

Petroleum Fund of Timor-Leste

Quarterly Report

31 December 2012

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 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 and amended on 28 September 2011. 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 October to 31 December 2012.

Key statistics for the quarter include:

- The capital of the Fund grew from \$11,054.41 million to US\$ 11,775.35 million.
- Gross cash inflows to the fund from royalties and taxes were US\$ 1,234.45 million.
- Cash outflows were US\$ 590.4 million of which \$586.9 million for transfers to State Budget and \$3.51 million for direct external and internal management costs.
- Net cash inflows during the period were US\$ 644.04 million.
- The portfolio return in the period was 0.66% compared with the benchmark return for the quarter of 0.64%.

The total Fund's returns by quarter, one year, FYTD, three years and since inception of the Fund up to 31 December 2012 as follows:

Currency \$USD	(%)				
	QTR	FYTD	1 Year	3 Years	Since Inc
Total Fund	0.66	3.88	3.88	3.24	4.05
Benchmark	0.64	3.74	3.74	3.17	4.06
<i>Excess</i>	<i>0.02</i>	<i>0.14</i>	<i>0.14</i>	<i>0.07</i>	<i>-0.01</i>

1. PETROLEUM FUND MANAGEMENT MANDATE

A revised Management Agreement between the Ministry of Finance and the Central Bank was signed on 25 June 2009 and its annex 1 was further updated on 16 July 2012. Following Minister's decision on increase of equity exposure, the existing equities manager' exposure was increased gradually and achieved 26% in December 2012. The new benchmarks as of December 2012 may be summarized as follows:

Global Benchmark

US Government Bonds	74%
Global Equity Mandate	26%

Subsidiary Benchmarks

BCTL 1-3 Years US Treasury (13.93% of global portfolio)

Merrill Lynch 1-3 Years US Treasury Bond Index	100%
--	------

BCTL 3 - 5 Years US Treasury (40.37% of global portfolio)

Merrill Lynch 3-5 Years US Treasury Bond Index	100%
--	------

Bank for International Settlements (19.67% of global portfolio)

Merrill Lynch 5-10 Years US Treasury Bond Index	100%
---	------

Schroder Investment Management Limited (5.20% of global portfolio)

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

State Street Global Advisors (20.83% of global portfolio)

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

2. MARKET TRENDS DURING THE QUARTER

Global Market

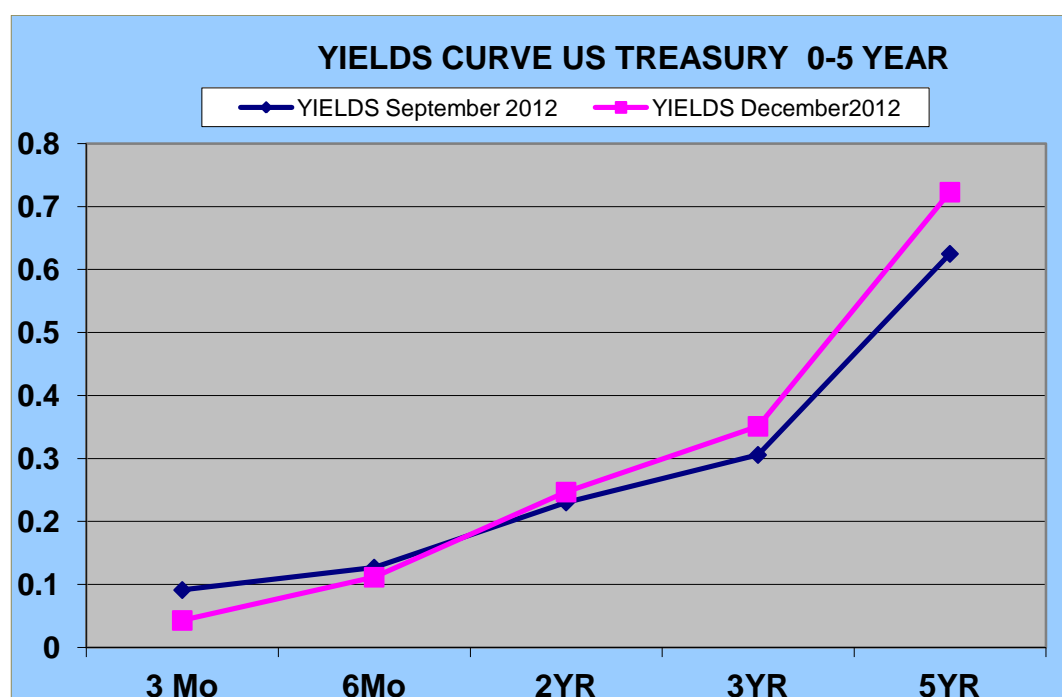
The primary focus during the period was the tense budget negotiations; there were significant concerns about the potential “fiscal cliff” in the event an agreement was not forged by year-end.

Negotiations were difficult and were not resolved until the last minute. In late December, Treasury Secretary wrote to notify Congress that the U.S. would hit the statutory debt ceiling on in December, 2012. The Treasury Department would then take extraordinary measures to avoid breaking that limit. In January, the Senate approved a bipartisan bill to avoid tax increases on a large part of the population and to postpone spending cuts.

US Treasury Market

During the period from 30 September 2012 to 31 December 2012 US Treasury bonds 0 to 5 years yields increased significantly. At the short end 3 months US Treasury benchmark reference bills decreased by 5 basis point and 6 months US Treasury benchmark reference bills decreased by 2 basis points, while 2 year bond yields increased by 2 basis points. The 3 year US Treasury benchmark reference notes increased by 5 basis points while, the 5 year US Treasury benchmark reference notes increased by 10 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 December 2012 compared to the previous quarter end 30 September 2012.



US Treasury bond yields decreased significantly. The 3 month US Treasury benchmark reference bills decrease 5 basis point 6 month US Treasury benchmark reference bills decreased by 2 basis points, 2 and 3 years yields increased by 2 and 5 basis points while, 5 years increased 10 basis points.

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 December 2012.

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.

The objective of State Street Global Advisor (SSgA) mandate shall be managed in a passive indexing style to seek to closely match the Performance Benchmark, before tax and fees and maintained within an ex ante tracking error relative to the benchmark that does not normally exceed 35 basis points.

For the Central Bank's internal mandates, 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 benchmark as described in Subsidiary Benchmark section in page 2 of this report.

For Schrodgers and State Street Global Advisors mandates, 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 mandates are operationalised by holding 8 of the approximately 131 US Treasury Securities that form the defined benchmark indexes. The bonds are selected to best replicate the risk and return characteristics of the benchmarks.

The BIS mandate is operationalised by holding US Treasury bonds of 5-10 Years per BIS's new benchmark.

Schrodgers and State Street Global Advisors mandates operationalized by holding equities in equities listed in 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

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.

for the total Fund including the BIS, Schrodgers and SSgA mandates are produced by the Fund's custodian as part of the management process.

External Managers

Following Minister's decision on increase of equity exposure, the existing equities manager's exposure was increased gradually and achieved 26% in December 2012.

The Fund as of December 2012 has 3 external managers namely Bank for International Settlements (BIS) managing about 20% of the total portfolio, Schroder Investment Management Limited (Schrodgers) managing about 5% of the total portfolio and State Street Global Advisors (SSgA) managing about 21% 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 \$11,054.41 million to \$11,775.35 million as follows:

Capital Account, Quarter Oct-Dec 2012	In thousand \$
Opening book value (1 Oct 2012)	11,054,413
Receipts during the period	1,234,449
Transfer to General State Budget during the period	(586,900)
Management Fees	(3,510)
Gross return in the period	76,898
Closing book value (31 Dec 2012)	11,775,349

The balance was invested in the following financial asset

Assets	In Thousand (\$)
Cash and Cash Equivalent	60,882
Marketable Deb Securities	8,646,608
Global Equities	3,034,828
Receivables and other Assets	36,189
Less; Pending Purchase of Securities	(811)
Other Liabilities	(2,347)
Total	11,775,349

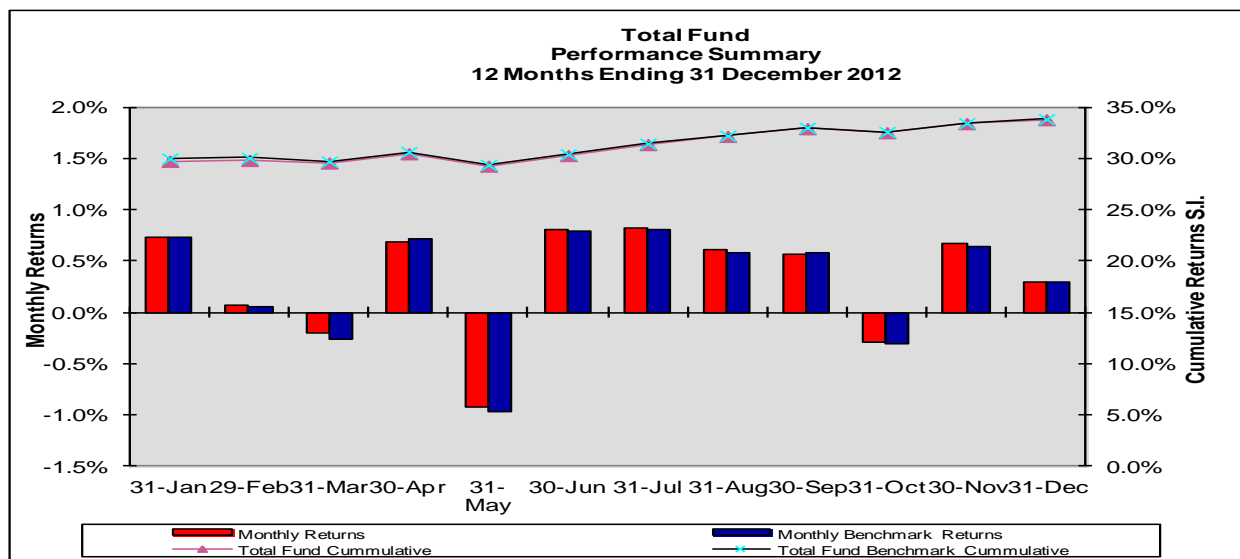
The Net Income for the quarter comprised the following.

INCOME	In thousand (\$)
Investment Income	52,723
Income	52,723
Market Revaluations	24,175
Less: Management Fees	(3,510)
Net Result for the Period	73,388

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	0.66	3.88	3.88	3.24	4.05
Benchmark	0.64	3.74	3.74	3.17	4.06
<i>Excess</i>	<i>0.02</i>	<i>0.14</i>	<i>0.14</i>	<i>0.07</i>	<i>-0.01</i>
International Fixed Interest	0.04	1.94	1.94	2.83	3.78
Benchmark	0.01	1.77	1.77	2.76	3.78
<i>Excess</i>	<i>0.03</i>	<i>0.17</i>	<i>0.17</i>	<i>0.07</i>	<i>-0.01</i>
International Equities	2.57	16.18	22.30	n.a	8.03
Benchmark	2.49	15.83	21.59	n.a	6.88
<i>Excess</i>	<i>0.08</i>	<i>16.18</i>	<i>0.70</i>	<i>n.a</i>	<i>1.14</i>

The cumulative performance of the Petroleum Fund compared with the performance of the Global Benchmark over the same period is shown in the next 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				
	QTR	FYTD	1 Year	3 Years	Since Inc
International Fixed Interest	0.04	1.94	1.94	2.83	3.78
Benchmark	0.01	1.77	1.77	2.76	3.78
<i>Excess</i>	<i>0.03</i>	<i>0.17</i>	<i>0.17</i>	<i>0.07</i>	<i>-0.01</i>
BCTL 1-3 yrs US Treasury	0.28	n.a	n.a	n.a	0.41
Benchmark	0.26	n.a	n.a	n.a	0.32
<i>Excess</i>	<i>0.02</i>	<i>n.a</i>	<i>n.a</i>	<i>n.a</i>	<i>0.09</i>
BCTL 5-10 yrs US Treasury	0.78	n.a	n.a	n.a	1.62
Benchmark	0.76	n.a	n.a	n.a	1.47
<i>Excess</i>	<i>0.02</i>	<i>n.a</i>	<i>n.a</i>	<i>n.a</i>	<i>-0.15</i>
Bank for International Settlement	1.07	3.68	n.a	n.a	4.21
Benchmark	1.00	3.62	n.a	n.a	4.05
<i>Excess</i>	<i>0.07</i>	<i>0.07</i>	<i>n.a</i>	<i>n.a</i>	<i>-0.16</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				
	QTR	FYTD	1 Year	3 Years	Since Inc
International Equities	2.57	16.18	16.18	n.a	8.03
Benchmark	2.49	15.83	15.83	n.a	6.88
<i>Excess</i>	<i>0.08</i>	<i>0.35</i>	<i>0.35</i>	<i>n.a</i>	<i>1.14</i>
Schroder Investment Management	2.48	16.81	16.81	n.a	8.20
Benchmark	2.49	15.83	15.83	n.a	6.88
<i>Excess</i>	<i>-0.01</i>	<i>0.99</i>	<i>0.99</i>	<i>n.a</i>	<i>1.31</i>
SSgA International Equity*	1.86	n.a	n.a	n.a	12.66
Benchmark	1.88	n.a	n.a	n.a	12.01
<i>Excess</i>	<i>-0.02</i>	<i>n.a</i>	<i>n.a</i>	<i>n.a</i>	<i>0.64</i>

* Commenced from COB 18th January 2012.

5. MANAGEMENT COSTS

A management fee of \$3,509,850 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:

	In Million
External Management and Custody expenses	833,878
Central Bank management expenses	654,406
IAB expenses	-
Accrued Expenses	2,021,566
Total Fees	3,509,850

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\$ 587 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 (\$)
Transfers October 2012	203
Transfers November 2012	153
Transfers December 2012	231
Transfers for this Quarter	587
Total Transfers previous quarters	908
Total Transfers this fiscal year to Dec 2012	1,495

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 (0.02% or 2 basis points) while the excess return for the BIS and Schrodgers mandates were -0.02% (or -2 basis points) and -0.01% (or -1 basis point) respectively. The excess return for State Street Global Advisors (SSgA) mandate was 0.10% (or 10 basis points) while the excess return for the BCTL mandates 1-3 years and 3-5 years were 0.01% (or 1 basis point) and 0.00% (or 0 basis point) 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 high credit rating (AA+) or higher. Investments in global equities are not rated. All investments reflected the new investment mandate as reported in page 2 of this report

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

Banco Central de Timor-Leste 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 66 basis points compared with the benchmark performance of 64 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 Mandate

The Central Bank portfolios 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 31 December 2012.

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	Dec-12	Sep-12	Dec-11
Cash and Cash Equivalent	60,882	22,479	24,053
Marketable Debt Securities	8,646,608	8,440,212	8,886,193
Equities at market value	3,034,828	2,533,825	355,244
Receivable and Other Assets	36,189	63,101	46,659.00
Less: Pending Purchase of Securities	(811)	(4,878)	(1,000)
Other Liabilities	(2,347)	(325)	(828.00)
TOTAL	11,775,349	11,054,413	9,310,321
CAPITAL			
Opening Balance	9,310,321	9,310,321	6,903,996
PF Law Art. 6.1 (a) Revenue Receipts	1,612,519	957,919	1,331,353
PF Law Art. 6.1 (b) DA Receipts	1,937,725	1,357,876	1,900,759
PF Law Art. 6.1 (e) Other Receipts	8,877	8,877	7,978
PF Law Art. 7.1 Transfer to General State Budget	(1,494,900)	(908,000)	(1,055,000)
Net Income	400,807	327,419	221,234
TOTAL	11,775,349	11,054,413	9,310,321

Profit & Loss Statement

	Quarter		Year To Date (YTD)	
INCOME	Dec-12	Dec-11	Dec-12	Dec-11
Investment Income	52,723	65,992	223,073	244,900
Income	52,723	65,992	223,073	244,900
Market Revaluations	24,175	(11,699)	184,685	(17,363)
Less: Management Fees	(3,510)	(3,070)	(6,951)	(6,303)
Net Result for the Period	73,388	51,224	400,807	221,234

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, 24 January 2013

Venancio Alves Maria
Executive Director

Abraão de Vasconcelos
Governor