandate prohibit the investment in energy stocks as defined by Russell Investments. During the quarter, this provision was inadvertently breached on two occasions. The investment managers have reviewed their compliance frameworks to ensure future compliance.

At the beginning of July 2015, one of the US Equity managers received shares in a spinoff of a utility company which was subsequently classified as an energy stock. As this trade was not a direct purchase by the manager, the stock was not flagged in their pre trade compliance system as an energy stock. When the manager discovered the compliance breach the security was immediately sold for a profit and the manager has implemented more effective alerts for spinoff securities.

During the month of August 2015, a US Equity manager purchased a security through an initial public offering (IPO). At the time of the IPO, this stock was not classified by Russell Investments and as such the manager used its internal classification scheme to classify the stock in the semiconductor sector, to reflect their view that the company is a technology investment. However, at the end of the quarter, Russell Indexes included the stock in the Russell 3000 and classified the stock as an energy company, at which time the security was sold promptly at a loss. Despite this, the manager outperformed its benchmark for the month.

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 September 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 September 30, 2015.

Table 5

Weighted Average Duration

/Years/

Mandate	Portfolio	Benchmark
US Short Duration	**2.43**	**2.64**
US Core Domestic Fixed Income	**5.52**	**5.60**

Currency Risk

Currency Risk is managed by containing and managing the exposure to non-US dollar instruments. For the Fixed Income and US Core Domestic Equity mandates, no more than 10 per cent of the market value of the portfolio can be invested in securities, which are denominated in currencies other than the US Dollar. The Non-US Core International Equity Portfolio is comprised primarily of non-US dollar denominated securities, and the Fund accepts the currency risk inherent in the relevant benchmark. For this mandate, currency hedging is permitted up to 15 per cent of the market value of the portfolio using the US dollar as the base currency. At the end of September 2015, the currency exposure for this portfolio was 96 per cent of its market value. During the quarter, all the portfolios were within their respective limits.

Appendix I
HSF Portfolio
Historical Performance

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

Quarter End	Current Returns			Financial YTD			Annualised Return Since Inception		
	Portfolio	Benchmark	Excess	Portfolio	Benchmark	Excess	Portfolio	Benchmark	Excess
	%	%	bps	%	%	bps	%	%	bps
FY 2015									
September	-2.02	-2.19	16.83	2.47	1.13	134.06	5.31	4.73	58.12

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	Total Comprehensive 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	68,412,770	110,379,131	1,054,174,457
September 30,2009	2,964,686,478	76,248,691	186,755,766	-
September 30,2010	3,621,984,041	177,645,460	364,361,226	477,344,263
September 30,2011	4,084,016,158	9,715,841	374,074,067	451,400,519
September 30,2012	4,712,376,278	420,693,705	794,770,772	207,550,846
September 30,2013	5,154,027,747	399,007,950	1,193,778,722	42,414,251
September 30,2014	5,533,425,248	379,167,024	1,572,945,746	-
September 30,2015	5,655,143,565	120,639,605	1,693,585,351	-
Quarterly Portfolio Valuation				
March 31, 2012	4,397,263,070	205,928,989	687,290,865	-
June 30, 2012	4,378,930,036	(44,520,884)	642,769,982	26,241,964
September 30, 2012	4,712,376,278	152,000,791	794,770,772	181,308,882
December 31, 2012	4,780,065,524	66,787,005	861,557,777	-
March 31, 2013	4,933,344,741	220,441,931	1,015,212,703	-
June 30, 2013	4,914,375,234	(18,801,609)	996,411,094	-
September 30, 2013	5,154,027,747	197,367,628	1,193,778,722	42,414,251
December 31, 2013	5,354,721,875	199,949,013	1,393,727,735	-
March 31, 2014	5,429,643,570	74,268,941	1,467,996,676	-
June 30, 2014	5,563,339,006	134,504,162	1,602,500,838	-
September 30, 2014	5,533,425,248	(29,555,092)	1,572,945,746	-
December 31, 2014	5,653,895,156	120,509,077	1,693,454,823	-
March 31, 2015	5,779,420,631	125,471,133	1,818,925,956	-
June 30, 2015	5,774,951,169	(4,765,278)	1,814,160,678	-
September 30, 2015	5,655,143,565	(120,575,327)	1,693,585,351	-

Appendix III
Summary Characteristics of Composite Benchmarks
Fixed Income Benchmarks

Key Characteristics	Barclays US Aggregate Index	Merrill Lynch 1-5 Index
Total Holdings	9,611	155
Coupon (%)	3.20	1.87
Duration (Years)	5.60	2.64
Average Life (Years)	7.86	2.73
Yield to Maturity (%)	2.31	0.85
Option Adjusted Spread (bps)	59	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	2,809	860
Earnings Per Share (EPS Growth 3-5y fwd)	10.6	8.61
Price Earnings (P/E fwd)	15.45	13.68
Price / Book (P/B)	2.5	1.59
Weighted Average Market Capitalization* (Bn)	$101.6	$52.95

*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.

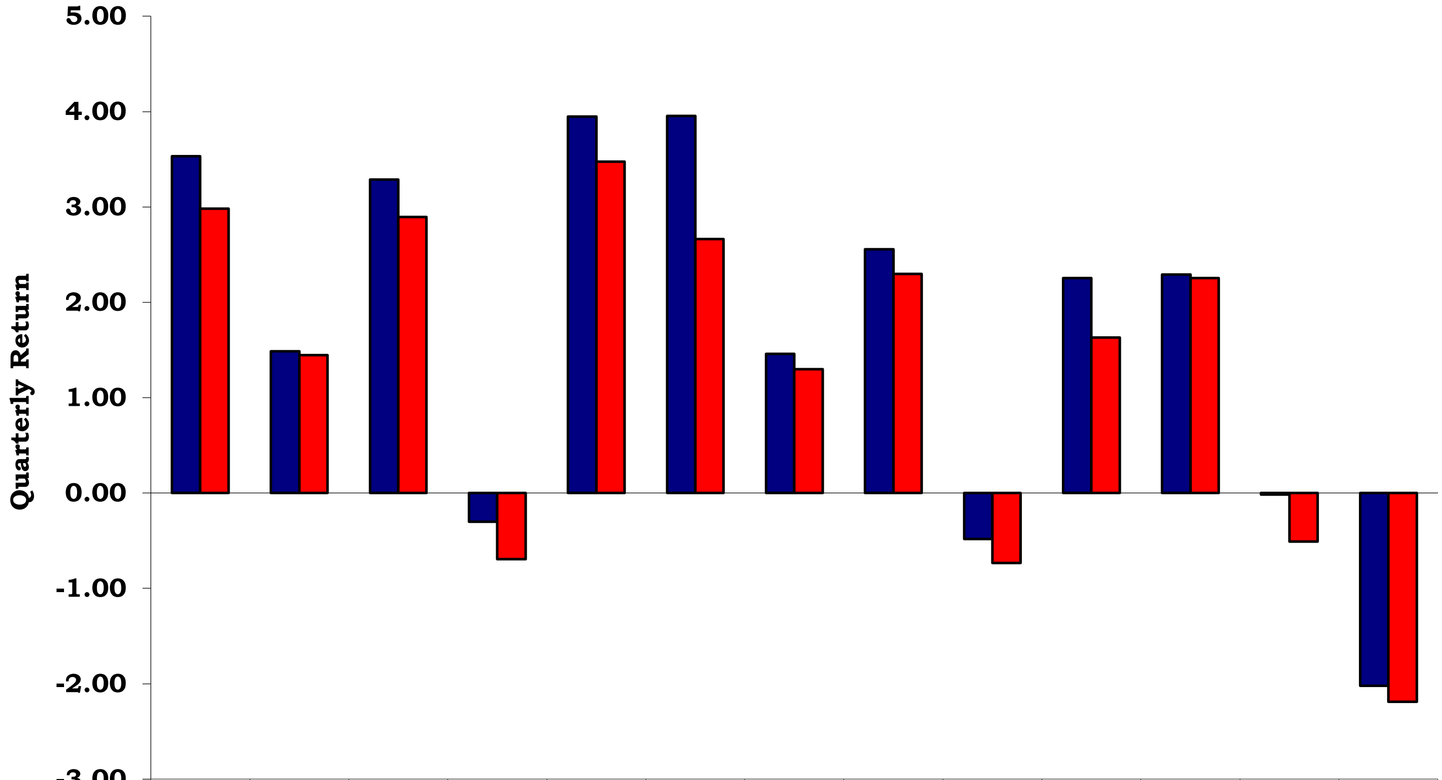
Appendix IV
Summary of the Fund's Net Asset Value by Mandate
/US$ Million/

	Sep-14	Dec-14	Mar-15	Jun-15	Sept-15
Total Fund Value	**5,533**	**5,654**	**5,779**	**5,775**	**5,665**
Total Value of Equity	**2,213**	**2,299**	**2,380**	**2,409**	**1,851**
US Core Domestic Equity	1,180	1,272	1,299	1,304	938
Non-US Core International Equity	1,033	1,027	1,081	1,105	913
Total Value of Fixed Income	**3,319**	**3,354**	**3,399**	**3,366**	**3,803**
US Short Duration Fixed Income	1,243	1,247	1,257	1,256	1,467
US Core Domestic Fixed Income	2,076	2,106	2,143	2,110	2,337
Total Value of Cash or Cash Equivalents	**1**	**1**	**0**	**0**	**1**

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	FY2015 Q3	FY2015 Q4
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	-2.02
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	-2.19

HSF Portfolio **Benchmark**