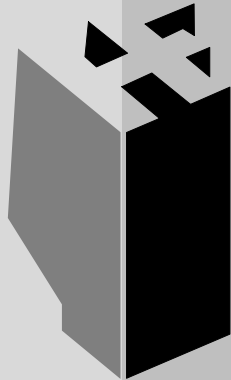


Alberta

Heritage Savings Trust Fund



nineteen ninety nine

Alberta
TREASURY

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 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 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.”



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 304, Terrace Building, Edmonton, Alberta, T5K 2C3 or by telephoning (780) 427-4414.

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Provincial Treasurer's Report

The restructuring of the Alberta Heritage Savings Trust Fund is now one third complete. As part of the restructuring, the Fund was divided into two distinct portfolios. The Endowment Portfolio was established to optimize long term returns while the Transition Portfolio earns income to support the immediate fiscal needs of the Province. On a gradual basis, the assets of the Transition Portfolio are transferred to the Endowment Portfolio and the emphasis of the Fund will shift from providing income to optimizing long term returns. At the end of March 1999, approximately one third of the assets of the Heritage Fund were held in the Endowment Portfolio.

The Heritage Fund continues to play an important role in the fiscal success of the Province. During the 1998-99 fiscal year, the Fund generated \$932 million in investment income. However, as the Fund becomes more heavily invested to optimize long term returns, its market value and therefore the income it earns, will fluctuate more on a short term basis. Investing in equities, which generate much of their return through capital appreciation, have generally out-performed bonds over the long term, but will endure short term fluctuations in prices as markets anticipate changing economic expectations. Short term market volatility was demonstrated by equity markets in 1998. The key is always to maintain a disciplined, long term focus.

An important part of the restructuring was the introduction of clearly defined performance measures. In the case of the Transition Portfolio, the objective is to earn a market rate of return greater than the market cost of the Province's Canadian dollar debt. In the 1998-99 fiscal year the Transition Portfolio earned 5.4% while the market cost of the Province's Canadian dollar debt was 5.9%. The underperformance is partly due to the returns in the equity holdings of the portfolio. In the case of the Endowment Portfolio, we evaluate the performance in a number of ways. We look at the Portfolio's return relative to a policy benchmark calculated using returns on market indices. In the 1998-99 fiscal year the Endowment Portfolio had a return of 4.7%, equal to the policy benchmark return. We also look at how the Portfolio has performed relative to other institutional portfolios. For this we look at surveys of fund returns. For the year ending March 31, 1999, the median or middle ranked fund return, based on an industry survey, was 1.3%.

Combining the Transition Portfolio and the Endowment Portfolio over two years, the Fund, as a whole, returned 7.5% (annualized) compared to the market cost of the Province's Canadian dollar debt of 6.8% (annualized).

While there is still a ways to go in terms of restructuring the Heritage Fund, much has already been accomplished. As we continue to review and assess the performance of the Fund, we have growing confidence that the Fund will be able to support Albertans' current fiscal priorities and provide an ongoing legacy for future generations.

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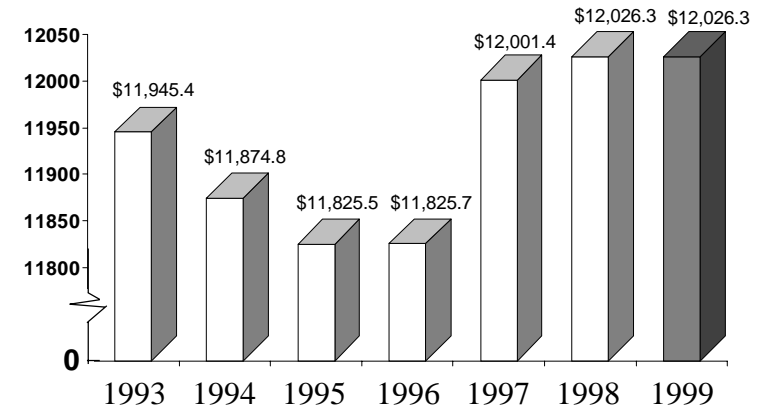
Stockwell Day
Provincial Treasurer

The Year in Review

- The Fund earned net income of \$932.0 million in income in 1998-99, down from \$947.3 million a year earlier, reflecting lower realized capital gains due to market volatility and having a lower proportion of the assets invested in fixed income.
- The Government of Alberta financial statements are prepared on a consolidated basis and therefore eliminates the income the Heritage Fund receives on holding Alberta government and Provincial Corporation securities. Net income of the Heritage Fund for the year ending March 31, 1999 on that basis is \$816 million which is \$115 million greater than budgeted.
- On March 31, 1999, the total equity of the Fund was \$12,026.3 million on a cost basis and \$12,714.2 million on a fair value basis. On the cost basis, the equity of the Fund did not change from 1998 and on a fair value basis, the Fund equity declined from the March 31, 1998 amount of \$12,969.5 million due to the transfer of the net income to general revenues of the province.
- Over the year, \$1,205.4 million (at cost) was transferred from the Transition Portfolio to the Endowment Portfolio.
- The Transition Portfolio returned 5.4% and underperformed its benchmark of 5.9% by 50 basis points. The Endowment Portfolio returned 4.7% the same as the policy benchmark of 4.7%. Combining the Transition Portfolio and the Endowment Portfolio over two years, the Fund, as a whole, returned 7.5% (annualized) compared to the market cost of the Province's Canadian dollar debt of 6.8% (annualized).
- On March 31, 1999 the long run equity benchmark exposure was increased to 60% from 55% and the foreign equity benchmark exposure was increased from 20% to 30% for the Endowment Portfolio.
- In addition to the annual report and quarterly updates, the Standing Committee once again undertook a series of public meetings to report on the Fund and answer Albertans' questions.

Total Heritage Fund Equity*

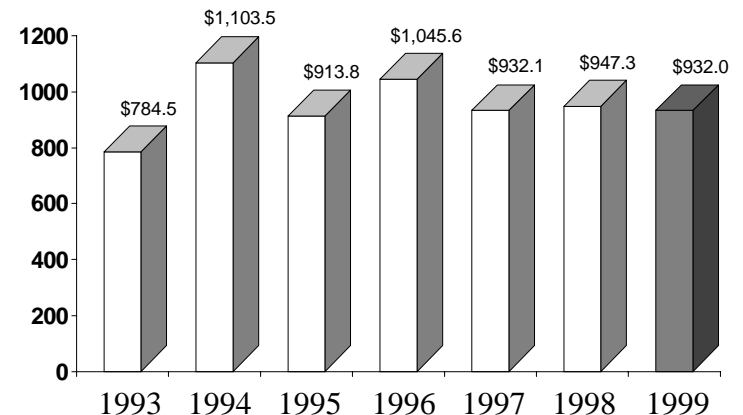
(millions)



* Assets less liabilities, at cost.

Total Heritage Fund Income

(millions)



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.

Business Plan

The business plan for the Heritage Fund describes the mission and specific investment objectives of the Fund and how the Fund will be invested, managed and measured. The business plan is reviewed annually and is published as part of the budget. 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 is then reviewed and approved by the Legislature’s Standing Committee on the Alberta Heritage Savings Trust Fund. The Standing Committee has representation from the major parties of the Legislature.

The Fund has been structured into two 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 Fund calls for a long term policy allocation of 60% in equities. Further, the policy allocation to foreign equities is 30% of the Endowment Portfolio.

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

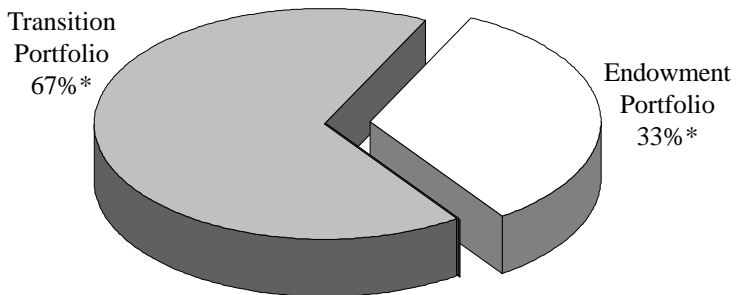
This goal includes the timely release of quarterly reports and detailed discussion of the Fund within the Annual Report. In addition, the Standing Committee provides for ongoing public consultation through public meetings held throughout the province on an annual basis. Each Portfolio of the Fund is compared to clearly defined performance benchmarks.

On March 23, 1999, the *Fiscal Responsibility Act* received Royal Assent and, until the accumulated gross debt is eliminated, the Provincial Treasurer is not required to retain amounts for inflation proofing in the Fund, but may retain such amounts as the Provincial Treasurer considers advisable.

Heritage Fund Assets (Cost Basis)

at March 31, 1999 (\$ millions)

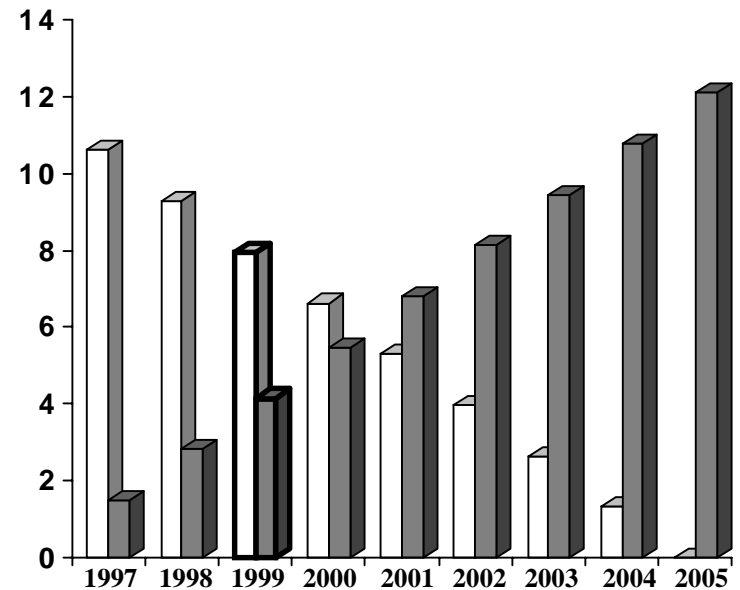
Total: \$12,097.5 million



* Excludes accrued interest and accounts receivable of \$138.2 million.

Transfer of Assets over Transition Period*

(\$ billions)



□ Transition Portfolio Assets
 ■ Endowment Portfolio Assets

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

Transition Portfolio

Introduction

The Transition Portfolio transfers \$100 million per month to the Endowment Portfolio. At March 31, 1999, the fair value of the Transition Portfolio's investments was \$8.3 billion (includes loans totaling \$107.8 million at cost) compared to a cost of \$8.1 billion.

Transition Portfolio Breakdown of Investments

as at March 31, 1999

(\$ millions)

	1999			1998		
	Fair Value	Cost	%	Fair Value	Cost	%
Cash	45.0	45.0	0.6	78.6	78.6	0.8
Marketable Fixed Income Securities	7,178.2	7,062.7	87.7	7,774.7	7,571.5	80.8
Policy Investments						
Provincial Corporation Debentures	902.0	771.8	9.6	1,370.1	1,199.3	12.8
Project Loans	—	107.8	1.3	—	408.2	4.4
Canadian Equities	79.9	65.7	0.8	181.3	112.3	1.2
Total Policy Investments	982.0	945.3	11.7	1,551.4	1,719.8	18.4
Total	8,205.1	8,053.0	100.0	9,404.7	9,369.9	100.0

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. The investment objective of the Transition Portfolio is 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 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 (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 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 continue to be in marketable fixed income securities (87.7%). Provincial debentures constitute 9.6% and project loans are 1.3% of the Transition Portfolio. Corporate securities comprise 40.3% of the Transition Portfolio's marketable fixed income securities. Federal government and Federal government guaranteed bonds constitute another 31.0% of the marketable fixed income securities. The third largest component of the fixed income investments, at 25.8% of the total, is the Transition Portfolio's holdings of other provincial governments' bonds.

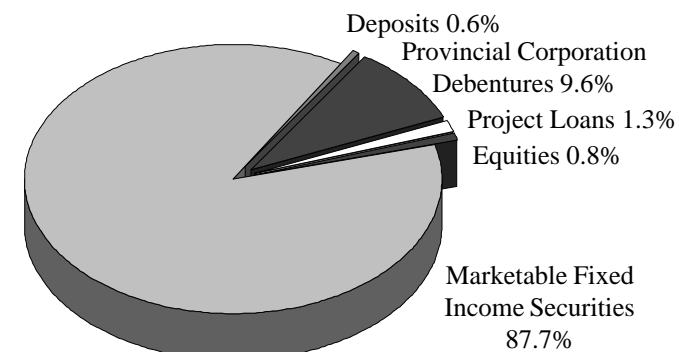
Project loans have been substantially reduced. The Murphy Oil debenture has been repaid and the Alpac loans sold. As a result, on a cost basis the value of project loans is now \$107.8 million or 1.3% of the Transition Portfolio. These loans are Ridley Grain Ltd. (\$93.5 million) and Vencap Acquisition Corporation (\$14.3 million).

Transition Portfolio Investment Breakdown

(% of cost)

at March 31, 1999

Total: \$8,053.0 million

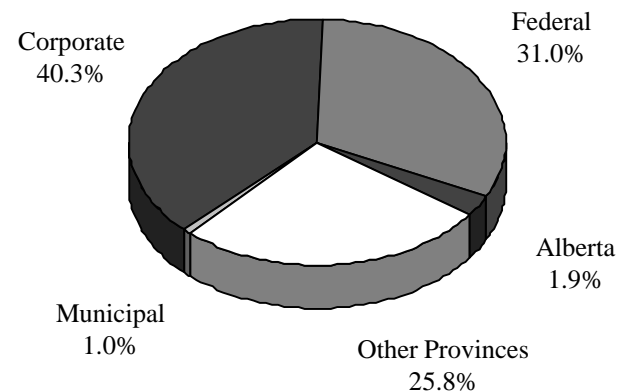


Marketable Fixed Income Securities Breakdown

(% of fair value)

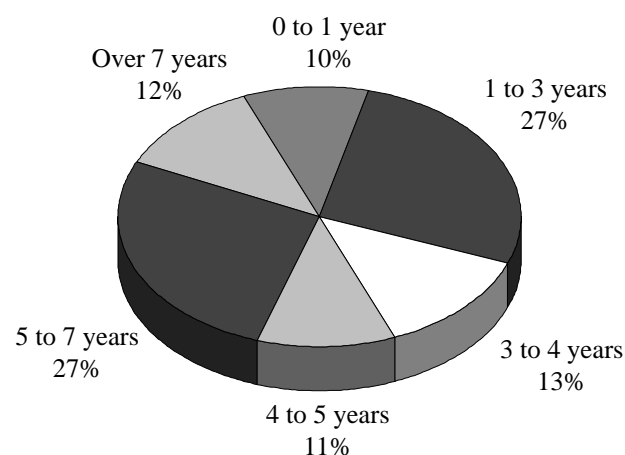
at March 31, 1999

Total: \$7,178.2 million



Term Structure of Fixed Income Securities*

as at March 31, 1999 (Par Value)



Market Return

	Last 3 months*	Last 6 months*	1 year
Transition	0.7	2.4	5.4
Liability Portfolio	1.0	2.7	5.9

* Returns are not annualized.

In addition, \$427.5 million of Provincial corporation debentures were repaid or redeemed. The Fund's investment in provincial corporation debentures was reduced from \$1,199.3 million at the beginning of the year to \$771.8 million at March 31, 1999.

Performance

For the current fiscal year 1998-99, the one year market return for the Transition Portfolio was 5.4% with a modified duration of 2.79 years. The benchmark cost of borrowing was 5.9% during that same period with a modified duration of 2.81 years. The Transition Portfolio underperformed the Liability Portfolio due to:

- the equity holdings in the Transition Portfolio which had a negative effect of 24 basis points on return;
- the return on cash, required to be transferred to the Endowment Portfolio detracted from performance;
- a significant portion of the Transition Portfolio, which is in Government of Canada bonds for liquidity purposes, returned less than the Alberta benchmark;
- until the Alpac loan was disposed of in May 1998, this investment did not earn any income; and
- a timing difference in the pricing of the Transition Portfolio relative to the benchmark as the source of pricing is different.

When the Transition Portfolio and the Endowment Portfolio are combined over a two year period, the Fund, as a whole, returned 7.5% (annualized) versus the Liability Portfolio return of 6.8% (annualized).

The book value return of the Transition Portfolio for the 1998-99 fiscal year was 7.9% compared to a debt book value cost of 6.3%. The book value return on the Transition Portfolio is higher than the book value cost of the Liability Portfolio due to the lower cost of borrowing in the Liability Portfolio and recognition of realized gains on the sale of securities in the Transition Portfolio.

Investment Income

During the year, the Transition Portfolio generated investment income totalling \$663.1 million. Approximately \$70.8 million was accounted for by realized capital gains and \$592.3 million was due to interest, dividend and other income.

Endowment Portfolio

Introduction

The Endowment Portfolio was established on January 1, 1997 with a transfer from the “old” Heritage Fund of \$1.2 billion of investments (at cost). This included equity holdings previously held in the former Commercial Investment Division and a mix of short term and mid term fixed income securities. Since the initial \$1.2 billion funding, the Endowment Portfolio has received \$100 million a month from the Transition Portfolio. The Endowment Portfolio has increased in market value to \$4,334.3 million reflecting both transfers from the Transition Portfolio and market appreciation. The Endowment Portfolio has undergone considerable change as the initial assets and subsequent cash flow has been invested to meet the policy objectives.

Investment Objective

The investment objective of the Endowment Portfolio is to optimize 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 optimize 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 offset 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%.

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. A four year measurement period is used to focus management attention on the longer term. It is expected that over a four year period, management would add 0.5% in return over and above what would have been generated by the benchmark portfolio asset mix.

Benchmark Measurement Index

Scotia Capital Markets 91 day T-Bills Index (SCM 91 Day T-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 Bond 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 Index (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.

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 of investment grade (a minimum of a "BBB" credit rating or equivalent)
- 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. The asset allocation policy has evolved over the last three years and is focussed on a long run benchmark asset mix of 40% fixed income / 60% equities. The emphasis is on optimizing long term returns associated with equities relative to current income associated with fixed income.

Asset Class Allocation

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

In order to manage the risk of increasing the equity exposure and further enhance the potential returns, the foreign equity target is 30% of the Portfolio's market value. The foreign equity exposure will increase the diversification of the fund across countries, industries and individual companies.

In addition, the Fund's exposure to enhanced growth opportunities would be increased and therefore the potential for higher long run returns.

It is expected that an additional 0.5% return will be added through the management of the specific asset classes and the overall asset mix. To meet this objective, external managers are used in addition to the investments made by Alberta Treasury to take advantage of specialized knowledge and expertise. This has made it possible to invest in specific asset classes such as Canadian "small-cap" equities, U.S. equities, global equities and diversify investment strategies within the Canadian "large cap" equity component.

Asset Mix

On March 31, 1999, deposits and fixed income instruments accounted for 46.7% of total investments in the Endowment Portfolio and equity investments accounted for 49.4%. Taking the effect of equity swaps into account increases the equity exposure to 56.6%. Through the fiscal year, the Portfolio was gradually shifting towards the new asset mix policy of 60% equity and including 30% in foreign equity effective March 31, 1999. By the end of the fiscal year, the portfolio was at the target allocation for Canadian equities, 2% under in foreign equities and 1% under in real estate.

Endowment Portfolio's Ten Largest Equities by Country*

Fair Value at March 31, 1999
(millions)

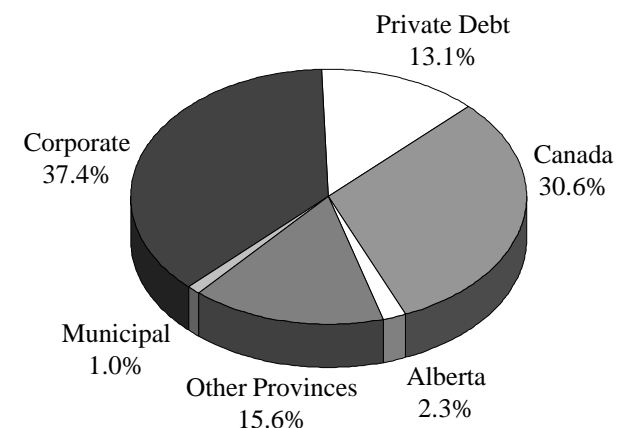
Total:	
United States	\$543
Japan	\$153
United Kingdom	\$100
France	\$74
Germany	\$68
Netherlands	\$49
Switzerland	\$43
Italy	\$29
Australia	\$27
Spain	\$19

* Includes the effect of derivatives.

Distribution of Endowment Portfolio's Marketable Fixed Income Holdings*

Fair Value as at March 31, 1999

Total: \$1,410.8 million



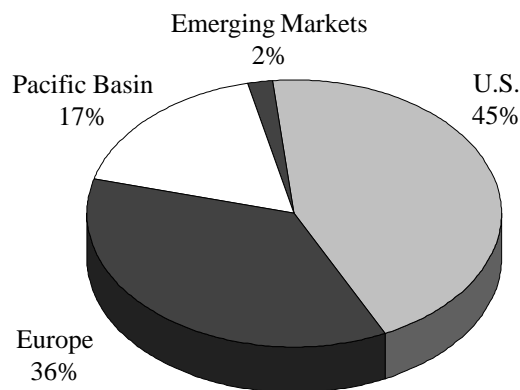
* Excludes short term deposits and the Floating Rate Note Pool.

Endowment Portfolio's Industry Exposure

	Canadian Equities	TSE 300
Communications & Media	8.70%	8.09%
Conglomerates	4.86%	3.25%
Consumer Products	5.07%	4.14%
Financial Services*	19.84%	21.15%
Gold & Precious Minerals	3.45%	4.25%
Industrial Products	18.89%	20.65%
Merchandising	5.35%	3.43%
Metals & Minerals	4.75%	3.64%
Oil & Gas	8.32%	8.87%
Paper & Forest Products	2.09%	2.32%
Pipelines	4.62%	3.07%
Real Estate	1.05%	1.79%
Transportation & Environmental Services	2.27%	2.28%
Utilities	10.74%	13.07%
Total	100.0%	100.0%

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

Endowment Portfolio's Distribution of Foreign Equity



Endowment Portfolio Breakdown of Investments

as at March 31, 1999

(millions)

	1999			1998		
	Cost	Fair Value	%	Cost	Fair Value	%
Deposits	\$ 122.5	\$ 122.5	2.8	\$ 127.3	\$ 127.3	3.9
Fixed Income Securities						
Public Fixed Income Securities	1,459.3	1,445.6	33.4	1,193.6	1,198.5	36.8
Floating Rate Note Pool*	39.9	40.8	1.0	—	—	—
Private Mortgage Pool	275.2	274.3	6.3	141.6	142.0	4.3
Private Debt Pool	—	—	—	134.6	135.3	4.1
Total Deposits and Fixed Income Securities	1,896.9	1,883.2	43.5	1,597.1	1,603.1	49.1
Equities						
Canadian Equities	701.8	1,075.8	24.8	503.5	957.3	29.3
U.S. Equities	317.2	343.7	7.9	136.9	153.1	4.7
Global Equities	828.8	861.5	19.9	492.2	512.0	15.7
Real Estate	161.7	170.1	3.9	34.9	39.2	1.2
Total Equities	2,009.5	2,451.1	56.5	1,167.5	1,661.6	50.9
Total	\$3,906.4	\$4,334.3	100.0	\$2,764.6	\$3,264.7	100.0

* The Floating Rate Note Pool is used to support the Canadian equity swaps issued by the Portfolio. Without the effect of the swaps, the 1999 asset mix would be 46.7% total deposits and fixed income Securities, 21.6% Canadian equities, and 53.3% total equities and real estate. Without the effect of the swaps, the 1998 asset mix would be 53.9% of total deposits and fixed income securities, 24.5% Canadian equities and 46.1% total equities and real estate. For more information, see note (m) of Schedule 1.

The Endowment Portfolio's holdings of Canadian equities is diversified across all sectors of the TSE 300. Of the Endowment Portfolio's foreign equity holdings, 45% are invested in the U.S., 36% are in Europe, 17% are in the Pacific Basin and only 2% are invested in Emerging Markets.

Investment Performance

Endowment Portfolio Performance

Period ending March 31, 1999

	Actual Fund Return					Benchmark					
	Weightings		Market Return			Index Weight	Market Return				
	March 31, 1999	3 Months	6 Months	9 Months	1 Year		3 Months	6 Months	9 Months	1 Year	
Short term fixed income	3.3%	1.3%	2.6%	3.8%	5.0%	SCM 91 Day T-Bills Index	3.0%	1.2%	2.5%	3.8%	4.9%
Long term fixed income	39.7%	0.6%	2.5%	5.3%	6.8%	SCM Universe Bond Index	42.0%	0.8%	2.7%	5.3%	7.0%
Canadian Equities	25.3%	1.8%	16.2%	-8.2%	-9.2%	TSE 300 Index	30.0%	2.1%	18.5%	-9.3%	-11.3%
Foreign Equities	27.8%	4.3%	25.2%	11.4%	16.1%	MSCI World Index (excluding Canada)	20.0%	2.0%	24.4%	14.0%	20.5%
Real Estate	3.9%	1.5%	11.7%	12.8%	13.4%	Frank Russell Commercial Property Index	5.0%	3.3%	9.0%	12.5%	15.8%
Total Portfolio	100.0%	2.0%	11.4%	3.3%	4.7%	Total Portfolio	100.0%	1.6%	11.9%	3.3%	4.7%

The one year performance of the Endowment Portfolio was in line with the policy benchmark return of 4.7%. The absolute performance of the Portfolio was negatively impacted by the sharp correction in the equity markets in the second quarter of the fiscal year. The Portfolio did very well in terms of asset allocation. The Endowment Portfolio was overweight in foreign equities, which was the best performing asset class. The Portfolio was also underweight in Canadian equities which was the lowest performing asset class.

In terms of returns within the asset categories, the Canadian equity component outperformed its market benchmark by 210 basis points. The outperformance was due to the large cap focus of the Portfolio.

Despite its high absolute returns, the foreign equity component underperformed expectations. The under performance can be attributed first to the strength and narrowness of the US and European equity markets. Both markets were driven by a relatively small number of large cap stocks which made it very difficult for active managers to outperform the benchmark. The under performance can also be attributed to the under exposure of the Portfolio to foreign currencies.

A significant portion of the Portfolio is currently invested through swap contracts. These are entirely hedged back into Canadian dollars. The benchmark assumes that investment is made in local currencies and therefore the return will include both market and currency returns. The decline in the Canadian dollar relative to most world currencies in 1998 added to the benchmark's return and resulted in the Portfolio under performing. This was partially reversed in the first quarter of 1999 as the Canadian dollar rallied. As the Canadian dollar continues to strengthen, the under performance due to currency will correct.

On a relative basis the Endowment Portfolio did substantially better than other institutional funds. SEI, an asset management consulting firm, surveys the returns of institutional funds on a quarterly basis. Based on SEI's survey, the middle ranked or median fund earned 1.3% over the one year period ending March 31, 1999. This would have put the Portfolio into the top 25% of fund managers.

Investment Income

The Endowment Portfolio earned \$270.5 million in the last year. \$83.6 million was realized capital gains and \$186.9 million was interest, dividend and other income.

Profile of Individual Asset Classes

Short-term Investments

The return over the course of the year, as measured by the ScotiaCapital Markets 91-day T-bill Index, was 4.9%, while the fund's short term return was 5.0%. Short term investments are used to temporarily invest funds that have been raised through the sale of investments and will be re-allocated to other investments. Liquidity is important and the focus is on high quality marketable securities. The average term to maturity will not exceed 180 days. At least 40% of the short term portfolio is in government (Federal and provincial) and government guaranteed securities.

Long-term Fixed Income Investments

Total return for the fund's long term fixed income component was 6.8%, slightly below the benchmark of 7.0%. The Portfolio is invested across a wide range of fixed income products including publicly traded bonds, mortgages and privately issued debt. The publicly traded bonds and private debt component returned 7.5% for the year and mortgages returned 6.5%. The under performance occurred early in the year when the Portfolio still held a number of shorter term bonds as a result of

the initial transfer from the Transition Portfolio and therefore had a shorter duration than the benchmark.

A portion of the publicly traded pool is managed on an index basis and is invested using swaps. The remainder is actively managed on a risk controlled basis through adjusting the duration and sector weightings.

Canadian Equity

The Canadian equity market returned minus 11.3% for the year ending March 31, 1999 as measured by the TSE 300 on a total return basis. The Fund's combined Canadian equity component returned minus 9.2% over the same period. The strong relative performance can be attributed to the heavy weighting to large capitalized companies in the portfolio which performed better than the broad market in 1989-99.

It is unlikely that large capitalized companies will, over the longer term, consistently out perform the market. To reduce the exposure to large capitalized companies, an investment in small capitalized companies has been established. In addition, as it grows, the Endowment Portfolio will become more diversified in terms of strategy, manager, style and capitalization.

Foreign Equity

Returns in non-Canadian equity markets varied for the year ending March 31, 1999. The US market as measured by the S&P 500 index returned 25.7% in Canadian dollars. Europe performed well in absolute terms returning 11.3% based on the Morgan Stanley European index. The Pacific region earned 17.4% in Canadian dollars while Emerging Markets had a minus 15.9% return.

The foreign equity component was the most significant area of under performance. The Portfolio returned 16.1% for the year but the benchmark returned 20.5%. Under performance can be attributed to three areas. First, the US market has been relatively narrow with a small number of large capitalized companies contributing most of the performance and a difficult market for active managers to out-perform. This was particularly evident in the US component of our global managers (which included US investments). We have recently rationalized our manager structure to eliminate global mandates and now manage the US and international components on separate mandates. This will allow for tighter risk control relative to the performance benchmark. The second was our Canadian dollar swap exposure. Currently, nearly a half of the foreign equity

exposure is through swaps with approximately two thirds on a hedged basis. The dollar declined dramatically against most world currencies during the first part of the year and only started to recover as we moved into 1999. We continue to view the Canadian dollar as under valued and have seen a dramatic pick-up in performance as the dollar began to recover. The third was our underweighting in the US market. The US market has consistently appeared to be the most over valued market over the last two years and we continue to underweight that market relative to the MSCI world index.

The foreign equity exposure is broadly diversified across all markets. Relative to the policy benchmark (equally weighted between the US and Europe and the Far East), the fund has an underweight in the US offset by overweights in Europe, the Far East and emerging markets.

Real Estate

This was the second strong year in a row for real estate. The Frank Russell Commercial Property Index returned 15.8% while the Portfolio's real estate return was 13.4%. The under performance was attributable to difference in calculation between the benchmark and the Portfolio's return. The benchmark is calculated on a gross basis and excludes capital expenditure and transaction costs. The Portfolio return is calculated on a net basis and includes all costs. In addition, the Portfolio is valued annually (as at December 31) while the Frank Russell Commercial Property Index reflects new valuations quarterly. If compared on a calendar year basis and if the Portfolio is calculated on the same basis as the index, the return would have been 16.4% versus 16.1% for the benchmark.

The real estate property is invested in a diversified portfolio which includes office buildings, industrial properties and retail (shopping malls). The portfolio invests only in major Canadian urban markets.

Administrative Expenses

Administrative expenses include investment management, cash management, custodial and other expenses. External management and custodial fees are deducted directly from the income of the externally managed pooled funds. Internal administrative expenses are deducted from the internally managed pooled funds and directly from the Endowment Portfolio and the Transition Portfolio.

In previous years, only administrative expenses directly charged to the Fund were reported. In the 1998-99 year the administrative expenses charged directly to the Fund were \$1.6 million (\$0.5 million in the Endowment Portfolio and \$1.1 million in the Transition Portfolio) compared to \$2.0 million in the 1997-98 year (\$0.3 million in the Endowment Portfolio and \$1.7 million in the Transition Portfolio).

The Fund's total administrative expenses for the year ending 1998-99, including amounts deducted directly from the investment income of the pooled funds, amounted to \$5.0 million compared to \$3.5 million in the 1997-98 year.

Administrative Expenses Breakdown

for the year ended March 31, 1999

(millions)

	<u>1999</u>	<u>1998</u>
Endowment Portfolio		
direct	\$ 0.5	\$ 0.3
externally managed pools	2.9	1.4
internally managed pools	<u>0.5</u>	<u>0.1</u>
	<u>3.9</u>	<u>1.8</u>
Transition Portfolio		
direct	<u>1.1</u>	<u>1.7</u>
	<u>\$ 5.0</u>	<u>\$ 3.5</u>

The reason for the increase is the transfer of at least \$1.2 billion each year from the Transition Portfolio to the Endowment Portfolio. The Endowment Portfolio is more expensive to administer because it is predominantly invested in equities, a large portion of which are foreign equities which are externally managed.

Economic Climate

The investment performance of the Heritage Fund is closely linked with economic conditions both in Canada and abroad. Two themes dominated 1998. The first was the crisis in the Far East resulting in devaluation of the region's currencies and downward pressure on commodity prices and the second was the continued strength of the US economy.

The Canadian economy performed well during 1998. Real Gross Domestic Product (GDP) expanded at a rate of 3.0% versus 3.8% in 1997. Real consumption increased by 2.7% while the net exports increased by 8.1% and investment spending rose by 4.1%. The growth in 1998 saw a continued improvement in employment (the unemployment rate declined to 8.4% from 9.2% in 1997 and dropped to 7.8% in the first quarter of 1999) and contained inflation.

A major risk to the Canadian outlook is the US economy. With a significant portion of the growth in 1998 accounted for by exports, a key concern is the continued strength of the US economy. Thus far, the US economy has maintained its momentum. For 1998, US real GDP expanded at a 3.9% rate with a significant portion of the growth coming in the fourth quarter of 1998. The consumer was an important source of strength, with real consumption up 4.8% for the year. Investment spending was also strong, increasing 10.4% for the year. The strength of the US economy continues to be impressive, especially the momentum in the second half of the year. This appears to have continued into 1999, with strong employment growth (the US unemployment rate declined to 4.2% in the first quarter of 1999 versus 4.7% at the beginning of 1998). Inflation remains contained within the 1%-2% range.

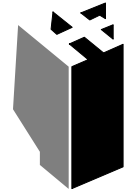
Globally, the economic results for 1998 were mixed with some areas such as the Far East experiencing recession and Europe steady but more subdued growth than in North America. Weakness in the Far East region had a deflationary impact on commodity prices and inflation in general. A number of countries have implemented significant reforms and the prospects are improving in this region. A key issue for the global economic growth in 1999 is whether a possible slowdown in growth in the US will be offset by a pick-up in growth in the Far East.

While the recession in the Far East economies put downward pressure on inflation, the impact on commodity prices hurt many developing countries and also had an impact on countries closely linked to commodities. Canada was among those countries and the Canadian dollar experienced broadly based pressure. Against the US dollar, the Canadian dollar started the year at \$0.71 and then declined throughout the year to finish at \$0.65. Although the Canadian dollar appears cheap in terms of relative purchasing power, an improvement will be closely tied to an improvement in commodity prices. During the first quarter of 1999, the price of oil stabilized as did several other commodities. Further improvement will be tied to a broadly based rise in global economic growth.

Short term interest rates in Canada rose slightly in 1998 with the 3-month Government of Canada Treasury bill yield increasing from 4.0% to 4.7%. Long term rates, on the other hand, declined from 5.6% to 4.9%. Early in the year, Canadian long bond yields were lower than the US although by the end of the year US bond yields had fallen to below Canadian yields. The economic instability was reflected in wider credit spreads.

It was a volatile year in capital markets. Short term investments returned 4.7% based on the ScotiaCapital Markets 91-day Treasury Bill Index. Bond returns were 9.2% based on the ScotiaCapital Markets Universe Bond Index reflecting the drop in yields which results in an increase in bond prices. Canadian equities, as measured by the TSE 300 Index, returned -1.6%. International equity markets fared better, the US equity markets as measured by the Standard and Poors 500 Index, was up 37.7% in Canadian dollars while Europe was up 38% and the Pacific Basin returned 10%. The stronger relative performance of foreign equity markets reflects in part the widespread decline in the Canadian dollar and commodity exposure of the Canadian equity market.

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 Income

Investment income is income from realized capital gains, interest, dividends, security lending and swaps.

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 R E P O R T O N I N V E S T M E N T R E T U R N S



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, 1999. 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, 1999 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 26, 1999

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

for the year ended March 31, 1999

	1999	1998
Transition Portfolio		
Short term fixed income	5.4	4.0
Long term fixed income	5.7	8.3
Policy loans (Note 2)	6.8	4.3
Equities	-24.0	—
Total return	5.4	6.6
Endowment Portfolio		
Short term fixed income	5.0	3.8
Long term fixed income	6.8	10.7
Real estate	13.4	21.7
Canadian equities	-9.2	40.6
Foreign equities	16.1	29.8
Total return	4.7	21.4

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

for the year ended March 31, 1999

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 monthly valuations.

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 are based on cost values.

Note 3 Uncertainty Due to the Year 2000

The year 2000 issue is the result of some computer systems using two digits rather than four to define the applicable year. Government computer systems 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. Despite the government's efforts to address this issue, it is not possible to be certain that all aspects of the year 2000 problem affecting the Fund, including those related to the efforts of customers, suppliers and other third parties, will be fully resolved.

Note 4 Management Approval

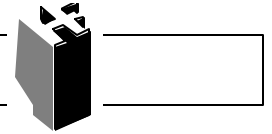
The Statement of Investment Returns of the Transition Portfolio and the Endowment Portfolio has been approved by management.

FINANCIAL STATEMENTS



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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, 1999 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, 1999 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 21, 1999

FINANCIAL STATEMENTS



BALANCE SHEET

March 31, 1999 (thousands)

	1999	1998
Assets:		
Portfolio investments:		
Endowment portfolio (Schedule 1)	\$ 3,906,359	\$ 2,764,586
Transition portfolio (Schedule 2)	8,053,014	9,369,888
Accrued interest and accounts receivable	138,153	174,792
	<u>\$ 12,097,526</u>	<u>\$ 12,309,266</u>
Liabilities and fund equity:		
Liabilities:		
Accounts payable	\$ 3,195	\$ 84,601
Due to the General Revenue Fund	68,012	198,346
	<u>71,207</u>	<u>282,947</u>
Fund equity (Note 5)		
Endowment portfolio	3,818,649	2,613,202
Transition portfolio	8,207,670	9,413,117
	<u>12,026,319</u>	<u>12,026,319</u>
	<u>\$ 12,097,526</u>	<u>\$ 12,309,266</u>

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



FINANCIAL STATEMENTS

STATEMENT OF OPERATIONS for the year ended March 31, 1999 (thousands)

	1999		1998
	Budget	Actual	Actual
Income:			
Investment income			
Endowment portfolio	\$ 189,000	\$ 270,545	\$ 293,898
Transition portfolio	614,400	663,117	769,585
	<u>803,400</u>	<u>933,662</u>	<u>1,063,483</u>
Expenses:			
Administrative expenses (Note 7)	2,200	1,651	1,956
Provision for loan impairment in the Transition portfolio	—	—	114,219
	<u>2,200</u>	<u>1,651</u>	<u>116,175</u>
Net income (Note 6)	801,200	932,011	947,308
Transfers:			
Transfers to the General Revenue Fund	716,200	932,011	922,347
Amounts retained (Note 5)	85,000	—	24,961
Net increase in fund equity	\$ 85,000	—	24,961
Fund equity at beginning of year		12,026,319	12,001,358
Fund equity at end of year		\$ 12,026,319	\$ 12,026,319

FINANCIAL STATEMENTS



STATEMENT OF CHANGES IN FINANCIAL POSITION For the year ended March 31, 1999 (thousands)

	1999	1998
<i>Operating transactions:</i>		
Net income	\$ 932,011	\$ 947,308
Non-cash items included in net income	(82,755)	20,595
	<u>849,256</u>	<u>967,903</u>
Decrease in receivables	36,639	83,150
Increase (decrease) in payables	(81,406)	49,561
	<u>804,489</u>	<u>1,100,614</u>
<i>Investing transactions:</i>		
Proceeds from disposals, repayments and redemptions of investments	7,817,615	13,520,333
Purchase of investments	(7,603,587)	(13,777,554)
	<u>214,028</u>	<u>(257,221)</u>
<i>Transfers:</i>		
Transfers to the General Revenue Fund	(932,011)	(922,347)
Increase (decrease) in Due to the General Revenue Fund	(130,334)	150,898
	<u>(1,062,345)</u>	<u>(771,449)</u>
<i>Increase (decrease) in cash and cash equivalents</i>	(43,828)	71,944
<i>Cash and cash equivalents at beginning of year</i>	211,342	139,398
	<u>\$ 167,514</u>	<u>\$ 211,342</u>
<i>Consisting of Deposits in the Consolidated Cash Investment Trust Fund:</i>		
Endowment Portfolio (Schedule 1)	\$ 122,504	\$ 132,730
Transition Portfolio (Schedule 2)	45,010	78,612
	<u>\$ 167,514</u>	<u>\$ 211,342</u>

FINANCIAL STATEMENTS



NOTES TO THE FINANCIAL STATEMENTS

March 31, 1999

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 accounting policies of significance to the Fund are as follows:

(a) Portfolio investments

Fixed income securities, mortgages, equities and real estate investments held 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) Private fixed income securities, mortgages, 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 value 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 values of investments and any other assets and liabilities denominated in a foreign currency are translated at the year-end exchange rate.

FINANCIAL STATEMENTS



Note 3 Investment 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 an optimal financial return at an acceptable level of risk, the 1998-99 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. Controls are in place respecting the use of derivatives (see Note 4). 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, Foreign Exchange and Futures 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, 1999:

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	1999	1998
	(thousands)	
Index swaps:		
Bonds (Canadian Dollar Public Debt Pool)	\$ 250,319	\$ 153,783
Canadian equities, directly held	142,069	159,924
Foreign equities (Global Structured Equity Pooled Fund)	292,227	163,946
United States equities (US Passive Equity Pooled Fund)	168,296	59,523
Interest rate swaps:		
Directly held	134,614	65,000
Canadian Dollar Public Debt Pool	179,896	76,977
Global Structured Equity Pooled Fund	208,107	94,047
Floating Rate Note Pool	138,048	108,365
US Passive Equity Pooled Fund	15,247	—
Total	<u>\$ 1,528,823</u>	<u>\$ 881,565</u>

The fair value of swaps have been included in the determination of the fair value 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, 1999, the Fund's proportionate share of outstanding forward foreign exchange contracts issued by the External Managers Fund amounted to \$145,486,000 (1998: \$67,768,000).

A stock index futures contract is an agreement to take or make delivery of an amount of cash reflecting the difference between changes in the level of the specified stock index. As at March 31, 1999, the Fund's proportionate share of the notional value of stock index futures contracts issued by the External Managers Fund amounted to \$5,062,000 (1998: nil).

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. In 1998-99 the Lieutenant Governor in Council approved this transfer of assets with a book value of not less than \$1.2 billion.

Annually, a portion of net income of the Fund was 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. Section 11(1) of the *Alberta Heritage Savings Trust Fund Act* (the Act) required that, until the completion of the 1998-99 fiscal year, the Fund would 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. On March 23, 1999 the *Fiscal Responsibility Act* received Royal Assent and Section 11(1) of the Act was repealed. Section 11(5) was added to the Act and states that for fiscal years subsequent to 1999 and until the accumulated debt is eliminated, the Provincial Treasurer is not required to retain amounts for inflation proofing in the Fund, but may retain such amounts as the Provincial Treasurer considers advisable. In 1998-99, no portion of the net income of the Fund was retained in the Endowment Portfolio.

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Note 6 Net Income

	Endowment Portfolio	Transition Portfolio	Total 1999	Total 1998
	<i>(thousands)</i>			
Deposit and fixed income securities:				
Deposits in the Consolidated Cash Investment Trust Fund	\$ 5,763	\$ 3,168	\$ 8,931	\$ 7,565
Public fixed income securities, directly held:				
Government of Canada, direct and guaranteed	5,764	163,086	168,850	273,479
Alberta, direct and guaranteed	1,120	11,524	12,644	15,998
Other provincial, direct and guaranteed	7,156	166,389	173,545	186,606
Municipal	—	4,336	4,336	2,696
Corporate	824	179,918	180,742	146,533
Security lending	24	373	397	431
Provincial corporations debentures	—	103,388	103,388	160,322
Canadian Dollar Public Debt Pool	87,826	—	87,826	67,112
Floating Rate Note Pool	8,318	—	8,318	3,320
Private Mortgage Pool	16,406	—	16,406	7,820
Private Debt Pool	4,707	—	4,707	1,889
	137,908	632,182	770,090	873,771
Equities:				
Public Canadian equities, directly held	22,258	30,935	53,193	75,164
Canadian Pooled Equity Fund	598	—	598	—
External Managers Fund (Canadian)	3,335	—	3,335	2,518
Private Equity Pool	808	—	808	1,847
Private Equity Pool (98)	(14)	—	(14)	—
External Managers Fund (Global)	44,474	—	44,474	14,084
Global Structured Equity Pooled Fund	36,382	—	36,382	34,205
United States Pooled Equity Fund	831	—	831	4,375
US Passive Equity Pooled Fund	28,038	—	28,038	658
External Managers Fund (United States)	16,051	—	16,051	5,000
Security lending	82	—	82	44
Swaps, direct	(24,584)	—	(24,584)	50,924
Private Real Estate Pool	4,378	—	4,378	893
	132,637	30,935	163,572	189,712
Investment income	270,545	663,117	933,662	1,063,483
Administrative expenses (Note 7)	(502)	(1,149)	(1,651)	(1,956)
Provision for loan impairment	—	—	—	(114,219)
Net Income	\$ 270,043	\$ 661,968	\$ 932,011	\$ 947,308

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Note 6 Net Income (continued)

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

Investment income from the Endowment portfolio and the Transition portfolio includes net gains from disposal of investments totalling \$83,614,000 (1998: \$101,081,000) and \$70,774,000 (1998: \$91,427,000) respectively.

Note 7 Administrative Expenses

Administrative expenses include 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 (Canadian, Global and United States). During the year, the Fund's share of administrative expenses deducted directly from investment income of externally and internally managed pooled funds (see Note 6) amounted to \$2,896,000 and \$493,000 respectively (1998: \$1,381,000 and \$161,000).

Total administrative expense during the year, including amounts deducted directly from investment income of pooled funds amounted to \$5,040,000 (1998: \$3,498,000) or approximately 4 basis points on rate of return (1998: 3 basis points).

Note 8 Uncertainty Due to the Year 2000

The year 2000 issue is the result of some computer systems using two digits rather than four to define the applicable year. Government computer systems 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. 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 1998 figures have been reclassified to conform to 1999 presentation.

Note 10 Approval of Financial Statements

These financial statements were approved by management.

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SCHEDULE OF ENDOWMENT PORTFOLIO INVESTMENTS

March 31, 1999 (thousands)

SCHEDULE 1

	1999			1998		
	Cost	Fair Value	%	Cost	Fair Value	%
Deposit in the Consolidated Cash Investment Trust Fund (a) \$	122,504	\$ 122,504	2.8	\$ 132,730	\$ 132,730	4.1
Fixed Income securities:						
Public, directly held (b)						
Government of Canada, direct and guaranteed	63,772	65,439	1.5	170,738	172,125	5.3
Provincial:						
Alberta, direct	—	—	—	35,907	36,890	1.1
Other, direct and guaranteed	44,830	46,059	1.1	97,850	102,060	3.1
Corporate	—	—	—	40,966	41,773	1.3
Canadian Dollar Public Debt Pool (c)	1,350,689	1,334,164	30.8	848,113	845,622	25.9
Floating Rate Note Pool (d)	181,982	182,865	4.2	154,509	154,998	4.7
Private Mortgage Pool (e)	275,243	274,250	6.3	141,627	141,962	4.3
Private Debt Pool	—	—	—	134,587	135,338	4.1
Total deposit and fixed income securities (m)	2,039,020	2,025,281	46.7	1,757,027	1,763,498	53.9
Canadian equities:						
Public, directly held (f)	279,726	651,008	15.0	277,989	725,845	22.3
Canadian Pooled Equity Fund (g)	40,598	41,760	1.0	—	—	—
External Managers Fund (Canadian) (h)	210,681	215,144	5.0	46,846	52,664	1.6
Private Equity Pool (i)	14,177	11,273	0.3	18,614	18,356	0.6
Private Equity Pool (98) (i)	14,502	14,502	0.3	—	—	—
Total Canadian equities (m)	559,684	933,687	21.6	343,449	796,865	24.5
Foreign equities:						
External Managers Fund (Global) (h)	525,561	564,157	13.0	320,368	344,962	10.6
Global Structured Equity Pooled Fund (j)	303,261	297,346	6.9	171,879	167,020	5.1
US Passive Equity Pooled Fund (k)	170,381	170,466	3.9	60,823	63,073	1.9
External Managers Fund (United States) (h)	143,616	171,535	4.0	72,737	84,832	2.6
United States Pooled Equity Fund	3,139	1,675	—	3,373	5,224	0.2
Total foreign equities	1,145,958	1,205,179	27.8	629,180	665,111	20.4
Real estate (l)	161,697	170,146	3.9	34,930	39,234	1.2
Total equities and real estate (m)	1,867,339	2,309,012	53.3	1,007,559	1,501,210	46.1
Total investments (n)	\$ 3,906,359	\$ 4,334,293	100.0	\$ 2,764,586	\$ 3,264,708	100.0

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NOTES TO SCHEDULE 1

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, 1999, the Fund's percentage ownership, at market, in pooled investment funds is as follows:

	% Ownership	
	1999	1998
Canadian Dollar Public Debt Pool	16.4	12.1
Canadian Pooled Equity Fund	2.0	—
External Managers Fund	21.9	15.8
Floating Rate Note Pool	7.5	11.0
Global Structured Equity Pooled Fund	21.7	16.6
Private Debt Pool	—	17.3
Private Equity Pool	13.6	13.4
Private Equity Pool (98)	100.0	—
Private Mortgage Pool	27.1	17.9
Private Real Estate Pool	23.4	8.4
US Passive Equity Pool	26.9	13.3
United States Pooled Equity Fund	18.0	13.7

- (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 5.22% per annum based on market for securities maturing between one and twenty years (1998: 5.24%) and the following term structure based on par: 1 to 5 years - 47%; 5 to 10 years - 26%; 10 to 20 years - 27%. As at March 31, 1999, securities with a fair value of \$28,646,000 (1998: \$106,213,000) were loaned to certain borrowers. The loans were secured by marketable securities with a fair value of \$31,370,000 (1998: \$112,373,000). 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 Capital Markets 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. During the year, the pool received private fixed income securities from the Private Debt Pool and the Private Mortgage Pool. As at March 31, 1999, securities held by the Pool have an average effective yield of 5.51% per annum based on market (1998: 5.41%) and the following term structure based on par: under 1 year - 10%; 1 to 5 years - 37%; 5 to 10 years - 24%; 10 to 20 years - 21%; over 20 years - 8%.

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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, 1999:

	1999		1998	
	Cost	Fair Value	Cost	Fair Value
	<i>(thousands)</i>			
Deposit in the Consolidated Cash Investment Trust Fund	\$ 18,797	\$ 18,797	\$ 10,800	\$ 10,800
Public Fixed Income securities:				
Government of Canada, direct and guaranteed	364,229	366,823	286,770	291,346
Province of Alberta, direct and guaranteed	30,769	31,780	22,997	24,179
Other provinces, direct and guaranteed	168,520	174,009	137,271	140,556
Municipal	13,746	13,632	6,990	7,231
Corporate	544,561	527,995	375,401	363,626
Private Fixed Income securities				
Corporate	193,991	185,052	—	—
Total deposit and fixed income securities	1,334,613	1,318,088	840,229	837,738
Accounts receivable and accrued investment income	32,496	32,496	14,470	14,470
Accounts payable	(16,420)	(16,420)	(6,586)	(6,586)
	16,076	16,076	7,884	7,884
Total - Alberta Heritage Savings Trust Fund	\$ 1,350,689	\$ 1,334,164	\$ 848,113	\$ 845,622
Total Canadian Dollar Public Debt Pool	\$ 7,812,035	\$ 8,112,618	\$ 6,635,228	\$ 7,000,911

- (d) The Floating Rate Note Pool is managed with the objective of generating floating rate income needed for the swap obligations of the 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, 1999, mortgages held by the Pool have an average effective yield of 7.08% per annum based on market (1998: 7.37%) and the following term structure based on par: under 1 year - 9%; 1 to 5 years - 33%; 5 to 10 years - 42%; over 10 years - 16%.

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- (f) 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, 1999, equity securities with a fair value of \$99,820,000 (1998: \$58,298,000) were loaned to certain borrowers. The loans were secured by marketable securities with a fair value of \$109,310,000 (1998: \$61,679,000). During the term of the loans, the Fund retains the right to receive income on the securities loaned, in addition to the fees earned. The following is a summary of directly held Canadian public equities which are listed by industrial classifications used by the Toronto Stock Exchange:

	1999			1998		
	Cost	Fair Value	%	Cost	Fair Value	%
	<i>(thousands)</i>			<i>(thousands)</i>		
Communications and media	\$ 16,269	\$ 73,078	11	\$ 8,752	\$ 37,280	5
Conglomerates	14,472	44,367	7	14,472	55,348	8
Consumer products	5,176	26,722	4	13,800	51,357	7
Financial services	4,657	20,571	3	4,657	21,655	3
Gold and precious metals	21,334	28,987	4	21,334	37,338	5
Industrial products	49,351	135,254	21	52,797	155,264	22
Merchandising	11,543	39,900	6	12,262	41,164	6
Metals and minerals	31,479	43,202	7	33,217	57,068	8
Oil and gas	36,909	62,720	10	35,844	73,893	10
Paper and forest products	12,005	15,707	2	13,471	22,897	3
Pipelines	22,748	42,891	7	13,766	35,409	5
Real estate	2,667	7,873	1	2,667	9,487	1
Transportation and environmental services	14,027	16,602	3	14,027	30,814	4
Utilities	37,089	93,134	14	36,923	96,871	13
	<u>\$ 279,726</u>	<u>\$ 651,008</u>	<u>100</u>	<u>\$ 277,989</u>	<u>\$ 725,845</u>	<u>100</u>

- (g) The Canadian Pooled Equity Fund is managed with the objective of providing competitive returns comparable to the total return of the Toronto Stock Exchange 300 Index while maintaining maximum preservation of participants' capital. The portfolio is comprised of publicly traded equities in Canadian corporations. Risk is reduced by prudent security selection and sector rotation.

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- (h) The External Managers Fund is managed by external managers with expertise in global equity markets and Canadian small capitalized companies and large capitalized companies. The objective of the Fund is to provide investment returns higher than the total return of the applicable Morgan Stanley, Standard & 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, 1999:

	1999		1998	
	Cost	Fair Value	Cost	Fair Value
	<i>(thousands)</i>			
Foreign Public Equity Pools:				
Multi Region	\$ 206,656	\$ 218,518	\$ 140,157	\$ 154,058
Europe	204,448	201,303	105,040	122,046
Pacific Basin	104,299	132,253	75,171	68,858
Emerging Markets	10,158	12,083	—	—
	<u>525,561</u>	<u>564,157</u>	<u>320,368</u>	<u>344,962</u>
United States	<u>143,616</u>	<u>171,535</u>	<u>72,737</u>	<u>84,832</u>
Canadian				
Large capitalized companies	114,621	116,432	—	—
Small capitalized companies	96,060	98,712	46,846	52,664
	<u>210,681</u>	<u>215,144</u>	<u>46,846</u>	<u>52,664</u>
Total - Alberta Heritage Savings Trust Fund	<u>\$ 879,858</u>	<u>\$ 950,836</u>	<u>\$ 439,951</u>	<u>\$ 482,458</u>
Total - External Managers Fund	<u>\$ 3,537,968</u>	<u>\$ 4,338,781</u>	<u>\$ 2,399,553</u>	<u>\$ 3,043,960</u>

The following is a summary of assets and liabilities of the External Managers Fund as at March 31, 1999:

	1999	1998
	<i>(thousands)</i>	
Cash and short term securities	\$ 109,079	\$ 130,426
Investments - Public equities	3,438,393	2,270,812
- Fixed income securities	1,247	3,936
Accounts receivable and accrued investment income	27,890	27,357
Accounts payable	(38,641)	(32,978)
Total - External Managers Fund	<u>\$ 3,537,968</u>	<u>\$ 2,399,553</u>

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- (i) The Private Equity Pool and the Private Equity Pool (98) are 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 as at March 31, 1999, 90% (1998: 81%) of the Pool's underlying investments supporting the index swaps are held in units of the Floating Rate Note Pool (see Schedule 1 (d)).
- (k) 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 & Poor's 500 United States Equity Index. Futures, swaps and other structured investments may be used to enhance performance of the fund.
- (l) 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.
- (m) Deposits and Floating Rate Note Pool units are used as the underlying securities to support the index swaps issued by the Fund (See Note 4). If the effect of the swaps were reflected in this schedule, deposit and fixed income securities would be reduced by \$142,069,000 (1998: \$159,924,000) and Canadian equities increased by a corresponding amount. The resulting assets mix percentage would be 43.5% fixed income and 56.5% equities.
- (n) See Schedule 2, note (f).

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SCHEDULE OF TRANSITION PORTFOLIO INVESTMENTS

SCHEDULE 2

March 31, 1999 (thousands)

	1999			1998		
	Cost	Fair Value	%	Cost	Fair Value	%
Deposit in the Consolidated Cash Investment Trust Fund (a)	\$ 45,010	\$ 45,010	0.6	\$ 78,612	\$ 78,612	0.7
Fixed income securities:						
Public, directly held (b)						
Government of Canada, direct and guaranteed	2,189,957	2,222,780	27.4	2,401,344	2,463,997	26.7
Provincial:						
Alberta, direct and guaranteed	132,129	134,188	1.7	208,133	212,104	2.3
Other, direct and guaranteed	1,810,526	1,851,512	22.8	1,991,993	2,085,971	22.6
Municipal	71,888	75,165	0.9	61,704	64,671	0.7
Corporate	2,858,237	2,894,530	35.6	2,908,280	2,947,935	32.0
Total deposit and fixed income securities, public	7,107,747	7,223,185	89.0	7,650,066	7,853,290	85.0
Provincial corporation debentures (c):						
Agriculture Financial Services Corporation	401,212	426,483	5.2	576,900	617,717	6.7
Alberta Social Housing Corporation	230,558	326,252	4.0	476,444	587,703	6.5
Alberta Municipal Financing Corporation	140,000	149,317	1.8	140,000	158,631	1.7
Alberta Opportunity Company	—	—	—	5,977	6,081	0.1
Total Provincial corporation debentures	771,770	902,052	11.0	1,199,321	1,370,132	15.0
Total deposit, debentures and fixed income securities	7,879,517	\$ 8,125,237	100.0	8,849,387	\$ 9,223,422	100.0
Canadian equities:						
Public, directly held						
TransCanada Pipelines Limited	53,966	\$ 63,812		—	\$ —	
NOVA Chemical Ltd.	11,714	16,077		—	—	
NOVA Corporation of Alberta Ltd.	—	—		112,283	\$ 181,276	
Total Canadian equities	65,680	\$ 79,889		112,283	\$ 181,276	
Loans:						
Ridley Grain Ltd.						
11.303% due July 31, 2015 (d)	93,500			97,750		
Vencap Acquisition Corporation (e)						
due 2001 and 2046	14,317			12,498		
Murphy Oil Company Ltd.	—			37,970		
Alberta Pacific Pulp Mill Project	—			260,000		
Total loans	107,817			408,218		
Total investments (f)	\$ 8,053,014			\$ 9,369,888		

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NOTES TO SCHEDULE 2

- (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, 1999, fixed income securities held have an average effective yield of 4.91% per annum based on market value for securities maturing within a year (1998: 4.84%), and 5.30% per annum for securities maturing between 1 and 35 years (1998: 5.34%). As at March 31, 1999, the securities have the following term structure based on par: under 1 year - 10%; 1 to 5 years - 56%; 5 to 10 years - 33%; over 10 years - 1%. As at March 31, 1999, securities with a fair value of \$857,691,000 (1998: \$660,737,000) were loaned to certain borrowers. The loans were secured by marketable securities with a fair value of \$939,235,000 (1998: \$699,059,000). 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, 1999, Provincial corporation debentures have an average effective yield of 7.52% per annum based on market value (1998: 7.41%). The maturity profile based on expected repayments is as follows: under 1 year - \$259,216,000; 1 to 5 years - \$417,897,000; and over 5 years - \$94,657,000. 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. 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 \$350,725,000 (1998: \$496,815,000) were redeemed prior to maturity.

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

	1999	1998
	<i>(thousands)</i>	
Balance at beginning of year	\$ 1,199,321	\$ 1,798,037
Disposals, repayments and redemptions:		
Agriculture Financial Services Corporation	(175,688)	(158,751)
Alberta Social Housing Corporation	(245,886)	(427,201)
Alberta Opportunity Company	(5,977)	(12,764)
Balance at end of year	<u>\$ 771,770</u>	<u>\$ 1,199,321</u>

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.

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- (d) 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, 1999 the allowance for credit losses amounts to \$42,927,000 (1998: \$42,927,000).

Grain throughput volumes are the main determinant of profitability of the grain terminal and its ability to service its loan from the province, and therefore 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.

- (e) 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 on a straight line basis.

- (f) During the period, investments with a cost of \$1,205,447,000 (market \$1,207,196,000), including \$1,200,000,000 in deposits in the Consolidated Cash Investment Trust Fund and \$5,447,000 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 (Unaudited)

The following unaudited schedules present the ten largest investments in the pools where the Endowment Portfolio's holdings were greater than 5%, the ten largest Canadian Public Equity issues that are directly held by the Endowment Portfolio, and the ten largest issues that are directly held in the Transition Portfolio. The Floating Rate Note Pool is presented because approximately 90% of the Global Structured Equity Pooled Fund is invested in the Floating Rate Note Pool. For a detailed listing of all investments please call (780) 427-4414.

The following schedules present this detail:

CANADIAN DOLLAR PUBLIC DEBT POOL SCHEDULE OF TEN LARGEST ISSUES (BASED ON MARKET) AS AT MARCH 31, 1999 (UNAUDITED)

SCHEDULE 1

Security Name	Security Type	Coupon (%)	Maturity	Par Value	Book Value	Market Value
CANADIAN FIXED INCOME						
Toronto Dominion Centre	Bond	6.30%	28-Feb-08	340,000,000	\$ 339,959,969	\$ 341,355,771
Bay Wellington Tower	Bond	6.40%	8-Apr-13	300,000,000	295,716,630	298,895,925
Pacific Centre	Bond	6.19%	31-Jan-03	267,000,000	265,816,724	265,984,322
Government of Canada	Bond	5.50%	1-Jun-09	194,420,000	199,275,248	200,933,070
Province of Ontario	Bond	9.50%	12-Jan-07	122,000,000	143,861,021	191,127,640
Government of Canada	Bond	9.75%	1-Jun-21	118,744,000	160,182,640	185,478,128
Toronto Eaton Centre	Floating Rate Note	5.59%	31-Oct-01	129,375,000	129,375,000	132,454,125
Government of Canada	Bond	13.00%	1-May-01	102,860,000	104,971,172	118,957,590
Government of Canada	Bond	10.50%	1-Mar-01	106,046,000	112,917,451	116,650,600
Government of Canada	Bond	11.00%	1-Jun-09	78,655,000	92,806,911	114,993,610
Total Ten Largest Issues					\$ 1,844,882,766	\$ 1,966,830,781
Total Net Asset Value - Canadian Dollar Public Debt Pool					\$ 7,812,035,000	\$ 8,112,618,000
Total Net Asset Value - Alberta Heritage Savings Trust Fund - Endowment Portfolio Holdings					\$ 1,350,689,000	\$ 1,334,164,000

**CANADIAN PUBLIC EQUITIES, DIRECTLY HELD
SCHEDULE OF TEN LARGEST ISSUES (BASED ON MARKET)
AS AT MARCH 31, 1999 (UNAUDITED)**

SCHEDULE 2

Security Name	Number of Shares	Book Value	Market Value
CANADIAN PUBLIC EQUITIES, directly held			
Northern Telecom	597,600	\$ 5,622,208	\$ 56,174,400
BCE	822,498	17,595,229	54,901,742
Seagram	501,200	8,696,597	37,965,900
Bombardier	1,530,000	2,595,645	30,370,500
Thomson	633,529	3,655,462	26,766,600
TransCanada Pipelines	1,279,336	15,620,191	24,627,220
IMASCO	690,324	3,343,218	22,608,111
Canadian Pacific	675,309	10,209,554	19,719,023
Power Corporation of Canada	670,200	1,094,437	19,368,780
ALCAN Aluminum	468,178	7,181,936	18,188,715
Total Ten Largest Issues		\$ 75,614,477	\$ 310,690,991
Total Canadian Public Equities, directly held		\$ 279,726,000	\$ 651,008,000

EXTERNAL MANAGERS FUND (GLOBAL AND UNITED STATES)
SCHEDULE OF TEN LARGEST FOREIGN ISSUES (BASED ON MARKET)
AS AT MARCH 31, 1999 (UNAUDITED)

SCHEDULE 3

Security Name	Country	Number of Shares	Book Value	Market Value
Microsoft	United States	344,113	\$ 15,277,835	\$ 46,775,933
General Electric	United States	234,157	17,107,307	39,186,810
Cisco Systems	United States	222,888	12,913,571	36,942,655
Citigroup	United States	351,733	17,480,581	33,987,836
MCI Worldcom	United States	246,550	12,000,037	33,031,961
Novartis	Switzerland	12,558	27,144,444	30,816,784
Nippon Telegraph and Telephone	Japan	1,870	21,511,431	27,708,751
Telecom Italia	Italy	1,899,984	17,528,287	27,641,834
BP Amoco	United Kingdom	1,046,218	21,745,114	26,750,502
Home Depot	United States	278,222	8,800,003	26,200,544
Total Ten Largest Foreign Issues			<u>\$ 171,508,610</u>	<u>\$ 329,043,610</u>
Total Net Asset Value - External Managers Fund - Foreign Issues			<u>\$ 2,344,276,000</u>	<u>\$ 3,101,175,000</u>
Total Net Asset Value - Alberta Heritage Savings Trust Fund - Endowment Portfolio Holdings			<u>\$ 669,177,000</u>	<u>\$ 735,692,000</u>

GLOBAL STRUCTURED EQUITY POOLED FUND
DETAILED LIST OF INVESTMENTS
AS AT MARCH 31, 1999 (UNAUDITED)

SCHEDULE 4

Security Name	Security Type	Coupon (%)	Maturity	Par Value or Number of Shares	Book Value	Market Value
DEPOSIT IN THE CONSOLIDATED CASH INVESTMENT TRUST FUND					\$ 20,520,796	\$ 20,520,796
CANADIAN FIXED INCOME						
Floating Rate Note Pool (see Schedule 5)	Pool Units			107,058,456	1,233,451,141	1,239,911,553
GM Acceptance Canada	Note	5.450%	21-Jan-02	25,000,000	25,000,000	24,925,000
Canadian Imperial Bank of Commerce	Floating Rate Bond	5.303%	07-Mar-07	20,000,000	20,000,000	19,982,000
Toronto Eaton Centre	Floating Rate Note	5.590%	31-Oct-01	24,375,000	24,375,000	24,955,125
Total Deposit and Fixed Income Securities					1,323,346,937	1,330,294,474
Accrued income and accounts receivable					42,843,079	42,843,079
Total Net Asset Value - Global Structured Equity Pooled Fund(a)					\$ 1,366,190,016	\$ 1,373,137,553
Total Net Asset Value - Alberta Heritage Savings Trust Fund - Endowment Portfolio Holdings					\$ 303,261,000	\$ 297,346,000

(a) Investments support the foreign equity index swaps of the pool which provide exposure to global markets.

FLOATING RATE NOTE POOL
SCHEDULE OF TEN LARGEST ISSUES (BASED ON MARKET)
AS AT MARCH 31, 1999 (UNAUDITED)

SCHEDULE 5

Security Name	Security Type	Coupon (%)	Maturity	Par Value or Number of Shares	Book Value	Market Value
CANADIAN FIXED INCOME						
Canadian Imperial Bank of Commerce	Floating Rate Bond	5.250%	30-Oct-07	150,000,000	\$ 150,000,000	\$ 149,812,500
Ford Credit Canada	Floating Rate Bond	5.248%	12-May-03	126,000,000	125,666,201	125,080,200
Toronto Eaton Centre	Floating Rate Note	5.590%	31-Oct-01	99,375,000	99,375,000	101,740,125
Canadian Pacific Limited	Bond	10.500%	30-Apr-01	50,000,000	53,761,205	54,957,500
Associates Cap	Note	5.550%	15-Dec-03	50,000,000	50,000,000	50,104,500
Canadian Imperial Bank of Commerce	Floating Rate Note	5.342%	4-Mar-08	50,000,000	50,000,000	49,970,000
Canadian Imperial Bank of Commerce	Floating Rate Bond	5.303%	7-Mar-07	30,000,000	30,000,000	29,973,000
General Motors Acceptance Canada	Note	5.700%	12-Mar-01	25,000,000	25,984,458	25,087,500
General Motors Acceptance Canada	Note	5.350%	11-Jan-01	25,000,000	25,000,000	24,962,500
Total Ten Largest Issues					\$ 609,786,864	\$ 611,687,825
Total Net Asset Value - Floating Rate Note Pool					\$ 2,415,316,028	\$ 2,422,076,644
Total Net Asset Value - Global Structured Equity Pooled Fund Holdings					\$ 1,233,451,141	\$ 1,239,911,553
Total Net Asset Value - Alberta Heritage Savings Trust Fund - Endowment Portfolio Holdings					\$ 181,982,000	\$ 182,865,000

EXTERNAL MANAGERS FUND - CANADIAN
SCHEDULE OF TEN LARGEST CANADIAN ISSUES (BASED ON MARKET)
AS AT MARCH 31, 1999 (UNAUDITED)

SCHEDULE 6

Security Name	Number of Shares	Book Value	Market Value
BCE	742,600	\$ 40,228,685	\$ 49,568,550
Northern Telecom	407,800	26,539,128	38,333,200
Royal Bank Canada	519,200	38,499,842	36,733,400
Bank of Montreal	504,600	31,659,228	30,553,530
Toronto Dominion Bank	417,250	22,873,922	28,831,975
Bank of Nova Scotia	881,025	27,039,176	28,236,851
Canadian Imperial Bank of Commerce	560,200	18,852,350	21,623,720
Transcanada Pipelines	1,002,054	21,950,270	19,289,540
Imasco	561,000	16,539,727	18,372,750
Bombardier	719,500	13,107,641	14,282,075
Total Ten Largest Canadian Issues		<u>\$ 257,289,969</u>	<u>\$ 285,825,591</u>
Total Net Asset Value - External Managers Fund - Canadian Issues		<u>\$ 1,193,692,000</u>	<u>\$ 1,237,606,000</u>
Total Net Asset Value - Alberta Heritage Savings Trust Fund - Endowment Portfolio Holdings		<u>\$ 210,681,000</u>	<u>\$ 215,144,000</u>

PRIVATE MORTGAGE POOL
CANADIAN PRIVATE MORTGAGES
SCHEDULE OF TEN LARGEST ISSUES (BASED ON MARKET)
AS AT MARCH 31, 1999 (UNAUDITED)

SCHEDULE 7

Security Name	Location	Book Value(a)	Market Value(a)
Canada Place	Edmonton, Alberta		
Richmond Adelaide Centre	Toronto, Ontario		
The Atria	North York , Ontario		
Habour Centre Vancouver	Vancouver, British Columbia		
Selkirk Office Buildings	Victoria, British Columbia		
West Metro Centres	Etobicoke, Ontario		
320 Bay Street	Toronto, Ontario		
999 West Hastings	Vancouver, British Columbia		
Mississauga Executive Centre	Mississauga, Ontario		
Fitzpatrick Housing Co-operative	Richmond Hill, Ontario		
Total Net Asset Value - Private Mortgage Pool		\$ 965,091,000	\$ 1,011,902,000
Total Net Asset Value - Alberta Heritage Savings Trust Fund - Endowment Portfolio Holdings		\$ 275,243,000	\$ 274,250,000

(a) Book and market values have not been provided due to the confidentiality of the investments.

ALBERTA HERITAGE SAVINGS TRUST FUND - TRANSITION PORTFOLIO
SCHEDULE OF TEN LARGEST CANADIAN ISSUES (BASED ON MARKET)
AS AT MARCH 31, 1999 (UNAUDITED)

SCHEDULE 8

Security Name	Security Type	Coupon %	Maturity	Par Value	Book Value	Market Value
Hydro Quebec	Bond	11.00%	15-Oct-04	\$ 200,000,000	\$ 197,663,954	\$ 206,100,000
Province of British Columbia	Bond	10.75%	19-Feb-01	140,714,000	148,963,761	153,905,938
Government of Canada	Bond	7.75%	01-Sep-99	145,140,000	146,690,247	146,881,680
Province of Ontario	Coupon	—	05-Apr-01	150,000,000	135,242,639	134,812,500
Government of Canada	Coupon	—	01-Dec-04	166,600,000	122,134,777	124,950,000
Government of Canada	Bond	10.50%	01-Mar-01	112,000,000	119,226,429	123,200,000
Hydro Quebec	Bond	11.75%	15-Jul-05	110,000,000	110,000,000	119,130,000
Government of Canada	Bond	5.00%	01-Sep-04	113,866,000	112,560,175	113,979,866
Province of Ontario	Bond	9.75%	29-Oct-01	96,613,000	104,895,144	106,515,833
Government of Canada	Bond	11.75%	01-Feb-03	84,547,000	104,678,162	104,077,357
Total Ten Largest Issues					\$ 1,302,055,288	\$ 1,333,553,174
Total Net Asset Value - Transition Portfolio (a)					\$ 8,053,014,000	\$ 8,312,943,000

(a) Includes Policy Loans at cost.

Alberta Heritage Savings Trust Fund

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Alberta Heritage Savings Trust Fund Standing Committee

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Ms. Debby Carlson
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Investment Manager

Alberta Treasury

Auditor

Auditor General of Alberta