Alberta

Heritage Savings Trust Fund

Alberta
TREASURY

nineteen ninety eight

Annual Report

Fund Profile

The Fund, established in 1976, operates under the authority of the *Alberta Heritage Savings Trust Fund Act*. A new *Act* was passed and came into force on January 1, 1997 that sets out the new investment framework for the Heritage Fund. The Legislative Assembly's Standing Committee on the Alberta Heritage Savings Trust Fund reviews and approves the business plan and annual report of the Fund. The Provincial Treasurer has responsibility for Fund investments.

An Investment Operations Committee has been established to add private sector financial and business oversight of the Fund's investment policies and results. The Investment Operations Committee is chaired by the Deputy Provincial Treasurer and consists primarily of private sector members. The Committee reviews and makes recommendations with respect to the business plan, annual report and investment policy statements for the Fund. The investment manager for the Fund is Alberta Treasury's Investment Management Division, with certain asset classes being managed by specialist external managers (private sector investment managers).

The new statutory mission of the Fund is:

> "To provide prudent stewardship of the savings from Alberta's non-renewable resources by providing the greatest financial returns on those savings for current and future generations of Albertans."

Alberta
TREASURY

Honourable Stockwell Day
Provincial Treasurer

Additional copies of this report and copies of the future quarterly reports on the Heritage Fund may be obtained by writing: Heritage Fund, Room 302, Terrace Building, Edmonton, Alberta, T5K 2C3 or by telephoning (403) 427-4414.

Table of Contents

Provincial Treasurer's Report

This marks the first full year of transition for the Alberta Heritage Savings Trust Fund. Based on the advice of Albertans, the focus of the Fund is now on providing the greatest financial return on investments. The Heritage Fund no longer invests in specific projects with economic or social goals and existing investments will be reduced through time. In addition, the Fund will retain enough income to offset the effects of inflation. As a result, the Heritage Fund once again has begun to grow and will be able to provide an ongoing legacy to future generations of Albertans.

The business plan approved for the Fund has three clear goals: to earn income to support the government's fiscal plan, to maximize long-term financial returns and to improve Albertans' understanding and transparency of the Fund. To meet these goals, two separate portfolios are now in place: a Transition Portfolio and an Endowment Portfolio. The Transition Portfolio is invested primarily in fixed income securities to generate income to fund current programs. The Endowment Portfolio is invested to maximize the long run return and therefore has a heavy emphasis on equity investments. At a minimum, $1.2 billion is transferred from the Transition Portfolio to the Endowment Portfolio each year and, by no later than 2005, all of the assets will be fully invested in the Endowment Portfolio. This transfer is well underway. The Endowment Portfolio has grown to $3.3 billion on a market value basis since its inception on January 1, 1997.

Each portfolio has its own investment policy and performance benchmarks. While it is relatively early in the transition, Albertans now have objective standards by which the performance of the Fund can be assessed.

The Investment Operations Committee undertook its first review of the business plan during 1997-98. Its recommendations called for increasing the equity weight in the policy benchmark of the Endowment Portfolio from 50% to 60% and for substantially increasing investments in foreign equities from 15% to 30%. The net effect of these changes should be to increase the long-run potential return on a prudent and risk managed basis. The recommendations were approved by the Standing Committee and are in the process of being implemented over the next two years.

This year, the Fund earned $947 million in income with nearly $25 million of income being retained to ensure that the value of the Fund grows to off-set the effects of inflation. This ensures that Alberta's Heritage Fund is there to support Albertans' priorities today and for generations to come.

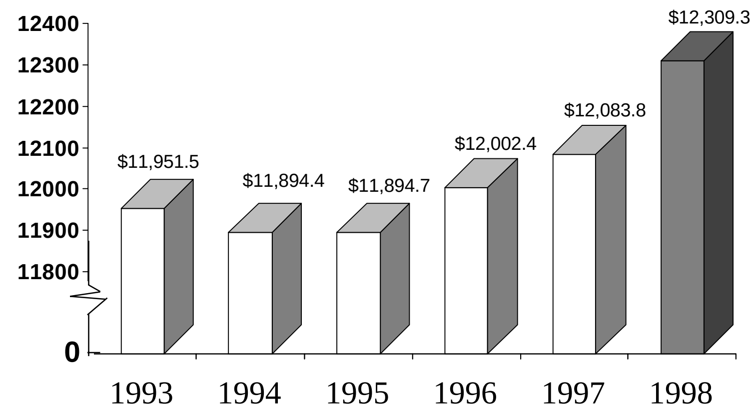
[original signed]

Stockwell Day
Provincial Treasurer

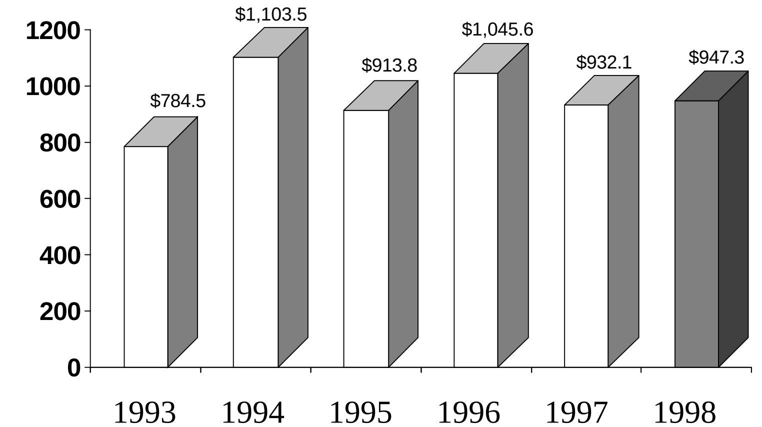
The Year in Review

- The Fund earned net income of $947.3 million in 1997-98, up from $932.1 million a year earlier, reflecting higher than expected realized capital gains through restructuring and realization of gains on equity holdings.
- The net assets of the Fund increased to $12,309 million on March 31, 1998.
- Over the year, $1,200 million (at cost) was transferred from the Transition Portfolio to the Endowment Portfolio.
- The Transition Portfolio, excluding the Alpac loans, had a market return of 8.0%, while the benchmark returned 7.7% and the Endowment Portfolio returned 21.4% versus a policy benchmark of 21.9%.
- The business plan was reviewed and the investment policy for the Endowment Portfolio was revised to (a) increase the long run equity benchmark exposure from 50% to 60% and (b) to increase the foreign equity benchmark exposure from 15% to 30%.
- During 1997-98 a $114 million provision for loan impairment was made for the Alpac loans. An agreement to sell the loans was signed in March 1998 and proceeds of $260 million were received on May 15, 1998.
- In addition to the annual report and quarterly updates, the Standing Committee undertook a series of public meetings to report on the Fund and answer Albertans' questions.

Total Heritage Fund Equity
($millions)



Total Heritage Fund Income
($millions)



Business Plan

The first business plan for the Heritage Fund was published in the government's 1997 budget, released in February 1997. The business plan is reviewed and approved by the Legislature's Standing Committee on the Alberta Heritage Savings Trust Fund on an annual basis. In addition, the Investment Operations Committee reviews and makes recommendations regarding the business plan and the investment policies for the Fund. The Investment Operations Committee is largely composed of private sector individuals with relevant financial and business expertise. The business plan describes the mission and specific investment objectives of the Fund and how the Fund will be invested, managed and measured.

The focus of the business plan is to restructure the Fund by 2005. A key feature of the restructuring is to divide the Fund into two distinct portfolios: the Transition Portfolio and the Endowment Portfolio. Each portfolio has its own investment objective and policy which is closely tied to the goals of the Fund. The three goals of the Fund, as outlined in the plan, remain as follows:

Goal 1 Earn income to support the government's consolidated fiscal plan.

The Transition Portfolio is to provide a relatively stable level of interest income to the government over the short to medium term horizon and to gradually transfer assets to the Endowment Portfolio. The Transition Portfolio is expected to earn a market rate of return greater than the market cost of the province's Canadian dollar debt.

Goal 2 Make investments in the Endowment Portfolio to maximize long-term financial returns.

The Endowment Portfolio focuses on the long-term investment horizon. The Endowment Portfolio is being funded gradually over time with assets transferred from the Transition Portfolio. Eventually all Heritage Fund assets will be invested in the Endowment Portfolio. The investment policy for the Endowment Portfolio was revised with the range for fixed income investments reduced to 35% to 55% and the range for equities increased to 45% to 65% with the objective of increasing the long term equity exposure of the Fund and increasing the potential long-run return without substantially increasing risk. The increased equity exposure will be managed by increasing the exposure to international equities from 15% to 30%.

Goal 3 To improve Albertans' understanding and the transparency of the Alberta Heritage Savings Trust Fund.

This is the second annual report for the restructured Fund and it is part of an overall strategy which has included quarterly updates and public meetings. The Fund is compared to clearly defined performance benchmarks.

In addition, provision has been made to "inflation-proof" the Heritage Fund by retaining enough of the Fund's income in the Endowment Portfolio to keep up with inflation. The net income of the Heritage Fund, less the amount allocated to the Endowment Portfolio for inflation proofing, is transferred from the Heritage Fund to the General Revenue Fund. The amount of income retained in a given year is the value of the total equity (assets less payables) of the Heritage Fund at fiscal year end multiplied by the percentage increase, if any, for the fiscal year in the Canadian gross domestic product price index. For fiscal year 1997-98, the total equity of the Fund was $12.001 billion, inflation was estimated to be 0.208%, and therefore $24.96 million was retained ($12.001 billion X 0.208% = $24.96 million). The legislation requires that, until the completion of the 1998-99 fiscal year, the Fund will only be allowed to keep that income necessary to offset inflation, if the province's surplus exceeds $500 million as it did in 1997-98. If the income of the Fund in a fiscal year is less than that required for inflation proofing, then that income, if any, will be allocated to the Endowment Fund.

Accounting for the Heritage Fund

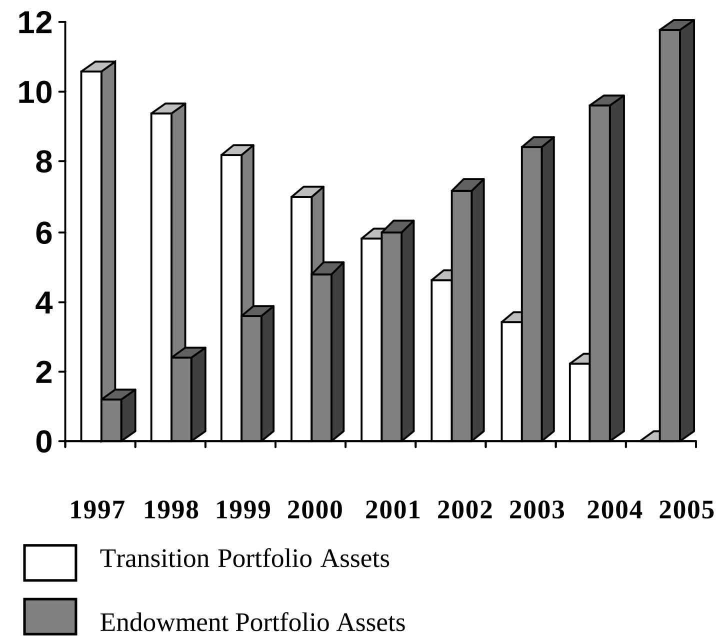
The Heritage Fund is accounted for on a cost basis. Cost includes the amount of applicable amortization of discount or premium using the straight-line method over the life of the investments. Where there has been a loss in value of an investment that is other than a temporary decline, the investment is written down to recognize the loss. Investments in loans are recorded at cost less any unearned income and allowance for credit loss.

Investment income is recorded on the accrual basis where there is reasonable assurance as to its measurement and collectability. Capital gains or losses are recognized in income when the asset is sold.

Fair or "market" values are provided in schedules to the financial statements for comparison purposes.

Transfer of Assets over Transition Period*

($ billions)

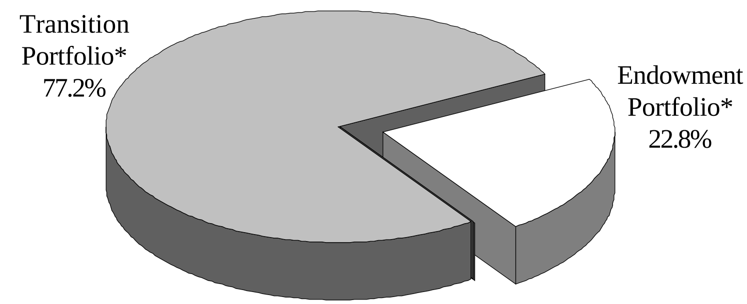


* Cost value; excludes accrued interest and accounts receivable, and additions to Endowment Portfolio due to inflation proofing.

Heritage Fund Assets (Cost Basis)

at March 31, 1998 ($ millions)

Total: $12,309.3 million



* excludes accrued interest and accounts receivable of $174.8 million

Transition Portfolio

Introduction

On January 1, 1997 the Transition Portfolio was allocated $10.6 billion of investments from the "old" Heritage Fund. Since then, at least $100 million has been transferred each month from the Transition Portfolio to the Endowment Portfolio. By no later than December 31, 2005 all the assets will be transferred to the Endowment Portfolio. At March 31, 1998, the fair value of the Transition Portfolio's investments was $9.8 billion (includes loans totalling $408 million at cost) compared to a cost of $9.4 billion.

Transition Portfolio Breakdown of Investments

as at March 31, 1998

($ millions)

	1998			1997		
	Fair Value	Cost	%	Fair Value	Cost	%
Cash	78.6	78.6	0.8	64.8	64.8	0.6
Marketable Fixed Income Securities	7,774.7	7,571.5	80.8	8,289.1	8,079.6	76.3
Policy Investments						
Provincial Corporation Debentures	1,370.1	1,199.3	12.8	1,997.4	1,798.0	17.0
Project Loans *	—	408.2	4.4	—	540.0	5.1
Canadian Equities	181.3	112.3	1.2	125.2	113.0	1.0
Total Policy Investments	1,551.4	1,719.8	18.4	2,122.6	2,451.0	23.1
Total	9,404.7	9,369.9	100.0	10,476.5	10,595.4	100.0

* Fair values of loans are not reported due to there being no organized financial market for the instruments.

Investment Objective

The legislated investment objective of the Transition Portfolio is to make investments with the objective of supporting the government's short term to medium term income needs as reflected in the government's consolidated fiscal plan. This objective will be realized if the Transition Portfolio provides a market rate of return higher than the market cost of the Canadian dollar portion of the province's debt portfolio. To measure this, a "benchmark portfolio" has been created. The borrowing objective of the province will be to try to achieve a lower interest cost than the benchmark cost. The investment objective of the Transition Portfolio will be to earn a return that exceeds the interest cost of the Canadian dollar portion of the province's debt.

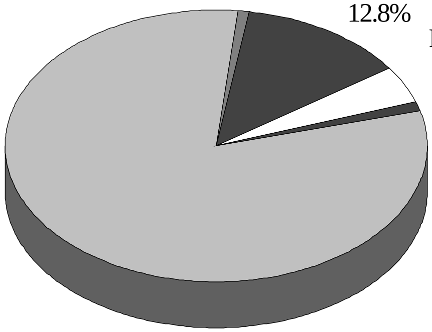
Investment Policy

The Transition Portfolio's investment policy statement is reviewed and recommended annually by the Investment Operations Committee to the Provincial Treasurer. The investment policy statement for the Portfolio is then approved by the Provincial Treasurer and forms the reference document for Alberta Treasury as the investment manager. The investment policy statement must be consistent with the business

Transition Portfolio Investments Breakdown

% of cost at March 31, 1998

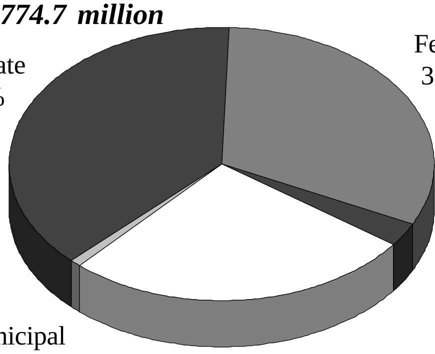
Total: $9,369.9 million



Marketable Fixed Income Securities Breakdown

Fair Value at March 31, 1998

Total: $7,774.7 million



plan of the Fund and it provides the overall investment framework as well as specific policies and guidelines such as:

- a quality constraint for fixed income securities of investment grade (a minimum of a "BBB" credit rating or equivalent)
- investment limits for the various categories of fixed income securities
- controls to minimize the deviation of the Portfolio's duration from that of the province's debt portfolio
- a summary of the legislative authority and governance structure, including specific duties of the investment manager
- requirement to adhere to the "prudent person" rule when making investments
- how investment performance is to be measured and what benchmark is to be used in assessing performance
- controls with respect to the use of derivatives. Derivative instruments such as swaps can only be used to add value by enhancing fundamental investment strategies and cannot be used for speculative purposes. Over-the-counter derivatives may only be purchased from counterparties with at least a A+ credit rating at the time of purchase.

Investment Strategy

The investment strategy, as expressed in the business plan and investment policy statement, is to invest in investment grade interest-bearing securities within a duration range for the overall Portfolio of between 2.4 and 3.2 (to minimize the deviation from the province's debt portfolio duration). Duration is the weighted average of the timing of when cash flows (such as interest and principal) are received and provides a means of gauging how sensitive a fixed income portfolio is to increases or decreases in the general level of interest rates.

The bulk of assets in the Transition Portfolio continues to be in marketable fixed income securities (80.8%). Provincial corporation debentures constitute 12.8% and project loans are 4.4% of the Transition Portfolio.

Corporate securities comprise 37.9% of the Transition Portfolio's marketable fixed income securities. Federal government and Federal government guaranteed bonds constitute another 31.7% of the marketable fixed income securities. The third largest component of the marketable fixed income investments, at 26.9% of the total, is the Transition Portfolio's holdings of other provincial governments' bonds.

During 1997-98, a $114 million provision for loan impairment was recorded for the Alpac loans, reducing the net book value of the loans to $260 million. An agreement to sell the Alpac loans was signed in March 1998. The sale closed on May 15, 1998 and proceeds of $260 million were received.

In addition, $598.7 million of Provincial corporation debentures were repaid or redeemed. The Fund's investment in provincial corporation debentures was reduced from $1,798.0 million at the beginning of the year to $1,199.3 million at March 31, 1998.

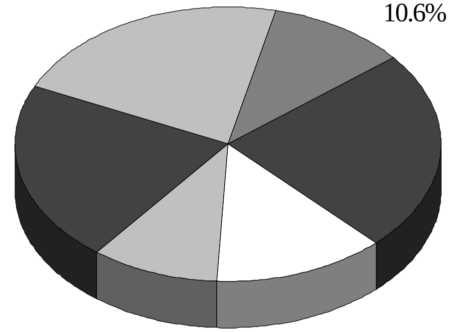
Performance

For the current fiscal year 1997-98, the one year market return for the Transition Portfolio was 6.6%. The one year performance was 8.0% when the loans to the Alpac pulp mill project in Northern Alberta are excluded. The benchmark cost of borrowing was 7.7% during that same period. The book value return on the Transition Portfolio over the same period was 6.7% compared to a debt book value cost of 7.4%.

Investment Income

During the year, the Transition Portfolio generated investment income totalling $769.6 million. Approximately $91.4 million was accounted for by capital gains and $678.2 million was due to interest and dividend income.

Term Structure of Fixed Income Securities
at March 31, 1998 (Par Value)



Market Return

	Last 3 Months*	Last 6 Months*	1 Year
Transition	2.3	3.2	6.6
Transition Excluding Alpac	2.3	3.3	8.0
Liability Portfolio	1.9	2.7	7.7

* Returns are not annualised

Endowment Portfolio

Introduction

The Endowment Portfolio was established on January 1, 1997 with a starting position of $1.2 billion of assets (at cost) transferred from the "old" Heritage Fund. This included equity holdings previously held in the former Commercial Investment Division and a mix of short-term and mid-term fixed income securities. The Endowment Portfolio has increased to a fair value of $3,264.7 million reflecting a further transfer of $1.5 billion, the retention of income to offset inflation and increases in market prices. The Endowment Portfolio is now invested in a broadly diversified portfolio of debt and equity securities.

Investment Objective

The investment objective of the Endowment Portfolio is to maximize long-term financial returns subject to an acceptable level of risk. Alberta Treasury operates under the "Prudent Person Rule" by legislation. This assigns the investment manager the responsibility to restrict investments to assets that would be approved by a prudent investor. By investing to maximize long term returns it is expected that over time, the Heritage Fund will generate higher financial returns than in the past when social and economic objectives were pursued or if only shorter term income objectives were pursued. Similar investment funds with long-term investment horizons and an objective to optimize long run returns invest a significant amount of their assets in equities since equities have historically provided investors with higher total returns (dividends and capital gains) than interest bearing investments. This higher performance is generally off-set by lower and less predictable income flows. Based on historical experience, a similar asset mix policy would have generated a real rate of return of around 5.0% over the long term.

The return in each asset class is compared to a market benchmark. The performance of the Endowment Portfolio will be measured by comparing the actual return of the fund to the return generated by a benchmark portfolio asset mix. The policy benchmark return is calculated by multiplying the returns of the market indices by the Portfolio benchmark asset mix weights. A four year measurement period is used to focus management attention on the longer term. A "stretch target" has been adopted for management over the four year period to add 0.5% in return over and above what would have been generated by the benchmark portfolio asset mix.

Investment Policy

The Endowment Portfolio's investment policy statement is reviewed and recommended annually by the Investment Operations Committee to the Provincial Treasurer. The investment policy statement for the Portfolio is then approved by the Provincial Treasurer and forms the reference document for Alberta Treasury as the investment manager. The investment policy statement must be consistent with the business plan of the Fund and it provides the overall investment framework as well as specific policies and guidelines such as:

- a quality constraint for fixed income securities
- investment limits by asset class
- a summary of the legislative authority and governance structure, including specific duties of the investment manager
- requirement to adhere to the "prudent person" rule when making investments
- how investment performance is to be measured and what benchmark is to be used in assessing performance (see below)
- controls with respect to the use of derivatives. Derivative instruments such as swaps can only be used to add value by enhancing fundamental investment strategies and cannot be used for speculative purposes. Over-the-counter derivatives may only be purchased from counterparties with at least a A+ credit rating at the time of purchase.

Investment Strategy

The strategy is to invest in a diversified portfolio to optimize long-term returns at an acceptable level of risk. As liquid, marketable securities are transferred from the Transition Portfolio at an average of $100 million a month, the securities are reinvested based on the asset allocation policy established for the Portfolio. During 1997, the Investment Operations Committee recommended that the asset mix ranges be changed to reduce the maximum that could be invested in fixed income and increase the minimum for equities. As a result, the long run benchmark asset mix will be amended to 40% fixed income / 60% equities from a 50/50 split. This will increase the potential rate of return for the Portfolio.

Scotia Capital Markets 91 day T-Bills Index (SCMT-Bills Index)
Reflects the performance of the Canadian money market as measured by investments in 91-day Treasury Bills.

Scotia Capital Markets Universe Bond Index (SCM Universe Index)
Covers all marketable Canadian bonds with terms to maturity of more than one year.
The purpose of this index is to reflect performance of the broad Canadian bond market in a manner similar to the way the TSE 300 represents the Canadian equity market.

Toronto Stock Exchange 300 Total Return Index (TSE 300 Index)
An index of 300 stocks, in fourteen subgroups, listed on the Toronto Stock Exchange designed to represent the Canadian equity market. It is a capitalization-weighted index calculated on a total return basis.

Morgan Stanley Capital International World (excluding Canada) (MSCI World Index)
An index of over 1,470 stocks on 23 stock exchanges around the world designed to represent an international equity market (excluding Canada). The index is calculated on a total return basis, which includes investment of gross dividends before deduction of withholding taxes. The index covers about 60% of the issues listed on the exchanges of the countries included.

Russell Canadian Property Index (Russell Index)
An index comprised of institutionally held real estate investments consisting of over 1,100 properties distributed across Canada.

Asset Class Allocation

Asset Class	Policy Benchmark March 31 1997	1998	1999	Benchmark Measurement Index
Interest-Bearing Securities				
Deposits	3%	3%	3%	SCM 91 Day T-Bill Index
Fixed Income Securities	47%	42%	37%	SCM Bond Universe Index
Total Interest Bearing Securities	50%	45%	40%	
Equities				
Canadian Equities	30%	30%	25%	TSE 300 Index
Foreign Equities	15%	20%	30%	MSCI World Index
Real Estate	5%	5%	5%	Russell Canadian Property Index
Total Equities	50%	55%	60%	

In order to manage the risk of increasing the equity exposure and further enhance the potential returns, the foreign equity target was raised from 15 percent to 30 percent. Increasing the foreign equity exposure will increase the diversification of the fund. The Canadian equity market represents only 3% of world market capitalization and is heavily skewed towards a small number of industries. By increasing the foreign equity exposure, the Fund will be able to better diversify across industries and individual companies thereby off-setting the volatility of the increased equity exposure. In addition, the Fund's exposure to enhanced growth opportunities would be increased and therefore the potential for higher long run returns.

In terms of Canadian equities, a significant portion of the assets will be run as a modified index fund based on the TSE 100.

Finally, external investment managers are used in addition to the investments made by Alberta Treasury to take advantage of their specialized knowledge and expertise. This has made it possible to invest in specific asset classes such as Canadian "small-cap", U.S. equities and global equities. This use of external managers to complement internal investment strategies in other sectors is also being explored and it is expected that the use of external managers will increase.

Asset Mix

On March 31, 1998, deposits and fixed income instruments accounted for 53.9% of total investments in the Endowment Portfolio and equity investments accounted for 46.1%. Taking the effect of equity swaps in to account increases the equity exposure to 50.9%, slightly over-weighted to fixed income relative to the policy benchmark in effect at March 31, 1998.

Endowment Portfolio Breakdown of Investments

as at March 31, 1998

($ millions)

	1998			1997		
	Cost	**Fair Value**	**%**	**Cost**	**Fair Value**	**%**
Deposits	$ 127.3	$ 127.3	3.9	$ 17.4	$ 17.4	1.1
Fixed Income Securities						
Public Fixed Income Securities	1,193.6	1,198.5	36.8	598.1	604.3	38.6
Private Mortgage Pool	141.6	142.0	4.3	18.0	18.1	1.2
Private Debt Pool	134.6	135.3	4.1	—	—	—
Total Deposits and Fixed Income Securities	1,597.1	1,603.1	49.1	633.5	639.8	40.9
Equities						
Canadian Equities	503.5	957.3	29.3	348.8	686.7	43.9
U.S. Equities	136.9	153.1	4.7	69.7	64.3	4.1
Global Equities	492.2	512.0	15.7	177.0	171.4	11.0
Real Estate	34.9	39.2	1.2	1.5	1.5	0.1
Total Equities	1,167.5	1,661.6	50.9	597.0	923.9	59.1
Total	$2,764.6	$3,264.7	100.0	$1,230.5	$1,563.7	100.0

* The Floating Rate Note Pool and deposits are used to support the Canadian equity swaps issued by the portfolio. Without the effect of the swaps, the 1998 asset mix would be 53.9% total deposits and fixed income securities, 24.5% Canadian equities, and 46.1% total equities and real estate. Without the effect of the swaps, the 1997 asset mix would be 44.6% of total deposits and fixed income securities, 40.2% Canadian equities, and 55.4% total equities and real estate. For more information, see note (n) of Schedule 1.

The Portfolio's exposure to fixed income increased during the year, reflecting the 50/50 asset mix. With the adoption of a higher equity weighting in the policy benchmark, the equity exposure will increase as the new policy allocations are implemented.

The Endowment Portfolio's holdings of Canadian equities is diversified across all sectors of the TSE 300. The Endowment Portfolio's holding of fixed income securities is equally well diversified. Of the Endowment Portfolio's foreign equity holdings, 42% are invested in the U.S., 38% are in Europe, 15% are in Asia and only 2% are invested in emerging markets. Within the foreign equity component, the fair value of the Global Structured Equity Pool is slightly lower than its cost. This reflects recent market volatility.

Canadian Equities - Distribution

% of fair value at March 31, 1998

Canadian Equities*	Endowment Portfolio	TSE 300
Communications and Media	4.2%	3.5%
Conglomerates	6.2%	3.9%
Consumer Products	5.8%	5.5%
Financial Services	20.5%	23.1%
Gold and Precious Minerals	4.2%	5.2%
Industrial Products	17.5%	18.1%
Merchandising	4.7%	3.4%
Metals and Minerals	6.4%	4.8%
Oil and Gas	8.3%	10.6%
Paper and Forest Products	2.6%	3.0%
Pipelines	4.0%	2.6%
Real Estate	1.1%	1.6%
Transportation and Environmental Services	3.5%	3.3%
Utilities	11.0%	11.4%
Total	100.0%	100.0%

* Includes the effects of equity swaps in the Financial Services Sector.

Endowment Portfolio's Equities by Country

Fair Value at March 31, 1998 ($ millions)

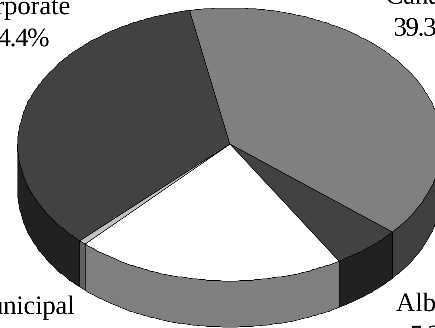
Total: $665.1 million

United States	286.3
United Kingdom	66.2
Japan	64.2
Germany	39.3
France	28.5
Netherlands	27.5
Switzerland	26.6
Hong Kong	12.6
Austrailia	12.2
Sweden	11.5
Others	90.2

Distribution of Endowment Portfolio's Marketable Fixed Income Holdings

Fair Value at March 31, 1998

Total: $1,179.8 million*

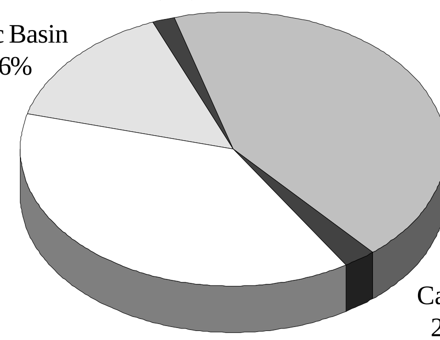


* Excludes deposits in the Canadian Dollar Public Debt pool of $10.8 million in the CCITF, accounts receivable and accrued investment income of $14.5 million and accounts payable of $6.6 million. In addition, holdings in CCITF, the Floating Rate Note Pool, the Private Mortgage Pool and the Private Debt Pool are excluded.

Endowment Portfolio's Distribution of Foreign Equity

% of fair value at March 31, 1998

Total: $665.1 million



Endowment Portfolio Performance

Period ending March 31, 1998

	Actual Fund Return				Benchmark				
	Weightings at 31-Mar-98	Market 3 Months	Market 6 Months	Market 1 Year		Index Weight	Market Return 3 Months	Market Return 6 Months	Market Return 1 Year
Short-term fixed income	3.9%	1.1%	2.1%	3.8%	SCM 91 Day T-Bill Index	3.0%	1.0%	1.8%	3.6%
Long-term fixed income	45.2%	2.7%	4.0%	10.7%	SCM Bond Universe Index	47.0%	2.8%	4.4%	13.2%
Canadian Equities (Public)	28.7%	15.6%	14.9%	40.9%	TSE 300 Index	30.0%	13.3%	8.2%	31.3%
Canadian Equities (Private)	0.6%	8.9%	1.4%	11.5%					
Foreign Equities	20.4%	12.4%	7.2%	29.8%	MSCI World Index (excluding Canada)	15.0%	13.6%	14.8%	35.9%
Real Estate	1.2%	0.7%	19.1%	21.7%	Russell Canadian Property Index*	5.0%	0.7%	8.0%	16.6%
Total Portfolio	100.0%	7.2%	7.1%	21.4%	Total Portfolio	100.0%	7.4%	7.2%	21.9%

* Estimate, final numbers are to come from Frank Russell.

The fixed income component returned 10.7% in the year ending March 31, 1998, underperforming its benchmark, the SCM Bond Universe Index, by 250 basis points. The underperformance arose because the fixed income component had a shorter duration than the Index. The initial transfer of fixed income was largely short term and it took time to sell the securities and replace them with longer term securities. The duration of the fixed income component is now consistent with the SCM Bond Universe Index. The Canadian equity component performed strongly in the year ending March 31, 1998, returning 40.6% while the TSE 300's total return was 31.3%.

Investment Income

The Endowment Portfolio earned $293.9 million in the last year. $101.1 million was capital gains and $192.7 million was interest income.

Economic Climate

Highlights

In this section, a brief analysis of the economic environment in Canada and abroad is provided, as investment performance of the Heritage Fund is closely linked with economic conditions.

The Canadian economy performed well during 1997. Real GDP expanded at an average rate of 3.8% compared to 1.6% in 1996. Real final sales increased by an annual rate of over 3% last year with consumer spending leading the way. Net exports re-emerged as a positive contributor to Canada's real GDP growth during the last three months of 1997. The expansion in 1997 was marked by accommodating monetary policy, solid employment gains and lower inflation.

Some of the risks to Canadian growth in 1998 are higher than usual inventory accumulation, a decline in non-residential construction spending, and a leveling off of corporate profit growth.

By most measures, Canada's inflation rate remains benign. The Consumer Price Index, CPI, advanced by 1.6% during 1997, the same as during the previous year. For the first three months of 1998, the CPI has increased at an average rate of 1%. The Bank of Canada has extended the inflation target band of 1% - 3% until the end of 2001. This sets the stage for an economic environment where continued economic expansion can occur at a moderate pace with little inflation.

The strength of the US economy last year surpassed all expectations. For all of 1997, US real GDP expanded at an average growth rate of 3.8% compared with 2.8% growth rate a year earlier. Growth continued as the US real GDP expanded at an annual rate of 4.2% during the first three months of this year. US job growth followed at an impressive rate. The unemployment rate fell below 5% for practically all of 1997. Despite a tight labour market in 1997, wage pressures failed to ignite inflationary expectations. The CPI advanced by an average 2.0% for the full year 1997 compared with an average increase of 2.3% in 1996. During the first three months of this year, the CPI rose at an average rate of 1.5%. However, there are signs to indicate that the current rate of expansion in the US economy should moderate.

Short-term interest rates in Canada (the 3-month Government of Canada Treasury bill yields and the 3-month Prime Corporate paper rates) rose slowly throughout 1997. This was partially in anticipation of higher US rates and partially in defense of the Canadian dollar. Since the middle of 1997, the Bank of Canada increased the Overnight lending rate four times totalling 175 basis points (from 3.50% to 5.25%). In the US, short term interest rates remained flat – thus narrowing the negative spread between Canadian and US rates. Long bond yields in Canada and in the US fell below 6% towards the end of 1997.

World economic growth was moderate in 1997. While North-American economies have been growing at a healthy pace, European economic growth has begun to recover. Most of the Pacific Rim economies are entering into a recession. Japan, after growing by a modest 0.9% in 1997, is likely going to record 0% growth or even a negative growth in real GDP this year. Until the Japanese economy recovers, the economic environment in that part of the world will remain bleak.

Global output growth will likely accelerate to around 4% by the end of this year as economic growth in Europe gets into high gear. This implies continued expansion in real GDP both here and in the U.S. Recessionary conditions in the Far East are expected to keep global inflation dormant due to lower import costs for the major industrialized countries.

The Canadian dollar lost ground relative to the U.S. dollar. It traded at a high of US$0.7360 during the first quarter of 1997 but closed at US$0.7100 at year end. The terms of trade deteriorated and the current account recorded a deficit of $17.0 billion from a modest surplus a year ago.

Considering the economic and financial conditions described above, the investment return on the SCM 91-day Treasury Bill Index was 3.56%. The investment return on the SCM Short-term Bond Index was 7.01% (average term: 3 years) and 24.22% on the SCM Long-term Bond Index (average term: 20 years). As bond prices and bond yields are inversely related, higher returns on long bonds reflect the lower long term interest rates. This increase in price is included in the market value rate of return.

The Canadian stock market as measured by the Toronto Stock Exchange (TSE 300 Composite) experienced strong growth during 1997. The TSE 300 rose to a high of 7,559 in March, 1998 compared to 5,848 a year before, a total return of 31.3%. The S&P 500 recorded a gain of 48% during the same period moving up from a level of 795.07 at the end of March last year to a level of 1,101.75 this year. Considering the normal valuation criteria, the US equity market appears to be significantly overvalued.

Looking Forward

One of the three goals of the Fund's business plan is to improve Albertans' understanding and the transparency of the Fund. To do so, the Standing Committee on the Alberta Heritage Savings Trust Fund undertook a series of public meetings in Edmonton, Calgary, Medicine Hat and Peace River in the fall of 1997. The Standing Committee believes this is an important way of communicating the Fund's results and its performance. Similar meetings with Albertans will take place in the Fall of 1998. Notice of the meetings is published in local newspapers and every effort is made to make the meetings as accessible as possible.

Albertans can be assured that, with a well thought out business plan, clear investment strategies and benchmarks in place, their Heritage Fund will make a strong contribution to the province for generations to come.

GLOSSARY

Accrued Interest
Interest income that has been earned but not yet paid in cash.

Bond/Debenture
A financial instrument showing a debt where the issuer promises to pay interest and repay the principal by the maturity date.

Book Value
See Cost Value.

Capital Gain
The market value received on sale of an asset beyond its book value or purchase price. If an asset is bought for $50 and sold for $75, the realized capital gain (profit) is $25.

Cost Value
The value for which an asset was acquired.

Deposits
Liquid, short-term investments. A cash equivalent.

Duration (also called Modified Duration)
Modified duration is the weighted average term to maturity of the security's cash flows (i.e., interest and principal) and is a measure of price volatility; the greater the modified duration of a bond, the greater its percentage price volatility.

Fair Value
Fair value is the amount of consideration agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. Fair value is similar to market value.

Fixed Income Securities
Interest-bearing investments such as bonds or debentures and money market investments such as treasury bills and discount notes (see “Bond” and “Money Market Security”).

General Revenue Fund (GRF)
The central operating account for the Province of Alberta. It is where most of the revenues received by the province are deposited and from where most expenditures are made.

Generally Accepted Accounting Principles (GAAP)
These are accounting guidelines, formulated by the CICA's (Canadian Institute of Chartered Accountants) Accounting Standards Committee, that govern how businesses report their financial statements to the public. They are the principles under which the financial statements of the Heritage Fund and other provincial funds are prepared. These principles help ensure fair presentation of the financial affairs of the province.

Income
The return from an investment. Can be derived from interest, dividends or appreciation in the value of the asset that is realized when the asset is sold.

Internal Rate of Return
The internal rate of return is the average rate earned by each and every dollar invested during the period. This rate is influenced not only by the movements in financial markets and decisions made by portfolio managers, but also by the timing and size of the cash inflows and outflows and the beginning and ending book or market values. Since the internal rate of return weights the final overall return by the size of the investment and the timing and size of cash flows in each subperiod, the method produces inappropriate results if the purpose is to compare the performance of two investment funds. For that purpose, the investment industry standard is to use time-weighted rates of return (see "Market (Value) Rate of Return").

Investment Portfolios
A pool of securities held as an investment. Holdings of a diverse group of assets by an individual company or fund.

Liquidity
Describes the ease with which an asset can be turned into cash and the certainty of the value it will fetch.

Market (Value) Rate of Return
The market value rate of return measures income (dividends, cash interest and accrued interest) and capital appreciation (or capital depreciation). The method used to calculate the return is the time-weighted method with quarterly valuations. Time-weighted rates of return are designed to eliminate the effect that the size and timing of cash flows has on the **internal rate of return** since the pattern of cash flows vary significantly among funds. The investment industry uses time-weighted rates of return when comparing the returns of one fund to another fund or to an index.

Marketable Security
An investment for which there is usually a ready market.

Mid-term Investment
A fixed income investment (bonds, debentures, treasury bills or discount notes) that matures in one to five years from the date of acquisition.

Modified Duration
A measure of price volatility of fixed income securities (i.e., bonds). It is the weighted average term-to-maturity of the security's cash flows (i.e., interest and principal). The greater the duration of a bond, the greater its percentage price volatility.

Money Market Security
A fixed income security that matures within one year from the date of acquisition.

Net Income
The amount of earnings remaining after deducting expenses.

Nominal Rate of Return
A measure of return that does not exclude or net out the effect of inflation (see *Real Rate of Return*).

Par Value
A value set as the face amount of a security, typically expressed as multiples of $100 or $1,000. Bondholders receive par value for their bonds on maturity.

Portfolio
The collection of investment securities held by an investor or a subset thereof.

Provincial Crown Corporations
Special purpose companies which carry out government programs. Provincial Crown corporations are used because the nature of the programs are different than those delivered through government departments. The provincial Crown corporations discussed in this report generally offer financial services on a partial or full cost-recovery basis. Alberta Opportunity Company and the Alberta Social Housing Corporation are examples of Alberta provincial Crown corporations.

Real Value or Real Rate of Return
A measure of value or return after accounting for inflation. It is equal to the nominal value or return less an amount for inflation.

Realized/ Unrealized
Terms generally used to describe capital gains or losses. A gain or loss is realized when an asset is sold; prior to sale the gain or loss is unrealized and it is only a potential gain or loss.

Security
Any investment instrument such as a bond, common stock, deed of trust on property, or any evidence of indebtedness or equity.

Short-term Investment
An investment with a maturity date of less than one year.

Term-to-maturity
The number of years left until a bond matures.

Volatility
In financial matters, volatility of returns is the measurement used to define risk. The greater the volatility, the higher the risk.

Auditor's Report on Investment Returns

To the Provincial Treasurer

I have audited the Statement of Investment Returns of the Transition Portfolio and the Endowment Portfolio of the Alberta Heritage Savings Trust Fund for the year ended March 31, 1998. This statement is the responsibility of the Fund's management. My responsibility is to express an opinion on this statement based on my audit.

I conducted my audit in accordance with generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the statement is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the statement. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation.

In my opinion, this statement presents fairly, in all material respects, the investment returns of the Transition Portfolio and the Endowment Portfolio of the Fund for the year ended March 31, 1998 in accordance with the disclosed basis of accounting as described in Note 2 to the statement.

[original signed]

Peter Valentine, FCA
Auditor General

Edmonton, Alberta
May 28, 1998

Statement of Investment Returns of the Transition Portfolio and the Endowment Portfolio

for the year ended March 31, 1998

	Year Ended March 31, 1998	Three Months Ended March 31, 1997 (Note 3)
Transition Portfolio		
Short-term fixed income	4.0	0.7
Long-term fixed income	8.3	0.0
Policy investments (Note 2)	4.3	1.3
Total return	6.6	0.5
Endowment Portfolio		
Short-term fixed income	3.8	0.7
Long-term fixed income	10.7	-0.2
Real estate	21.7	—
Canadian equities	40.6	-0.4
Foreign equities	29.8	—
Total return	21.4	-0.4

Notes to the Statement of Investment Returns of the Transition Portfolio and the Endowment Portfolio

for the year ended March 31, 1998

Note 1 Authority and Purpose

The Alberta Heritage Savings Trust Fund operates under the authority of the Alberta Heritage Savings Trust Fund Act (the "Act"), Chapter A-27.01, Revised Statutes of Alberta 1980, as amended.

Note 2 Significant Accounting Policy

Rates of return have been calculated using the time-weighted method with quarterly valuations. For the three months ended March 31, 1997, the rates of return are not annualized. Industry practice and performance presentation standards require that performance for periods of less than one year not be annualized.

The rate of return on investment measures the total proceeds received from an investment per dollar initially invested. Total proceeds include cash distributions (interest and dividend payments) and capital gains or losses (realized and unrealized). The investment industry uses time-weighted rates of return when comparing the returns of funds with other funds or indices. The time-weighted rate of return is designed to eliminate the effect that the size and timing of cash flows has on the internal rate of return, since the pattern of cash flows vary significantly among funds.

According to the Heritage Fund Business Plan, the performance of both the Transition Portfolio and the Endowment Portfolio are to be measured on a market value basis. Investment returns for the project loans, which are included in policy investments, are based on cost values. If the Alpac loans were excluded in the calculation of the investment returns of the Transition Portfolio, then the total return would be 8.0% for the year ended March 31, 1998 and 0.2% for the three months ended March 31, 1997.

Note 3 Comparative Investment Returns

Investment returns for 1996 are not presented because the Fund was changed effective January 1, 1997. Under the former structure, the Fund consisted of investments held in the Canada, Alberta, Energy and the Commercial Investment Divisions and the Capital Project Division and cash and marketable securities.

Note 4 Uncertainty Due to the Year 2000

The year 2000 issue is the result of some computer programs being written using two digits rather than four to define the applicable year. Government computer programs that have date sensitive software may recognize a date using "00" as the year 1900 rather than the year 2000, which could result in miscalculations or system failures. In addition, similar problems may arise in some systems if certain dates in 1999 are not recognized as a valid date or are recognized to represent something other than a date. The effects of the year 2000 issue may be experienced before, on, or after January 1, 2000. If not addressed, the effect on operations and financial reporting may range from minor errors to significant systems failure that could affect the ability to conduct some government operations.

The government is currently working to resolve the potential effect of the year 2000 on the processing of date sensitive information by the government's computerized information systems in a timely manner. The costs of addressing potential problems by modifying, replacing or retiring significant portions of computerized information systems are not expected to have a material adverse effect on the Fund's financial condition. Despite the government's efforts to address this issue, it is not possible to be certain that all aspects of the year 2000 issue affecting the Fund, including those related to the efforts of customers, suppliers and other third parties, will be fully resolved.

Note 5 Management Approval

The Statement of Investment Returns of the Transition Portfolio and the Endowment Portfolio has been approved by management.

FINANCIAL STATEMENTS

AUDITOR'S REPORT

To the Provincial Treasurer

I have audited the balance sheet of the Alberta Heritage Savings Trust Fund as at March 31, 1998 and the statements of operations and changes in financial position for the year then ended. These financial statements are the responsibility of the Fund's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In my opinion, these financial statements present fairly, in all material respects, the financial position of the Fund as at March 31, 1998 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles.

[original signed]

Peter Valentine, FCA
Auditor General

Edmonton, Alberta
May 22, 1998

Balance Sheet

March 31, 1998 (in $ thousands)

	1998	1997
Assets:		
Portfolio investments:		
Endowment portfolio (Schedule 1)	**$ 2,764,586**	$ 1,230,549
Transition portfolio (Schedule 2)	**9,369,888**	10,595,355
Accrued interest and accounts receivable	**174,792**	257,942
	$ 12,309,266	$ 12,083,846
Liabilities and fund equity:		
Liabilities:		
Accounts payable	**$ 84,601**	$ 35,040
Due to the General Revenue Fund	**198,346**	47,448
	282,947	82,488
Fund equity (Note 5)		
Endowment portfolio	**2,613,202**	1,387,521
Transition portfolio	**9,413,117**	10,613,837
	12,026,319	12,001,358
	$ 12,309,266	$ 12,083,846

The accompanying notes and schedules are part of these financial statements.

STATEMENT OF OPERATIONS
for the year ended March 31, 1998 (in $ thousands)

	1998 Budget	1998 Actual	1997 Actual
Income:			
Investment income			
Endowment portfolio	**$ 117,800**	**$ 293,898**	$ 21,574
Transition portfolio	**739,000**	**769,585**	206,672
Former structure (Note 6)	**—**	**—**	705,078
	856,800	**1,063,483**	933,324
Expenses:			
Administrative expenses (Note 7)	**1,900**	**1,956**	1,201
Provision for loan impairment in the Transition portfolio (Schedule 2, Note (d))	**—**	**114,219**	—
	1,900	**116,175**	1,201
Net income (Note 6)	**854,900**	**947,308**	932,123
Transfers:			
Transfers to the General Revenue Fund	**854,900**	**922,347**	756,448
Amounts retained (Note 5)	**—**	**24,961**	175,675
Net increase in fund equity	**$ —**	**24,961**	175,675
Fund equity at beginning of year		**12,001,358**	11,825,683
Fund equity at end of year		**$ 12,026,319**	$ 12,001,358

STATEMENT OF CHANGES IN FINANCIAL POSITION

for the year ended March 31, 1998 (in $ thousands)

	1998	1997 (Note 9)
Operating transactions:		
Net income	**$ 947,308**	$ 932,123
Non-cash items included in net income	**20,595**	(44,532)
	967,903	887,591
Decrease in receivables	**83,150**	96,648
Increase (decrease) in payables	**49,561**	(120,394)
Cash provided by operating transactions	**1,100,614**	863,845
Investing transactions:		
Proceeds from disposals, repayments and redemptions of investments	**13,520,333**	2,159,697
Purchase of investments	**(13,777,554)**	(2,232,186)
Cash applied to investing transactions	**(257,221)**	(72,489)
Transfers:		
Transfers to the General Revenue Fund	**(922,347)**	(756,448)
Increase in Due to the General Revenue Fund	**150,898**	26,121
Cash applied to transfers	**(771,449)**	(730,327)
Increase in cash and cash equivalents	**71,944**	61,029
Cash and cash equivalents at beginning of year	**139,398**	78,369
Cash and cash equivalents at end of year	**$ 211,342**	$ 139,398
Consisting of Deposits in the Consolidated Cash Investment Trust Fund:		
Endowment Portfolio (Schedule 1)	**$ 132,730**	$ 74,586
Transition Portfolio (Schedule 2)	**78,612**	64,812
	$ 211,342	$ 139,398

NOTES TO THE FINANCIAL STATEMENTS

March 31, 1998

Note 1 Authority and Mission

The Alberta Heritage Savings Trust Fund operates under the authority of the Alberta Heritage Savings Trust Fund Act (the Act), Chapter A-27.01, Revised Statutes of Alberta 1980, as amended.

The preamble to the Act describes the mission of the Fund as follows:

"To provide prudent stewardship of the savings from Alberta's non-renewable resources by providing the greatest financial returns on those savings for current and future generations of Albertans."

Investments of the Fund are held in an Endowment Portfolio and a Transition Portfolio. The Endowment Portfolio has the objective of maximizing long-term financial returns. The Transition Portfolio has the objective of providing income support to the Government's consolidated fiscal plan over the short term to medium term. Commencing in 1996-97, the Act provides that all assets in the Transition Portfolio must be transferred to the Endowment Portfolio by December 31, 2005.

Note 2 Summary of Significant Accounting Policies and Reporting Practices

These financial statements are prepared in accordance with generally accepted accounting principles.

The majority of the Endowment Portfolio investments are held in pooled investment funds established and administered by the Provincial Treasurer. Pooled investment funds have a market based unit value that is used to allocate income to participants and to value purchases and sales of pool units. As at March 31, 1998, the Fund's percentage ownership, at market, in pooled investment funds is as follows:

	% Ownership	
	1998	1997
Canadian Dollar Public Debt Pool	12.1	—
External Managers Fund	15.8	6.8
Floating Rate Note Pool	11.0	—
Global Structured Equity Pooled Fund	16.6	10.4
Private Debt Pool	17.3	—
Private Equity Pool	13.4	1.8
Private Mortgage Pool	17.9	3.4
Private Real Estate Pool	8.4	0.4
US Passive Equity Pool	13.3	—
United States Pooled Equity Fund	13.7	6.6

The accounting policies of significance to the Fund are as follows:

(a) Portfolio investments

Fixed-income securities, mortgages, equities and real estate investments held either directly by the Fund or by pooled investment funds are recorded at cost. Cost includes the amount of applicable amortization of discount or premium using the straight-line method over the life of the investments.

Investments in loans are recorded at cost less any unearned income and allowance for credit loss. Where there is no longer reasonable assurance of timely collection of the full amount of principal and interest of a loan, a specific provision for credit loss is made and the carrying amount of the loan is reduced to its estimated realizable amount.

The cost of disposals is determined on the average cost basis.

Where there has been a loss in value of an investment in fixed-income securities, mortgages, equities and real estate that is other than a temporary decline, the investment is written down to recognize the loss. The written down value is deemed to be the new cost.

(b) Investment Income

Investment income is recorded on the accrual basis where there is reasonable assurance as to its measurement and collectability. When a loan becomes impaired, recognition of interest income in accordance with the terms of the original loan agreement ceases. Any subsequent payments received on an impaired loan are applied to reduce the loan's book value.

Income and expense on index swaps and interest rate swaps are accrued as earned and gains and losses arising as a result of disposal of investments are included in the determination of investment income.

(c) Foreign Currency

Foreign currency transactions are translated into Canadian dollars using average rates of exchange, except for hedged foreign currency transactions which are translated at rates of exchange established by the terms of the forward exchange contracts. Exchange differences on unhedged transactions are included in the determination of investment income.

(d) Investment Valuation

Fair value is the amount of consideration agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. Fair values of investments held either directly by the Fund or by pooled investment funds are determined as follows:

(i) Public fixed-income securities and equities are valued at the year-end closing sale price, or the average of the latest bid and ask prices quoted by an independent securities valuation company.

(ii) Mortgages, Provincial corporation debentures and certain non-public provincial debentures are valued based on the net present value of future cash flows. These cash flows are discounted using appropriate interest rate premiums over similar Government of Canada benchmark bonds trading in the market.

(iii) The fair values of private equities is estimated by management.

(iv) Real estate investments are reported at their most recent appraised value, net of any liabilities against the real property. Real estate properties are appraised annually by qualified external real estate appraisers.

(v) Fair values of loans are not reported due to there being no organized financial market for the instruments and it is not practicable within constraints of timeliness or cost to estimate the fair values with sufficient reliability.

(vi) The fair values of deposits, receivables, accrued interest and payables are estimated to approximate their book values.

(vii) The fair value of investments and any other assets and liabilities denominated in a foreign currency are translated at the year-end exchange rate.

Note 3 Risk Management

Income and financial returns of the Fund are exposed to credit risk and price risk. Credit risk relates to the possibility that a loss may occur from the failure of another party to perform according to the terms of a contract. Price risk is comprised of currency risk, interest rate risk and market risk. Currency risk relates to the possibility that the investments will change in value due to future fluctuations in foreign exchange rates. Interest rate risk relates to the possibility that the investments will change in value due to future fluctuations in market interest rates. Market risk relates to the possibility that the investments will change in value due to future fluctuations in market prices.

The *Standing Committee on the Alberta Heritage Savings Trust Fund* reviews and approves the business plan of the Fund. In order to earn the greatest financial returns at an acceptable level of risk, the business plan establishes an asset mix policy of 35% to 55% fixed-income instruments and 45% to 65% equities for the Endowment Portfolio and limits investments of the Transition Portfolio to include only fixed-income securities other than securities transferred from the old structure. Risk is reduced through asset class diversification, diversification within each asset class, quality and duration constraints on fixed-income instruments, and restrictions on amounts exposed to countries designated as emerging markets. Borrowing or leveraging is not allowed with the exception of pre-existing mortgages on real estate properties. Controls are in place respecting the use of derivatives (see Note 4). Credit risk relating to swaps is minimal as management deals only with the most credit worthy counterparties. Forward foreign exchange contracts may be used to manage currency exposure in connection with securities purchased in foreign currency (see Note 4).

Note 4 Index Swaps, Interest Rate Swaps and Foreign Exchange Contracts

The Fund uses index and interest rate swaps held directly, or indirectly through pooled funds to enhance return and for hedging risks. A swap is a contractual agreement between two parties to exchange a series of cash flows based on a notional amount and does not involve the exchange of the underlying principal.

An index swap involves the exchange of a floating interest rate cash flow for one based on the performance of a market index. For interest rate swaps, parties generally exchange fixed and floating rate interest cash flows based on a notional value. The notional value is the amount to which a rate is applied in order to calculate the exchange of cash flows. All swaps are supported by underlying securities. Leveraging is not allowed.

The following is a summary of the Fund's proportionate share of the notional amount of index swaps and interest rate swaps held directly or issued by pooled funds at March 31, 1998:

	1998	1997
	($ thousands)	
Index swaps:		
Bonds (Canadian Dollar Public Debt Pool)	$ 153,783	$ —
Canadian equities, directly held	159,924	57,180
Foreign equities (Global Structured Equity Pooled Fund)	163,946	61,681
United States equities (US Passive Equity Pooled Fund)	59,523	—
Interest rate swaps:		
Directly held	65,000	—
Canadian Dollar Public Debt Pool	76,977	—
Global Structured Equity Pooled Fund	94,047	32,243
Floating Rate Note Pool	108,365	—
Total	$ 881,565	$ 151,104

Fair values of swaps have been included in the determination of the fair values of the respective pooled investment funds.

Foreign exchange contracts are contractual agreements to exchange specified currencies at an agreed upon exchange rate and on an agreed settlement date in the future. As at March 31, 1998, the Fund's proportionate share of outstanding forward foreign exchange contracts issued by the External Managers Fund amounted to $67,768,000 (1997: $17,227,000).

Note 5 **Fund Equity**

Each year, commencing in 1996-97, a minimum of $1.2 billion of assets, at cost, will be transferred to the Endowment Fund from the Transition Fund until all assets are transferred no later than 2005.

Annually, a portion of net income of the Fund is retained in the Endowment Portfolio, as determined by multiplying the net assets of the Fund by the percentage increase in the Canadian gross domestic product price index for the fiscal year. The *Alberta Heritage Savings Trust Fund Act* requires that, until the completion of the 1998-99 fiscal year, the Fund will be allowed to keep the lesser of (i) the income necessary to fully offset inflation, and (ii) the amount, if any, by which the province's surplus exceeds $500 million in that year. Inflation proofing is recorded at the fiscal year end when the amount can be estimated with sufficient reliability.

From the inception of the Fund in 1976 to March 31, 1987, non-renewable resource revenue totalling $12,049,325,000 was transferred to the Fund from the General Revenue Fund under authority of "Special Acts". From inception to March 1995, the Fund expended $3,486,060,000 on capital projects. Since March 1995, accumulated recoveries from capital projects have amounted to $171,000. From inception to August 1982, net income totalling $3,262,247,000 has been retained by the Fund. Since September 1982, all of the net income of the Fund has been transferred to the General Revenue Fund, except for $24,961,000 in1997-98 and $175,675,000 in 1996-97 which have been retained to preserve the real capital of the Fund.

Note 6 **Net Income**

	1998		
	Endowment Portfolio	Transition Portfolio	Total
		($ thousands)	
Deposit and fixed-income securities:			
Deposits in the Consolidated Cash Investment Trust Fund	$ 4,483	$ 3,082	$ 7,565
Public fixed-income securities, directly held:			
Government of Canada, direct and guaranteed	6,236	267,243	273,479
Alberta, direct and guaranteed	2,327	13,671	15,998
Other provincial, direct and guaranteed	9,492	177,114	186,606
Municipal	—	2,696	2,696
Corporate	5,757	140,776	146,533
Security lending	79	352	431
Provincial corporations debentures	—	160,322	160,322
Canadian Dollar Public Debt Pool	67,112	—	67,112
Floating Rate Note Pool	3,320	—	3,320
Private Mortgage Pool	7,820	—	7,820
Private Debt Pool	1,889	—	1,889
	108,515	765,256	873,771
Equities:			
Public Canadian equities, directly held	70,835	4,329	75,164
External Managers Fund (Small Cap)	2,518	—	2,518
Private Equity Pool	1,847	—	1,847
External Managers Fund (Global)	14,084	—	14,084
Global Structured Equity Pooled Fund	34,205	—	34,205
United States Pooled Equity Fund	4,375	—	4,375
US Passive Equity Pooled Fund	658	—	658
External Managers Fund (United States)	5,000	—	5,000
Security lending	44	—	44
Swaps, direct	50,924	—	50,924
	184,490	4,329	188,819
Real Estate			
Private Real Estate Pool	893	—	893
Investment income	293,898	769,585	1,063,483
Administrative expenses (Note 7)	(293)	(1,663)	(1,956)
Provision for loan impairment (Schedule 2, Note d)	—	(114,219)	(114,219)
Net Income	$ 293,605	$ 653,703	$ 947,308

Note 6 Net Income (continued)

Investment income is comprised of interest, dividends, amortization of discounts and premiums, swap income, security lending income and realized gains and losses, net of write-downs, on investments.

Investment income from the Endowment portfolio includes net gains of $101,081,000 of which $58,187,000 is derived from directly held public Canadian equities; $17,876,000 from the Canadian Dollar Public Debt Pool; $17,387,000 from External Manager Funds (Small Cap, Global, United States); and $7,631,000 from remaining investments. Investment income of the Transition portfolio includes net gains of $91,427,000 derived from fixed income securities.

Income figures for 1997 have not been presented as they are not considered meaningful for comparative purposes because the structure of the Fund was changed effective January 1, 1997. The former structure of the Fund consisted of investments in the Canada, Alberta, Energy and Commercial Investment Divisions and the Capital Project Division.

Note 7 Administrative Expenses

Administrative expense includes investment management, cash management, safekeeping costs and other expenses charged on a cost-recovery basis directly from the Department of Treasury. External management and custodial fees are deducted directly from investment income of External Managers Fund (Small Cap, Global and United States) and are excluded from administrative expenses of the Fund (see Note 6).

Note 8 Uncertainty Due to the Year 2000

The year 2000 issue is the result of some computer programs being written using two digits rather than four to define the applicable year. Government computer programs that have date sensitive software may recognize a date using “00” as the year 1900 rather than the year 2000, which could result in miscalculations or system failures. In addition, similar problems may arise in some systems if certain dates in 1999 are not recognized as a valid date or are recognized to represent something other than a date. The effects of the year 2000 issue may be experienced before, on, or after January 1, 2000. If not addressed, the effect on operations and financial reporting may range from minor errors to significant systems failure that could affect the ability to conduct some government operations.

The government is currently working to resolve the potential effect of the year 2000 on the processing of date sensitive information by the government’s computerized information systems in a timely manner. The costs of addressing potential problems by modifying, replacing or retiring significant portions of computerized information systems are not expected to have a material adverse effect on the Fund’s financial condition. Despite the government’s efforts to address this issue, it is not possible to be certain that all aspects of the year 2000 issue affecting the Fund, including those related to the efforts of customers, suppliers and other third parties, will be fully resolved.

Note 9 Comparative Figures

Certain 1997 figures have been reclassified to conform to 1998 presentation.

Note 10 Approval of Financial Statements

These financial statements were approved by management.

SCHEDULE OF ENDOWMENT PORTFOLIO INVESTMENTS — SCHEDULE 1

March 31, 1998 ($ thousands)

	1998 Cost	1998 Fair Value	1998 %	1997 Cost	1997 Fair Value	1997 %
Deposit in the Consolidated Cash Investment Trust Fund (a)	$ 132,730	$ 132,730	4.1	$ 74,586	$ 74,586	4.8
Fixed-Income securities:						
Public, directly held (b)						
Government of Canada, direct and guaranteed	170,738	172,125	5.3	135,261	135,859	8.7
Provincial:						
Alberta, direct	35,907	36,890	1.1	36,380	37,346	2.4
Other, direct and guaranteed	97,850	102,060	3.1	138,254	142,514	9.1
Corporate	40,966	41,773	1.3	288,155	288,614	18.5
Canadian Dollar Public Debt Pool (c)	848,113	845,622	25.9	—	—	—
Floating Rate Note Pool (d)	154,509	154,998	4.7	—	—	—
Private Mortgage Pool (e)	141,627	141,962	4.3	17,994	18,104	1.1
Private Debt Pool (f)	134,587	135,338	4.1	—	—	—
Total deposit and fixed-income securities (n)	1,757,027	1,763,498	53.9	690,630	697,023	44.6
Canadian equities:						
Public, directly held (g)						
Communications and media	8,752	37,280	1.1	8,107	25,638	1.6
Conglomerates	14,472	55,348	1.7	12,839	36,623	2.3
Consumer products	13,800	51,357	1.6	14,592	48,463	3.1
Financial services	4,657	21,655	0.7	8,173	24,358	1.6
Gold and precious metals	21,334	37,338	1.1	25,042	50,777	3.2
Industrial products	52,797	155,264	4.8	38,806	94,829	6.1
Merchandising	12,262	41,164	1.3	13,546	35,412	2.3
Metals and minerals	33,217	57,068	1.7	30,945	68,001	4.3
Oil and gas	35,844	73,893	2.3	37,151	81,459	5.3
Paper and forest products	13,471	22,897	0.7	11,399	19,432	1.2
Pipelines	13,766	35,409	1.1	11,348	23,259	1.5
Real estate	2,667	9,487	0.3	2,594	8,700	0.6
Transportation and environmental services	14,027	30,814	0.9	7,517	17,626	1.1
Utilities	36,923	96,871	3.0	38,921	65,542	4.2
External Managers Fund (Small Cap) (h)	46,846	52,664	1.6	28,728	27,325	1.7
Private Equity Pool (i)	18,614	18,356	0.6	2,000	2,049	0.1
Total Canadian Equities (n)	343,449	796,865	24.5	291,708	629,493	40.2
Foreign equities:						
External Managers Fund (Global) (h)	320,368	344,962	10.6	109,276	107,177	6.8
Global Structured Equity Pooled Fund (j)	171,879	167,020	5.1	67,674	64,206	4.1
United States Pooled Equity Fund (k)	3,373	5,224	0.2	49,164	44,655	2.9
US Passive Equity Pooled Fund (l)	60,823	63,073	1.9	—	—	—
External Managers Fund (United States) (h)	72,737	84,832	2.6	20,583	19,624	1.3
Total foreign equities	629,180	665,111	20.4	246,697	235,662	15.1
Real estate (m)	34,930	39,234	1.2	1,514	1,505	0.1
Total equities and real estate (n)	1,007,559	1,501,210	46.1	539,919	866,660	55.4
Total investments (o)	$ 2,764,586	$ 3,264,708	100.0	$ 1,230,549	$ 1,563,683	100.00

(a) The Consolidated Cash Investment Trust Fund is managed with the objective of providing competitive interest income to depositors while maintaining maximum security and liquidity of depositors' capital. The portfolio is comprised of high-quality short-term and mid-term fixed income securities with a maximum term to maturity of five years.

(b) Public fixed-income instruments are managed with the objective of providing competitive returns over a four year period while maintaining maximum security of the Fund's capital. Return is maximized within the risk constraints on the portfolio by management of portfolio duration and issuer mix. Fixed-income securities held by the Fund have an average effective yield of 5.24% per annum based on market for securities maturing between one and twenty years (1997: 5.69%), and the following term structure based on par: 1 to 5 years - 84%; 5 to 10 years - 8%; 10 to 20 years - 8%. As at March 31, 1998, securities with a fair value of $106,213,000 (1997: $105,388,000) were loaned to certain borrowers. The loans were secured by marketable securities with a fair value of $112,373,000 (1997: $112,976,000). During the term of the loan, the Fund retains the right to receive income on the securities loaned, in addition to the fees earned.

(c) The Canadian Dollar Public Debt Pool is managed with the objective of providing above average returns compared to the total return of the Scotia McLeod Universe Bond Index over a four-year period while maintaining adequate security and liquidity of participants' capital. The excess return is expected to be achieved through management of portfolio duration and sector rotation. The portfolio is comprised of high quality Canadian fixed-income instruments and debt related derivatives. As at March 31, 1998, securities held by the Pool have an average effective yield of 5.41% per annum based on market, a duration of 5.65 years and the following term structure based on par: under 1 year - 13%; 1 to 5 years - 40%; 5 to 10 years - 19%; 10 to 20 years - 12%; over 20 years - 16%. The following is a summary of the Alberta Heritage Savings Trust Fund's investment in the Canadian Dollar Public Debt Pool as at March 31, 1998:

	1998	
	Cost	Fair Value
	($ thousands)	
Deposit in the Consolidated Cash Investment Trust Fund	$ 10,800	$ 10,800
Fixed-income securities:		
Government of Canada, direct and guaranteed	286,770	291,346
Province of Alberta, direct and guaranteed	22,997	24,179
Other provinces, direct and guaranteed	137,271	140,556
Municipal	6,990	7,231
Corporate	375,401	363,626
Total deposit and fixed-income securities	840,229	837,738
Accounts receivable and accrued investment income	14,470	14,470
Accounts payable	(6,586)	(6,586)
	7,884	7,884
Total - Alberta Heritage Savings Trust Fund	$ 848,113	$ 845,622
Total Canadian Dollar Public Debt Pool	$ 6,635,228	$ 7,000,911

(d) The Floating Rate Note Pool is managed with the objective of providing a reinvestment vehicle for participants with structured investments in foreign equities, domestic equities and domestic bonds. Through the use of interest rate swaps, the Pool provides investment opportunities in high quality floating-rate instruments with remaining term-to-maturity of ten years or less.

(e) The Private Mortgage Pool is managed with the objective of providing investment returns higher than attainable from the publicly traded bond market over a five to ten year period. The portfolio is comprised primarily of high quality commercial mortgage loans. Risk is reduced by limiting investments to include NHA insured loans and first mortgage loans that provide diversification by property usage. The Pool does not invest in mortgages on single family houses, hotels, motels, trailer parks or recreational properties. As at March 31, 1998, mortgages held by the Pool have an average effective yield of 7.37% per annum based on market (1997: 8.58%) and the following term structure based on par: under 1 year - 2%; 1 to 5 years - 48%; 5 to 10 years - 40%; over 10 years - 10%.

(f) The Private Debt Pool is managed with the objective of providing investment returns higher than attainable from the publicly traded bond market over a five to ten-year period. The portfolio is comprised of high quality Canadian private placement fixed-income securities. As at March 31 1998, investments in First Mortgage Bonds of two companies comprised 79% of portfolio. Risk is reduced by limiting investments to instruments with a credit rating of A or higher. As at March 31, 1998, securities held by the Pool have an average effective yield of 6.33% per annum based on market and the following term structure based on par: 1 to 5 years - 38%; 5 to 10 years - 61%; over 10 years - 1%.

(g) The industrial classifications are those used by the Toronto Stock Exchange. Competitive returns and capital preservation are expected from investments in Canadian public equities. Risk is reduced by prudent security selection and management of holdings in various industrial sectors. As at March 31, 1998, equity securities with a fair value of $58,298,000 (1997: $79,271,000) were loaned to certain borrowers. The loans were secured by marketable securities with a fair value of $61,679,000 (1997: $84,978,000). During the term of the loan, the Fund retains the right to receive income on the securities loaned, in addition to the fees earned.

(h) The External Managers Fund is managed by external managers with expertise in global equity markets and Canadian Small-Cap stocks. The objective of the Fund is to provide investment returns higher than the total return of the applicable Morgan Stanley, Standard and Poor's and Toronto Stock Exchange indices over a four-year period. The portfolio is comprised of publicly traded equity securities on Canadian and approved foreign markets. Risk is reduced through manager style and market diversification. The following is a summary of the Alberta Heritage Savings Trust Fund's investment in the External Managers Fund, by geographic region, as at March 31, 1998:

	1998		1997	
	Cost	Fair Value	Cost	Fair Value
	($ thousands)			
Foreign Public Equity Pools:				
Multi Region	$ 140,157	$ 154,058	$ 65,750	$ 64,214
Pacific Basin	75,171	68,858	31,059	30,001
Europe	105,040	122,046	12,467	12,962
	320,368	344,962	109,276	107,177
United States	72,737	84,832	20,583	19,624
Canadian Small Cap Pools	46,846	52,664	28,728	27,325
Total - Alberta Heritage Savings Trust Fund	$ 439,951	$ 482,458	$ 158,587	$ 154,126
Total - External Managers Fund	$ 2,399,553	$ 3,043,960	$ 2,065,866	$ 2,267,291

The following is a summary of assets and liabilities of the External Managers Fund as at March 31, 1998:

	1998	1997
	($ thousands)	
Cash and short-term securities	$ 130,426	$ 174,077
Accounts receivable and accrued investment income	27,357	20,838
Investments - Public equities	2,270,812	1,895,761
- Fixed income securities	3,936	19,880
Accounts payable	(32,978)	(44,690)
Total - External Managers Fund	$ 2,399,553	$ 2,065,866

(i) The Private Equity Pool is managed with the objective of providing investment returns higher than attainable from the TSE 300 Index over a five to ten year period. The portfolio is comprised of equity investments in companies that show higher than average growth potential. Risk is reduced by avoiding direct investments in start-up and venture capital situations and by limiting holdings in any single company.

(j) The Global Structured Equity Pooled Fund is managed with the objective of providing investment returns comparable to the total return of the Morgan Stanley World Equity Index. The Pool provides exposure to global markets through the use of structured investments such as foreign equity index swaps and interest rate swaps.

(k) All investments held in the United States Pooled Equity Fund are being sold and the proceeds are used to purchase units in the US Passive Equity Pooled Fund.

(l) The US Passive Equity Pooled Fund is a passively managed United States equity fund that provides a return equal to the total rate of the Standard and Poor's 500 United States Equity Index. Futures, swaps and other structured investments may be used to enhance performance of the fund.

(m) The Private Real Estate Pool is managed with the objective of providing investment returns comparable to the Russell Canadian Property Index over a five to ten year period. Real estate is held through intermediate companies which have issued to the Pool, common shares and participating debentures secured by a charge on real estate. Risk is reduced by investing in properties that provide diversification by geographic location, by property type and by tenancy. As real estate returns are positively correlated to inflation and negatively correlated to returns from fixed income securities and equities, the Pool provides diversification from the securities market with opportunities for high return.

(n) Deposits and Floating Rate Note Pool units are used as the underlying securities to support the index swaps issued by the Fund (See Note 5). If the effect of the swaps were reflected in this schedule, deposit and fixed-income securities would be reduced by $159,924,000 (1997: $57,180,000) and Canadian equities increased by a corresponding amount. The resulting asset mix percentage would be 49.1% fixed income and 50.9% equities.

(o) See Schedule 2, note (g).

SCHEDULE OF TRANSITION PORTFOLIO INVESTMENTS — SCHEDULE 2

March 31, 1998 ($ thousands)

	1998			1997		
	Cost	Fair Value	%	Cost	Fair Value	%
Deposit in the Consolidated Cash Investment Trust Fund (a)	$ 78,612	$ 78,612	0.7	$ 64,812	$ 64,812	0.6
Fixed-Income securities:						
Public, directly held (b)						
Government of Canada, direct and guaranteed	2,401,344	2,463,997	26.7	3,653,996	3,728,173	36.0
Provincial:						
Alberta, direct and guaranteed	208,133	212,104	2.3	217,355	222,049	2.1
Other, direct and guaranteed	1,991,993	2,085,971	22.6	2,032,543	2,139,746	20.7
Municipal	61,704	64,671	0.7	12,218	13,098	0.1
Corporate	2,908,280	2,947,935	32.0	2,163,428	2,186,017	21.1
Total deposit and fixed-income securities, public	7,650,066	7,853,290	85.0	8,144,352	8,353,895	80.6
Provincial corporation debentures (c):						
Agriculture Financial Services Corporation	576,900	617,717	6.7	735,651	793,629	7.7
Alberta Social Housing Corporation	476,444	587,703	6.5	903,645	1,018,065	9.9
Alberta Municipal Financing Corporation	140,000	158,631	1.7	140,000	166,160	1.6
Alberta Opportunity Company	5,977	6,081	0.1	18,741	19,527	0.2
Total Provincial corporation debentures	1,199,321	1,370,132	15.0	1,798,037	1,997,381	19.4
Total deposit, debentures and fixed-income securities	8,849,387	$ 9,223,422	100.0	9,942,389	$10,351,276	100.0
Canadian equities:						
Public, directly held						
NOVA Corporation of Alberta Ltd.	112,283	$ 181,276		112,283	$ 122,835	
Canadian Western Bank	—	—		720	2,400	
Total Canadian equities	112,283	$ 181,276		113,003	$ 125,235	
Loans:						
Alberta Pacific Pulp Mill Project (d)						
Crestbrook Forest Industries Ltd.	104,000			148,697		
Kanzaki Paper Canada Inc.	65,000			92,744		
MC Forest Investments Inc.	91,000			129,876		
Murphy Oil Company Ltd.						
6.25% due December 22, 1998	37,970			55,970		
Ridley Grain Ltd.						
11.303% due July 31, 2015 (e)	97,750			102,000		
Vencap Acquisition Corporation (f)						
due 2001 and 2046	12,498			10,676		
Total loans	408,218			539,963		
Total investments (g)	$ 9,369,888			$ 10,595,355		

(a) See Schedule 1, note (a).

(b) Public fixed-income instruments are managed with the objective of providing a market rate of return higher than the market cost of the Canadian dollar portion of the Province's debt portfolio on an annual basis. Any excess return is expected to be achieved through management of portfolio duration as well as through issuer mix. As at March 31, 1998, fixed-income securities held have an average effective yield of 4.84% per annum based on market for securities maturing in a year (1997: 3.63%), and 5.34% per annum for securities maturing between 1 and 35 years (1997: 5.52%). As at March 31, 1998, the securities have the following term structure based on par: under 1 year - 13%; 1 to 5 years - 55%; 5 to 10 years - 31%; over 10 years - 1%. As at March 31, 1998, securities with a fair value of $660,737,000 (1997: $948,812,000) were loaned to certain borrowers. The loans were secured by marketable securities with a fair value of $699,059,000 (1997: $1,017,127,000). During the term of the loan, the Fund retains the right to receive income on the securities loaned, in addition to the fees earned.

(c) As at March 31, 1998, Provincial corporation debentures have an average effective yield of 7.41% per annum based on market (1997: 8.05%). Approximately $82 million will mature within a year, $478 million between one and five years, and $639 million after five years. Interest rates on Alberta Municipal Financing Corporation debentures are fixed to maturity and redemption is by a single payment of the full principal sum on maturity. In general the interest rates on the other provincial corporation debentures are fixed for a five year period only and repayment is by either semi-annual or annual instalments of the principal sum over the life of the debenture with the following exceptions: the Province, through the General Revenue Fund, plans to borrow funds in the market and lend the funds to Agriculture Financial Services Corporation (AFSC) and lend or grant funds to Alberta Social Housing Corporation (ASHC). AFSC and ASHC will use the funds to repay the debentures held by the Transition Portfolio generally on the dates when the interest rates on these debentures are reset (every five years). During the year, debentures amounting to $496,815,000 (1997: $90,560,000) were redeemed prior to maturity.

The Fund's investment in provincial corporation debentures is summarized hereunder:

	1998	1997
	($ thousands)	
Balance at beginning of year	$ 1,798,037	$ 1,991,273
Disposals, repayments and redemptions:		
Agriculture Financial Services Corporation	(158,751)	(101,507)
Alberta Social Housing Corporation	(427,201)	(71,863)
Alberta Opportunity Company	(12,764)	(19,866)
Balance at end of year	$ 1,199,321	$ 1,798,037

Fair values of Provincial corporation debentures are based on the net present value of future cash flows. Each individual cash flow payment is discounted at a rate which matches the term of the cash flow payment and is adjusted for a yield premium to reflect several factors. These include a liquidity premium to reflect the fact that if the debentures are sold, there will be a limited pool of these securities trading in the market; that the debentures would be new to the market and are not direct issues of the Province; a premium for the periodic interest reset feature where applicable; and a factor to reflect the blended payment structure of the debentures.

(d) During the year ended March 31, 1998, a provision for loan impairment of $114,219,000 was recorded on the Alberta Pacific Pulp Mill Project loans. In addition, $17,133,000 of interest accrued on the loans was reversed, reducing investment income of the Transition portfolio. Recognition of interest income in accordance with the terms of the original loan agreements has ceased. After recording the interest reversal and the provision for loan impairment, the Alberta Pacific Pulp Mill Project loans are recorded at $260,000,000. The principal and interest of the loans prior to the provision for loan impairment and the reversal of interest was $391,352,000. The basis of determining the amount for loan impairment is that the Province accepted an offer from the Joint Venture Participants to purchase their loans for $260 million. On May 15, 1998, the deal closed and the Province received proceeds of $260,000,000.

(e) Under the terms of the loans, prior to July 31, 1985, interest on the loans has been capitalized and compounded annually; thereafter interest is compounded semi-annually and payable annually to the extent of available cash flow for that purpose, and any shortfall is to be capitalized. The principal, including capitalized interest, is repayable on or before July 31, 2015. As at March 31, 1998 the allowance for credit losses amounts to $42,927,000 (1997: $42,927,000).

The value is sensitive to changes in grain throughput volumes. Grain throughputs are difficult to forecast because they are dependent in part upon port allocation decisions of the Canadian Wheat Board and a number of other factors such as crop size and composition.

(f) In October 1995, the Province agreed to terms of an Arrangement Agreement with Vencap Equities Alberta Ltd. (Vencap) and Vencap Acquisition Corporation, an indirect wholly owned subsidiary of Onex Corporation. Pursuant to this Agreement, the province sold its $199,989,000 Vencap loan and four million Vencap share options for cash of $166 million and non-interest bearing payments totalling $63,988,000 rescheduled on amended terms as follows:

- $11,400,000 is repayable in January 2001, and will bear no interest.
- The balance of $52,588,000 is repayable in July 2046, and will also bear no interest.

The carrying value of the loan has been adjusted to an amount equal to the present value of anticipated loan repayments. The discount is amortized to investment income over the remaining term of the loan.

(g) During the period, investments with a cost of $1,200,720,000 (market $1,202,520,000), including $1,200,000,000 in deposits in the Consolidated Cash Investment Trust Fund and $720,000 in equities, were transferred from the Transition Portfolio to the Endowment Portfolio in accordance with the investment provisions of the *Alberta Heritage Savings Trust Fund Act*.

List of Investments

The list of investments in the following schedules is provided for your information. Presented are the ten largest investments in the pools where the Endowment Portfolio's holdings were greater than 5% and the ten largest Canadian Public Equity issues that are directly held by the Endowment Portfolio. The Floating Rate Note Pool is presented because approximately 80% of the Global Structured Equity Pooled Fund is invested in the Floating Rate Note Pool.

The following schedules present this detail:

CANADIAN DOLLAR PUBLIC DEBT POOL
SCHEDULE OF TEN LARGEST ISSUES (BASED ON MARKET)
AS AT MARCH 31, 1998 (UNAUDITED)

SCHEDULE 1

Issuer	Security Type	Coupon (%)	Maturity	Par Value	Book Value	Market Value
CANADIAN PUBLIC FIXED INCOME						
Government of Canada	Bond	9.00%	1-Jun-25	137,623,000	$ 179,810,777	$ 199,553,350
Province of Ontario	Bond	9.50%	12-Jan-07	122,000,000	144,469,425	184,693,360
Government of Canada	Bond	9.75%	1-Jun-21	95,260,000	109,704,017	144,652,310
Government of Canada	Bond	11.00%	1-Jun-09	90,138,000	106,989,345	131,556,411
Cadillac Fairview Corporation Limited	Floating Rate Note	5.59%	31-Oct-01	129,375,000	129,375,000	130,539,375
Government of Canada	Bond	10.50%	1-Mar-01	106,046,000	115,219,294	121,316,624
Government of Canada	Bond	13.00%	1-May-01	95,610,000	97,133,024	116,452,980
Government of Canada	Bond	11.25%	15-Dec-02	86,733,000	94,157,581	108,242,784
Province of Ontario	Bond	6.50%	8-Mar-29	97,100,000	102,031,031	103,654,250
Canadian Imperial Bank of Commerce	Floating Rate Note	6.04%	30-Oct-07	100,000,000	100,000,000	99,875,000
Total Ten Largest Issues					$ 1,178,889,494	$ 1,340,536,444
Total Net Asset Value - Canadian Dollar Public Debt Pool					$ 6,635,228,199	$ 7,000,911,186
Total Net Asset Value - Alberta Heritage Savings Trust Fund - Endowment Portfolio Holdings					$ 848,112,624	$ 845,622,157

Alberta Heritage Savings Trust Fund - Endowment Portfolio
Canadian Public Equities, directly held
Schedule of Ten Largest Issues (based on market)
As at March 31, 1998 (Unaudited)

Schedule 2

Issuer	Number of Shares	Book Value	Market Value
CANADIAN PUBLIC EQUITIES, directly held			
Northern Telecom Limited	597,600	$ 5,622,208	$ 54,829,800
BCE Incorporated	822,466	17,593,388	48,936,750
Canadian Pacific Limited	675,309	10,209,558	28,362,990
Thomson Corporation	633,529	3,655,462	28,192,041
Seagram Company Limited	501,200	8,696,597	27,014,680
Bombardier Incorporated	765,000	2,595,645	26,813,250
ALCAN Aluminum Limited	468,178	7,181,936	20,716,885
IMASCO Limited	345,163	3,343,221	19,674,277
Power Corporation of Canada	335,100	1,094,437	18,447,255
Laidlaw Incorporated	786,000	5,961,426	17,724,300
Total Ten Largest Issues		$ 65,953,878	$ 290,712,228
Total Canadian Public Equities, directly held		$ 277,989,990	$ 725,844,985

External Mangers Fund
Schedule of Ten Largest Foreign Issues (based on market)
As at March 31, 1998 (Unaudited)

Schedule 3

Issuer	Country	Number of Shares	Book Value	Market Value
FOREIGN PUBLIC EQUITIES				
Nestle	Switzerland	10,484	$ 17,715,900	$ 28,489,476
Cendant	United States	440,700	15,747,253	24,912,627
General Electric	United States	190,827	10,445,626	23,389,653
Novartis	Switzerland	9,061	12,599,058	22,805,261
Glaxo Wellcome	United Kingdom	457,881	9,078,471	17,523,446
Total	France	101,654	11,007,256	17,359,904
ING Groep	Netherlands	209,431	9,805,645	16,901,545
Pfizer	United States	116,951	10,628,813	16,579,992
Microsoft	United States	123,892	4,584,020	15,769,066
Travelers Group	United States	181,353	4,614,936	15,474,466
Total Ten Largest Foreign Issues			$ 106,226,978	$ 199,205,436
Total Net Asset Value - External Managers Fund			$ 2,399,552,882	$ 3,043,960,437
Total Net Asset Value - Alberta Heritage Savings Trust Fund - Endowment Portfolio Holdings			$ 439,950,801	$ 482,457,656

Global Structured Equity Pooled Fund
Detailed List of Investments
As at March 31, 1998 (Unaudited)

Schedule 4

Issuer	Security Type	Coupon (%)	Maturity	Par Value or Number of Shares	Book Value	Market Value
DEPOSIT IN THE CONSOLIDATED CASH INVESTMENT TRUST FUND					$ 60,870,027	$ 60,870,027
CANADIAN PUBLIC FIXED INCOME						
Floating Rate Note Pool (see Schedule 5)	Pool Units			73,662,753	805,609,812	811,684,106
Canadian Imperial Bank of Commerce	Floating Rate Bond	5.57%	7-Mar-07	20,000,000	20,000,000	20,034,000
Canadian Imperial Bank of Commerce	Floating Rate Note	4.63%	16-Mar-99	20,000,000	19,994,605	19,975,000
Royal Bank of Canada	Floating Rate Note	4.84%	16-Mar-99	20,000,000	19,996,707	19,960,000
Cadillac Fairview Corporation Limited	Floating Rate Note	5.66%	31-Oct-01	18,281,250	18,281,250	18,445,781
Toronto Dominion Realty Limited	Floating Rate Note	5.66%	31-Oct-01	6,093,750	6,093,750	6,148,594
Total Fixed Income					889,976,124	896,247,481
Accrued income and accounts receivable					50,678,344	50,678,344
Total Net Asset Value - Global Structured Equity Pooled Fund					$ 1,001,524,495	$ 1,007,795,852
Total Net Asset Value - Alberta Heritage Savings Trust Fund - Endowment Portfolio Holdings					$ 171,879,432	$ 167,019,984

Floating Rate Note Pool
Schedule of Ten Largest Issues (based on market)
As at March 31, 1998 (Unaudited)

Schedule 5

Issuer	Security Type	Coupon (%)	Maturity	Par Value	Book Value	Market Value
CANADIAN PUBLIC FIXED INCOME						
Canadian Imperial Bank of Commerce	Floating Rate Bond	6.11%	30-Oct-07	150,000,000	$ 150,000,000	$ 149,812,500
Cadillac Fairview Corporation Limited	Floating Rate Note	5.66%	31-Oct-01	74,531,250	74,531,250	75,202,031
Canadian Pacific Limited	Bond	10.50%	30-Apr-01	50,000,000	55,565,200	56,932,500
Canadian Imperial Bank of Commerce	Floating Rate Note	5.14%	4-Mar-08	50,000,000	50,000,000	50,010,000
Bell Canada	Bond	10.63%	15-Jul-99	34,920,000	37,255,833	37,102,500
Thomson Corp	Fully Hedged Bond	5.96%	2-May-00	37,071,000	37,071,000	37,071,000
Bank of Nova Scotia	Fully Hedged Bond	6.50%	15-Jul-07	36,000,000	36,000,000	36,000,000
Bank of Nova Scotia	Fully Hedged Bond	6.50%	15-Jul-07	35,880,000	35,880,000	35,880,000
Bank of Nova Scotia	Fully Hedged Bond	6.50%	15-Jul-07	34,575,000	34,575,000	34,575,000
Canadian Imperial Bank of Commerce	Floating Rate Bond	5.57%	7-Mar-07	30,000,000	30,000,000	30,051,000
Total Ten Largest Issues					$ 540,878,283	$ 542,636,531
Total Net Asset Value - Floating Rate Note Pool					$ 1,403,532,712	$ 1,409,242,054
Total Net Asset Value - Global Structured Equity Pooled Fund Holdings					$ 805,609,812	$ 811,684,106
Total Net Asset Value - Alberta Heritage Savings Trust Fund - Endowment Portfolio holdings directly in the Floating Rate Note Pool					$ 154,509,247	$ 154,998,337

Alberta Heritage Savings Trust Fund
Room 302, 9515-107 Street
Edmonton, Alberta T5K 2C3
Phone: (403) 427-4414

Alberta Heritage Savings Trust Fund Standing Committee

Chairman:	Mr. Hung Pham
Deputy Chairman:	Mr. Victor Doerksen
Members:	Ms. Debby Carlson
	Mr. Glen Clegg
	Mr. Ron Hierath
	Mr. Rob Lougheed
	Mr. Shiraz Shariff
	Mr. Ron Stevens
	Mr. Gene Zwozdesky

Administrative Assistant to the Standing Committee
Mrs. Diane Shumyla

Investment Operations Committee

Chairman:	A.D. O'Brien Deputy Provincial Treasurer
Members:	John Beddome, Independent businessman and corporate director
	Carl H. Otto, Carl Otto Associates Inc.
	Robert L. Phillips, President and Chief Executive Officer, Dreco Energy Services Ltd.
	Roger S. Smith, Acting Vice-President (Research and External Affairs) and Professor of Economic Analysis, University of Alberta
	John D. Watson, Vice-President, Finance and Chief Financial Officer, Alberta Energy Company Ltd.
Secretary:	Robert A. Bhatia, Assistant Deputy Provincial Treasurer, Treasury Operations

Investment Manager
Alberta Treasury

Auditor
Auditor General of Alberta