Heritage and Stabilisation Fund

Quarterly Investment Report

September – December 2015

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EXECUTIVE SUMMARY

Economic growth, in the four major economic regions of the world, continued on its positive trajectory, albeit at a slower pace during the fourth quarter of 2015. Emerging markets on the other hand, remained a drag on the global economy as China, the main driver of global demand, continued to falter. In financial markets, divergent monetary policy dominated investor sentiment over the quarter, as the Federal Reserve (Fed) officially hiked interest rates in December while other major developed central banks, including the European Central Bank (ECB) and the Bank of Japan (BoJ) expanded their quantitative easing (QE) programmes. According to the International Monetary Fund (IMF), global growth is forecasted at 3.1 per cent for 2015 and 3.4 per cent for 2016, which was downwardly revised from 3.6 per cent in October.

The **United States (US)** economy slowed in the third quarter as GDP growth was recorded at 2 per cent annualized down from 3.9 per cent in the second quarter. Current economic data suggests a slowing manufacturing sector however the labour market continues to be a bright spot, with nonfarm payrolls outpacing estimates during the quarter. The unemployment rate fell to 5.0 per cent, which was its lowest level in seven years, while the Fed’s preferred gauge of inflation (Personal Consumption Expenditure – PCE) remained steady at 1.30 per cent in November. Finally as expected, the Fed embarked on its rate hike, by increasing the range of the Fed Funds rate from 0 - 0.25 per cent to 0.25 - 0.50 per cent. The US central bank continued to reiterate that its monetary stance will remain accommodative for the medium term.

In the **Euro zone,** the economic recovery slowed in the third quarter of 2015. In the three months to September, growth came in at 0.3 per cent, down from 0.4 per cent in the second quarter, with GDP in the three largest economies, Germany, France and Italy posting modest rates of expansion. More recent data pointed to a pickup in economic activity in the region in the fourth quarter. Eurozone unemployment improved over the quarter, even though it remained uneven across the member states. At its December meeting, the ECB bolstered its stimulus program by cutting its deposit rate and extending its QE program by six months. These policy moves however, were met with disappointment by markets which suggested that more aggressive actions were sought by investors. To this end, President Mario Draghi indicated that the measures taken in December were “entirely appropriate and have been effective” and that they were “…based on the circumstances that were prevailing at that time.”

The economy of the **United Kingdom (UK)** continued to exhibit positive growth trends during the third quarter, albeit at a slower pace, as GDP expanded 0.4 per cent compared with a previously estimated 0.5 per cent for the same period. Recent PMI data also suggests positive growth in the UK. The Bank of England (BoE) maintained its benchmark interest rate and its stock of asset purchases constant and also gave approval to re-invest the £8.4 billion of cash flows associated with the redemption of the January 2016 gilt held in the Asset Purchase Facility.

The **Japanese** economy narrowly missed falling into a recession in the third quarter, as the economy expanded by 1 per cent (annual rate) revised up from an initial estimate of a 0.8 per cent contraction (which would have followed the second quarter contraction of 0.5 per cent). Economic data was mixed during the quarter as both industrial production and export volumes declined, while unemployment and inflation measures improved. On the monetary policy front, the BoJ made some technical changes to its policies during the quarter, by increasing the average maturity of bonds the central bank can purchase along with the establishment of a new ETF facility.

Equity markets rallied over the quarter on the heels of stellar performance in October. Over the quarter, central bank monetary policy divergence continued to impact markets, particularly in Europe and the US. Germany led the way in Europe as the equity market was buoyed by further monetary easing by the ECB, while in Asia, Japan returned 9.46 per cent and was the second best performing equity market. The Russell 3000 and the MSCI EAFE increased (on a price return basis) 5.72 per cent and 4.37 per cent respectively in the three months to December 2015.

Sovereign bond yields spiked, as divergent monetary policies drove movements in yields. As the Fed and ECB embarked on differing monetary policies, US 10 year bonds increased 23 basis points, while 10 year German bunds increased slightly by 4 basis points. The US Treasury yield curve flattened over the quarter, even though the overall yield curve shifted upward. The spread between the 2 and 10 year segments of the curve declined 18.7 basis points to 1.22 per cent at the end of the quarter. The broader US fixed income market as measured by the Barclays Capital US Aggregate Bond index, declined 0.57 per cent for the quarter. Spread performance was mixed as Asset backed and supranational securities underperformed similar duration US Treasuries during the period, while US Investment Grade bonds outperformed.

The HSF investment portfolio gained 1.68 per cent for the quarter ended December 2015, compared with an increase of 1.67 per cent for the Strategic Asset Allocation (SAA) benchmark. The Fund's exposure to fixed income securities detracted from absolute returns, eroding some of the gains generated by the equity portfolio. At the end of December 2015, the net asset value of the HSF was US$5,745.0 million, an increase from US$5,655.1 million reported at the end of September 2015.

Contribution to Quarterly Return
For the period Oct 2015 – Dec 2015
/per cent/

	SAA Weights	Portfolio Weights as at 31-Dec-2015	Weighted Return HSF	Weighted Return Benchmark
Composite Portfolio	100.00	100.00	1.68	1.67
US Core Domestic Fixed Income	40.00	40.45	-0.19	-0.22
US Core Domestic Equity	17.50	17.40	1.11	1.19
Non US Core International Equity	17.50	16.77	0.92	0.89
US Short Duration Fixed Income	25.00	25.37	-0.14	-0.17

NB: Differences in totals are due to rounding.

Comparative Quarterly Returns

For the Quarters ended June 2015 – December 2015

/per cent/

	3 Months Weighted Return as at 31-Dec-2015		3 Months Weighted Return as at 30-Sept-2015		3 Months Weighted Return as at 30-June-2015	
	HSF	**Bench-mark**	**HSF**	**Bench-mark**	**HSF**	**Bench-mark**
Composite Portfolio	1.68	1.67	-2.02	-2.19	-0.02	-0.51
US Core Domestic Fixed Income	-0.19	-0.22	0.39	0.50	-0.56	-0.67
US Core Domestic Equity	1.11	1.19	-1.12	-1.10	0.10	0.06
Non US Core International Equity	0.92	0.89	-1.42	-1.74	0.44	0.11
US Short Duration Fixed Income	-0.14	-0.17	0.16	0.17	0.00	0.00

Comparative Financial Year to Date Returns

For the periods December 2014 & December 2015

/per cent/

	Financial Year to Date Return as at 31-Dec-2015		Financial Year to Date Return as at 31-Dec-2014	
	HSF	Bench-mark	HSF	Bench-mark
Composite Portfolio	1.68	1.67	2.25	1.63
US Core Domestic Fixed Income	-0.19	-0.22	0.57	0.71
US Core Domestic Equity	1.11	1.19	1.68	1.22
Non US Core International Equity	0.92	0.89	-0.08	-0.42
US Short Duration Fixed Income	-0.14	-0.17	0.08	0.12

SECTION 1 – INTERNATIONAL ECONOMIC ENVIRONMENT

United States

Data emanating from the US over the final quarter of 2015 suggests that the economy continued to strengthen, albeit at a slow but steady pace. During the third quarter, Gross Domestic Product (GDP) increased at an annualized rate of 2 per cent, compared with growth of 3.9 per in the second quarter. The relatively healthy expansion during the third quarter was supported by consumer and business spending, while efforts by businesses to reduce an inventory glut weighed on GDP growth.

During the fourth quarter, U.S. manufacturing lost momentum and the sector contracted as a result of the effects of a stronger dollar, weaker exports and lower demand for drilling equipment in the wake of plunging oil prices. The Institute of Supply Management's Purchasing Managers Index (PMI), which gauges the level of activity in the manufacturing sector, slipped to 48.2 in December from 48.6 in November and 50.2 in September. This was the second consecutive month that the reading fell below 50, the line between contraction and expansion within the manufacturing sector.

The labour market was a bright spot during the period and showed sustained improvement in the three months leading to December 2015. Non-farm payrolls averaged 284,000 during the fourth quarter versus 200,000 in the first nine months of the year, suggesting a recovery in job creation. The unemployment rate fell to a seven year low and remained steady at 5 per cent during the final quarter of 2015.

The improving labour market, lower gasoline prices and warmer-than-normal winter temperatures were expected to support consumer spending during the quarter. However, retail sales disappointed in December falling by 0.10 per cent on a monthly basis. For the year 2015, retail sales increased by 2.1 per cent, compared with the 3.9 per cent annual gain experienced in 2014.

Headline inflation inched higher during the quarter, as the Consumer Price Index (CPI) rose 0.7 per cent year-on-year in December 2015, up from zero per cent at the end of September. The core inflation rate, which removes the impact of food and energy costs, rose 2.1 per cent in December compared to 1.9 per cent three months earlier. The Federal Reserve's (Fed) preferred gauge of inflation, the Core PCE index remained stable at 1.30 per cent during the first eleven months of the year.

The final quarter of 2015 was momentous for U.S. monetary policy developments. At the start of the fourth quarter, investors largely expected any changes to the Fed's policy stance to be delayed into 2016. However, at its October meeting, while the Federal Open Market Committee (FOMC) did not adjust its policy stance, the Committee surprised investors by directly referencing the possibility of a rate hike at its next meeting in December 2015. As such, market expectation of a 2015 'lift-off' in U.S. rates was once again on the table.

At its December's meeting, the FOMC raised the federal funds target rate to a range of 0.25 – 0.50 per cent from the historic low of 0 – 0.25 per cent. The FOMC noted that despite the increase in the federal funds interest rate range, its monetary stance remains accommodative and is expected to support further improvements in the labour market and return inflation to the 2 per cent target.

The FOMC indicated the timing and size of future adjustments to the federal funds rate will continue to be data dependent and expects "economic conditions will evolve in a manner that will warrant only gradual increases in the federal funds rate". Also, in the press conference following the first rate hike since 2006, Fed Chair Janet Yellen noted the decision reflected the Fed's confidence that the U.S. economy is on a path to "sustainable improvement" and emphasized that subsequent hikes will follow a gradual trajectory.

Eurozone

The Eurozone economy advanced by 0.3 per cent for the three months to September, down from 0.4 per cent in the quarter ending June. Germany, France and Italy posted modest growth figures over the quarter as these economies were affected by the emerging markets slowdown. Despite slower growth in the third quarter, recent data suggests a slight pickup in economic activity in the final quarter of 2015. The Markit Euro Area Composite Purchasing Manufacturing Index (PMI) rose to 54.3 in December, up from 54.2 in November and 53.6 in September, with growth in both the manufacturing and services sectors.

Eurozone inflation, as measured by the Consumer Price Index (CPI), improved somewhat over the fourth quarter, although remaining at relatively low rates and below expectations. Headline CPI climbed to 0.2 per cent in December, up from 0.1 per cent in both November and October, and -0.1 per cent in September. Conversely, core CPI worsened to 0.9 per cent in December, after climbing to 1.1 per cent in October. Given the current levels of inflation and inflation expectations in Europe, it is anticipated that further economic stimulus may be announced in the future.

The jobless rate in the Eurozone improved over the quarter to 10.5 per cent in November, from 10.7 per cent in September and 11.2 per cent at the beginning of year. November's reading was the lowest rate recorded since October 2011. Meanwhile, unemployment remained uneven across member states, from a low of 6.3 per cent in the bloc's largest economy, Germany to 21.2 per cent in Spain[1].

In its December meeting, the ECB moved to bolster its stimulus program to counter low inflation. The central bank's decision resulted in a cut in the deposit rate by 10 basis points to -0.30 per cent. Additionally the main re-financing rate and lending rate were maintained at 0.05 per cent and 0.30 per cent respectively. The Governing Council also moved to extend its QE program by 6 months while maintaining monthly net asset purchases of €60 billion. Despite these moves, market participants were largely disappointed after earlier comments by President Draghi suggested that more aggressive action would have been taken. In response to this, President Draghi, however, indicated that the measures taken in December were "entirely appropriate and have been effective" and that they were "…based on the circumstances that were prevailing at that time." Against this backdrop, the outlook for growth and inflation for the Eurozone remained positive albeit low, which suggested that the additional easing may be necessary ahead.

United Kingdom

The UK lost momentum over the third quarter of 2015. Real GDP grew by 0.4 per cent in the three months to September, revised down from the previous 0.5 per cent estimate. Growth in the third quarter also slowed relative to second quarter growth of 0.5 per cent. Although growth was weaker than previously estimated, this represented the eleventh consecutive quarter of GDP growth and continued the trend in positive output that started in 2013. Over the fourth quarter, data was mixed but suggested that the economy grew at a steady pace. The PMI Composite increased quarter on quarter to 55.3 in December, from

[1] No data was available for Spain for the final quarter of 2015. The unemployment rate of 21.2 per cent represents the rate for the period July to September 2015.

53.3 in September on the back of solid expansion in the services sector which was up 55.5 in December from 53.3 in September.

Headline inflation, as measured by the CPI, remained close to zero per cent during the fourth quarter. Core inflation inched closer to the BoE's 2 per cent medium term inflation target while headline inflation remained heavily influenced by its volatile constituents. Headline inflation in the UK rose 0.2 per cent in December, up from 0.1 per cent in November and -0.1 per cent in September. Low inflation rates persist mainly due to the drag from oil prices, subdued material prices and an appreciation of the sterling. Core inflation, however, improved to 1.2 per cent in December, up from 1.1 per cent in November and 1 per cent in September. The disparity between headline and core inflation continued to point to the negative contributions of energy, food, alcohol and tobacco.

UK unemployment data was mixed but broadly improved in the three months to December. The unemployment rate dropped to 5.1 per cent in November compared with 5.2 per cent in October and 5.3 per cent in September. Despite continued reductions in the rate of unemployment, wage growth remained restrained. Average weekly earnings (3-month average) eased to 2.0 per cent in November, down from 2.4 per cent in October and 3 per cent in September while Average Earnings (ex-Bonus) declined to 1.9 per cent in November, from 2.4 per cent in September. Notwithstanding the dip in wage growth, the Monetary Policy Committee (MPC) judged that labour market slack had declined, more than expected, which suggested labour market tightness comparable to pre-crisis periods. The MPC judged that wages are still lower than would be consistent with achieving the 2 per cent medium term inflation target, however growth in wages is currently being forecast.

At its January meeting, the Monetary Policy Committee (MPC) of the BoE voted by a majority of 8-1 to maintain the Bank Rate at 0.5 per cent. The Committee voted unanimously to maintain the stock of purchased assets financed by the issuance of central bank reserves at £375 billion, and to re-invest the £8.4 billion of cash flows associated with the redemption of the January 2016 gilt held in the Asset Purchase Facility. As in previous meetings, the Committee judged that leaving the stance of monetary policy unchanged would best balance the risks around achieving the MPC's objective of returning inflation sustainably to its target in around two years' time as headwinds restraining economic growth were likely to persist.

Finally, on the political front, there have been calls for a "Brexit" that would delink Britain from the EU's policies, including those on the free movement of people, which has become particularly important over the past year following several terrorist attacks in the Eurozone. The possible departure from the EU, or “Brexit”, could be held in June 2016 in the form of a referendum.

Japan

The Japanese economy expanded by 1 per cent (annual rate) during the third quarter of 2015. The final reading of third quarter GDP was revised upward from the preliminary estimate of negative 0.8 per cent, which would have placed Japan in a technical recession following the second quarter’s 0.5 per cent contraction. During the three months to September, economic activity was boosted by stronger capital expenditure and household spending, while public investment and inventories detracted from growth.

During the fourth quarter, Japan’s economic data was mixed. Industrial production declined by 0.9 per cent on a monthly basis in November, following two consecutive months of increases. Additionally, for the fifth consecutive month, export volume trended downwards and declined by 3.10 per cent in November, amid falling demand from Asia and the U.S.

Domestic demand data was disappointing as retail sales fell by 1.10 per cent in November from the prior year. Additionally, overall household spending declined by 2.90 per cent on a yearly basis in November, the largest fall in eight months.

Meanwhile, the labour market continued to show resilience during the fourth quarter. Japan’s unemployment rate fell to 3.30 per cent in November from 3.40 per cent in September. Also, increasing levels of job offers resulted in the ratio of job openings to job seekers rising to a 24 year high of 1.25 in November. However, wage growth during the period was muted, as monthly cash earnings remained flat year on year in November, compared to the 0.40 per cent increase recorded in September.

Inflationary pressures trended upwards, but remained below the Bank of Japan’s 2 per cent inflation target. Inflation as measured by the Consumer Price Index (CPI) rose by 0.30 per cent in November compared to zero per cent in September. The uptick in prices was also seen in core consumer prices. Core CPI, which excludes more volatile food and energy prices, increased by 0.90 per cent in November from the prior year.

At its final monetary policy meeting for 2015, the Bank of Japan (BOJ) maintained its annual asset purchases at 80 trillion yen, but outlined several operational changes for the purchase of assets. Under the new adjustments, the average maturity of bonds the BOJ can purchase was increased to 7-12 years from 7-10 years. Additionally, the central bank established a new program to buy 300 billion yen in ETFs and increased the maximum amount of real-estate investment trusts it can buy to ten per cent of each issue, from five per cent. BOJ Governor Kuroda noted the changes did not constitute additional monetary easing but rather was designed to make it easier for the BOJ to maintain its current policy.

SECTION 2 – CAPITAL AND MONEY MARKET REVIEW

International equity and bond markets continued to be impacted by global headwinds, although downside risks subsided somewhat during the quarter. Investor risk appetite increased as evidenced by the solid performance of certain risk assets over the quarter. Global bonds yields markedly increased over the period as well, with European yields leading the developed sovereign bond yield market upwards.

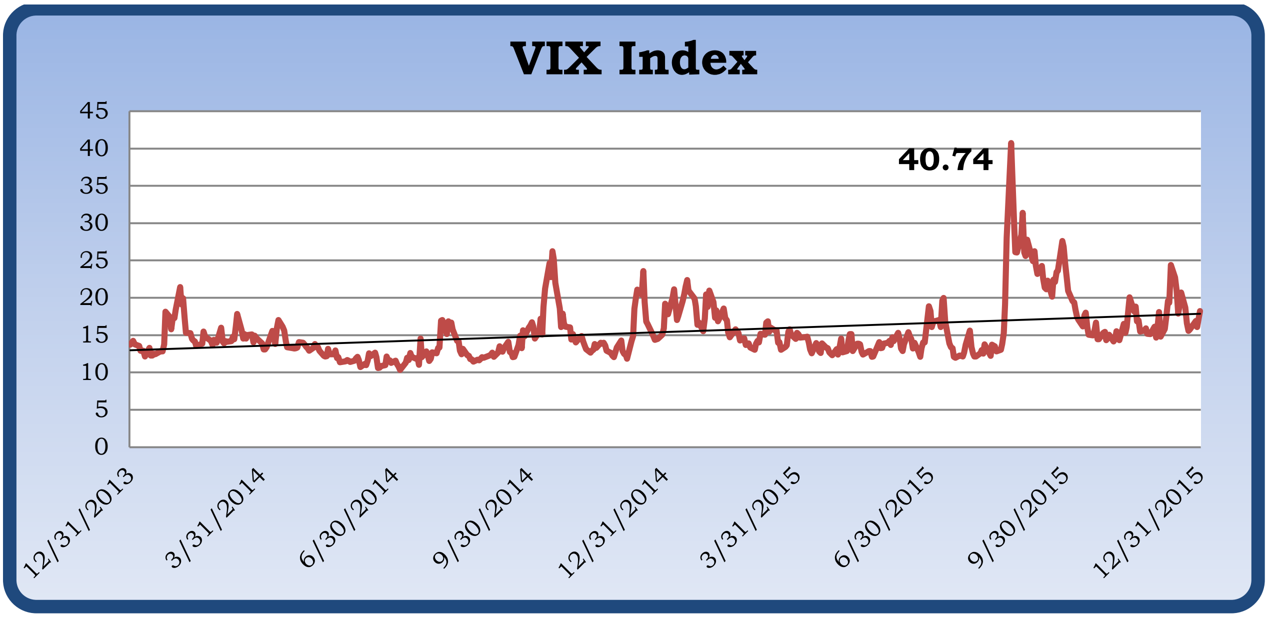
The anticipated Fed rate hike weighed on investor sentiment throughout the quarter and finally occurred in December. Across the ocean accommodative monetary policies in Europe and Japan, helped to buoy equity markets, as both Germany and Japan produced outsized returns relative to their developed market counterparts.

The Chicago Board Options Exchange Volatility Index (VIX), which is a proxy for investor anxiety and market risk, remained relatively volatile during the fourth quarter of 2015 as unstable commodity prices and the anticipation of the Fed's widely expected December rate hike weighed heavily on investor sentiment. Over the quarter, the VIX averaged 17.03 points down from 19.31 points in the third quarter, and the index peaked at 24.39 points on December 11th 2015.

Figure 1

Equity Market Volatility in the US

/points/



Source: Bloomberg

U.S. Fixed Income

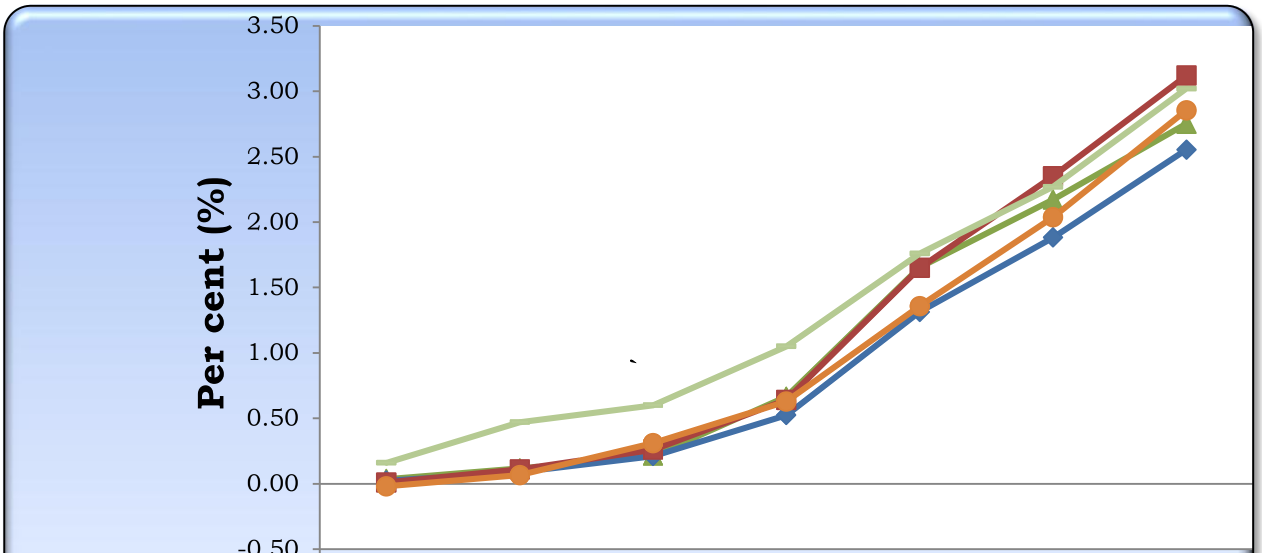
Over the final quarter of 2015, U.S. treasury yields rose sharply across the curve. The upward trajectory of yields was attributed to heighted market expectations of a 2015 rate hike by the Fed, following October's FOMC meeting. The market's expectation was fulfilled, with the Fed raising the federal funds rates by 25 basis points in December, the first rate hike in nine years.

The yield curve flattened during the quarter as the spread between the 2 and 10 year segment of the curve fell 18.7 basis points to 1.22 per cent. Short and medium term yields rose more aggressively over the period, with 2 year and 5 year yields rising by 42 and 40 basis points respectively. The spike in yields was less pronounced on the longer end of the curve which was anchored by lower growth and inflation expectations. U.S. 10-year Treasury yields rose by 23 basis points to end the quarter at 2.27 per cent.

Figure 2

U.S. Treasury Yield Curve

/per cent/



	3 Month	6 Month	1 Year	2 Year	5 Year	10 Year	30 Year
December 31, 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
December 31, 2015	0.16	0.47	0.6	1.05	1.76	2.27	3.02

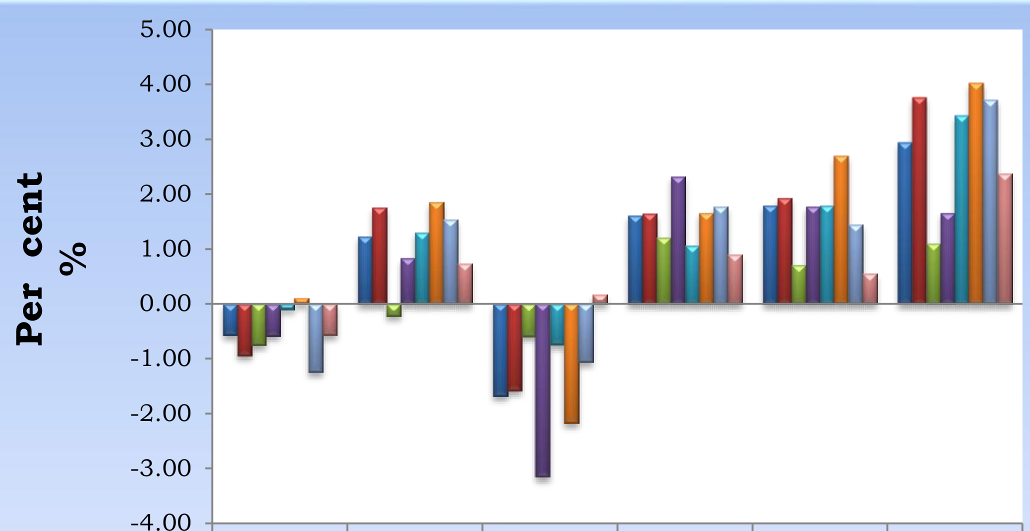
Source: Bloomberg

The broader U.S. fixed income market, as measured by the Barclays Capital U.S. Aggregate Bond index, returned negative 0.57 per cent over the fourth quarter of 2015. Spread performance over the period was mixed, with Supra-nationals, Asset-Backed Securities and Commercial Mortgage Backed Securities underperforming similar duration U.S. Treasuries, while Local Authorities, U.S. Corporate Investment Grade and G-7 Global bonds outperformed. During the fourth quarter, U.S. Investment Grade credit spreads tightened by 4 basis points to 165.4 basis points.

Figure 3

Returns on Fixed Income Indices

/per cent/



	QTR ended Dec-15	QTR ended Sept-15	QTR ended Jun-15	QTR ended Mar-15	QTR ended Dec-14	FY 14/15
Barclays U.S. Aggregate	-0.57	1.23	-1.68	1.61	1.79	2.94
U.S. Treasuries	-0.94	1.76	-1.58	1.64	1.93	3.76
U.S. Agencies	-0.75	-0.22	-0.59	1.21	0.71	1.10
U.S. Corporate	-0.58	0.83	-3.16	2.32	1.77	1.66
U.S. MBS	-0.10	1.30	-0.74	1.06	1.79	3.43
G-7 Global Bonds (Hedged)	0.11	1.85	-2.17	1.66	2.69	4.03
CMBS Index	-1.24	1.54	-1.06	1.77	1.45	3.72
ABS Index	-0.57	0.74	0.17	0.90	0.55	2.38

Source: Barclays Capital

Global Fixed Income Markets

Diverging monetary policy was one of the main drivers of global sovereign bond yields over the fourth quarter of 2015. During the first two months of the quarter, European sovereign yields trended downwards as rhetoric from the ECB signalled additional monetary easing was forthcoming. However, this trend was reversed in December and yields inched higher as the stimulus package announced by the ECB fell short of market expectations. For the quarter, the 10-year German bund yield climbed 4.20 basis points to 0.628 per cent.

Japanese bond yields trended lower during the quarter in response to the Bank of Japan's adjustment to its asset-purchase programme. The Japanese 10-year bond yield fell by 9.10 basis points during the period, to end at 0.26 per cent.

In the United Kingdom, bond yields climbed higher amid concerns of a possible 'Brexit' from the European Union. The U.K. government has signalled that a referendum on Britain's membership in the EU may take place as early as June 2016. The 10-year U.K. gilt ended the fourth quarter at 1.959 per cent, 19.80 basis points higher when compared to September 2015.

Table 1

G-7 Generic Government 10 Year Yields

/per cent/

Country	Generic Government 10 Year Yields		Change (basis points)
	Dec 2015	Sep 2015	
US	2.269	2.037	23.26
UK	1.959	1.761	19.80
France	0.986	0.984	0.20
Germany	0.628	0.586	4.20
Italy	1.592	1.723	(13.10)
Canada	1.392	1.430	(3.80)
Japan	0.260	0.351	(9.10)

Source: Bloomberg

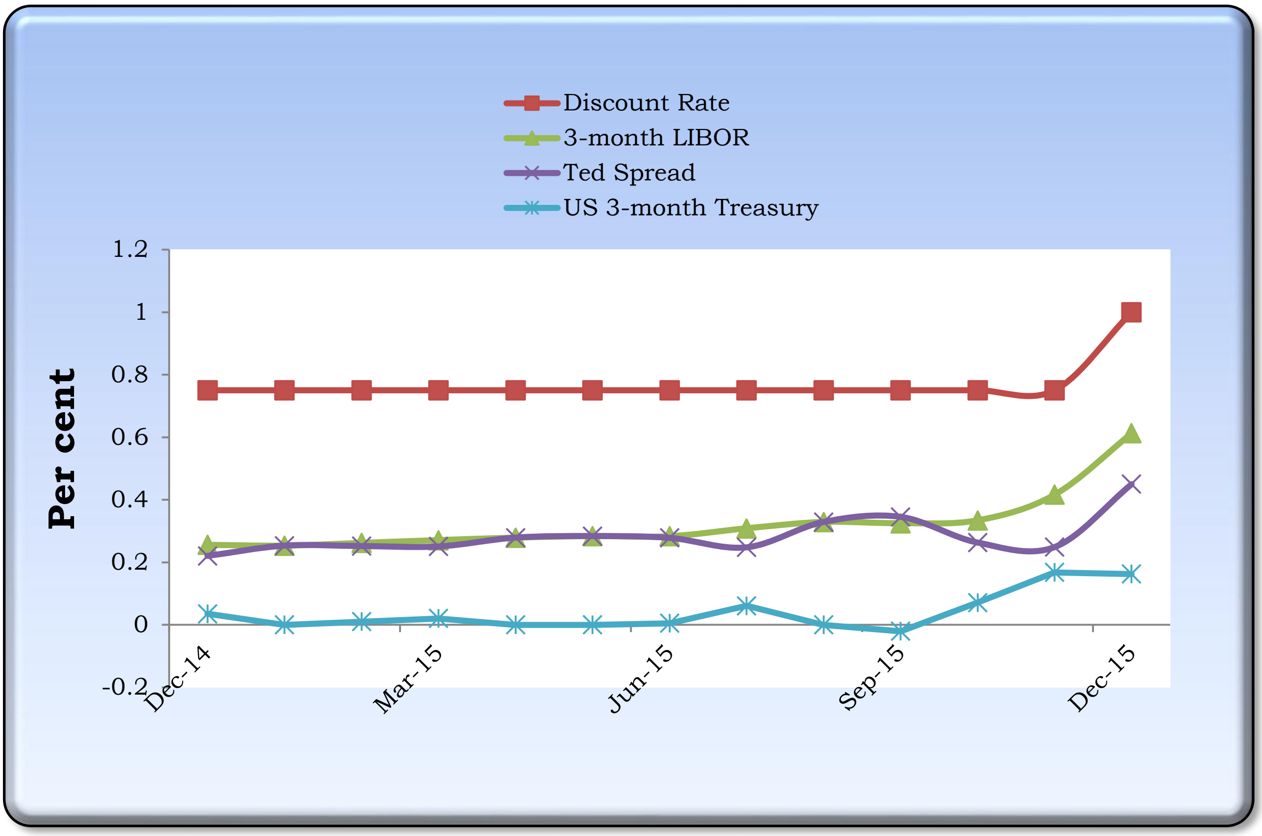
Money Markets

Short-term interest rates rose over the fourth quarter of 2015, as expected, following the Fed's 25 basis point hike in the Fed Funds rate. At the end of the quarter, the Fed Funds rate was 0.50 per cent, up from 0.25 per cent and the discount rate notched up to 1 per cent from 0.75 per cent. The 3-month US Treasury bill rate returned to positive territory in December, up 18 basis points to 0.163 per cent from -0.020 per cent in September. The 3-month London Inter-Bank Offered Rate (LIBOR) also rose by 29 basis points to 0.613 per cent from 0.325 per cent.

Figure 4

U.S. Money Market Rates

/per cent/



Source: Bloomberg

Equity Markets

In the three months to December 2015, developed equity markets posted solid returns, mainly on the back of a stellar rebound in October, after experiencing sharp declines in the previous quarter. By the end of quarter, US indices had returned over 5.5 per cent each while in the Eurozone, Germany's DAX 30 posted solid returns, buoyed by further easing by the ECB over the quarter. In other European markets, returns were somewhat muted as the impact of the oil price decline dragged on markets. In Asia, Japan's Nikkei 225 was the second best performing equity market. The MSCI EAFE also rallied over the quarter. *(See Figure 5).*

In US, the Fed raised rates on December 16th, putting an end to the zero bound interest rate environment, albeit in a low inflation setting. This move came as conviction in labour market improvement was substantiated by robust October and November non-payrolls reports alongside the achievement of a 5 per cent unemployment rate. Despite slightly elevated levels of volatility in the lead-up to the rate "lift-off", the 25 basis point hike was widely expected by investors. The Russell 3000 and S&P 500 rallied 5.72 per cent and 6.45 per cent respectively. Overall, large cap stocks outperformed small cap companies. All sectors including Energy added to performance over the quarter, with the Healthcare and Materials sectors leading the upward trend.

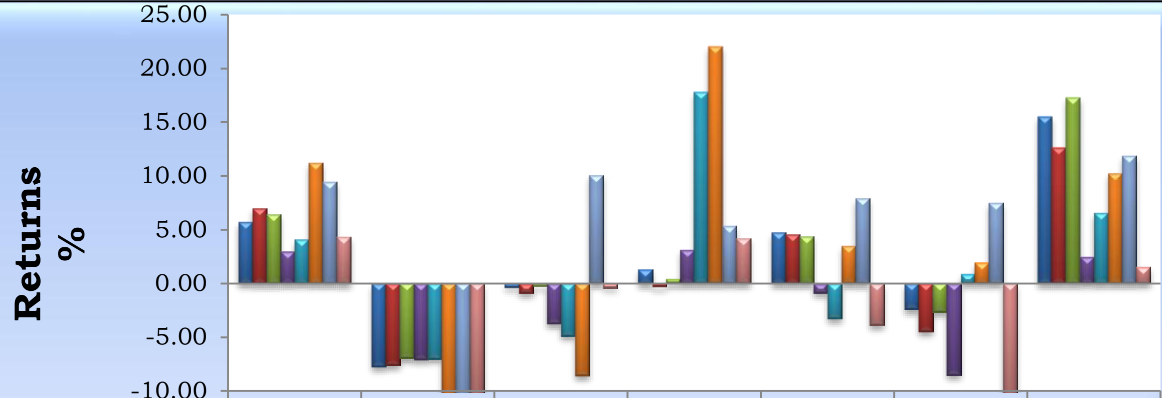
In non-US developed markets, the MSCI EAFE added 4.37 per cent, as Japanese and European markets rebounded over the quarter on the heels of continued support from expansionary monetary policies. In Europe, economic data was also largely encouraging. Over the quarter, Germany's DAX 30 rallied 11.21 per cent while France's CAC 40 returned 4.08 per cent. Elsewhere in Europe, London's FTSE 100 added 2.98 per cent, mainly on account of energy price declines over the quarter.

In Asian equity markets, Japan's Nikkei reversed the previous quarter's declines, posting a solid 9.46 per cent in the three months to December. Accommodative easing from the BoJ along with 1 per cent (annual rate) growth in the third quarter helped to buoy the Japanese equity market.

Figure 5

Price Returns on Equity Indices

/Per cent/



	QTR ended Dec-15	QTR ended Sept-15	QTR ended Jun-15	QTR ended Mar-15	QTR ended Dec-14	FY 14/15	FY 13/14
Russell 3000	5.72	-7.71	-0.34	1.32	4.74	-2.39	15.54
Dow Jones	7.00	-7.58	-0.88	-0.26	4.58	-4.45	12.65
S&P 500	6.45	-6.94	-0.23	0.44	4.39	-2.65	17.29
FTSE 100 - UK	2.98	-7.04	-3.72	3.15	-0.86	-8.47	2.48
CAC 40 - France	4.08	-6.99	-4.84	17.81	-3.25	0.88	6.58
DAX 30 - Germany	11.21	-11.74	-8.53	22.03	3.50	1.96	10.24
Nikkei 225 - Japan	9.46	-14.07	10.06	5.36	7.90	7.51	11.88
MSCI EAFE	4.37	-10.75	-0.37	4.19	-3.86	-10.92	1.53

Source: Bloomberg

Currency Markets

The impact of diverging monetary policy dominated currency markets during the fourth quarter. Heighted market expectations for tighter monetary policy in the U.S. and the Fed's decision to raise rates in December led to the appreciation of the U.S. dollar against most of its trading partners.

In the Eurozone, the euro ended the quarter 2.82 per cent lower against the U.S. dollar. The euro currency was adversely affected by the interest rate disparity between the U.S. and Europe, given that both monetary authorities moved in opposite directions during the period. In December, the Fed tightened its monetary policy and raised its benchmark rate, while the ECB engaged in further easing by reducing its deposit rate into negative territory.

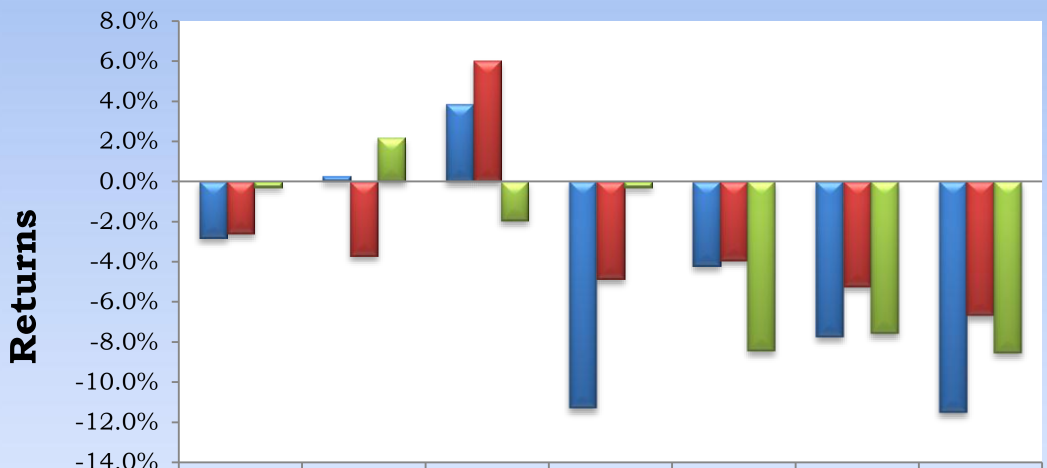
The British pound depreciated by 2.59 per cent against the U.S. dollar during the three months to December. The currency fell amid reduced expectations that the Bank of

England (BOE) would follow the Fed and raise interest rates in early 2016. Additionally, concerns over the future of the U.K. in the European Union and the potential for a 'Brexit' weighed on investor sentiment.

Monetary policy divergence also weighed on the Japanese yen during the fourth quarter, as the currency weakened by 0.28 per cent against the U.S. dollar. While the BoJ did not announce any further easing during the period, weaker than expected economic data increased expectation of further stimulus measures by the BoJ.

Figure 6

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



	QTR ended Dec-15	QTR ended Sep-15	QTR ended Jun-15	QTR ended Mar-15	QTR ended Dec-14	QTR ended Sept-14	FY 14/15
EUR	-2.82%	0.27%	3.88%	-11.30%	-4.22%	-7.75%	-11.51%
GBP	-2.59%	-3.72%	6.03%	-4.87%	-3.92%	-5.22%	-6.69%
JPY	-0.28%	2.19%	-1.93%	-0.29%	-8.46%	-7.59%	-8.53%

Source: Bloomberg

SECTION 3 – PORTFOLIO PERFORMANCE

Strategic Asset Allocation

During the period October 2015 to December 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%*

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 December 2015 was US$5,745.0 million, compared with US$5,655.1 million at the end of the previous quarter. Of this total, the investment portfolio was valued at US$5,744.9 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 March 31, 2015 to December 31, 2015 are shown in Table 2, overleaf.

Table 2

Portfolio Composition relative to the Approved SAA

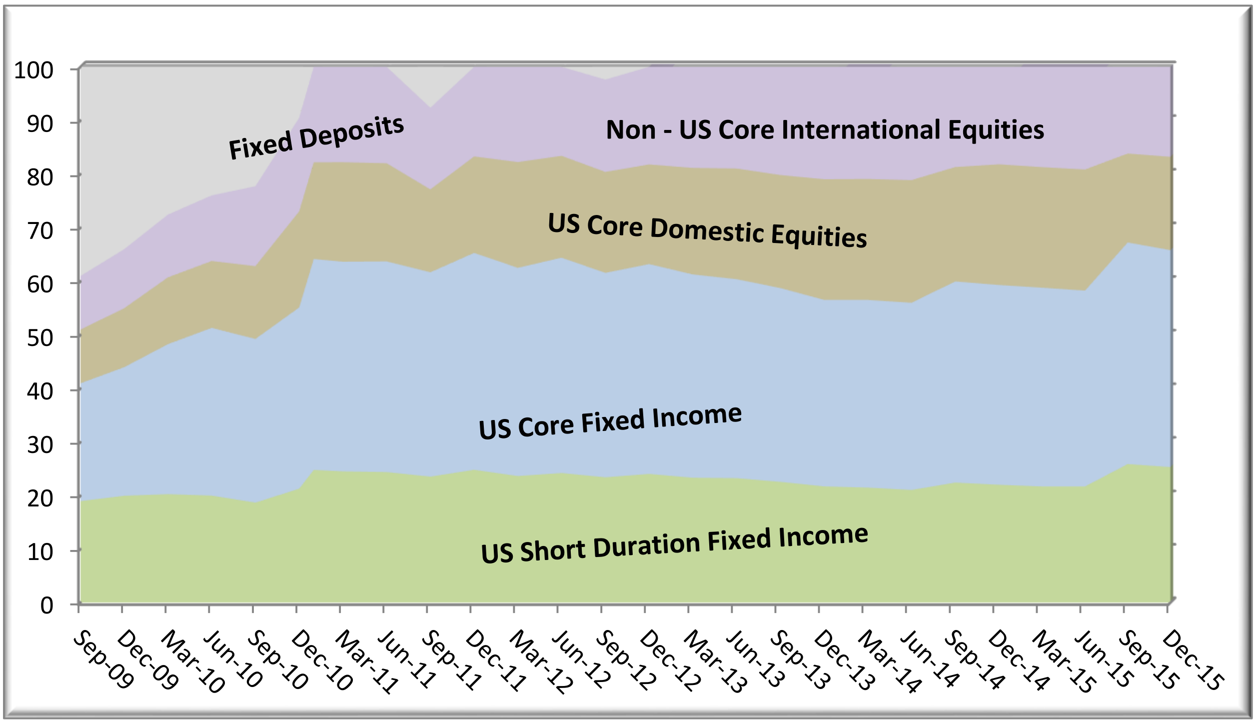
/per cent/

	Asset Class		Mar-15	Jun-15	Sep-15	Dec-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	21.74	21.75	25.94	25.37
	US Core Domestic Fixed Income	40.00	37.08	36.53	41.32	40.45
	US Core Domestic Equity	17.50	22.48	22.58	16.58	17.40
	Non-US Core International Equity	17.50	18.70	19.13	16.16	16.77

Figure 7

Asset Composition of the HSF Portfolio

/per cent/



Performance of the Investment Portfolio

For the fourth quarter of 2015, the HSF investment portfolio increased 1.68 per cent, compared with an increase of 1.67 per cent for the SAA benchmark[2]. This relatively inline performance can be attributed to the positive security selection effect of 17 basis points nullifying the deviation between the portfolio and SAA weightings. The HSF portfolio's quarterly return was primarily impacted by the equity mandates which added approximately 2.04 per cent, while the fixed income portion of the Fund detracted approximately 0.33 per cent.

The **US Short Duration Fixed Income** portfolio declined 0.55 per cent during the fourth quarter of 2015, outperforming its benchmark, the Bank of America Merrill Lynch US Treasury 1-5 year index, by 11 basis points. This outperformance was attributed to the portfolio's exposure to interest rate strategies being positive during the quarter and spread

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[2] 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%).

product allocations. Duration and breakeven inflation positioning also positively impacted performance during the quarter. The net asset value of this mandate as at December 31, 2015 was **US$1,457.5 million,** compared with US$1,466.7 million at the end of the previous quarter.

The longer duration fixed income mandate which consists of **US Core Fixed Income** securities, lost 0.48 per cent for the fourth quarter of 2015, outperforming its benchmark, the Barclays Capital US Aggregate Bond index, by 7 basis points. This outperformance was due mainly to security selection and country positioning during the quarter. With inflation below expectations in Europe the portfolio benefitted from a long Europe 10 year, short US 10 year trade. Additionally, the portfolio's selection of securitized and corporate securities, proved instrumental to outperformance during the period. The net asset value of this mandate as at December 31, 2015 stood at **US$2,324.1 million** compared with US$2,336.6 million as at September 30, 2015.

The **Non-US International Equities** mandate rallied 5.64 per cent for the fourth quarter of 2015, compared with an increase of 4.92 per cent for its benchmark, the MSCI EAFE ex Energy index. This outperformance was due to positive stock selection, country allocations and currency hedging in the portfolio. Stock selection provided the largest benefit to the portfolio stemming from selections in the UK, France, Finland and Denmark. Country allocations to Japan, Belgium Israel and Finland also added to performance. Finally, both the euro and yen hedges were positive during the quarter as both currencies weakened vis-à-vis the US dollar. The net asset value of the Non-US Core International Equity mandate as at December 31, 2015 increased to **US$963.6 million**, from US$913.5 million at the end of September 2015.

The **US Core Domestic Equities** mandate improved 6.69 per cent, compared with an increase in the benchmark of 6.76 per cent, resulting in the mandate underperforming its benchmark for the period. During the quarter both stock selection and sector allocation hindered performance. Allocations to the Health Care, Materials & Processing and Producer Durables sectors were the largest detractors from performance. Stock picking in the Consumer Discretionary sector also eroded excess returns during the quarter. Additionally, an underweight to higher volatility stocks also hurt performance during the quarter. The net asset value of this mandate, as at December 31, 2015, was **US$999.8 million**, compared with US$937.6 million at the end of September 2015.

Table 3

Contribution to Quarterly Return

For the period Oct 2015 – Dec 2015

/per cent/

	SAA Weights	Portfolio Weights as at 31-Dec-2015	Weighted Return HSF	Weighted Return Benchmark
Composite Portfolio	100.00	100.00	1.68	1.67
US Core Domestic Fixed Income	40.00	40.45	-0.19	-0.22
US Core Domestic Equity	17.50	17.40	1.11	1.19
Non US Core International Equity	17.50	16.77	0.92	0.89
US Short Duration Fixed Income	25.00	25.37	-0.14	-0.17

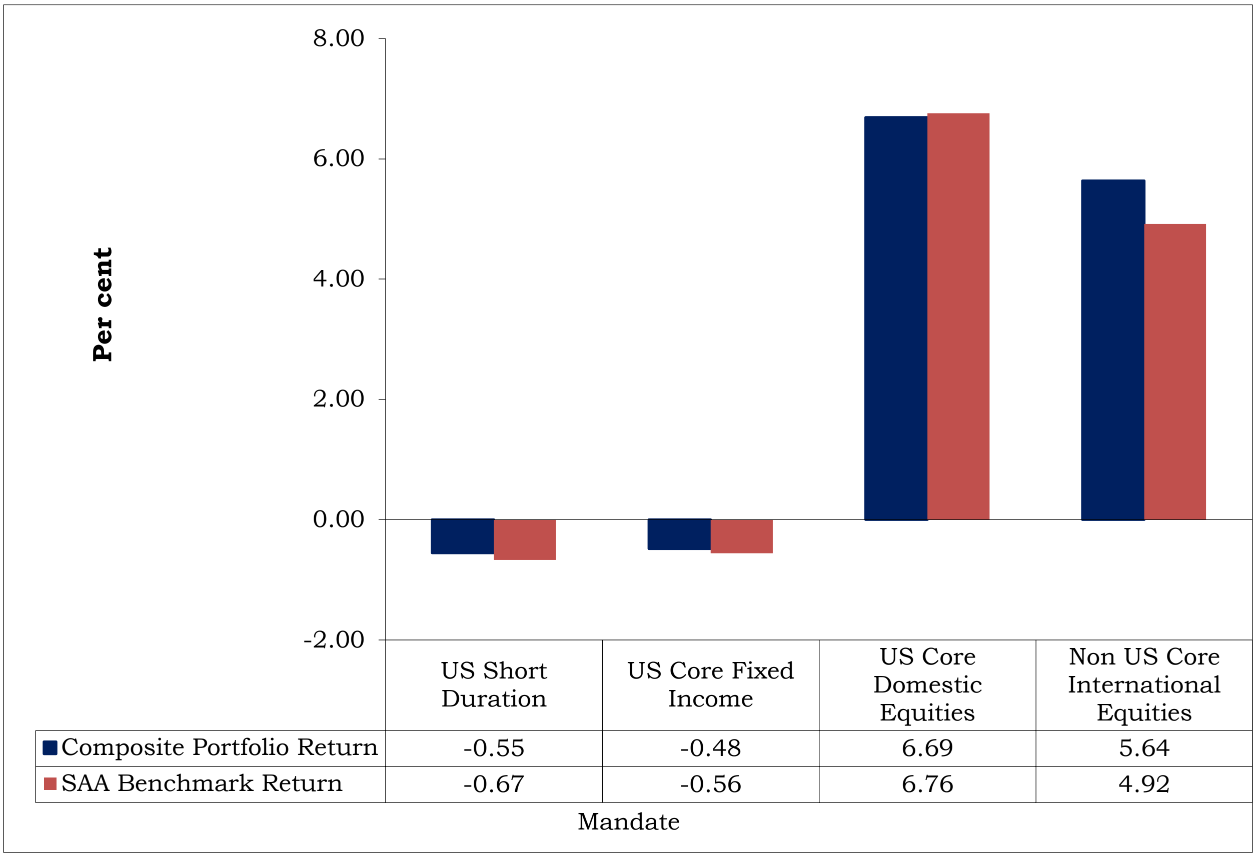
NB: Differences in totals are due to rounding.

Figure 8

Absolute Returns by Asset Class

For the period Oct 2015 – Dec 2015

/per cent/



	US Short Duration	US Core Fixed Income	US Core Domestic Equities	Non US Core International Equities
Composite Portfolio Return	-0.55	-0.48	6.69	5.64
SAA Benchmark Return	-0.67	-0.56	6.76	4.92

SECTION 4 – COMPLIANCE AND PORTFOLIO RISKS

Compliance

During the quarter ended December 31 2015, there were no breaches of the Investment Guidelines.

Portfolio Risks

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

Credit Risk

Within the **money market portion** of the Fund, Credit Risk is minimized by the strict adherence to the following standards: (i) all counterparties must have a minimum credit rating of either A-1 from the Standard and Poor's rating agency or P-1 from Moody's; and (ii) a maximum exposure limit for counterparties of no more than 5.0 per cent of the market value of the portfolio.

For **fixed income instruments**, Credit Risk is mitigated by the use of credit concentration limits as well as minimum credit quality ratings. Bonds must have an implied investment grade rating as defined by Standard and Poor's, Moody's or Fitch. Should the required ratings on an existing fixed income security fall below the minimum standards, the security must be sold within an agreed upon timeframe. Table 4 below shows the Average Credit Quality of the US Short Duration and US Core Fixed Income Portfolios as at December 31, 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 December 31, 2015.

Table 5

Weighted Average Duration

/Years/

Mandate	Portfolio	Benchmark
US Short Duration	**2.64**	**2.63**
US Core Domestic Fixed Income	**5.64**	**5.68**

Currency Risk

Currency Risk is managed by containing and managing the exposure to non-US dollar instruments. For the Fixed Income and US Core Domestic Equity mandates, no more than 10 per cent of the market value of the portfolio can be invested in securities, which are denominated in currencies other than the US Dollar. The Non-US Core International Equity Portfolio is comprised primarily of non-US dollar denominated securities, and the Fund accepts the currency risk inherent in the relevant benchmark. For this mandate, currency hedging is permitted up to 15 per cent of the market value of the portfolio using the US dollar as the base currency. At the end of December 2015, the currency exposure for this portfolio was 95 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
FY 2016									
December	1.68	1.67	0.22	1.68	1.67	0.22	5.36	4.79	56.52

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	-
December 31, 2015	5,744,963,957	90,833,573	1,784,418,924	-

Appendix III
Summary Characteristics of Composite Benchmarks
Fixed Income Benchmarks

Key Characteristics	Barclays US Aggregate Index	Merrill Lynch 1-5 Index
Total Holdings	9,720	152
Coupon (%)	3.18	1.86
Duration (Years)	5.68	2.63
Average Life (Years)	7.94	2.73
Yield to Maturity (%)	2.59	1.27
Option Adjusted Spread (bps)	56	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	2,841	871
Earnings Per Share (EPS Growth 3-5y fwd)	11.6	8.34
Price Earnings (P/E fwd)	15.8	15.14
Price / Book (P/B)	2.3	1.72
Weighted Average Market Capitalization* (Bn)	$105.98	$54.66

*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.

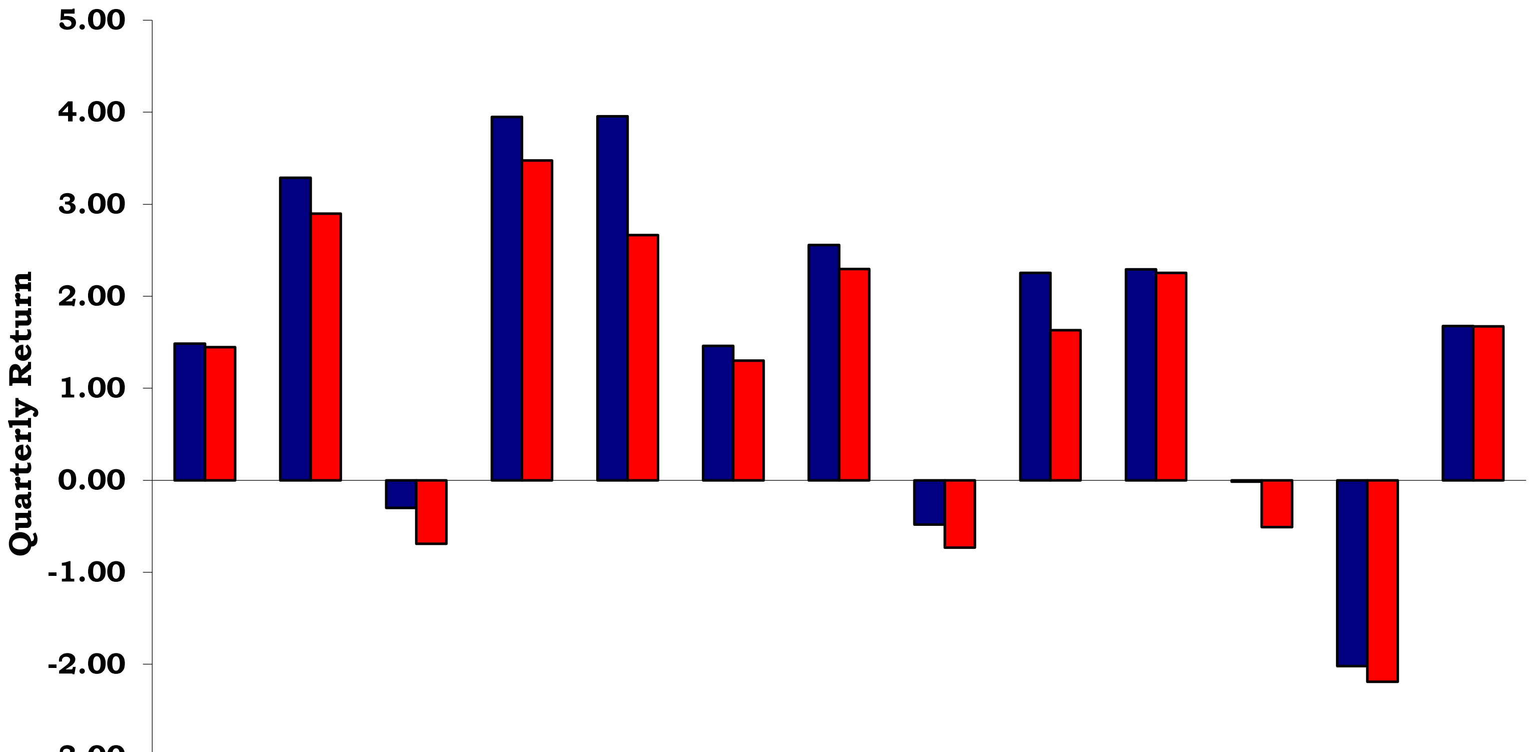
Appendix IV
Summary of the Fund's Net Asset Value by Mandate
/US$ Million/

	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15
Total Fund Value	**5,654**	**5,779**	**5,775**	**5,665**	**5,745**
Total Value of Equity	**2,299**	**2,380**	**2,409**	**1,851**	**1,963**
US Core Domestic Equity	1,272	1,299	1,304	938	1,000
Non-US Core International Equity	1,027	1,081	1,105	913	963
Total Value of Fixed Income	**3,354**	**3,399**	**3,366**	**3,803**	**3,782**
US Short Duration Fixed Income	1,247	1,257	1,256	1,467	1,458
US Core Domestic Fixed Income	2,106	2,143	2,110	2,337	2,324
Total Value of Cash or Cash Equivalents	**1**	**0**	**0**	**1**	**1**

NB: Differences in totals are due to rounding.

Appendix V
HSF Portfolio Quarterly Returns
/per cent/

Quarterly HSF & SAA Benchmark Returns



	FY2013 Q1	FY2013 Q2	FY2013 Q3	FY2013 Q4	FY2014 Q1	FY2014 Q2	FY2014 Q3	FY2014 Q4	FY2015 Q1	FY2015 Q2	FY2015 Q3	FY2015 Q4	FY2016 Q1
HSF Portfolio	1.49	3.29	-0.30	3.95	3.95	1.46	2.56	-0.48	2.25	2.29	-0.02	-2.02	1.68
Benchmark	1.44	2.90	-0.69	3.47	2.66	1.30	2.30	-0.73	1.63	2.25	-0.51	-2.19	1.67

HSF Portfolio **Benchmark**