CENTRAL BANK OF
TRINIDAD & TOBAGO

Heritage and Stabilisation Fund

Quarterly Investment Report

January – March 2016

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EXECUTIVE SUMMARY

In the first quarter of 2016, several key factors shaped the global economic outlook: uncertainty over the path of Chinese economic growth, continued downward pressure on commodity prices, low inflation, central bank actions and to a lesser extent, geopolitical risks. Over the quarter, financial markets pushed back expectations for monetary policy tightening in the United States and the United Kingdom while prospects became higher for policy expansion in the Euro Area, Japan and China.

Economic growth in the **United States** lost momentum at the end of 2015, as Gross Domestic Product growth slowed to 1.4 per cent annualized in the fourth quarter of 2015. The Composite and Services PMI's both fell in March compared with December 2015 and job growth, though remained above the 200,000 mark for the first quarter of 2016, slowed in pace from the gain in payrolls in 2015. Inflation data improved in March with core Personal Consumption Expenditure approaching the Federal Reserve's 2.0 per cent target, but expectations for 2016 remain subdued. In light of the aforementioned, the Federal Reserve continued to maintain its accommodative stance, and indicated that it would exercise caution ahead of any further rate increases.

In the **Euro Area,** economic growth remained flat. In the three months to December, Gross Domestic Product grew by 0.3 per cent, the same pace of growth in the three months to September 2015. More recent economic data was mixed but pointed to continued expansion despite political turmoil in the area. The European Central Bank introduced a number of measures to combat the region's low inflation and stagnant growth. Among these measures were the expansion in the amount of monthly bond purchases in the Asset Purchase Programme, the reduction in main policy interest rates and the introduction of a new series of longer term refinancing operations.

The economy of the **United Kingdom (UK)** continued to exhibit positive growth trends as the economy grew by 0.6 per cent in the fourth quarter, up from a previous estimate of 0.5 per cent. The labour market improved at a slower pace during the quarter reflecting the existing slack in the economy as both permanent and part time employment remained a concern. Monetary policy stance in the UK remained unchanged over the quarter, while on the political front, the country will be facing the polls on June 23rd to determine its continued membership in the EU.

The **Japanese** economy contracted in the fourth quarter of 2015 by 1.10 per cent on an annualised basis, after narrowly escaping a technical recession in the third quarter of 2015. Economic growth is expected to be subdued in the first quarter of 2016 mainly due to the spill-over impacts of China on external demand. The Bank of Japan surprised markets in January, by following its European counterpart and entering negative interest rate territory for its benchmark rate which was reduced to -0.10 per cent. The central bank also lowered its inflation expectations and extended its timeframe for meeting the 2.0 per cent inflation target to mid-2017.

Developed **equity market** returns were mixed across over the first quarter of 2016. Many countries posted negative equity market returns in the first six weeks of the quarter, led by Germany. However, markets rallied in the second half of the quarter and more specifically in March, with the United States leading the way. The reversal in March was however not enough to erase the losses incurred in some markets, as European developed equity markets and Japanese equity markets ended the quarter in the red, while US equity markets were up slightly for the quarter. The S&P 500 posted a total return of 1.34 per cent, while the Nikkei 225 and the MSCI EAFE were both down (on a total return basis) by 2.91 and 11.22 per cent respectively.

Sovereign bond yields broadly declined, as a risk-off sentiment was the main theme for bond markets in the first quarter. The Fed continued to hold interest rates but commentary from the Fed Chairman indicated a continued accommodative stance, which led to a decline in the yield of the US 10 year bond by 50 basis points over the quarter. The US Treasury yield curve flattened over the quarter, as the spread between the 2 and 10 year segment of the curve declined 17.3 basis points to 1.05 per cent at the end of the quarter. The broader US fixed income market as measured by the Barclays Capital US Aggregate Bond index, increased 3.03 per cent for the quarter. Spread investment products' performance were mixed as Mortgage Backed Securities underperformed similar duration US Treasuries during the period, while Commercial Mortgage Backed securities outperformed.

The HSF investment portfolio gained 0.80 per cent for the quarter ended March 2016, compared with an increase of 1.26 per cent for the Strategic Asset Allocation (SAA) benchmark as both the fixed income and equity portfolios detracted from relative performance during the quarter. In terms of absolute returns, the Fund's exposure to equity securities detracted, eroding some of the gains generated by the fixed income portfolio. At the end of March 2016, the net asset value of the HSF was US$5,787.3 million, an increase from US$5,745.0 million reported at the end of December 2015.

Contribution to Quarterly Return
For the period Jan 2016 - Mar 2016
/per cent/

	SAA Weights	Portfolio Weights as at 31-Mar-2016	Weighted Return HSF	Weighted Return Benchmark
Composite Portfolio	100.00	100.00	0.80	1.26
US Core Domestic Fixed Income	40.00	41.16	1.03	1.21
US Core Domestic Equity	17.50	17.17	-0.08	0.20
Non US Core International Equity	17.50	16.10	-0.54	-0.53
US Short Duration Fixed Income	25.00	25.57	0.41	0.39

NB: Differences in totals are due to rounding.

Comparative Quarterly Returns

For the Quarters ended Sept 2015 – Mar 2015

/per cent/

	3 Months Weighted Return as at 31-Mar-2016		3 Months Weighted Return as at 31-Dec-2015		3 Months Weighted Return as at 30-Sept-2015	
	HSF	**Bench-mark**	**HSF**	**Bench-mark**	**HSF**	**Bench-mark**
Composite Portfolio	0.80	1.26	1.68	1.67	-2.02	-2.19
US Core Domestic Fixed Income	1.03	1.21	-0.19	-0.22	0.39	0.50
US Core Domestic Equity	-0.08	0.20	1.11	1.19	-1.12	-1.10
Non US Core International Equity	-0.54	-0.53	0.92	0.89	-1.42	-1.74
US Short Duration Fixed Income	0.41	0.39	-0.14	-0.17	0.16	0.17

Comparative Financial Year to Date Returns

For the periods March 2015 & March 2016

/per cent/

	Financial Year to Date Return as at 31-Mar-2016		Financial Year to Date Return as at 31-Mar-2015	
	HSF	Bench-mark	HSF	Bench-mark
Composite Portfolio	2.48	2.95	4.60	3.92
US Core Domestic Fixed Income	0.84	0.98	1.22	1.36
US Core Domestic Equity	1.03	1.40	2.17	1.62
Non US Core International Equity	0.37	0.36	0.89	0.54
US Short Duration Fixed Income	0.26	0.22	0.25	0.35

SECTION 1 – INTERNATIONAL ECONOMIC ENVIRONMENT

United States

The United States (US) economy lost growth momentum towards the end of 2015. Gross Domestic Product (GDP) growth slowed from an average pace of 2.2 per cent annualized in the first three quarters of 2015 to an annualized rate of 1.40 per cent in the fourth quarter. Economic activity was driven by positive contributions from personal consumption expenditures, however weak non-residential fixed investment coupled with declining corporate profits weighed on growth.

Economic data for the first quarter of 2016 suggested that the pace of growth slowed even further in the US. The Markit US Composite PMI fell from 54.0 in December 2015 to 51.3 in March 2016, mostly due to a decline in the service sector. The Markit US Services PMI fell from 54.3 in December 2015 to 51.3 in March 2016. While the slowdown in the manufacturing sector abated somewhat, weak overseas demand continued to weigh on net exports and inventory investment. Consumer confidence dipped during the quarter and may have had a knock on effect on consumption. Meanwhile retail sales declined slightly during the quarter.

The labour market continued to strengthen albeit at a slower rate. Non-farm payrolls growth averaged 209,000 in the first quarter of 2016 down from average monthly growth of 229,000 during calendar 2015. While the unemployment rate in March 2016 remained unchanged at 5.0 per cent from December 2015, the participation rate rose from 62.6 per cent in December to 63.0 per cent in March 2016. Average hourly earnings rose modestly in March by 0.2 per cent, but the average weekly hours stagnated following a 0.6 per cent decline in February.

Headline inflation rose sharply at the beginning of the year but moderated towards the end of the quarter, alleviating concerns that prices would rise faster than expected. The Consumer Price Index rose 0.9 per cent year on year in March compared to 0.7 per cent in December. The Federal Reserve's (Fed) preferred gauge of inflation, the Core PCE index moved closer toward the Fed's 2.0 per cent target, rising from 1.4 per cent in December to 1.7 per cent in February.

At its March 2016 meeting, the Federal Open Market Committee (FOMC) assured markets that "the stance of monetary policy remains accommodative", notwithstanding its decision to raise the federal funds target rate by 25 basis points to 0.25-0.50 per cent at the December 2015 meeting. The Fed expressed that it would exercise caution ahead of any further rate increases, pledging to carefully monitor conditions before proceeding gradually.

The FOMC's Summary of Economic Projections released in March reflected a modest downward revision to economic growth and inflation from December 2015. The United States is expected to grow at 2.2 per cent for 2016 compared to the previous estimate of 2.4 per cent. Meanwhile, inflation is expected to remain subdued in 2016 but is projected to pick up thereafter, reaching the Fed's 2.0 per cent target by 2018. The median projection for the Federal Funds rate at the end of 2016 fell from 1.40 per cent in December to 0.90 per cent in March, while end of 2017 projections were also lowered, with the median rate declining from 2.4 per cent in December to 1.9 per cent in March.

Euro Area

The Euro Area's economic recovery continued in the last quarter of 2015. Economic data showed that GDP expanded 0.3 per cent quarter-on-quarter in the three months to December 2015, registering a flat pace of growth when compared to the three months ended September 2015. The economic expansion was led by solid domestic demand which showed an upsurge in investment and was supported by the improving labour market, low oil prices and the European Central Bank's (ECB) loose monetary policies. Private consumption, however, lost momentum over the quarter increasing 0.2 per cent compared with 0.5 per cent in the three months ended September 2015.

Over the first quarter of 2016, data was mixed but indicated that the Euro Area recovery was on track amid burgeoning political conflicts and downside risks to growth. The Composite Purchasing Manufacturing Index[1] (PMI) improved to 53.1 in March from 53.0 in February, with the modest increase in the rate of expansion driven by Italy and France. The Manufacturing PMI also improved in March to 51.6 from 51.2 in February while a slower rate of expansion was recorded in the Services sector. The Services PMI fell to 53.1 from 53.3 in February. Other data, however, pointed to deterioration in economic momentum. Industrial production slumped to 0.8 per cent year-on-year, in

[1] A reading above 50 indicates an expansion.

February from 2.9 per cent in January while retail sales moderated to 2.4 per cent in February from 2.0 per cent in January.

On the political front, turmoil in Spain and Ireland put a drag on first quarter performance, as inconclusive elections left the countries without a majority government. In France, there were some civil disturbances following the announcement of labour market reform while in Greece, debt negotiation concerns re-emerged as the country faced its first bailout review.

Price pressures in the Euro Area remained weak over the three month period amid low energy prices. Headline inflation was flat at 0.0 per cent year on year in March, escaping a second consecutive negative print after surprising to the downside in February at -0.2 per cent year on year. Core inflation, which strips out energy and food price movements, registered 1.0 per cent year-on-year in March, which reflected a 0.1 percentage point improvement from December's 0.9 per cent. Across member states, Belgium and Sweden were bright spots, while Romania and Cyprus, Bulgaria and Spain were a drag on inflation. According to the ECB, prices are still not rising as much as expected.

The latest labour market data showed broad strengthening in February with unemployment falling to 10.3 per cent, from 10.4 per cent in January. Among member states, Germany's joblessness rate was the lowest at 4.3 per cent, followed by Czech Republic, 4.5 per cent, while Greece[2] and Spain recorded the highest levels at 24.0 per cent and 20.4 per cent respectively.

Against this backdrop, at its monetary policy meeting in March, ECB President Mario Draghi announced further actions in pursuit of the central bank's price stability objective. The deposit rate was lowered by another 10 basis points to -0.40 per cent while the main re-financing rate and lending rate were decreased by 5 basis points each to 0.0 per cent and 0.25 per cent respectively. Additionally, the Governing Council launched a Corporate Sector Purchase Programme[3], a new series of four targeted longer-term

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[2] Greece's latest unemployment rate as at January 2016

[3] The Corporate Sector Purchase Program (CSPP) is set to begin toward the end of the second quarter of 2016. The CSSP introduced investment-grade (IG) euro-denominated bonds in the list of assets eligible for regular purchase under issued by non-bank corporations established in the Euro Area.

refinancing operations (TLTRO II)[4] and expanded the monthly purchases under the Asset Purchase Programme from €60 billion to €80 billion. These comprehensive measures are expected to further ease financial conditions, stimulate new credit and economic growth and ultimately advance the rate of inflation toward its target 2 per cent level.

United Kingdom

The British economy grew 0.6 per cent in the fourth quarter of 2015. This expansion reflected a 0.1 percentage point upward revision from the previous estimate and the 12th consecutive quarter of positive growth since 2013. Economic growth over the quarter was driven by solid expansion in the services sector while manufacturing, investments and an unfavourable trade balance detracted from growth. Gross fixed capital formation contracted 1.1 per cent over the quarter and growth in private consumption remained unchanged at 0.6 per cent quarter-on-quarter.

Recent economic indicators suggested that Britain's economy lost momentum, but growth remained solid. The Markit UK Composite PMI rose to 53.6 in March from 52.7 in February. The March print, though, reflected a fall from 56.2 in January 2016. The slowed expansion in the UK economy can be attributed to the weakening manufacturing sector during the quarter; UK Manufacturing PMI rose to 51.0 in March from 50.8 in February and down from 53.0 in January. UK Services growth also slowed over the quarter, as indicated by the Services PMI, which increased to 53.7 from 52.7 in February but down from 55.6 in January.

In addition to mixed PMIs, other recent data also indicated that domestic demand was weakening. Industrial production and manufacturing declined further to -0.5 per cent and -1.8 per cent in February from -0.2 per cent and -1.7 per cent in December 2015.

Prices in the UK remained subdued over the quarter, mainly attributable to the decline in commodity prices. UK headline Consumer Price Index (CPI) rose 0.5 per cent year on year in March, up from 0.3 per cent in February and from 0.2 per cent in December, but still significantly below the Bank of England's 2 per cent medium term target. Core

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[4] The TRTLO II is set to begin in June 2016, each with a maturity of four years. Counterparties will be entitled to borrow up to 30 per cent of the stock of eligible loans as at 31 January 2016.

inflation also remained subdued; a consequence of weak global inflation and restrained domestic cost growth. Core inflation rose 1.5 per cent in March, from 1.2 per cent in February and 1.4 per cent in December.

The labour market continued to strengthen during the first quarter, albeit at a slower pace and pointed to existing slack in the economy as underlying indicators such as permanent employment and part-time employment remained a concern. UK unemployment held at 5.1 per cent in February. According to the Office of National Statistics, there were 200,000 more persons working in the three months to February than for September 2015 to November 2015. Underlying indicators, however, revealed that the rate of permanent placements in the UK slowed to a 6-month low while temporary contracts rose at the sharpest pace in 4 months.

The BOE's Monetary Policy Committee (MPC) voted unanimously to maintain the Bank Rate at 0.5 per cent at its April meeting. The MPC also voted unanimously to maintain the stock of purchased assets financed by the issuance of central bank reserves at £375 billion. As it pertained to the BOE's intended rate hike, the MPC judged that it is more likely than not that Bank Rate will need to increase over the forecast 2-year period to ensure inflation returns to its target in a sustainable fashion.

On the political front, "Brexit" fears and associated financial stability challenges significantly impacted the UK economy over the quarter. The referendum, set for June 23rd, remains a source of uncertainty for the British economy.

Japan

The Japanese economy contracted during the fourth quarter of 2015 as the nation continued to struggle to grow given continued weakness in private consumption and external demand. The economy shrunk at an annualized rate of 1.10 per cent in the fourth quarter of 2015 and economic activity is expected to be restrained in the first quarter of 2016, as concerns around the slowdown in China persist.

Economic data for the first quarter reflected an uncertain outlook for the Japanese economy. Total export volume rose 0.20 per cent year on year in February and was the first positive reading in 10 months. However, the most recent Tankan survey results in March reflected a deterioration in broad business sentiment as large manufacturers remained cautious amidst the slowdown in emerging economies. The index for large manufacturers fell from 12 in December to 6 in March. While overall household spending grew for the first time in the six months, increasing 1.20 per cent year on year in February, consumption is expected to remain constrained without significant wage growth.

The labour market continued to make modest gains during the period. Though the unemployment rate was unchanged from December to February at 3.3 per cent, the Jobs-to-Applicants Ratio moved slightly higher from 1.27 to 1.28, reflecting a moderately tighter labour market. Nonetheless, higher wages have been slow to materialize. The lower settlement amounts from the most recent spring wage negotiations present challenges to Prime Minister Abe's plan for higher wages to boost consumption and inflation. After remaining flat during the previous three months, the average monthly cash earnings rose 0.9 per cent year on year in February however, gains were partially attributed to the leap year.

Inflationary pressures remained subdued with headline inflation reflecting the weakness in commodity prices. The Consumer Price Index (CPI) was flat in January but rose 0.3 per cent year on year in February; the index has ranged from 0.0 to 0.3 over the previous eight months. Core CPI, which excludes the effects of food and energy prices, was unchanged from December at 0.80 per cent in February.

In light of falling inflation expectations and the headwinds of a stronger Yen, the Bank of Japan (BOJ) surprised markets at its January meeting by cutting the interest rate on excess reserves to -0.10 per cent. The BOJ lowered its inflation outlook and delayed its timeframe for achieving its 2.0 per cent inflation target around six months, from late 2016 to mid-2017. This marks the fourth time the bank has pushed out expectations for reaching its inflation target since the initial goal of around March 2015. At its March policy meeting, the BOJ downgraded its assessment of the economy and pledged to provide additional easing if necessary. However, it kept its monetary policy unchanged, as it monitors the impact of the recent introduction of negative interest rates on the economy.

SECTION 2 – CAPITAL AND MONEY MARKET REVIEW

The start of 2016 proved to be a very difficult one for equity markets as concerns centred on the global growth outlook, China and other emerging market economies growth trends and plunging commodity prices sent indices down. Central Bank actions also impacted equity markets as the divergence in monetary policy was a clear indication that growth expectations have diverged amongst the major developed nations. For the quarter ended March 2016, developed equity market returns were mixed, with January and February erasing prior gains and a rebound ensuing in March. US stocks outperformed its European and Asian counterparts as the latter sank deeper in negative returns.

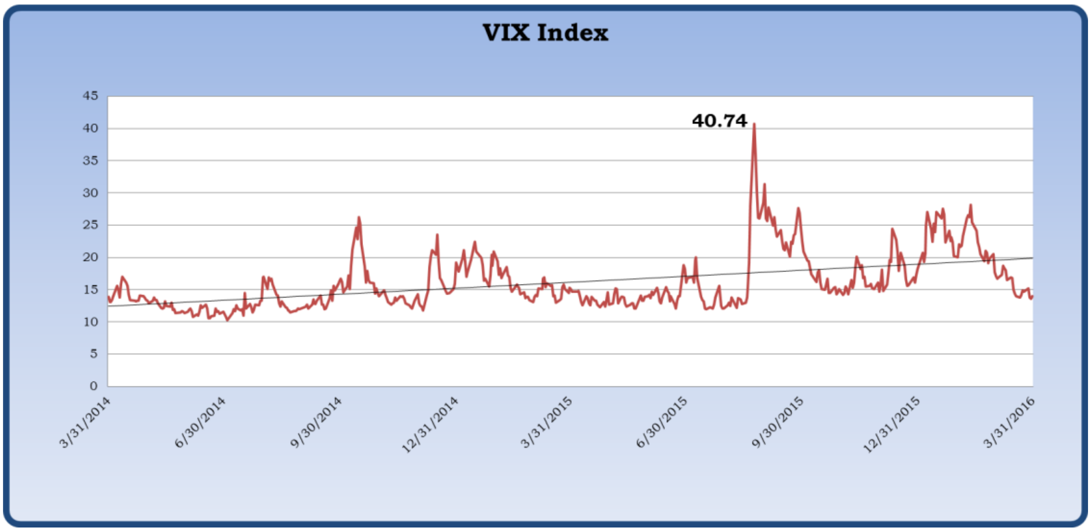
In bond markets, sovereign bond yields declined significantly across the globe due to risk aversion. The broader US fixed income market also performed well during the quarter, driven by the corporate bond sector and commercial mortgage backed securities.

The Chicago Board Options Exchange Volatility Index (VIX), which is a proxy for investor anxiety and market risk, returned to relatively elevated levels over the first quarter of 2016, but calmed in March. Volatility was particularly higher in January and February on account of the swings in the oil price, anxiety over Fed action and other global developments including the Chinese yuan devaluation and the Chinese economic woes. Over the quarter the VIX averaged 20.49 points, which was slightly higher than the last quarter's average, and peaked at 28.14 points on February 11th 2016.

Figure 1

Equity Market Volatility in the US

/points/



Source: Bloomberg

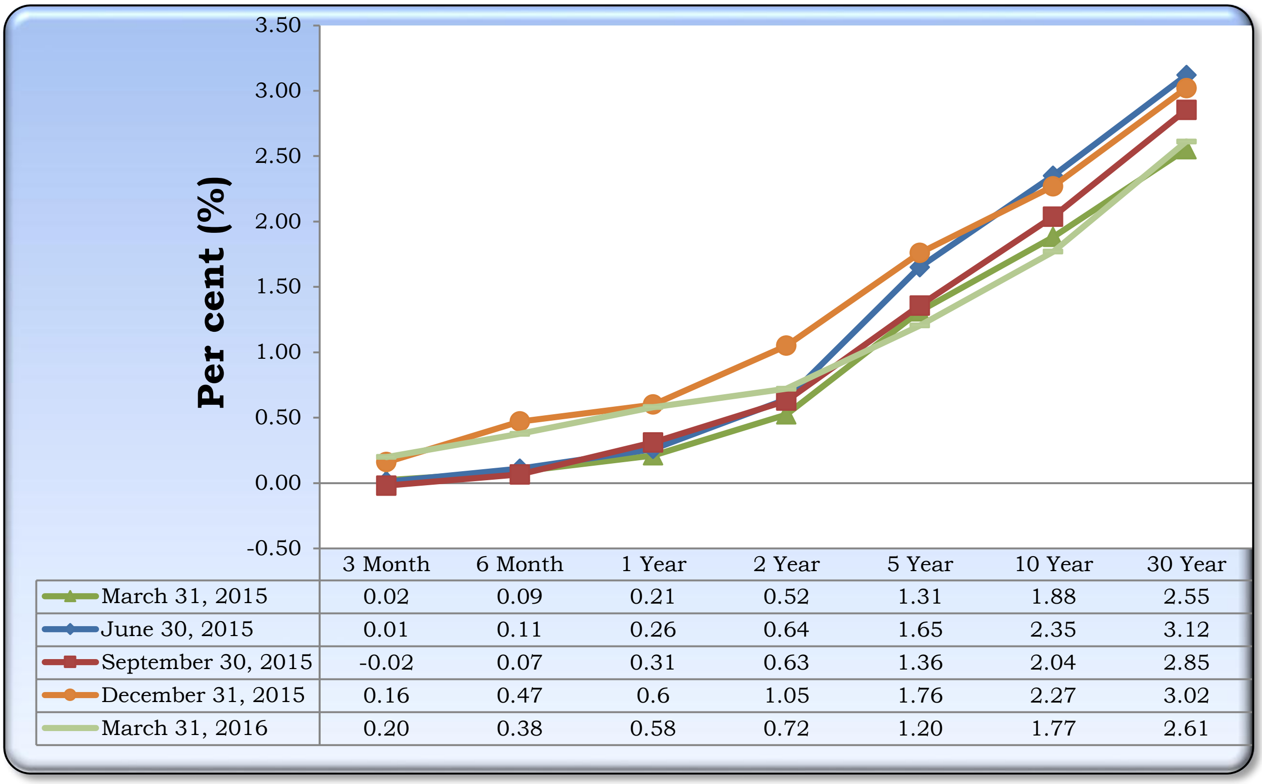
US Fixed Income

Over the first quarter of 2016, rates broadly fell across the curve. In January the decline was driven by safe haven flows emanating from heightened concerns around the slowdown in emerging markets and the sharp decline in oil prices. Moreover, the negative market sentiment coupled with signs that the United States economy lost some economic growth momentum at the start of the year weighed heavily on yields in January. US Treasury yields began to stabilize by February, as oil prices started to recover, but remained at subdued levels given the Federal Reserve's (Fed) indications that the tightening path would be even more gradual than initially anticipated. While the Fed was not widely expected to raise rates at its March meeting, comments by Fed Chairman Yellen reflected a more accommodative stance, placing downward pressure on yields towards the end of the quarter. The 10-year ended the period 50 basis points lower to 1.77 per cent, and the yield curve flattened with the spread between the 2-year and 10-year narrowing 17.3 basis points to 104.7 basis points.

Figure 2

US Treasury Yield Curve

/per cent/



	3 Month	6 Month	1 Year	2 Year	5 Year	10 Year	30 Year
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
March 31, 2016	0.20	0.38	0.58	0.72	1.20	1.77	2.61

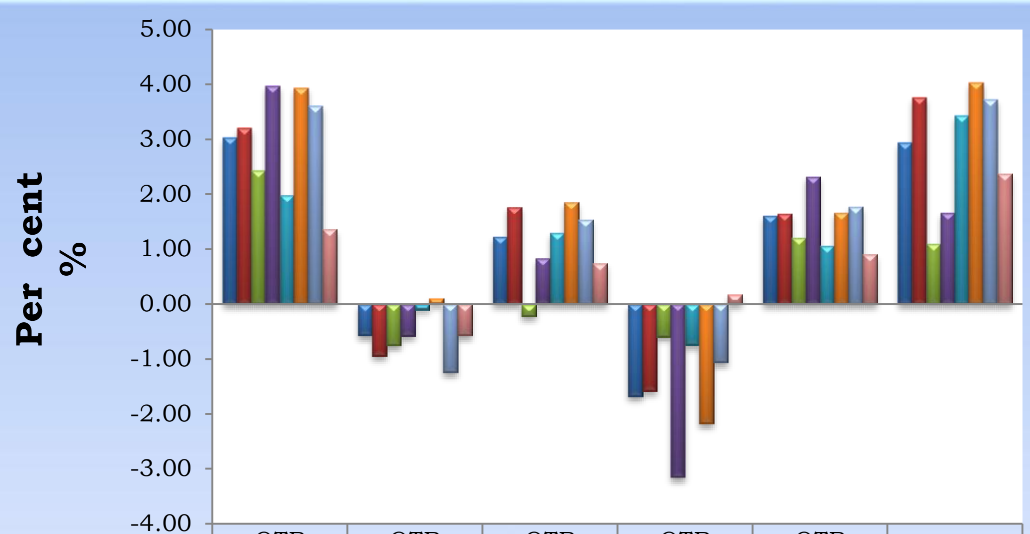
Source: Bloomberg

The broader US fixed income market, as measured by the Barclays Capital US Aggregate Bond index, returned 3.03 per cent over the first quarter of 2016. Mortgage Backed Securities and Local Authorities underperformed similar duration US Treasuries, while Sovereigns and Commercial Mortgage Backed Securities outperformed. During the first quarter, US Investment Grade credit spreads initially widened 31.4 basis points to 196.81 basis points at the end of February. However, spreads narrowed as risk aversion in the market abated and ended the three month period somewhat unchanged, tightening 2.3 basis points to 163.07 basis points.

Figure 3

Returns on Fixed Income Indices

/per cent/



	QTR ended Mar-16	QTR ended Dec-15	QTR ended Sept-15	QTR ended Jun-15	QTR ended Mar-15	FY 14/15
Barclays U.S. Aggregate	3.03	-0.57	1.23	-1.68	1.61	2.94
U.S. Treasuries	3.20	-0.94	1.76	-1.58	1.64	3.76
U.S. Agencies	2.43	-0.75	-0.22	-0.59	1.21	1.10
U.S. Corporate	3.97	-0.58	0.83	-3.16	2.32	1.66
U.S. MBS	1.98	-0.10	1.30	-0.74	1.06	3.43
G-7 Global Bonds (Hedged)	3.93	0.11	1.85	-2.17	1.66	4.03
CMBS Index	3.61	-1.24	1.54	-1.06	1.77	3.72
ABS Index	1.36	-0.57	0.74	0.17	0.90	2.38

Source: Barclays Capital

Global Fixed Income Markets

Heightened concerns around global growth given the slowdown in China and falling commodity prices helped to fuel demand for safe-haven assets during the first quarter of 2016. Moreover, additional accommodative policies by the European Central Bank (ECB) and the Bank of Japan (BOJ) helped to push developed sovereign bond yields lower.

In the Euro Area, German bund yields trended lower in January amidst the turmoil in financial and commodity markets, but managed to stabilize and moved modestly higher in February and into early March as oil prices rose from historic lows. However, yields fell towards the end of the quarter due to the ECB's decision to expand its monetary policy measures at its March 10th meeting, as well as the terror attacks in Europe. The 10-year German bund fell 47.6 basis points to end the period at 0.15 per cent.

In the United Kingdom, the Bank of England (BOE) indicated that it would delay the timing of its first interest rate increase. Moreover, the upcoming referendum on the United Kingdom's membership in the European Union at the end of June further fuelled the risk-off sentiment in the market. The 10-year gilt fell 54.5 basis points to end the quarter at 1.41 per cent.

Japanese bond yields were somewhat stable at the start of the year, but fell sharply following the Bank of Japan's surprise announcement at its monetary policy meeting at the end of January. Rates continued to decline over the quarter, as the pessimistic inflation and growth outlook for the nation increased the likelihood of further accommodative measures later this year. Yields across the sovereign bond curve entered negative territory and the Japanese 10-year bond yield fell 29.5 basis points to -0.035 per cent.

Table 1

G-7 Generic Government 10 Year Yields

/per cent/

Country	Generic Government 10 Year Yields		Change (basis points)
	Mar 2016	Dec 2015	
US	1.769	2.269	(50.07)
UK	1.414	1.959	(54.50)
France	0.485	0.986	(50.10)
Germany	0.152	0.628	(47.60)
Italy	1.220	1.592	(37.20)
Canada	1.224	1.392	(16.80)
Japan	(0.035)	0.260	(29.50)

Source: Bloomberg

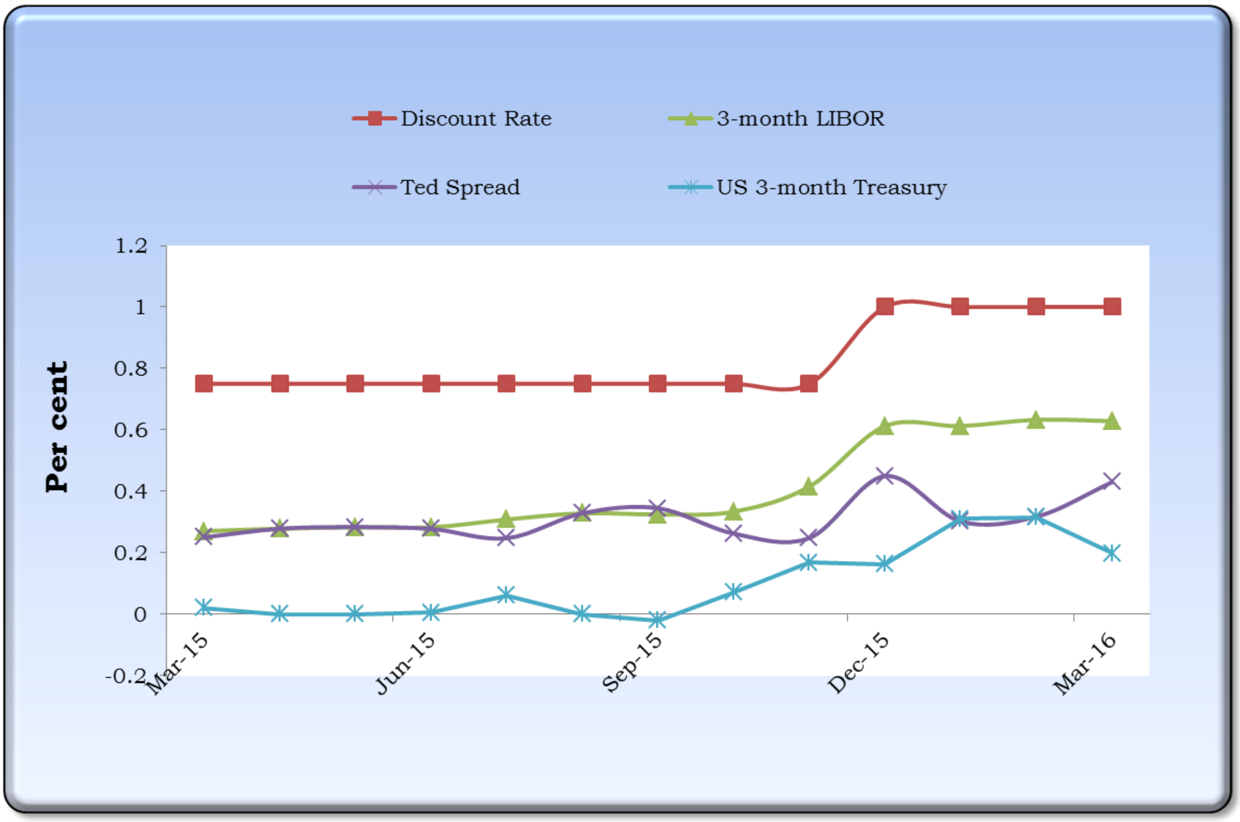
Money Markets

The yield on the US 3-month Treasury bill increased in January and February to 0.31 per cent but fell to 0.198 per cent in March. The 1-month London Inter-Bank Offered Rate (LIBOR) was marginally up to 0.441 per cent from 0.430 in December 2015. The 3-month London Inter-Bank Offered Rate (LIBOR) increased slightly to 0.629 per cent from 0.613 in December 2015, averaging 0.622 per cent over the quarter. The Ted Spread, the difference between the 3 month LIBOR and the US 3-month T-bill, moved in the opposite directions of the T-bill. The Ted spread fell in January and February and later increased in March. The Fed Funds rate and the discount rate remained unchanged at 0.50 per cent and 1 per cent respectively.

Figure 4

US Money Market Rates

/per cent/



Source: Bloomberg

Equity Markets

In the US, soft economic data released over the quarter alongside spillover effects from global developments may have heightened investor anxiety about the state of the US economy. As a result, US stocks declined in January and February as risk sentiment deteriorated, but reversed in March following dovish comments from Fed officials, including Fed Chair, Janet Yellen, and a rebound in oil prices which worked to support investor sentiment. By end March the S&P 500 index and Russell 3000 had recovered, posting returns of 6.78 per cent and 7.04 per cent (month-on-month) respectively. For the quarter ended March 2016, the S&P 500 index and Russell 3000 index were also up 1.34 per cent and 0.95 per cent and outperformed their global developed market counterparts. On a sector basis, healthcare and financials sectors detracted from performance over the quarter, while the remaining 8 sectors rallied.

In non-US developed equity markets, the MSCI EAFE declined 2.91 per cent over the quarter. In the Euro Area, equity market returns were negative despite the ECB's accommodative policy stance. The ECB's further actions in March however boded well for equities during that month but despite March's solid performance, the DAX 30 and CAC 40 still could not reverse earlier declines. By quarter-end Germany's DAX 30 had sunk 7.24 per cent, after climbing 11.21 per cent in the previous quarter while France's CAC 40 plunged 5.12 per cent for the three month period.

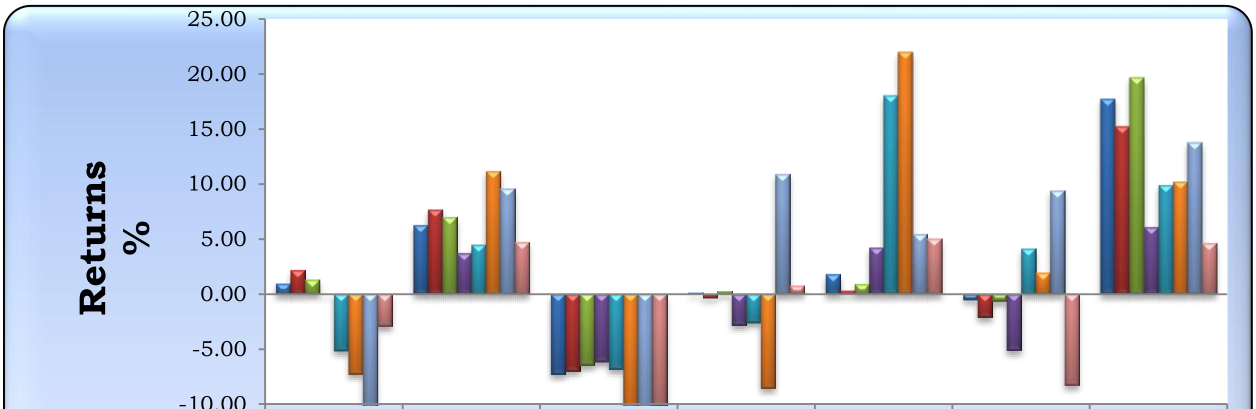
In London, the energy heavy FTSE 100 posted a slight gain of 0.08 per cent despite the volatile movements in the oil price over the period. The highly anticipated "Brexit" also weighed on investor sentiment, but had a greater impact on currency volatility than on equity market performance.

It was Japan's Nikkei 225, however, that lead developed markets underperformance over the quarter after 4 consecutive quarters of stellar returns in the Asian equity sphere. In the 3 months ended March 2016, Japan's Nikkei plunged 11.22 per cent. The significant drag on returns was due to the yen's strength as safe haven flows into Japan negatively impacted export-based companies in the index, thus fuelling a sell–off in stocks. *(See Figure 5).*

Figure 5[5]

Total Returns on Equity Indices

/Per cent/



	QTR ended Mar-16	QTR ended Dec-15	QTR ended Sept-15	QTR ended Jun-15	QTR ended Mar-15	FY 14/15	FY 13/14
Russell 3000	0.95	6.26	-7.24	0.14	1.80	-0.49	17.73
Dow Jones	2.18	7.70	-6.96	-0.29	0.32	-2.10	15.25
S&P 500	1.34	7.03	-6.43	0.28	0.95	-0.62	19.69
FTSE 100 - UK	0.08	3.72	-6.11	-2.80	4.25	-5.09	6.09
CAC 40 - France	-5.12	4.47	-6.80	-2.59	18.04	4.13	9.92
DAX 30 - Germany	-7.24	11.21	-11.74	-8.53	22.03	1.96	10.24
Nikkei 225 - Japan	-11.22	9.62	-13.42	10.92	5.45	9.42	13.76
MSCI EAFE	-2.91	4.75	-10.16	0.75	5.03	-8.26	4.63

Source: Bloomberg

Currency Markets

After strengthening throughout 2015, the US dollar depreciated over the first quarter of 2016, as the turmoil in financial and commodity markets lowered the expected path of policy rates in the United States. The US dollar as measured by the DXY index declined 4.10 per cent in the three months to March 2016.

The negative risk sentiment in the market increased the appeal of safe-haven currencies. Both the yen and the euro strengthened against the US dollar, despite increased accommodation from the Bank of Japan as well as the European Central Bank during

[5] Equity returns in previous reports were stated as price returns. All time periods listed above have been re-stated to reflect the total returns of the various indices.

the quarter. The Japanese Yen strengthened 6.8 per cent over the period partly due to repatriation flows. In addition, markets began to question whether the BOJ's negative interest rate policy would be effective in stimulating growth in the country.

The euro initially weakened as markets anticipated that the ECB would expand its easy accommodative policy at its March monetary policy meeting. While the range of policy tools announced exceeded expectations, the euro appreciated as markets focused on the outlook for the US tightening cycle. At its March meeting, the Fed indicated that it would apply a cautious approach to increasing interest rates and lowered its projections for the expected path of rates. US Dollar weakness drove the euro higher and the currency gained 4.77 per cent over the quarter.

The British pound depreciated 2.55 per cent against the USD over the first three months of 2016. The BOE indicated that it would delay the timing of the first rate hike and lowered its growth and inflation outlook. Moreover, the uncertainty regarding the country's future membership in the European Union weighed on the currency during the period.

Figure 6

Foreign Exchange Returns for Major Currencies vis-à-vis the US Dollar

	QTR ended Mar-16	QTR ended Dec-15	QTR ended Sep-15	QTR ended Jun-15	QTR ended Mar-15	QTR ended Dec-14	FY 14/15
EUR	4.77%	-2.82%	0.27%	3.88%	-11.30%	-4.22%	-11.51%
GBP	-2.55%	-2.59%	-3.72%	6.03%	-4.87%	-3.92%	-6.69%
JPY	6.80%	-0.28%	2.19%	-1.93%	-0.29%	-8.46%	-8.53%

Source: Bloomberg

SECTION 3 – PORTFOLIO PERFORMANCE

Strategic Asset Allocation

During the period January to March 2016, 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 March 2015 was US$5,787.3 million, compared with US$5,745.0 million at the end of the previous quarter. Of this total, the investment portfolio was valued at US$5,787.1 million, while the remaining portion (US$0.2 million) was held in cash to meet the day-to-day expenses that arise from the management of the Fund. The Fund's target asset allocation and the portfolio weightings for the period June 30, 2015 to March 31, 2016 are shown in Table 2, overleaf.

Table 2

Portfolio Composition relative to the Approved SAA

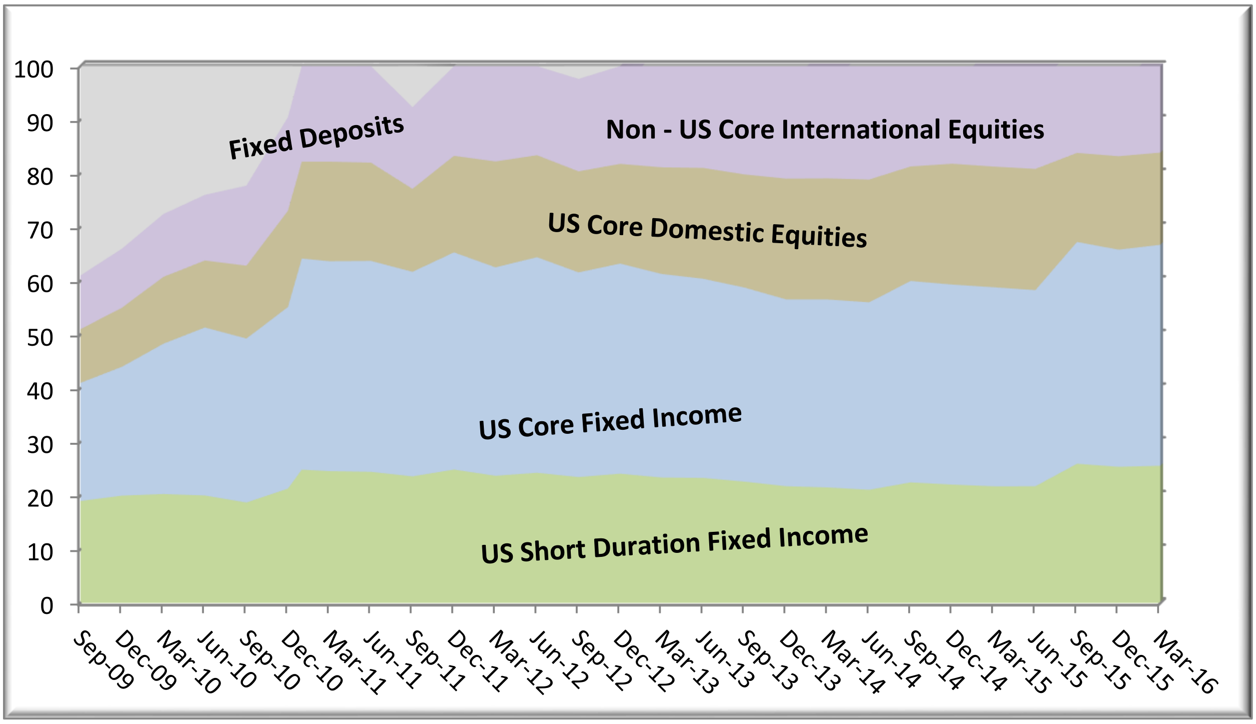
/per cent/

	Asset Class		***Jun-15***	***Sep-15***	***Dec-15***	***Mar-16***
		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	21.75	25.94	25.37	25.57
	US Core Domestic Fixed Income	40.00	36.53	41.32	40.45	41.16
	US Core Domestic Equity	17.50	22.58	16.58	17.40	17.17
	Non-US Core International Equity	17.50	19.13	16.16	16.77	16.10

Figure 7

Asset Composition of the HSF Portfolio

/per cent/



Performance of the Investment Portfolio

For the first quarter of 2016, the HSF investment portfolio increased 0.80 per cent, compared with an increase of 1.26 per cent for the SAA benchmark[6]. The underperformance of the investment portfolio for the quarter can be attributed to both negative security selection effects and the deviation between the portfolio and SAA weightings. More specifically, during the quarter the investment portfolio held an overweight position to the US Core Fixed Income mandate, which underperformed its benchmark over the period, while the Non-US International Equity mandate held an underweight position while the mandate outperformed its benchmark during the quarter.

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[6] 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%).

The HSF portfolio's quarterly return was primarily impacted by the fixed income mandates which added approximately 1.44 per cent, while the equity portion of the Fund detracted approximately 0.62 per cent.

The **US Short Duration Fixed Income** portfolio added 1.59 per cent during the first quarter of 2016, outperforming its benchmark, the Bank of America Merrill Lynch US Treasury 1-5 year index, by 2 basis points. This outperformance was attributed to the interest rate strategies employed during the quarter and the portfolio's exposure to spread products, more specifically Agency securities. Additionally, breakeven inflation products also aided outperformance during the quarter. The net asset value of this mandate as at March 31, 2016 was **US$1,479.9 million,** compared with US$1,457.5 million at the end of the previous quarter.

The longer duration fixed income mandate which consists of **US Core Fixed Income** securities, increased 2.52 per cent for the first quarter of 2016, underperforming its benchmark, the Barclays Capital US Aggregate Bond index, by 52 basis points. This underperformance was due to both security selection and sector allocations during the quarter. Allocations to asset backed and mortgage backed securities detracted from performance over the period. Additionally, security selection in the corporate and emerging bond markets along with selections in the asset backed market also hindered performance. The net asset value of this mandate as at March 31, 2016 stood at **US$2,382.0 million** compared with US$2,324.1 million as at December 31, 2015.

The **Non-US International Equities** mandate lost 3.21 per cent for the first quarter of 2016, compared with a decline of 3.38 per cent for its benchmark, the MSCI EAFE ex Energy index. This outperformance was due to positive stock selection and sector allocations. Stock selection provided the largest benefit to the portfolio stemming from security selections in the UK, Asia Pacific and Europe. Sector allocations to Consumer Discretionary, Telecommunications and Health Care also added to performance. The net asset value of the Non-US Core International Equity mandate as at March 31, 2016 decreased to **US$931.5 million**, from US$963.6 million at the end of December 2015.

The **US Core Domestic Equities** mandate detracted 0.50 per cent, compared with an increase in its benchmark of 0.84 per cent, resulting in the mandate underperforming its benchmark for the period. During the quarter both stock selection and sector allocation hindered performance. Stock selection was the largest detractor during the quarter, as certain Health Care stocks underperformed severely during the quarter. Allocations to the Health Care, Financial Services and Consumer Discretionary sectors were the largest detractors from performance. The net asset value of this mandate, as at March 31, 2016, was **US$993.7 million**, compared with US$999.8 million at the end of December 2015.

Table 3

Contribution to Quarterly Return

For the period Jan 2016 – Mar 2016

/per cent/

	SAA Weights	Portfolio Weights as at 31-Mar-2016	Weighted Return HSF	Weighted Return Benchmark
Composite Portfolio	100.00	100.00	0.80	1.26
US Core Domestic Fixed Income	40.00	40.45	1.03	1.21
US Core Domestic Equity	17.50	17.40	-0.08	0.20
Non US Core International Equity	17.50	16.77	-0.54	-0.53
US Short Duration Fixed Income	25.00	25.37	0.41	0.39

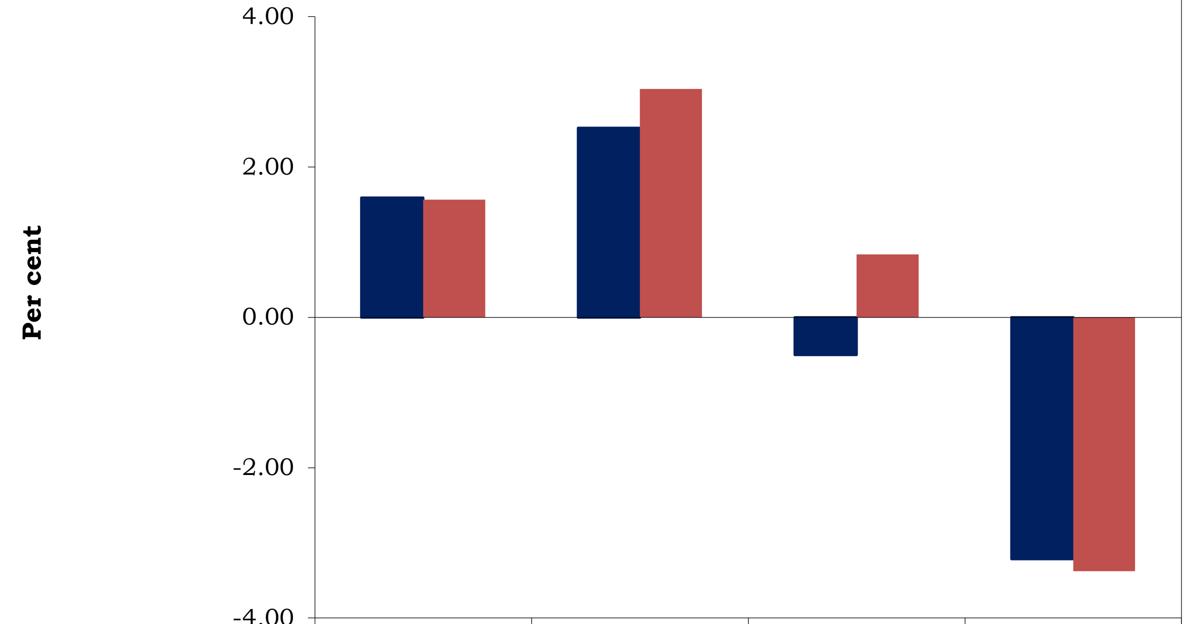
NB: Differences in totals are due to rounding.

Figure 8

Absolute Returns by Asset Class

For the period Jan 2016 – Mar 2016

/per cent/



	US Short Duration	US Core Fixed Income	US Core Domestic Equities	Non US Core International Equities
Composite Portfolio Return	1.59	2.52	-0.50	-3.21
SAA Benchmark Return	1.57	3.04	0.84	-3.38

SECTION 4 – COMPLIANCE AND PORTFOLIO RISKS

Compliance

In March 2016, one of the Investment Managers in the US Core Domestic Equity mandate breached one of the performance objective guidelines, which refers to the underperformance of the benchmark over a 12 month rolling period. Specifically, the guideline states that "*If, however, the cumulative annualised return of the portfolio, measured monthly, underperforms the Benchmark by 300 basis points on a rolling one year period, the Investment Manager shall notify the Client immediately and thereafter manage the portfolio in a manner agreed with the Client.*" The Investment Manager's return over the 12 month period April 2015 to March 2016 underperformed its benchmark by over 300 basis points. The Investment Manager was notified and discussions were held them on the way forward, including being placed on an enhanced monitoring and reporting regime.

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 March 31, 2016.

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 March 31, 2016.

Table 5

Weighted Average Duration

/Years/

Mandate	Portfolio	Benchmark
US Short Duration	**2.64**	**2.65**
US Core Domestic Fixed Income	**5.34**	**5.47**

Currency Risk

Currency Risk is managed by containing and managing the exposure to non-US dollar instruments. For the Fixed Income and US Core Domestic Equity mandates, no more than 10 per cent of the market value of the portfolio can be invested in securities, which are denominated in currencies other than the US Dollar. The Non-US Core International Equity Portfolio is comprised primarily of non-US dollar denominated securities, and the Fund accepts the currency risk inherent in the relevant benchmark. For this mandate, currency hedging is permitted up to 15 per cent of the market value of the portfolio using the US dollar as the base currency. At the end of March 2016, the currency exposure for this portfolio was 97 per cent of its market value. During the quarter, all the portfolios were within their respective limits.

Appendix I
HSF Portfolio
Historical Performance

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
March	0.80	1.26	-46.14	2.48	2.95	-46.70	5.30	4.80	49.64

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	-
March 31, 2016	5,787,343,363			

Appendix III
Summary Characteristics of Composite Benchmarks
Fixed Income Benchmarks

Key Characteristics	Barclays US Aggregate Index	Merrill Lynch 1-5 Index
Total Holdings	9,725	152
Coupon (%)	3.16	1.89
Duration (Years)	5.47	2.65
Average Life (Years)	7.79	2.74
Yield to Maturity (%)	2.17	0.88
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	2,801	890
Earnings Per Share (EPS Growth 3-5y fwd)	10.0	8.08
Price Earnings (P/E fwd)	15.9	13.84
Price / Book (P/B)	2.7	1.54
Weighted Average Market Capitalization* (Bn)	$110.5	$50.37

*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.

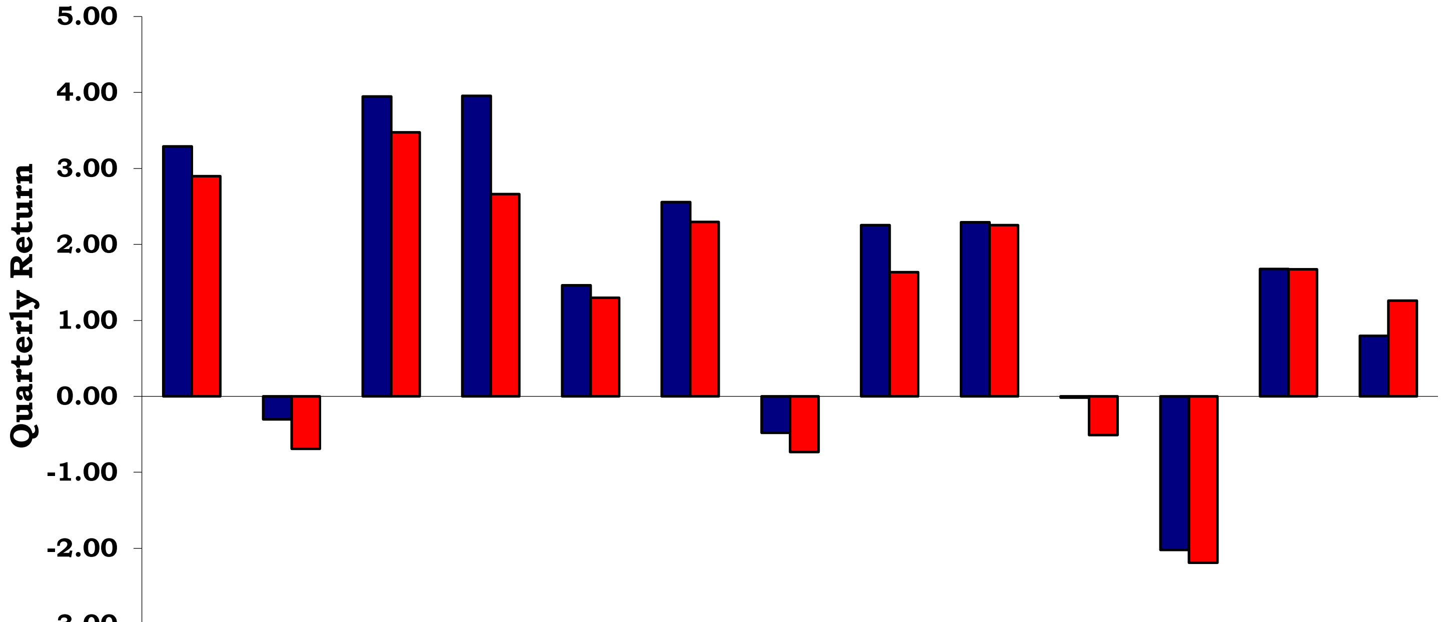
Appendix IV
Summary of the Fund's Net Asset Value by Mandate
/US$ Million/

	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16
Total Fund Value	**5,779**	**5,775**	**5,665**	**5,745**	**5,787**
Total Value of Equity	**2,380**	**2,409**	**1,851**	**1,963**	**1,925**
US Core Domestic Equity	1,299	1,304	938	1,000	994
Non-US Core International Equity	1,081	1,105	913	963	931
Total Value of Fixed Income	**3,399**	**3,366**	**3,803**	**3,782**	**3,862**
US Short Duration Fixed Income	1,257	1,256	1,467	1,458	1,480
US Core Domestic Fixed Income	2,143	2,110	2,337	2,324	2,382
Total Value of Cash or Cash Equivalents	**0**	**0**	**1**	**0**	**0**

NB: Differences in totals are due to rounding.

Appendix V
HSF Portfolio Quarterly Returns
/per cent/

Quarterly HSF & SAA Benchmark Returns



	FY2013 Q2	FY2013 Q3	FY2013 Q4	FY2014 Q1	FY2014 Q2	FY2014 Q3	FY2014 Q4	FY2015 Q1	FY2015 Q2	FY2015 Q3	FY2015 Q4	FY2016 Q1	FY2016 Q2
HSF Portfolio	3.29	-0.30	3.95	3.95	1.46	2.56	-0.48	2.25	2.29	-0.02	-2.02	1.68	0.80
Benchmark	2.90	-0.69	3.47	2.66	1.30	2.30	-0.73	1.63	2.25	-0.51	-2.19	1.67	1.26

HSF Portfolio **Benchmark**