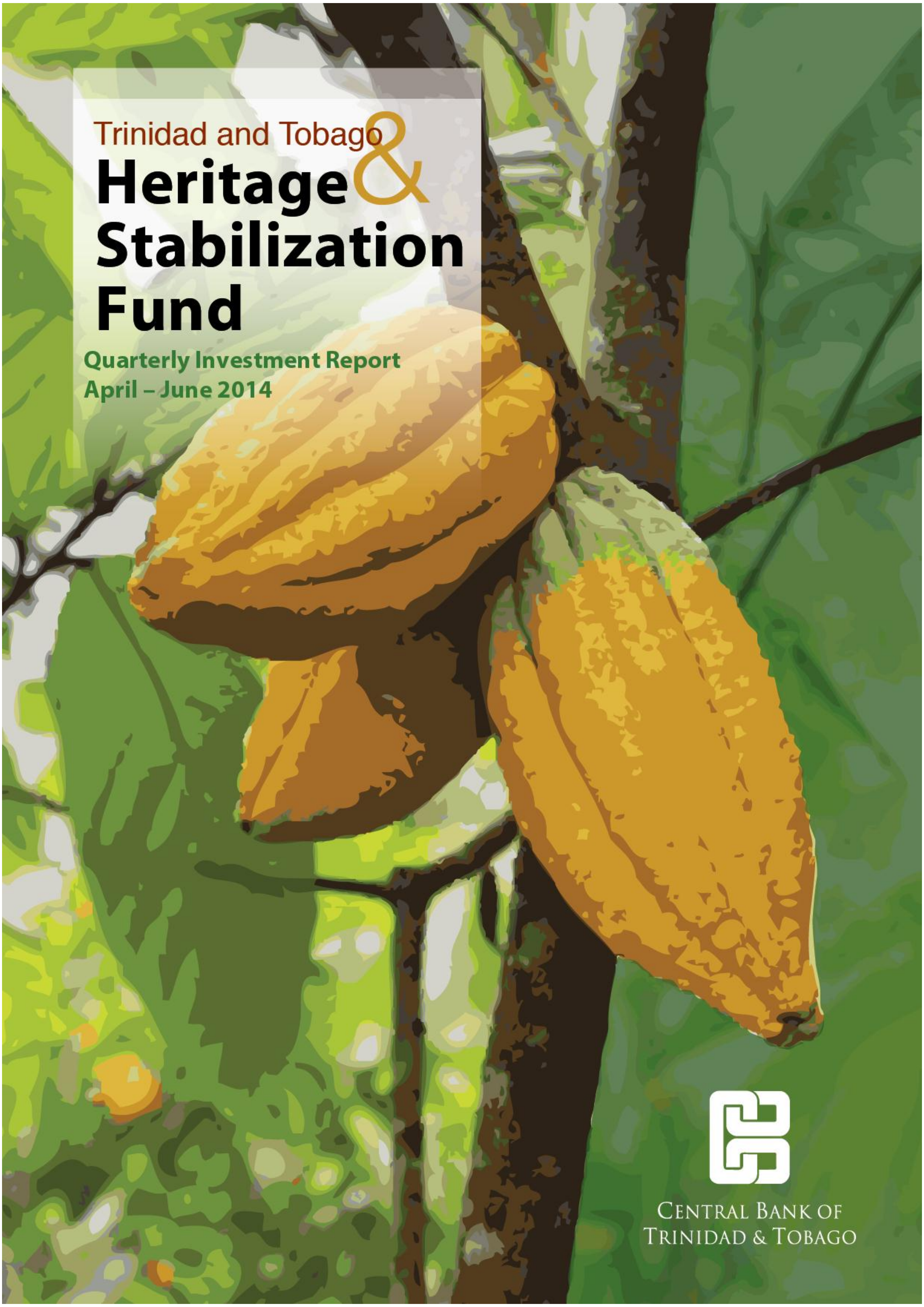

Trinidad and Tobago

Heritage & Stabilization Fund

Quarterly Investment Report
April – June 2014

CENTRAL BANK OF TRINIDAD & TOBAGO

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EXECUTIVE SUMMARY

Following the sharp contraction in gross domestic product (GDP) over the first quarter of 2014, data released for the second quarter point to an improvement in **US economic activity**. The unemployment rate fell from 6.7 per cent in March to 6.1 per cent in June due to a surge in job growth. Notwithstanding this, there appears to be some degree of slack in the labour market, since advances in employment have not yet translated into wage growth as average hourly earnings rose a little over 0.2 per cent in June.

On the policy front, the Federal Reserve (Fed) continued to pare its asset purchases by US$10 billion monthly. In June, bond purchases were down to US$35 billion a month from US$85 billion last December, and at its current rate, the Fed expects to announce its final reduction of US$15 billion in October.

In the **Euro zone**, data for the second quarter of 2014 indicated a slowdown in economic growth; this follows a disappointing GDP reading of 0.2 per cent in the first quarter. The Purchasing Managers' Index (PMI) reached a 35-month high of 54 in April but eased down to 53.5 in May and 52.8 in June.

In other developments, the European Central Bank (ECB) on June 5th announced a range of measures - including cutting its benchmark interest rate to 0.15 per cent from 0.25 per cent, lowering its overnight bank deposit rate to negative 0.10 per cent, and introducing cheap four-year loans (target long-term refinancing operations) aimed at boosting lending to small businesses and stimulating economic growth and fending off deflation. ECB president, Mario Draghi, indicated that further stimulus could be considered if inflation were to remain at current low levels.

The **United Kingdom** continued to exhibit strong economic growth in the second quarter, driven by improvements in household spending and business investment. Nevertheless, analysts are anticipating an increase in benchmark interest rates in 2015, possibly before the Fed hike, as a result of benign inflation. The Consumer Price Index (CPI) declined to 1.5 per cent in May, the sixth consecutive month that inflation has been below the Bank of England's 2 per cent target.

Strong first quarter growth in **Japan** was fuelled by an increase in consumer spending ahead of April's sales tax increase. Household spending has since declined and second quarter GDP is expected to be lower or may even contract. The Bank of Japan has however expressed confidence that the economy would regain momentum in the second half of this year.

In the **currency market**, the British pound performed well for the fourth consecutive quarter, appreciating by 2.66 per cent vis-à-vis the US dollar as robust economic activity supported GBP strength. The Japanese yen also gained over the quarter, appreciating by 1.88 per cent relative to the US dollar. The currency was supported in part by the Bank of Japan's optimistic outlook for the economy, as well as tensions in Iraq and renewed concerns about the crisis in the Ukraine.

The **US fixed income market** built upon gains generated in the first quarter of 2014 as the demand for safe haven assets increased following rising geopolitical risks and signs of economic improvement. The benchmark 10-year US Treasury yield fell over the quarter, despite a spike in early June following heightened expectations of an increase in policy rates. The 10-year US Treasury yield declined to 2.53 per cent by the end of the quarter from 2.72 per cent at the end of the previous quarter. The broader fixed income market, as measured by the Barclays Capital US Aggregate Bond index, returned 2.04 per cent over the quarter, this compares with a return of 1.84 per cent in the first quarter of 2014. Spread products outperformed like-duration Treasuries and within the index, the Mortgage Backed Securities and Asset Backed Securities sectors returned 2.41 per cent and 0.77 per cent respectively.

In **equity markets**, investors were able to overcome the geopolitical and emerging markets concerns of the first quarter as in the second quarter of 2014, markets reached record highs in the U.S. and Germany while measures of volatility remained relatively subdued. Markets were buoyed by continued positive economic data trends coupled with the ongoing accommodative monetary policies by developed nation central banks. In the US, the Standard and Poor's (S&P) 500 index rose by 4.69 per cent for the quarter while other developed market equities, as measured by the MSCI EAFE index, rose by 2.95 per cent over the quarter.

The HSF investment portfolio returned 2.56 per cent for the quarter ended June 2014, compared with a return of 2.30 per cent for the Strategic Asset Allocation (SAA) benchmark. The Fund's exposures to both equity and fixed income contributed positively to absolute returns. At the end of June 2014, the net asset value of the HSF was

US$5,563.3 million, an increase from the US$5,429.6 million reported at the end of March 2014.

Contribution to Quarterly Return,
For the period April 2014 – June 2014
/per cent/

	SAA Weights	Portfolio Weights as at 30-June-2014	Weighted Return HSF	Weighted Return Benchmark
Composite Portfolio	100.00	100.00	2.56	2.30
US Core Domestic Fixed Income	40.00	34.93	0.78	0.81
US Core Domestic Equity	17.50	22.87	0.89	0.72
Non US Core International Equity	17.50	21.12	0.75	0.62
US Short Duration Fixed Income	25.00	21.09	0.12	0.14

NB: Differences in totals are due to rounding.

Comparative Quarterly Returns
For the Quarters ended December 2013 – June 2014
/per cent/

	3 Months Weighted Return as at 30-Jun-2014		3 Months Weighted Return as at 31-Mar-2014		3 Months Weighted Return as at 31-Dec-2013	
	HSF	**Bench-mark**	**HSF**	**Bench-mark**	**HSF**	**Bench-mark**
Composite Portfolio	2.56	2.30	1.46	1.30	3.95	2.66
US Core Domestic Fixed Income	0.78	0.81	0.72	0.74	0.02	-0.05
US Core Domestic Equity	0.89	0.72	0.39	0.37	2.29	1.76
Non US Core International Equity	0.75	0.62	0.28	0.14	1.61	0.98
US Short Duration Fixed Income	0.12	0.14	0.08	0.06	0.01	-0.03

Comparative Financial Year to Date Returns
For the periods Jun 2013 & Jun 2014
/per cent/

	Financial Year to Date Return as at 30-Jun-2014		Financial Year to Date Return as at 30-Jun-2013	
	HSF	**Bench-mark**	**HSF**	**Bench-mark**
Composite Portfolio	8.17	6.38	4.51	3.66

SECTION 1 – INTERNATIONAL ECONOMIC ENVIRONMENT

United States

The final reading of first quarter gross domestic product (GDP) showed that the US economy contracted at an annualized rate of 2.90 per cent, a sharp decline from an earlier estimate of negative 1.0 per cent. Major contributors to the downward revision included weaker healthcare spending and a decrease in exports. As a result of the disappointing first quarter GDP reading, the Federal Reserve (Fed) lowered its growth estimate for this year from close to 3.0 per cent to between 2.1 - 2.3 per cent. The growth estimate for 2015 however, remained unchanged at 3.0 - 3.2 per cent.

Over the past three months, rising consumer confidence, improvements in the housing market and strong gains in the manufacturing and services sectors indicate that the economy has rebounded. Job growth surged in the second quarter and the unemployment rate fell from 6.7 per cent in March to 6.1 per cent in June. However, there still appears to be some amount of slack in the labour market, since strong advances in employment have not yet translated into wage growth; average hourly earnings rose a little over 0.2 per cent in June.

Meanwhile, the Fed's preferred inflation gauge, the personal-consumption-expenditures price index increased over the period, from 1.1 per cent in March to 1.8 per cent in May. Though the Fed's statements continue to re-iterate its accommodative stance, some officials caution that inflationary risks will rise significantly once the unemployment rate dips below 6 per cent, highlighting concerns that the Fed may need to raise rates earlier than anticipated.

On the policy front, the Fed continued to taper its bond buying program in US$10 billion increments at each meeting. In June, bond purchases were down to US$35 billion a month from US$85 billion last December, and at its current rate, the Fed expects to announce its final reduction of US$15 billion in October. As the bond purchase program approaches its final taper, the uncertainty around the future path of interest rates could re-introduce greater market volatility.

Euro zone

GDP in the 18-nation currency bloc came in at just 0.2 per cent in the first quarter of 2014, with Germany continuing to be the main driver of the region's economic growth. The pace of economic activity, however, slowed in the second quarter as indicated by the decline in the composite Purchasing Managers Index (PMI) to 52.8 in June.

The tepid economic recovery and persistently low inflation prompted the European Central Bank (ECB) to provide additional stimulus at its June meeting. The ECB cut its benchmark interest rate to a record-low 0.15 per cent, lowered its deposit rate to negative 0.10 per cent and unveiled a targeted loan plan directed at reviving lending in the region. The Governing Council also addressed the possibility of outright purchases in the Asset Backed Securities market, but only pledged to "intensify the preparatory work". ECB president Mario Draghi indicated that further stimulus could be considered if inflation remained at current low levels.

In other developments, inflation held steady in June at 0.5 per cent, the 9th straight month of below 1 per cent. There was little improvement in the labour market as the unemployment rate fell to 11.6 per cent in April from 11.7 per cent in March and was unchanged in May. There continues to be a huge disparity between member states, with the unemployment rate at 25.10 per cent in Spain, whereas Germany recorded a jobless rate of 5.1 per cent in May.

The ECB's July meeting was somewhat uneventful, as the governing council maintained its monetary policy from June. However, there were some changes to the ECB's operations; as of January 2015, meetings will go from a four to a six week cycle and the governing council will begin publishing minutes. This will hopefully improve the council's ability to manage interest rate expectations, as it should provide additional transparency and insight into the decision making process.

United Kingdom

The final first quarter GDP for the United Kingdom (U.K.) confirmed that the economy grew at 0.8 per cent. Figures from the Office of National Statistics revealed that the expansion was more balanced than previously thought; manufacturing and construction activity was revised upward and business investment surged higher from its earlier estimate of 2.7 per cent to 5.0 per cent. The U.K. continues to show robust growth in the second quarter, with positive developments in the construction, manufacturing and service sector PMIs. However, the trade deficit widened in May, indicating that the government has yet to make considerable progress towards increasing exports and creating more balanced growth.

The strengthening recovery boosted payrolls and unemployment in the U.K. which fell to 6.6 per cent in the three months to April from 6.8 per cent in the previous three months. Though the labour market has improved markedly, wage growth has lagged; average weekly earnings excluding bonuses slowed to 0.9 per cent in the three months through April versus 1.3 per cent during the prior three months.

During the second quarter, pricing pressures were somewhat subdued and inflation is expected to stay below the Bank of England's (BOE's) 2 per cent target in the coming months. In May, lower food prices and air fares, along with a stronger pound, resulted in the Consumer Price Index falling 0.3 percentage points to 1.5 per cent.

Despite the strong recovery, below target inflation has allowed the BOE to keep rates at record low levels. At its July meeting, the Bank of England kept the policy rate at 0.5 per cent and the size of its asset purchase programme at GBP375 billion. There is growing uncertainty as to how long the BOE can maintain rates at its current level, especially given the strength of the recovery. In June, Governor Mark Carney sent mixed messages regarding the bank's interest rate policy. At his Mansion House speech on June 12th, he surprised investors by hinting that the first rate hike "could happen sooner than markets currently expect". However, on June 24th, during his testimony to lawmakers, his message took a more dovish tone. The Governor indicated that even if that first rate hike occurs earlier than anticipated, "the path of interest rates is likely to be limited and gradual".

Japan

In Japan, the economy surprised to the upside, expanding at an annualized growth rate of 6.7 per cent in the first quarter of 2014. In addition to the widely anticipated increase in consumer spending ahead of the sale tax hike, the strong 7.4 per cent year-on-year rise in capital expenditure helped fuel the economy and points to a greater willingness on the part of businesses to invest.

In more recent economic developments, Japan's trade deficit shrank in May; the decline was driven by lower imports rather than stronger exports, as total exports declined by 2.7 per cent. Japan's household spending fell more than forecasted in May, tumbling 8 per cent year-on-year. Despite the weak economic data, the Bank of Japan remains confident that the negative effects of the sales tax increase will be temporary, and expects the economy to regain momentum in the second half of 2014.

Japan's unemployment rate hit a 16-year low in May falling to 3.5 per cent and the jobs-to-applicant ratio ticked higher from 1.07 in March to 1.09 in May. Average total wages, including overtime and bonuses, grew 0.8 per cent in May and have continued to lag, despite a tight labour market. Stronger income gains will be necessary to bolster consumer demand, as households try to cope with the recent sales tax increase. Excluding the tax hike, pricing pressures edged lower over the quarter. The core consumer price index (CPI) came in at 1.4 per cent in May versus 1.5 per cent in April due to the base effect of higher energy costs a year ago.

There was little development on the monetary policy front as the Bank of Japan left monetary policy unchanged in July. A small downward adjustment was made to its growth forecast for the fiscal year ending March 2015 from 1.1 per cent to 1.0 per cent. Japanese Prime Minister Shinzo Abe unveiled a package in June, aimed at increasing the country's long-term growth potential. Though the plans are viewed as a step in the right direction, the proposed strategies point to incremental policy changes and not comprehensive reform. Thus far, there has been little progress with respect to Mr. Abe's third arrow and some investors remain sceptical as to what will eventually be implemented.

SECTION 2 – CAPITAL AND MONEY MARKET REVIEW

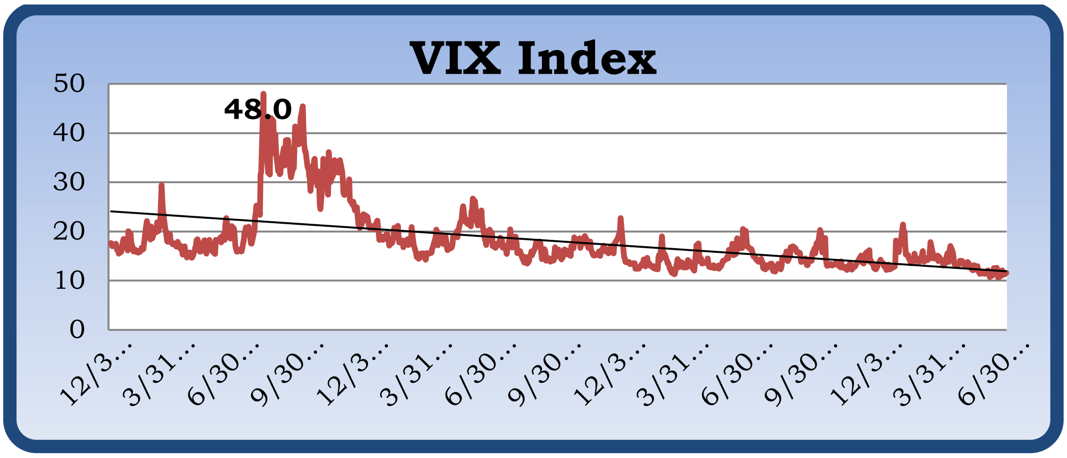
During the second quarter of 2014, the U.S. Treasury curve flattened further and yields ended the period mostly lower, despite a modest uptick in June. Early in the quarter, mixed U.S. economic data and the Fed's continued commitment to keep rates low for an extended period supported higher bond prices. U.S. Treasury demand increased towards the end of May; the prospect of new stimulus measures from the ECB and escalating tensions between Ukraine and Russia pushed the 10-year yield down to a low of 2.44 per cent. In June, concerns around the insurgency in Iraq, weaker than expected first quarter GDP and disappointing consumer consumption all weighed on yields. However, positive economic news and stronger than expected May inflation figures resulted in greater uncertainty around the future path of interest rates, and yields managed to end the month higher.

Other developed sovereign bond yields continued to trend lower over the quarter. European yields had the greatest declines, as the hint of more accommodative policy in May and the eventual introduction of negative deposit rates in June fuelled demand. Italian 10-year rates declined the most among the G-7 nations, falling by 44.60 basis points to end the quarter at 2.85 per cent. In the UK, Gilt yields headed lower early in the quarter but reversed course in June, given the mounting evidence that UK's recovery was firmly in place. In addition, mixed messages from the BOE governor Mark Carney increased the probability of a rate rise later this year.

After a mixed first quarter, developed equity markets moved higher over the second quarter of 2014. In the US, equity markets struggled to find direction in April, hampered in part by concerns around technology-based stock valuations, which prompted a sell-off early in the month. Markets gained momentum in May and June as a combination of improving economic data and the Fed's re-assurance that "a high degree of monetary accommodation remains warranted" were generally positive for equities. After a mixed first quarter, developed equity markets moved higher over the second quarter of 2014.

The Chicago Board Options Exchange Volatility Index (VIX), which is a proxy for investor anxiety and market risk, was relatively unchanged during the second quarter of 2014 ending the period at 11.57 points, down from 13.88 points at the end of the first quarter of 2014. The VIX reached a high for the quarter of 17.03 points in early April, amid concerns about the escalating geopolitical tensions in the Ukraine and continued economic growth concerns in China.

Figure 1
Market Volatility in the US
/points /

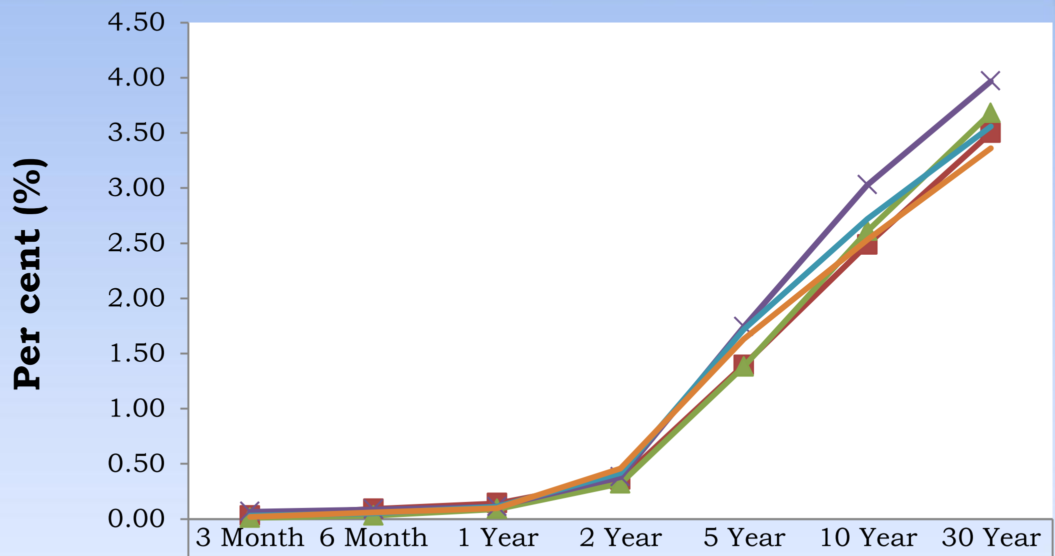


Source: Bloomberg.

U.S. Fixed Income

Over the period, 10-year and 30-year rates fell to 2.53 per cent and 3.36 per cent respectively and the long-end of the curve flattened slightly, with spreads narrowing by one basis point. Medium-term yields ended the quarter lower with 5-year yields down nine basis points and the 2-5 year part of the curve flattened, with spreads compressing by 13 basis points to 117 basis points at the end of the second quarter of 2014. Front-end yields (less than one year) declined with 3-month yields decreasing one basis point to 0.02 per cent at the end of the second quarter.

Figure 2
US Treasury Yield Curve
/per cent/



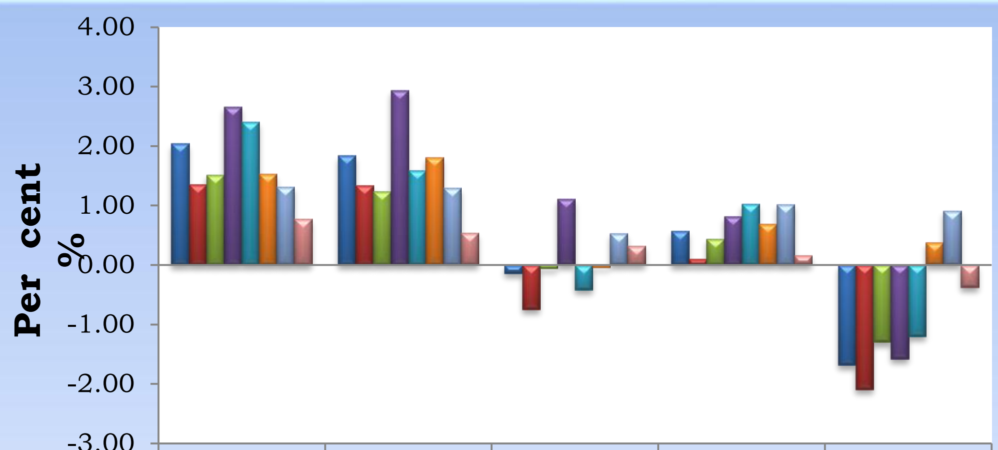
	3 Month	6 Month	1 Year	2 Year	5 Year	10 Year	30 Year
June 30, 2013	0.03	0.09	0.14	0.36	1.39	2.49	3.50
September 30, 2013	0.01	0.03	0.09	0.32	1.38	2.61	3.68
December 31, 2013	0.07	0.09	0.11	0.38	1.74	3.03	3.97
March 31, 2014	0.03	0.05	0.11	0.42	1.72	2.72	3.56
June 30, 2014	0.02	0.06	0.10	0.46	1.63	2.53	3.36

Source: Bloomberg.

The broader US fixed income, as measured by the Barclays Capital US Aggregate Bond index returned 2.04 per cent over the second quarter, compared with a gain of 1.84 per cent during the previous three months. Spread products outperformed similar-duration treasuries and within the index, the municipal and sovereign debt sectors provided the highest returns. In the U.S. Corporate Investment Grade market, utilities modestly outperformed industrials and financials and lower-quality Baa corporates generally outperformed higher quality A-rated issues.

US Corporates returned 2.66 per cent versus 1.35 per cent for US Treasuries while CMBS and ABS also generated positive returns for the quarter, outperforming like duration US Treasuries. CMBS securities returned 1.31 per cent, while ABS securities returned 0.77 per cent. G-7 Global Sovereign bonds returned 1.53 per cent as global developed bond yields declined over the quarter.

Figure 3
Returns on Fixed Income Indices
/per cent/



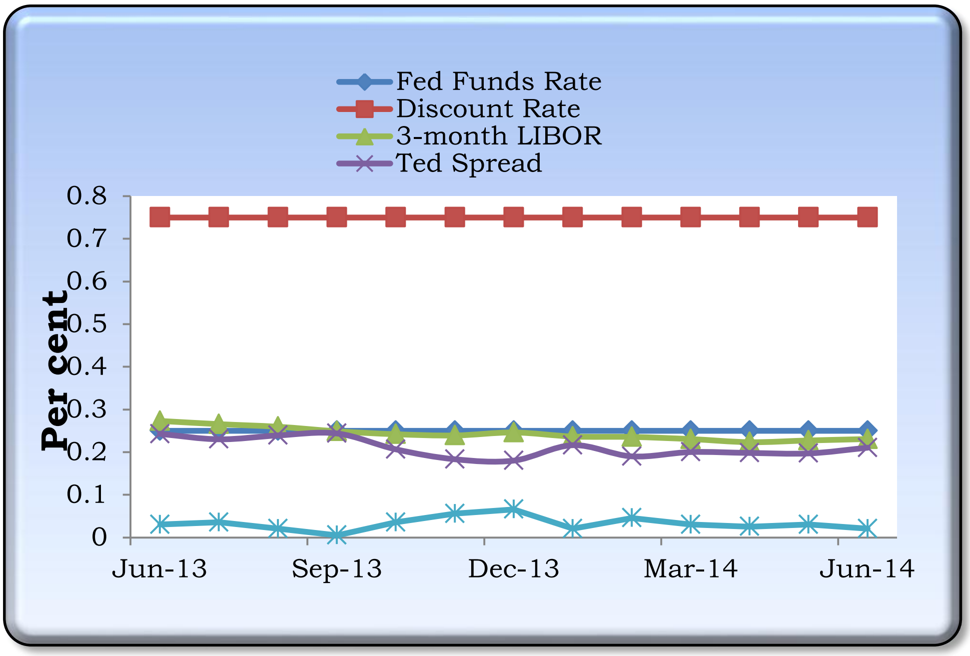
	QTR ended Jun-14	QTR ended Mar-14	QTR ended Dec-13	QTR ended Sep-13	FY 12/13
Barclays U.S. Aggregate	2.04	1.84	-0.14	0.57	-1.68
U.S. Treasuries	1.35	1.34	-0.75	0.10	-2.09
U.S. Agencies	1.52	1.24	-0.06	0.44	-1.30
U.S. Corporate	2.66	2.94	1.11	0.82	-1.58
U.S. MBS	2.41	1.59	-0.42	1.03	-1.20
G-7 Global Bonds (Hedged)	1.53	1.81	-0.04	0.69	0.38
CMBS Index	1.31	1.29	0.53	1.02	0.91
ABS Index	0.77	0.54	0.32	0.16	-0.38

Source: Barclays Capital.

Money Market

Short-term interest rates declined during the second quarter of 2014 as the major central banks maintained their accommodative monetary stance. The 3-month US Treasury bill rate decreased from 0.03 per cent at the end of the first quarter of 2014 to 0.02 per cent at the end of the second quarter. The 3-month London Inter-Bank Offered Rate (LIBOR) however was unchanged at 0.23 per cent at the end of the second quarter when compared to the end of previous quarter despite dropping to 0.22 per cent as at the end of April and May 2014.

Figure 4
US Money Market Rates
/per cent/



Source: Bloomberg

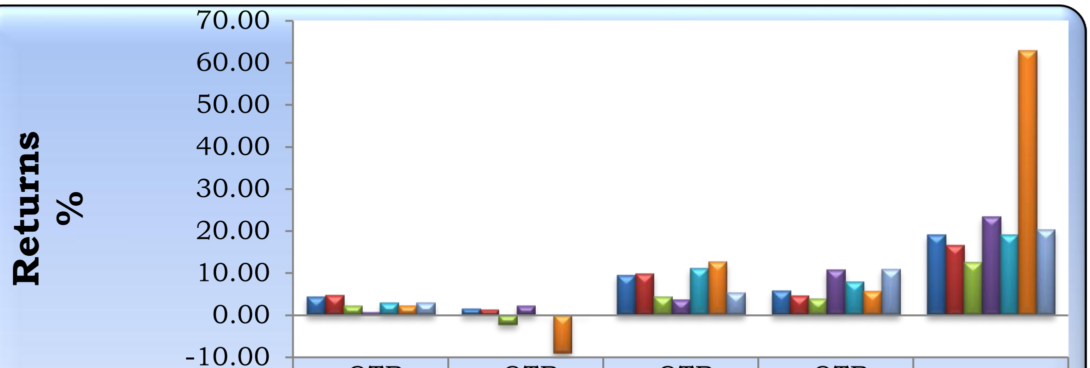
Equity Markets

The Russell 3000 returned 4.37 per cent and the S&P 500 gained 4.69 per cent with large cap companies generally outperforming small cap companies. Energy and utilities were the best performing sectors whereas financials and consumer discretionary lagged the broader market.

The MSCI EAFE gained 2.95 per cent over the quarter as European and Japanese stock markets rebounded. In the Euro zone, risk assets were supported by the new accommodative policies announced by the ECB in June, with the German DAX 30 rising 2.90 per cent over the quarter. In the UK, energy and health care stocks pushed the FTSE 100 higher early in the quarter. However, financials weighed on performance in June, due to disappointing profits and a growing awareness of risks to the banking sector given the BNP fine.

In Japan, the Nikkei's downward trend continued in April but Japanese stocks started to recover in May and June, ending the quarter up 2.25%. In addition to attractive valuations, improving economic data out of China and proposed changes to increase the equity allocation in the 129 trillion yen Government Pension Investment Fund were positive for stocks.

Figure 5
Price Returns on Equity Indices
/Per cent/



	QTR ended Jun-14	QTR ended Mar-14	QTR ended Dec-13	QTR ended Sept-13	FY 12/13
Russell 3000	4.37	1.50	9.56	5.83	19.11
S&P 500	4.69	1.30	9.92	4.69	16.72
FTSE 100 - UK	2.21	-2.23	4.44	3.97	12.54
CAC 40 - France	0.71	2.22	3.68	10.82	23.51
DAX 30 - Germany	2.90	0.04	11.14	7.98	19.10
Nikkei 225 - Japan	2.25	-8.98	12.70	5.69	62.97
MSCI EAFE	2.95	0.00	5.36	10.94	20.35

Source: Bloomberg

Currency Markets

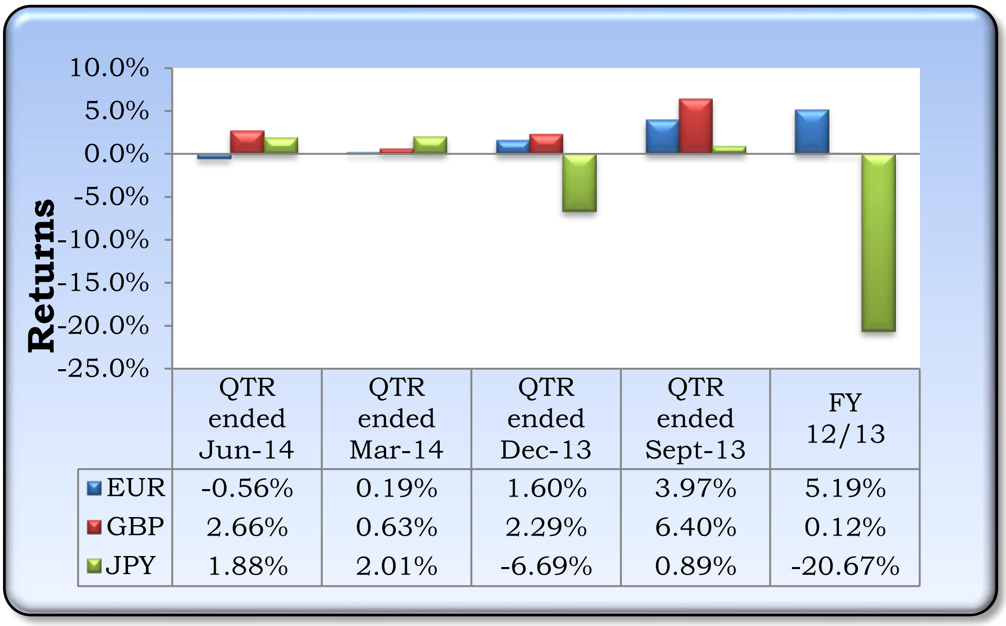
The euro had a volatile second quarter, as early strength in April was followed by a sharp sell-off in May and a modest recovery in June. The currency appreciated in April as Mario Draghi's attempts to talk down the currency had little effect. However, at the ECB's monetary policy meeting in May, Draghi signaled that "the Governing Council is comfortable with acting next time". This prompted markets to reduce euro positions, as there was heightened speculation around the potential scope and scale of new accommodative measures that the ECB might embark on. In June, the currency weakened further following the ECB's announcement, reaching a low of €1.3532 against the US dollar. Negative deposit rates, the new targeted loan facility along with the possibility of an asset purchase program, all weighed on the euro. Towards the end of the quarter, short covering, weaker than expected first quarter GDP in the U.S. and waning investor optimism regarding the possibility of the ECB engaging in a large-scale asset purchase program, all helped the euro to rebound modestly to end the period at €1.3692 per US dollar.

The British pound appreciated by 2.66 per cent during the second quarter; the U.K.'s economic recovery remained robust, increasing the likelihood that the BOE would raise rates before the end of this year.

The Japanese yen continued to strengthen into the second quarter of 2014. Despite some early weakness, the yen quickly recovered and continued to appreciate over the period. The currency was supported in part by the Bank of Japan's optimistic outlook for the economy, which dampened the likelihood that there would be any further stimulus in the near term. In addition, tensions in Iraq and renewed concerns about Ukraine increased the appeal of safe-haven assets and added to yen strength.

Figure 6

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



	QTR ended Jun-14	QTR ended Mar-14	QTR ended Dec-13	QTR ended Sept-13	FY 12/13
EUR	-0.56%	0.19%	1.60%	3.97%	5.19%
GBP	2.66%	0.63%	2.29%	6.40%	0.12%
JPY	1.88%	2.01%	-6.69%	0.89%	-20.67%

Source: Bloomberg

SECTION 3 – PORTFOLIO PERFORMANCE

Strategic Asset Allocation

Over the period April 2014 to June 2014, the asset classes of the Fund deviated from their Strategic Asset Allocation (SAA) and the US Core Domestic Equity mandate and the US Core Fixed Income Mandate fell out of the permitted (+/- 5 per cent) range. As at May 31, 2014, the US Core Domestic Equity Mandate had an allocation of 22.55 per cent, or 5.05 per cent above the SAA of 17.50 per cent. As at June 30, 2014, the US Core Domestic Equity mandate had an allocation of 22.87 per cent, which was 5.37 per cent above the SAA of 17.50 per cent and the US Core Domestic Fixed Income Mandate had an allocation of 34.93 per cent, or 5.07 per cent below the SAA of 40.00 per cent. The approved SAA for the HSF investment portfolio is as follows:

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

Throughout the quarter, the two equity mandates carried overweight allocations relative to their SAA weights and these resulted from their stronger performance when compared with their fixed income counterparts. By the end of the quarter, the asset class with the largest overweight was the US Core Domestic Equity mandate while the US Core Fixed Income mandate had the largest underweight position.

The total net asset value of the Fund as at the end of June 2014 totaled US$5,563.3 million, compared with US$5,429.6 million at the end of the previous quarter. Of this total, the investment portfolio was valued at US$5,560.8 million, while the remaining portion (US$2.5 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, 2013 to June 30, 2014 are shown in Table 1, overleaf.

Table 1

Portfolio Composition relative to the Approved SAA

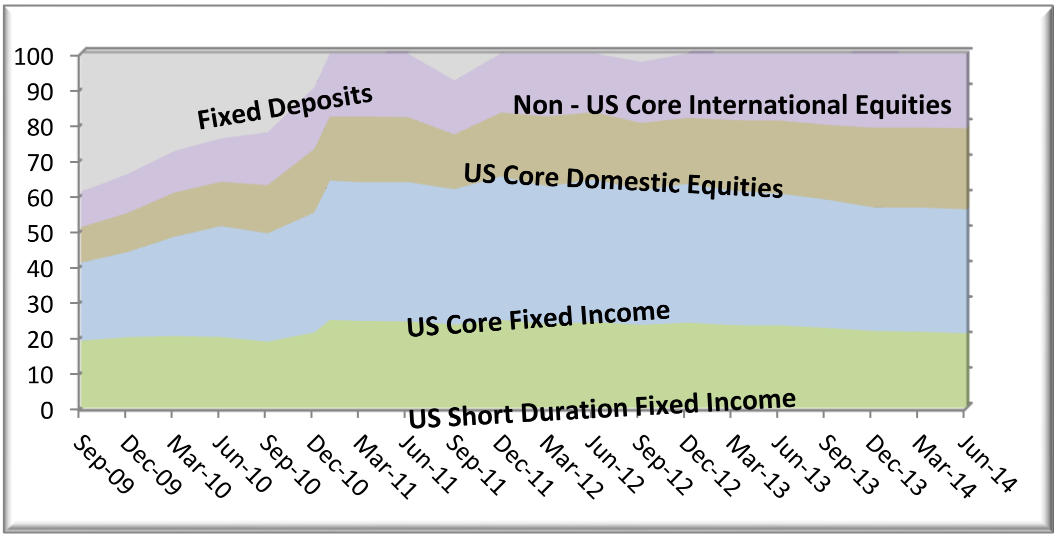
/per cent/

	Asset Class		*Jun-13*	*Sep-13*	*Dec-13*	*Mar-14*	*Jun-14*
Portfolio Weights		*Target Weight SAA*	*Actual % of Fund*	*Actual % of Fund*	*Actual % of Fund*	*Actual % of Fund*	*Actual % of Fund*
	Cash	0.00	0.00	0.00	0.00	0.00	0.00
	US Short Duration Fixed Income	25.00	23.30	22.61	21.76	21.53	21.09
	US Core Domestic Fixed Income	40.00	37.11	36.15	34.80	35.01	34.93
	US Core Domestic Equity	17.50	20.64	21.07	22.49	22.56	22.87
	Non-US Core International Equity	17.50	18.95	20.17	20.95	20.90	21.12

Figure 7

Asset Composition of the HSF Portfolio

/per cent/



Performance of the Investment Portfolio

For the second quarter of 2014, the HSF investment portfolio gained 2.56 per cent, compared with a return of 2.30 per cent for the SAA benchmark[1]. This outperformance of 26 basis points can be attributed to favorable security selection as well as the deviation between the portfolio and SAA weightings. The bulk of the HSF portfolio's returns were generated by the equity portion of the Fund, which contributed 1.64 per cent to the overall performance, while the fixed income mandates added 0.90 per cent to the overall return. On an asset class level, all four mandates except the US Core Domestic Equity mandate outperformed their respective benchmarks during the quarter ended June 30, 2014.

The **US Short Duration Fixed Income** portfolio posted an absolute return of 0.56 per cent during the first quarter of 2014, outperforming its benchmark, the Bank of America Merrill Lynch US Treasury 1-5 year index, by one basis point. This outperformance was attributed to the portfolio's exposure to spread products (Agency RMBS and CMBS) and non-US government bonds as spreads tightened during the quarter. Slightly detracting from performance was the portfolio's interest rate positioning in US Treasuries relative to its benchmark. The net asset value of this mandate as at June 30, 2014 was **US$1,172.8 million,** compared with US$1,168.9 million at the end of the previous quarter.

The longer duration fixed income mandate which consists of **US Core Fixed Income** securities, posted a return of 2.23 per cent during the second quarter of 2014, outperforming its benchmark, the Barclays Capital US Aggregate Bond index, which returned 2.04 per cent. The outperformance of this portfolio relative to the benchmark resulted from its allocations to the investment grade corporate credit sector and the Commercial Mortgage Backed Securities sector. Security selection added to overall returns over the period especially within the Commercial Mortgage Backed and Mortgage Backed along with the Agency Bond sector. The net asset value of this mandate as at June 30, 2014 increased in comparison to the previous quarter, totaling **US$1,942.1 million** compared with US$1,900.8 million as at March 31, 2014.

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[1] The SAA benchmark is a blended benchmark which comprises, Bank of America/Merrill Lynch US Treasury 1-5 Years Index (25%), Barclays US Aggregate Bond Index (40%), Russell 3000 ex Energy Index (17.5%), and MSCI EAFE ex Energy Index (17.5%).

The **Non-US International Equities** mandate generated a gain of 3.63 per cent for the second quarter of 2014, compared with a return of 3.56 per cent for its benchmark, the MSCI EAFE ex Energy index. This outperformance was due to favorable stock selection and sector allocation. The largest impact from stock selection stemmed from holdings in the Health Care and Information Technology sectors. Additionally, allocations to Europe, Japan, United Kingdom and Switzerland also benefited the portfolio. The net asset value of the Non-US Core International Equity mandate as at June 30, 2014 grew to **US$1,174.2 million**, from US$1,134.5 million at the end of March 2014.

The **US Core Domestic Equities** mandate returned 3.97 per cent, compared with a benchmark return of 4.12 per cent. This underperformance was due to the managers' unfavorable stock selection during the period. Stock selection in the Health Care, Producer Durables, Financial Services and Consumer Staples sectors detracted from performance over the period. The net asset value of this mandate, as at June 30, 2014, was **US$1,271.7 million**, compared with US$1,224.6 million at the end of March 2014.

Table 2
Contribution to Quarterly Return,
For the period April 2014 – June 2014
/per cent/

	SAA Weights	**Portfolio Weights as at 30-Jun-2014**	**Weighted Return HSF**	**Weighted Return Benchmark**
Composite Portfolio	100.00	100.00	2.56	2.30
US Core Domestic Fixed Income	40.00	34.93	0.78	0.81
US Core Domestic Equity	17.50	22.87	0.89	0.72
Non US Core International Equity	17.50	21.12	0.75	0.62
US Short Duration Fixed Income	25.00	21.09	0.12	0.14

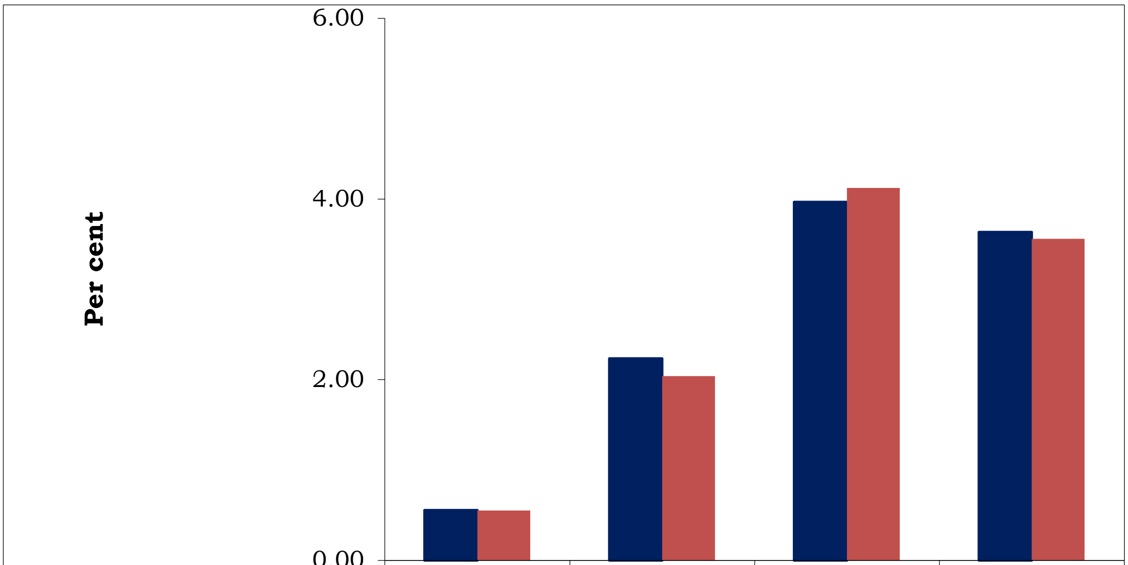
NB: Differences in totals are due to rounding.

Figure 8

Absolute Returns by Asset Class

For the period April 2014 – June 2014

/per cent/



Mandate	US Short Duration	US Core Fixed Income	US Core Domestic Equities	Non US Core International Equities
Composite Portfolio Return	0.56	2.23	3.97	3.63
SAA Benchmark Return	0.55	2.04	4.12	3.56

SECTION 4 –COMPLIANCE AND PORTFOLIO RISKS

Compliance

At the end of May and June 2014, the US Core Fixed Income mandate and the US Core Domestic equity mandate exceeded the maximum 5.0 per cent variation from the Strategic Asset Allocation as highlighted previously. Due to this breach, the Fund has undertaken to review the maximum allowable variation from the SAA in light of current market conditions and the outlook for the various asset classes.

During the month of June 2014, one of the managers of the US Core Domestic Equity mandate purchased an energy stock in error. The investment guidelines specifically prohibit investing in energy sector stocks. The error was detected during the compliance review process and the security was sold during the month of June at a gain.

Portfolio Risks

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

Credit Risk

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

For **fixed income instruments**, Credit Risk is mitigated by the use of credit concentration limits as well as minimum credit quality ratings. Bonds must have an implied investment grade rating as defined by Standard and Poor's, Moody's or Fitch. Should the required ratings on an existing fixed income security fall below the minimum standards, the security must be sold within an agreed upon timeframe. Table 3 below shows the Average Credit Quality of the US Short Duration and US Core Fixed Income Portfolios as at June 30, 2014.

Table 3

Average Credit Rating

Mandate	Portfolio	Benchmark
US Short Duration	**AA+**	**AA+**
US Core Fixed Income	**AA**	**AA+**

Concentration Risk

Concentration or Diversification Risk is minimised by investing across various asset types. The portfolio is currently invested across four asset groupings as follows - US Short Duration Fixed Income, US Core Domestic Fixed Income, US Core Domestic Equity and Non-US Core International Equity. The Asset classes in which the Fund invests react differently under a given market condition. As such, it is likely that when one asset class has strong returns, another may have lower returns. The Fund's investments are also diversified across a number of assets with the aim of securing a positive return over a range of market conditions and lowering the total risk of the portfolio. In addition, Concentration Risk is minimized within asset groups. For the **equity portfolios**, this Risk is managed by imposing a maximum percentage holding of 3.0 per cent of any security's outstanding shares, as well as a maximum sector deviation relative to the benchmark of 5.0 per cent.

Interest Rate Risk

Interest Rate Risk is managed using a weighted average effective duration limit on the respective portfolios, with an allowable range of one (1) year longer or shorter than the weighted average duration of the respective benchmark. Table 4 shows the weighted average duration for the US Short Duration and US Core Domestic Fixed Income portfolios as at June 30, 2014.

Table 4
Weighted Average Duration
/Years/

Mandate	Portfolio	Benchmark
US Short Duration	**2.30**	**2.66**
US Core Domestic Fixed Income	**5.18**	**5.35**

Currency Risk

Currency Risk is managed by containing and managing the exposure to non-US dollar instruments. For the Fixed Income and US Core Domestic Equity mandates, no more than 10 per cent of the market value of the portfolio can be invested in securities, which are denominated in currencies other than the US Dollar. The Non-US Core International Equity Portfolio is comprised primarily of non-US dollar denominated securities, and the Fund accepts the currency risk inherent in the relevant benchmark. For this mandate, currency hedging is permitted up to 15 per cent of the market value of the portfolio using the US dollar as the base currency. At the end of June 2014, the currency exposure for this portfolio was 98 per cent of its market value. During the quarter, all the portfolios were within their respective limits.

Appendix I
HSF Portfolio
Historical Performance since Inception

Quarter End	Current Returns			Financial YTD			Annualised Return Since Inception		
	Portfolio	Benchmark	Excess	Portfolio	Benchmark	Excess	Portfolio	Benchmark	Excess
	%	%	bps	%	%	bps	%	%	bps
FY 2010									
December	0.96	0.89	6.65	0.96	0.89	6.65	3.72	3.78	-6.16
March	1.61	1.68	-6.20	2.59	2.58	0.49	3.95	4.03	-7.76
June	-1.83	-1.89	6.05	0.71	0.64	6.69	3.07	3.12	-5.18
September	5.33	5.08	24.73	6.07	5.75	31.93	4.37	4.35	2.06
FY 2011									
December	2.29	2.21	8.15	2.29	2.21	8.15	4.70	4.65	4.13
March	1.62	1.54	7.24	3.94	3.79	15.68	4.81	4.76	5.72
June	1.88	1.81	6.68	5.89	5.67	22.91	4.98	4.91	7.00
September	-4.82	-4.28	-53.66	0.79	1.14	-34.89	3.57	3.63	-6.29
FY 2012									
December	2.74	3.03	-28.52	2.74	3.03	-28.52	3.97	4.08	-12.00
March	5.04	4.46	57.50	7.92	7.63	29.29	4.78	4.78	-0.08
June	-0.90	-0.60	-30.42	6.95	6.98	-3.72	4.37	4.43	-6.13
September	3.53	2.98	55.03	10.73	10.18	55.02	4.68	4.65	2.07
FY 2013									
December	1.49	1.45	4.11	1.49	1.45	4.11	4.88	4.83	4.76
March	3.29	2.90	39.19	4.82	4.38	44.01	5.23	5.12	11.20
June	-0.30	-0.69	39.05	4.51	3.66	84.64	4.97	4.80	17.26
September	3.95	3.47	47.35	8.63	7.26	137.06	5.40	5.16	24.01
FY 2014									
December	3.95	2.66	129.38	3.95	2.66	129.38	5.80	5.37	42.67
March	1.46	1.30	16.28	5.47	4.00	147.73	5.80	5.37	43.52
June	2.56	2.30	25.90	8.17	6.38	178.44	5.96	5.51	45.76

Notes:

(1) Differences in totals are due to rounding.

(2) In August 2009, International Equities and Fixed Income Securities were added to the HSF portfolio. The performance benchmark for the HSF portfolio became a blended benchmark which comprise, Bank of America/Merrill Lynch US Treasury 1-5 Years Index, US One-month LIBID Index, Barclays US Aggregate, Russell 3000 ex Energy, and MSCI EAFE ex Energy.

(3) In January 2011, the HSF Portfolio achieved its Strategic Asset Allocation where the portfolio was invested in four assets classes. US Short Duration Fixed Income (25), US Core Fixed Income (40), US Equity (17.5) and Non-US International Equity (17.5).

(4) With effect from the quarter ended December 2012, the Annualised Returns Since Inception were computed using a geometric average and not the previously used arithmetic average. For comparative purposes, prior period annualized returns since inception shown above were computing using a geometric average.

Appendix II
Heritage and Stabilisation Fund
Portfolio Valuation (USD)

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

Annual Portfolio Valuation

Valuation Date	Net Asset Value	Quarterly Income	Accumulated Surplus & Unrealized Capital Gains/Losses	Contributions
September 30, 2007	1,766,200,701	41,966,361	41,966,361	321,706,043
September 30, 2008	2,888,421,556	67,177,392	110,379,131	1,054,174,457
September 30, 2009	2,964,686,478	34,782,418	186,755,766	-
September 30, 2010	3,621,984,041	87,931,196	364,361,226	477,344,263
September 30, 2011	4,084,016,158	179,748,798	374,074,067	451,400,519
September 30, 2012	4,712,376,278	125,221,977	794,770,772	207,550,846
September 30, 2013	5,154,027,747	312,776,304	1,193,778,722	42,414,251

Quarterly Portfolio Valuation

Valuation Date	Net Asset Value	Quarterly Income	Accumulated Surplus & Unrealized Capital Gains/Losses	Contributions
December 31, 2011	4,191,162,904	10,474,106	481,361,876	-
March 31, 2012	4,397,263,070	42,045,281	687,290,865	-
June 30, 2012	4,378,930,036	34,014,167	642,769,982	26,241,964
September 30, 2012	4,712,376,278	38,688,423	794,770,772	181,308,882
December 31, 2012	4,780,065,524	42,243,928	861,557,777	-
March 31, 2013	4,933,344,741	70,726,991	1,015,212,703	-
June 30, 2013	4,914,375,234	56,685,027	996,411,094	-
September 30, 2013	5,154,027,747	143,120,358	1,193,778,722	42,414,251
December 31, 2013	5,354,721,875	77,853,526	1,393,727,735	-
March 31, 2014	5,429,643,570	86,362,097	1,467,996,676	-
June 30, 2014	5,563,339,006	90,809,342	1,602,500,838	-

Appendix III
Summary Characteristics of Composite Benchmarks
Fixed Income Benchmarks

Key Characteristics	Barclays US Aggregate Index	Merrill Lynch 1-5 Index
Total Holdings	8,664	147
Coupon (%)	3.37	1.82
Duration (Years)	5.35	2.66
Average Life (Years)	7.28	2.74
Yield to Maturity (%)	2.10	0.77
Option Adjusted Spread (bps)	32	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	2,808	854
Earnings Per Share (EPS Growth 3-5y fwd)	11.1	9.48
Price Earnings (P/E fwd)	15.45	14.15
Price / Book (P/B)	2.70	1.72
Weighted Average Market Capitalization* (Bn)	$93.42	$62.3

*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.

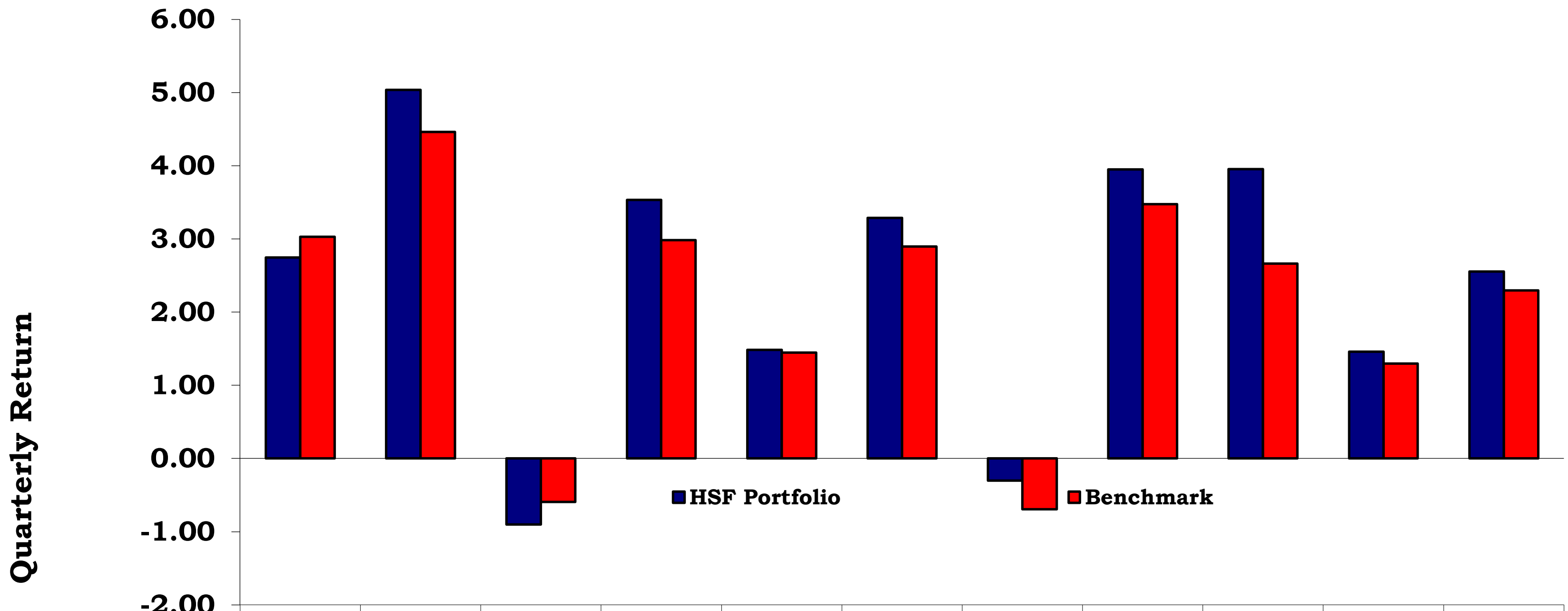
Appendix IV
Summary of the Fund's Net Asset Value by Mandate
/US$ Million/

	June 2013	September 2013	December 2013	March 2014	June 2014
Total Fund Value	**4,914**	**5,154**	**5,355**	**5,429**	**5,563**
Total Value of Equity	**1,945**	**2,125**	**2,325**	**2,359**	**2,446**
US Core Domestic Equity	1,013	1,086	1,204	1,225	1,272
Non-US Core International Equity	931	1,039	1,122	1,135	1,174
Total Value of Fixed Income	**2,969**	**3,027**	**3,028**	**3,070**	**3,115**
US Short Duration Fixed Income	1,145	1,165	1,165	1,169	1,173
US Core Domestic Fixed Income	1,823	1,863	1,863	1,901	1,942
Total Value of Cash or Cash Equivalents	**1**	**2**	**1**	**1**	**3**

NB: Differences in totals are due to rounding.

Appendix V
HSF Portfolio Quarterly Returns
/per cent/

Quarterly HSF & SAA Benchmark Returns



	FY2012 Q1	FY2012 Q2	FY2012 Q3	FY2012 Q4	FY2013 Q1	FY2013 Q2	FY2013 Q3	FY2013 Q4	FY2014 Q1	FY2014 Q2	FY2014 Q3
HSF Portfolio	2.74	5.04	-0.90	3.53	1.49	3.29	-0.30	3.95	3.95	1.46	2.56
Benchmark	3.03	4.46	-0.60	2.98	1.44	2.90	-0.69	3.47	2.66	1.30	2.30