

# Petroleum Fund of Timor-Leste

## Quarterly Report

31 March 2010

### Inside This Report

- 1 Introduction
- 1 Executive Summary
- 2 Investment Mandate
- 3 Market Trend
- 4 Operational Management
- 4 Portfolio Performance
- 7 Management Costs
- 7 Transfer to State Budget
- 7 Portfolio Risk
- 8 Compliances
- 9 Summary Financial Statements

### INTRODUCTION

This report is produced in accordance with Article 13 of the Petroleum Fund Law which requires the central bank to report on the performance and activities of the Petroleum Fund of Timor-Leste, referred to in this report as the Fund unless the context suggests otherwise.

All monetary references in this report are to United States dollars as the official currency of Timor-Leste.

While every effort has been made to ensure accuracy, the information is based on management reports and has not been independently audited or reviewed and is subject to change, in which case the changes will be incorporated into subsequent reports.

### Executive Summary

The Petroleum Fund was formed by the enactment of the Petroleum Fund law promulgated on 3 August 2005. The law gives the Banking & Payments Authority (BPA) of Timor-Leste the responsibility for the operational management of the Fund.

This report covers the period from 1 January to 31 March 2010.

Key statistics for the quarter include:

- The capital of the Fund grew from \$5,376.63 million to \$ 5,787.18 million
- Gross cash inflows to the fund from royalties, taxes and other receipt were \$468.34 million.
- Cash outflows were \$100.51million in which \$100 million for transfers to State Budget while \$0.51 million for direct external and internal management costs.
- Net cash inflows during the period was \$367.83 million
- The portfolio return in the period was 0.79% compared with the benchmark return for the quarter of 0.75%.

The returns by quarter, one year, FYTD, three years and since inception of the Fund up to 31 March 2010 as follows.

| Currency \$USD    | (%)         |             |              |              |              |
|-------------------|-------------|-------------|--------------|--------------|--------------|
|                   | QTR         | FYTD        | 1 Year       | 3 Years      | Since Inc    |
| <b>Total Fund</b> | 0.79        | 0.79        | 1.39         | 4.71         | 4.37         |
| Benchmark         | 0.75        | 0.75        | 1.40         | 4.77         | 4.42         |
| <i>Excess</i>     | <i>0.05</i> | <i>0.05</i> | <i>-0.01</i> | <i>-0.06</i> | <i>-0.04</i> |

## 1. PETROLEUM FUND MANAGEMENT MANDATE

An Updated revised management agreement including a new investment mandate between the Ministry of Finance and the Banking & Payments Authority was signed on 25 June 2009. The complete investment mandate was published in the updated management agreement and the benchmarks may be summarized as follows:

### Global Benchmark

|                                    |       |
|------------------------------------|-------|
| US Government 0-5 years            | 90.4% |
| US Government 5-10 years           | 2.0%  |
| Governments/Supranationals USD AAA | 2.6%  |
| Governments/Supranationals USD AA  | 1.4%  |
| Australian Government              | 1.4%  |
| Euro Governments                   | 1.4%  |
| United Kingdom Gilts               | 0.4%  |
| Japan Government                   | 0.4%  |

### Subsidiary Benchmarks

#### ***BPA Internal Management (80% of global portfolio)***

|                         |        |
|-------------------------|--------|
| US Government 0-5 years | 100.0% |
|-------------------------|--------|

#### ***Bank for International Settlements (20% of global portfolio)***

|                                    |       |
|------------------------------------|-------|
| US Government 0-5 years            | 52.0% |
| US Government 5-10 years           | 10.0% |
| Governments/Supranationals USD AAA | 13.0% |
| Governments/Supranationals USD AA  | 7.0%  |
| Australian Government              | 7.0%  |
| Euro Governments                   | 7.0%  |
| United Kingdom Gilts               | 2.0%  |
| Japan Government                   | 2.0%  |

## 2. MARKET TRENDS DURING THE QUARTER

### Global Market

Interest rates moves in the major currency areas were not uniform. Though stock markets indicated an increase in economic optimism, market sentiment in fixed income space was largely driven by headlines on sovereign credit risk-particularly in Europe. Macroeconomic fundamental were mixed. The longer term economic outlook remains uncertain.

### US Treasury Market

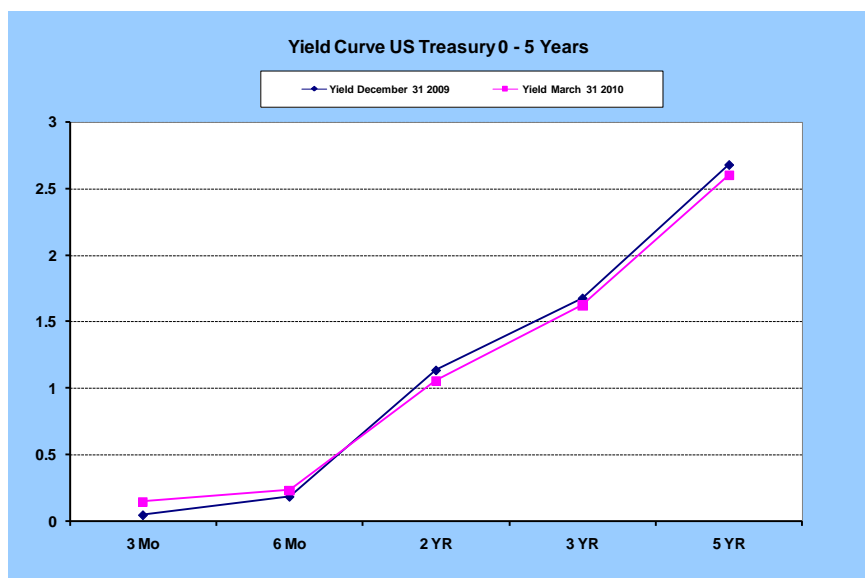
During the period from 31 December 2009 to 31 March 2010 US Treasury bonds 0 to 5 years yields decreased significantly. At the short end 3 months US Treasury benchmark reference bills increased by 10 basis points and 6 months US Treasury benchmark reference bills increased by 5 basis points, while 2 year bond yields decreased by 8 basis points. The 3 and 5 year US Treasury benchmark reference notes decreased by 5 and 8 basis points respectively compared to the previous quarter end. Bond prices and yields move in opposite directions.

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*US Treasury bond yields decreased significantly. The 3 and 6 month US Treasury benchmark reference bills increased by 10 and 5 basis points, 2 year yields decreased by 8 basis points. The 3 and 5 year yield decreased by 5 and 8 basis points respectively.*

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The graph below shows the 0-5 year US Government yield curve on 31 March 2010 compared to the previous quarter end 31 December 2009.



There has been no change to the U.S. Federal Reserve Bank's key overnight lending rate (the US Federal Funds target rate), with the current level target range remaining at 0 – 0.25% as of March 2010.

### 3. MANAGEMENT DURING THE QUARTER

#### Objectives

For the Internal Mandate, the BPA's objective in managing the portfolio is to achieve a portfolio return close to the return of the agreed benchmark; while the BIS's portfolio will be managed in an active manner and the objective is the expected outperformance of the portfolio gross of management fees is 25 basis points over the Benchmark performance, on an annual basis over a rolling three year period, while maintaining the ex ante tracking error within 100 basis points.

For the BPA's internal mandate, cash received by the Fund has been invested in the portfolio in a timely manner, normally within two working days. This policy is consistent with the passive investment mandate given to the BPA by the Ministry of Finance. For the BIS portfolio, cash received by the BIS has been invested in the portfolio within the instruments allowed in the composite benchmark as described in the updated management agreement summarized in Subsidiary Benchmark section in page 2 of this report.

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*The objective of the internal mandate is to achieve the portfolio return close to the benchmark within +/- 25 bps while the objective of BIS mandate is the expected outperformance of the portfolio gross of management fees is 25 basis points over a rolling 3 yrs period.*

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#### Operational Implementation

The BPA internal mandate is operationalised by holding ten of the approximately 116 US Treasury Securities that form the defined benchmark index. The bonds are selected to best replicate the risk and return characteristics of the benchmark.

The BIS mandate is operationalised by holding bonds issued by supranational organisations and sovereign states, including the United States, European Union, Australia, Japan, United Kingdom.

Regular financial reports on the performance of the Fund under BPA management are produced for BPA management and regular position reports for the total Fund including the BIS mandate are produced by the Fund's custodian as part of the management process.

### 4. PORTFOLIO PERFORMANCE

This section contains a number of tables and charts describing the performance of the Petroleum Fund.

The following notes are intended to assist in interpreting this information:

- The percentage figures show the return of the Fund, or a part of it, and compare the result with a benchmark. The benchmark represents the investment strategy established by the Minister and is used to set a goal against which the performance of the actual investments is measured. The Minister's benchmarks for the Petroleum Fund mandates are described earlier in this report.
- The excess is the difference (even if negative) between the benchmark and the portfolio being measured. In general a portfolio and its benchmark will respond in a similar manner to movements in the financial markets. The excess occurs because the benchmark does not recognise transaction costs, and because the actual portfolio usually contains a different mix of financial instruments to the benchmark.

## GLOBAL PORTFOLIO

In the course of the quarter the Petroleum Fund increased from \$5,376.63 million to \$5,787.18 million, as follows:

| In million USD                                     |            |
|--|------------|
| Return, Quarter January-March 2010                 | Amount     |
| Opening book value (1 January 2010)                | \$5,376.63 |
| Receipts during the period                         | \$468.34   |
| Transfer to General State Budget during the period | (\$100.00) |
| Management Fees                                    | (\$0.51)   |
| Return in the period                               | \$42.73    |
| Closing book value (31 March 10)                   | \$5,787.18 |

Total receipts during the quarter were \$468.34m consisting of tax receipts \$216.30m, Royalties \$244.99m & other receipts \$7.04m.

The gross returns was 42.73m of which \$46.95m was coupon & interest and market valuation was (\$4.23) m

This balance was invested in the following financial assets:

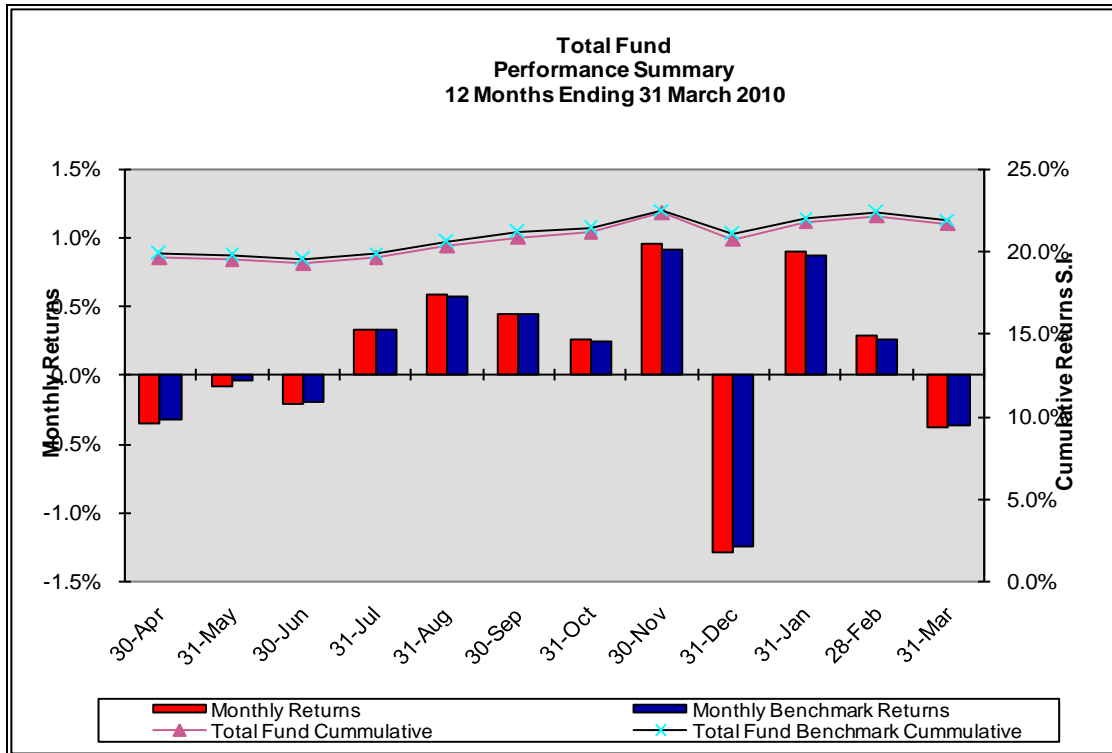
| In thousand USD                      |                  |
|--------------------------------------|------------------|
| Cash and Cash Equivalent             | 6,187            |
| Marketable Debt Securities           | 5,704,397        |
| Receivable and Other Assets          | 90,722           |
| Less: Pending Purchase of Securities | ( 14,127 )       |
| <b>TOTAL</b>                         | <b>5,787,178</b> |

The Net Income for the quarter comprised the following:

| INCOME                           | In Thousand   |
|----------------------------------|---------------|
| Investment Income                | 46,954        |
| Income                           | <b>46,954</b> |
| Market Revaluations              | ( 4,227 )     |
| Less: Management Fees            | ( 512 )       |
| <b>Net Result for the Period</b> | <b>42,216</b> |

The performance of the Fund for the quarter, including the performance of the relative asset classes, was as follows:

| Currency \$USD               | (%)         |             |              |              |              |
|------------------------------|-------------|-------------|--------------|--------------|--------------|
|                              | QTR         | FYTD        | 1 Year       | 3 Years      | Since Inc    |
| <b>Total Fund</b>            | 0.79        | 0.79        | 1.39         | 4.71         | 4.37         |
| Benchmark                    | 0.75        | 0.75        | 1.40         | 4.77         | 4.42         |
| <i>Excess</i>                | <i>0.05</i> | <i>0.05</i> | <i>-0.01</i> | <i>-0.06</i> | <i>-0.04</i> |
| International Fixed Interest | 0.79        | 0.79        | 1.39         | 4.71         | 4.37         |
| Benchmark                    | 0.75        | 0.75        | 1.40         | 4.77         | 4.42         |
| <i>Excess</i>                | <i>0.05</i> | <i>0.05</i> | <i>-0.01</i> | <i>-0.06</i> | <i>-0.04</i> |



The cumulative performance of the Petroleum Fund compared with the performance of the Global Benchmark over the same period is shown in the above graph.

#### **FIXED INTEREST**

The performance of the investments in Fixed Interest investments for the quarter, including the performance of the managers responsible for those investments, was as follows:

| Currency \$USD                           | (%)         |             |              |              |              |
|--|-------------|-------------|--------------|--------------|--------------|
|  | QTR         | FYTD        | 1 Year       | 3 Years      | Since Inc    |
| <b>International Fixed Interest</b>      | 0.79        | 0.79        | 1.39         | 4.71         | 4.37         |
| Benchmark                                | 0.75        | 0.75        | 1.40         | 4.77         | 4.42         |
| <i>Excess</i>                            | <i>0.05</i> | <i>0.05</i> | <i>-0.01</i> | <i>-0.06</i> | <i>-0.04</i> |
| <b>BPA Internal Mandate</b>              | 0.79        | 0.79        | 0.95         | 4.56         | 4.27         |
| Benchmark                                | 0.74        | 0.74        | 1.03         | 4.64         | 4.33         |
| <i>Excess</i>                            | <i>0.04</i> | <i>0.04</i> | <i>-0.08</i> | <i>-0.08</i> | <i>-0.06</i> |
| <b>Bank for International Settlement</b> | 0.83        | 0.83        |              |              | 3.32         |
| Benchmark                                | 0.76        | 0.76        |              |              | 3.33         |
| <i>Excess</i>                            | <i>0.07</i> | <i>0.07</i> |              |              | <i>-0.01</i> |

## 5. MANAGEMENT COSTS

A management fee of \$511,519 for operational management costs was deducted from the fund during the quarter to cover the direct external expenses and internal operational expenses.

The fee covered the following services:

|  |                   |
|--|-------------------|
| External management & custody expenses | \$ 105,769        |
| BPA Internal management expenses       | \$ 405,750        |
| <b>Total</b>                           | <b>\$ 511,519</b> |

## 6. TRANSFERS FROM THE PETROLEUM FUND

According to Article 7.1 of the Petroleum Fund law transfers from the Fund may only be made to the credit of a single State Budget account. During the quarter, there has been transfer of \$100 million from the Fund to the State Budget. A summary of transfers to the State Budget Account is as follows:

The fee covered the following services:

US\$ Million

|   |       |
|---|-------|
| Transfer - January 2010                         | \$0   |
| Transfer - February 2010                        | \$0   |
| Transfer - March 2010                           | \$100 |
| Total Transfers for this Quarter                | \$100 |
| Transfer for previous Quarter                   | N/A   |
| Total Transfer for this Fiscal Year to March 10 | \$100 |

## 7. RISK EXPOSURE OF PORTFOLIO

### 7.1 Tracking Error

The tracking error illustrates the manner in which the Fund portfolio tracked the benchmark index. The "Excess Return" measures the difference between the return of the Fund's portfolio and the benchmark. The excess return for the Fund's global portfolio is 0.05% while the excess return of the BPA internal mandate and the BIS mandate were 0.04% or 4 basis points and 0.07% or 7 basis points respectively.

### 7.2 Duration

The modified duration of the BPA internal portfolio shall be managed within  $\pm 0.2$  years of the modified duration of the benchmark. The Modified duration of the BIS portfolio shall be less than six years. The duration was within the mandate during the quarter.

### **7.3. Credit Risk**

The investments by the Petroleum Fund in US Treasury Securities with the highest credit rating (AAA) while the investments in other sovereign states and supranational fixed interest securities with the credit ratings of (NR-Not Rated to AAA) within the limit as provided in the BIS mandate. All investments reflected the new investment mandate as provided in the updated Management Agreement.

Cash received by the Petroleum Fund pending investment is invested at overnight money market interest rates in an overnight repurchase pool operated by the Federal Reserve Bank of New York.

## **8. COMPLIANCE STATEMENT**

The BPA asserts the following statements relating to compliance with the mandates given by the Minister:

### ***Qualifying Instruments***

The Fund was invested in instruments within the investment universe specified in the mandate at all times during the quarter.

### ***Return***

The performance on the global portfolio for the quarter was 79 basis points compared with the benchmark performance of 75 basis points.

### ***Modified Duration***

The modified duration of the Fund's fixed interest investment portfolio remained within the mandate during the quarter.

### ***Tracking Error***

The tracking error of the Fund's investment portfolio was within the mandate during the quarter.

### ***Internal Manager***

The BPA portfolio complied with the mandate throughout the quarter.

### ***External Managers***

The external manager investment was within the mandate during the quarter.

### ***Internal Audit***

In accordance with the provisions of Article 22 of the Petroleum Fund law number 9/2005 that requires BPA's Internal Auditor to perform an audit of the Fund every six months the Internal Auditor has performed an audit on the Fund to 31 December 2009.



## 9. FINANCIAL INFORMATION

The following financial information is presented for the purpose of assisting the Minister to review the quarterly performance of the Petroleum Fund as set out in this report. The figures have not been audited.

### Balance Sheet

In thousand\$

| NET ASSETS                                       | Mar-10           | Dec-09           | Mar-09           |
|--|------------------|------------------|------------------|
| Cash and Cash Equivalent                         | 6,187            | 3,162            | 14,114           |
| Marketable Debt Securities                       | 5,704,397        | 5,341,220        | 4,667,170        |
| Receivable and Other Assets                      | 90,722           | 32,244           | 68,796           |
| Less: Pending Purchase of Securities             | ( 14,127 )       | -                | -                |
| <b>TOTAL</b>                                     | <b>5,787,178</b> | <b>5,376,626</b> | <b>4,750,080</b> |
| CAPITAL  |                  |                  |                  |
| Opening Balance as at 1 January 2010             | 5,376,626        | 4,196,972        | 4,196,972        |
| PF Law Art. 6.1 (a) Revenue Receipts             | 216,303          | 661,235          | 232,771          |
| PF Law Art. 6.1 (b) DA Receipts                  | 244,992          | 993,713          | 317,113          |
| PF Law Art. 6.1 (e) Other Receipts               | 7,042            | 5,241            | -                |
| PF Law Art. 7.1 Transfer to General State Budget | ( 100,000 )      | ( 512,000 )      | -                |
| Net Income                                       | 42,216           | 31,466           | 3,224            |
| <b>TOTAL</b>                                     | <b>5,787,178</b> | <b>5,376,626</b> | <b>4,750,080</b> |

### Profit & Loss Statement

In thousand\$

| INCOME                           | Quarter       |                  | Year To Date (YTD) |               |
|----------------------------------|---------------|------------------|--------------------|---------------|
|                                  | Mar-10        | Dec-09           | Mar-10             | Dec-09        |
| Investment Income                | 46,954        | 43,663           | 46,954             | 40,113        |
| Income                           | <b>46,954</b> | <b>43,663</b>    | <b>46,954</b>      | <b>40,113</b> |
| Market Revaluations              | ( 4,227 )     | ( 49,296 )       | ( 4,227 )          | ( 36,889 )    |
| Less: Management Fees            | ( 512 )       | ( 1,337 )        | ( 512 )            | -             |
| <b>Net Result for the Period</b> | <b>42,216</b> | <b>( 6,970 )</b> | <b>42,216</b>      | <b>3,224</b>  |

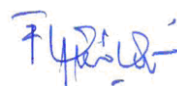
Note:

The accounting policies and method of computation used to prepare the above figures are the same as disclosed in the most recent annual financial statements of the Petroleum Fund.

Dili, 15 April 2010



**Venâncio Alves Maria**  
Executive Director



**Abraão de Vasconcelos**  
General Manager