

Petroleum Fund of Timor-Leste

Quarterly Report For the Quarter ended 30 September 2011

Vol. 7 Number XIX September 2011



Petroleum Fund of Timor-Leste

Quarterly Report

30 SEPTEMBER 2011

Inside This Report

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

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 Central Bank of Timor-Leste the responsibility for the operational management of the Fund.

This report covers the period from 1 July to 30 September 2011.

Key statistics for the quarter include:

- The capital of the Fund grew from US\$ 8,305.80 million to US\$ 8,903.14 million.
- Gross cash inflows to the fund from royalties and taxes were US\$ 805.85 million.
- Cash outflows were US\$ 251.26 million in which US\$ 250.00 million for transfer to the State Budget and US\$ 1.26 million for direct external and internal management costs.
- Net cash inflows during the period were US\$ 554.59 million.
- The portfolio return in the period was 0.52% compared with the benchmark return for the quarter of 0.44%.

The total Fund's returns by quarter, one year, FYTD, three years and since inception of the Fund up to 30 September 2011 as follows:

Currency \$USD	(%)				
	QTR	FYTD	1 Year	3 Years	Since Inc
Total Fund	0.52	2.22	1.86	3.31	4.15
Benchmark	0.44	2.18	1.82	3.32	4.17
<i>Excess</i>	<i>0.08</i>	<i>0.04</i>	<i>0.04</i>	<i>0.00</i>	<i>-0.02</i>

1. PETROLEUM FUND MANAGEMENT MANDATE

An updated revised management agreement including a new investment mandate between the Ministry of Finance and the Central Bank was signed on 25 June 2009 and its annex 1 was further updated on 8 October 2010. The complete investment mandate was published in the updated management agreement and the updated Annex I of the management agreement and the benchmarks may be summarized as follows:

Global Benchmark

US Government Bonds	88.40%
USD Foreign Government Supranationals	4.00%
Others Government Bonds (AUS, EU, UK, JP)	3.60%
Global Equity Mandate	4.00%

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%

Schroder Investment Management Limited (3-5% of the Fund)

Global Equities listed in developed market exchange-MSCI World Index Net Dividend Reinvested	100%
--	------

2. MARKET TRENDS DURING THE QUARTER

Global Market

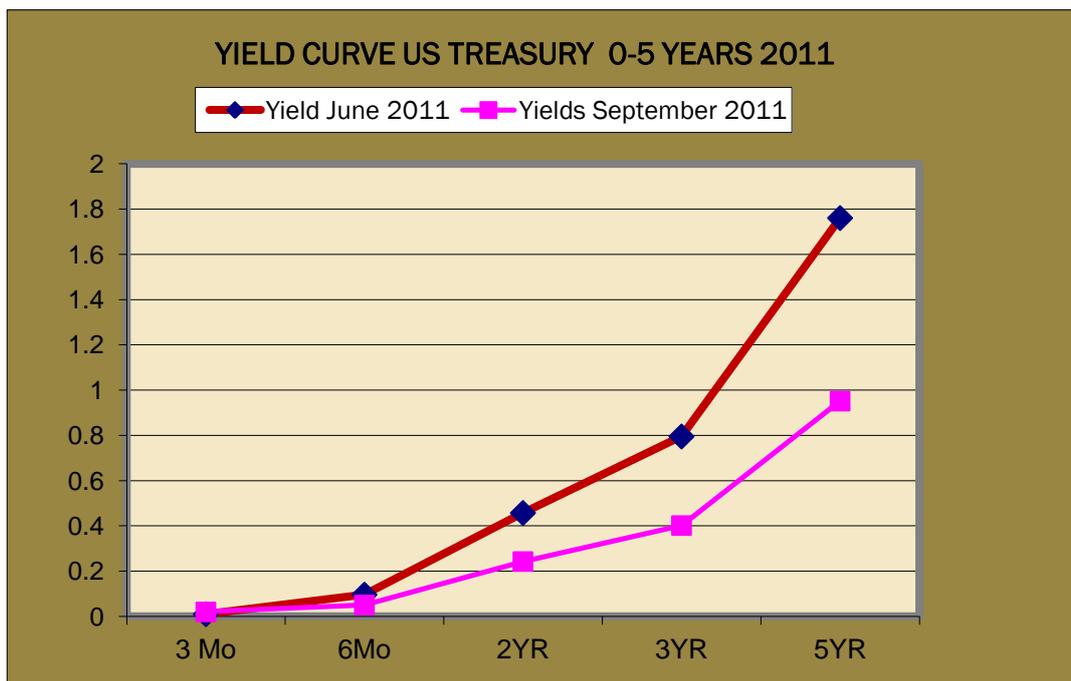
Financial markets globally continued to be heavily impacted by concerns over a possible default on Greek debt. Markets retreated as European leaders struggled to form a unified solution to contain the problem. Further aid to the Greek state will be dependent on meeting conditions set by European authorities, the results will be observed closely by global markets.

With the U.S. economy still in the midst of recovery, both the U.S Federal Reserve and White House announced plans to boost job creation and economic activity during the month.

US Treasury Market

During the period from 30 June 2011 to 30 September 2011 US Treasury bonds 0 to 5 years yields decreased significantly. At the short end 3 months US Treasury benchmark reference bills increased by 1 basis points and 6 months US Treasury benchmark reference bills decreased by -5 basis points, while 2 year bond yields decreased by -21 basis points. The 3 and 5 year US Treasury benchmark reference notes decreased by -39 and -81 basis points respectively compared to the previous quarter end. Bond prices and yields move in opposite directions.

The graph below shows the 0-5 year US Government yield curve on 30 September 2011 compared to the previous quarter end 30 June 2011.



US Treasury bond yields decreased significantly. The 3 and 6 month US Treasury benchmark reference bills decreased by 1 and -5 basis points, 2 years yields decreased by -21 basis points. The 3 and 5 years yield decreased by -39 and -81 basis points respectively.

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 September 2011.

3. MANAGEMENT DURING THE QUARTER

Objectives

For the Internal Mandate, the Central Bank'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.

The objective of Schrodgers mandate is to manage the portfolio in an enhanced passive indexing style and maintained within a tracking error relative to the benchmark that does not normally exceed 100 basis points, and with load differences maintained within 0.5% (security level) and 2.5% (country and sector levels). At no time shall the ex-ante tracking error exceed 150 basis points.

For the Central Bank'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 Central Bank 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.

For Schrodgers mandate, cash received invested in equities listed on developed market exchange (i.e. in countries belonging to developed markets as defined by the MSCI market classification framework).

Operational Implementation

The Central Bank internal mandate is operationalised by holding ten of the approximately 184 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.

Schrodgers mandate operationalized by holding equities in equities listed on developed market exchange.

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

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.

The objective of Schroder mandate is to manage the portfolio in an enhanced passive indexing style and maintained within a tracking error relative to the benchmark that does not normally exceed 100 basis points.

External Managers

Following the appointment of Schrodgers, the fund currently have 2 external managers namely Bank for International Settlements (BIS) managing 20% of the total portfolio and Schroder Investment Management Limited (Schrodgers) managing 4% of the total portfolio.

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 \$8,305.80 million to \$8,903.14 million as follows:

Capital Account, Quarter July - Sept 2011	In thousand \$
Opening book value (1 July 2011)	8,305,792
Receipts during the period	805,845
Transfer to General State Budget during the period	(250,000)
Management Fees	(1,264)
Return in the period	42,767
Closing book value (30 Sept 2011)	8,903,141

The balance was invested in the following financial assets:

NET ASSETS	in thousand \$
Cash and Cash Equivalent	16,080
Marketable Debt Securities	8,508,126
Equities at market value	283,856
Receivable and Other Assets	112,523
Less: Pending Purchase of Securities	(17,444)
Total	8,903,141

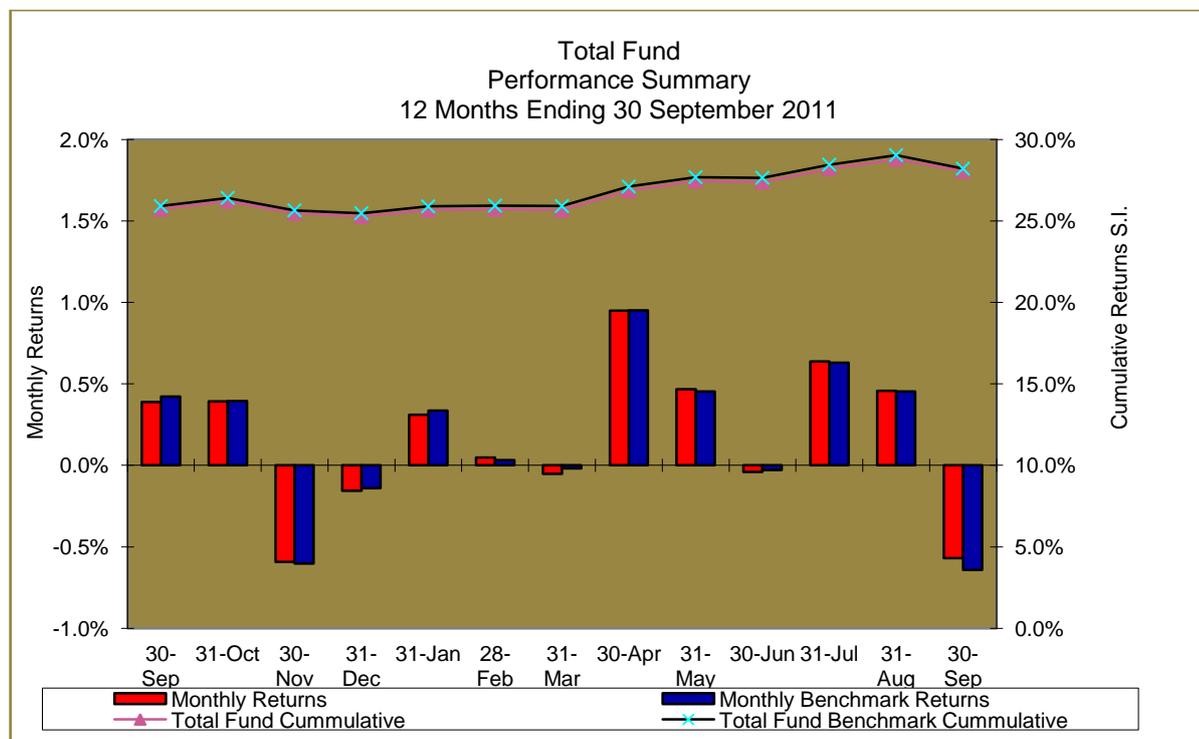
The Net Income for the quarter comprised the following:

INCOME	In thousand (\$)
Investment Income	61,627
Income	61,627
Market Revaluations	(18,849)
Less: Management Fees	(1,273)
Net Result for the Period	41,504

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
Total Fund	0.52	2.22	1.86	3.31	4.15
Benchmark	0.44	2.18	1.82	3.32	4.17
<i>Excess</i>	<i>0.08</i>	<i>0.04</i>	<i>0.04</i>	<i>0.00</i>	<i>-0.02</i>
International Fixed Interest	1.21	2.72	2.06	3.38	4.19
Benchmark	1.17	2.75	2.09	3.41	4.22
<i>Excess</i>	<i>0.04</i>	<i>-0.02</i>	<i>-0.03</i>	<i>-0.03</i>	<i>-0.03</i>
International Equity	-16.17	-11.08	n.a	n.a	-5.33
Benchmark	-16.61	-12.20	n.a	n.a	-6.78
<i>Excess</i>	<i>0.44</i>	<i>1.12</i>	<i>n.a</i>	<i>n.a</i>	<i>1.45</i>

The cumulative performance of the Petroleum Fund compared with the performance of the Global Benchmark over the same period is shown in the below 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
International Fixed Interest	1.21	2.72	2.06	3.38	4.19
Benchmark	1.17	2.75	2.09	3.41	4.22
<i>Excess</i>	<i>0.04</i>	<i>-0.02</i>	<i>-0.03</i>	<i>-0.03</i>	<i>-0.03</i>
Central Bank Internal Mandate	1.12	2.31	1.76	2.97	3.98
Benchmark	1.10	2.35	1.79	3.02	4.02
<i>Excess</i>	<i>0.03</i>	<i>-0.03</i>	<i>-0.03</i>	<i>-0.04</i>	<i>-0.04</i>
Bank for International Settlement	1.56	4.33	3.20	n.a	5.28
Benchmark	1.47	4.35	3.29	n.a	5.31
<i>Excess</i>	<i>0.09</i>	<i>-0.03</i>	<i>-0.09</i>	<i>n.a</i>	<i>-0.03</i>

INTERNATIONAL EQUITIES

The performance of the investments in global equities 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
International Equities	-16.17	-11.08	n.a	n.a	-5.33
Benchmark	-16.61	-12.20	n.a	n.a	-6.78
<i>Excess</i>	<i>0.44</i>	<i>1.12</i>	<i>n.a</i>	<i>n.a</i>	<i>1.45</i>
Schroder Investment Management	-16.17	-11.08	n.a	n.a	-5.33
Benchmark	-16.61	-12.20	n.a	n.a	-6.78
<i>Excess</i>	<i>0.44</i>	<i>1.12</i>	<i>n.a</i>	<i>n.a</i>	<i>1.45</i>

5. MANAGEMENT COSTS

A management fee of \$1,263,590 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 and Custody expenses	\$ 739,590
Central Bank Internal management expenses	\$ 528,000
Total	\$1,263,590

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, total amount of US\$ 250 million has been transferred from the Fund to the State Budget.

A summary of transfers to the State Budget Account is as follows:

	In Million
Transfer - July 2011	\$ 0
Transfer- August 2011	\$ 125
Transfer- September 2011	\$ 125
Total transfer this quarter	\$ 250
Total transfers previous quarter	\$ 300
Total transfer this fiscal year until September '11	\$ 550

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 0.08% (or 8 basis points) while the excess return of the Central Bank internal mandate, the BIS mandate and Schrodgers mandate were 0.03% (or 3 basis points), 0.09% (9 basis points) and 0.44% (or 44 basis points) respectively.

7.2 Duration

The modified duration of the Central Bank internal portfolio shall be managed within ± 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. Investments in global equities are not rated. All investments reflected the new investment mandate as provided in the updated Management Agreement and the Annex I.

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 Central Bank 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 52 basis points compared with the benchmark performance of 44 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 Central Bank portfolio complied with the mandate throughout the quarter.

External Managers

The external managers investments was within the mandate during the quarter.

Internal Audit

In accordance with the provisions of Article 22 of the Petroleum Fund law no. 9/2005 that requires Central Bank's Internal Auditor to perform an audit of the Fund every six months. The Internal Auditor has performed an audit on the Fund to 30 June 2011.

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	Sep-11	Jun-11	Sep-10
Cash and Cash Equivalent	16,080	44,832	10,421
Marketable Debt Securities	8,508,126	7,906,420	6,514,283
Equities at market value	283,856	310,924	-
Receivable and Other Assets	112,523	43,683	99,195
Less: Pending Purchase of Securities	(17,444)	(67)	(20,270)
TOTAL	8,903,141	8,305,792	6,603,629
CAPITAL			
Opening Balance	6,903,996	6,903,996	5,376,626
PF Law Art. 6.1 (a) Revenue Receipts	990,461	667,280	628,873
PF Law Art. 6.1 (b) DA Receipts	1,380,695	898,030	719,153
PF Law Art. 6.1 (e) Other Receipts	7,978	7,979	7,042
PF Law Art. 7.1 Transfer to General State Budget	(550,000)	(300,000)	(375,000)
Net Income	170,010	128,507	246,934
TOTAL	8,903,141	8,305,792	6,603,629

Profit & Loss Statement

in thousand \$

INCOME	Quarter		Year To Date (YTD)	
	Sep-11	Sep-10	Sep-11	Sep-10
Investment Income	61,627	53,270	178,908	152,656
Income	61,627	53,270	178,908	152,656
Market Revaluations	(18,859)	50,387	(5,664)	96,356
Less: Management Fees	(1,264)	(879)	(3,233.35)	(2,077)
Net Result for the Period	41,504	102,778	170,010	246,935

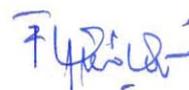
Notes:

- 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, 13 October 2011



Venancio Alves Maria
Executive Director of
Petroleum Fund Management Department-
Banco Central de Timor-Leste



Abraão de Vasconcelos
Governor