

# Petroleum Fund of Timor-Leste

## Quarterly Report

31 March 2014

### Inside This Report

- 1 Introduction
- 1 Executive Summary
- 2 Investment Mandate
- 2 Market Trends
- 3 Operational Management
- 4 Portfolio Performance
- 7 Management Costs
- 8 Transfers to State Budget
- 8 Compliance Statement
- 9 Financial Information

### 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 and custodial 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 as 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 January to 31 March 2014.

Key statistics for the quarter include:

- The capital of the Fund grew from \$14.9 billion to \$ 15.7 billion.
- Gross cash inflows to the fund from royalties and taxes were \$ 543.7 million.
- The profit for the quarter was \$175.0 million, representing a gross of fees return of 1.15% compared with the benchmark return of 1.16%.

The performance of the Fund for the quarter was:

Table 1

	QTR	FYTD	1 Year	3 Years	5 years	Since Inc
Total Fund	1.15	1.15	5.51	4.71	3.76	4.36
Benchmark	1.16	1.16	5.32	4.56	3.67	4.33
<i>Excess</i>	-0.01	-0.01	0.19	0.16	0.09	0.03

## 1. INVESTMENT MANDATE

A revised Management Agreement between the Ministry of Finance and the Central Bank was signed on 25 June 2009. Annex 1 was further updated on 21 February 2013 to incorporate the Minister's decision to increase the equity exposure gradually to 40% by June 2014. The benchmarks as of March 2014 were as follows:

Table 2

	31-Dec-13	31-Jan-14	28-Feb-14	31-Mar-14
BOA Merrill Lynch 1-3 Years Treasury Bond Index	5.00%	4.20%	3.30%	2.50%
BOA Merrill Lynch 3-5 Years Treasury Bond Index	40.00%	40.00%	40.00%	40.00%
BOA Merrill Lynch 5-10 Years Treasury Notes and Bond	10.00%	10.00%	10.00%	10.00%
Barclays Global Treasury Developed Market ex US, 30%	10.00%	10.00%	10.00%	10.00%
<b>Total Fixed Income</b>	<b>65.00%</b>	<b>64.20%</b>	<b>63.30%</b>	<b>62.50%</b>
MSCI World Index Dividends Reinvested	35.00%	35.80%	36.70%	37.50%
<b>Total Equities</b>	<b>35.00%</b>	<b>35.80%</b>	<b>36.70%</b>	<b>37.50%</b>
<b>Total</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>

## 2. MARKET TRENDS THE QUARTER

### *Equities*

Most equity benchmarks endured an acid test from late January into early February, when a key Chinese manufacturing indicator missed expectations. A similarly disappointing read on US manufacturing exacerbated slowdown fears and drove many equity averages to their 2014 lows in early February. News of a sizeable jump in US household employment during January helped share prices mount a rebound. Confidence built further as Janet Yellen, newly appointed chair of the US Federal Reserve, offered reassuring testimony on policy continuity, as Mario Draghi of the European Central Bank and Mark Carney of the Bank of England, allowing equity indexes to regain positive year-to-date territory in February. March saw Russia establish military control on the Crimean peninsula, and gold and oil prices surged to multi-month highs, with equity markets taking losses. The MSCI World Index climbed to a new record on March 6th after the European Central Bank kept policy unchanged and upped its forecast for 2014 growth. With more hesitant progress into quarter end, the MSCI World Index lagged during March, adding only 0.1% for the month, but consolidating a quarterly gain of 1.3%.

### *Bonds including US Treasuries*

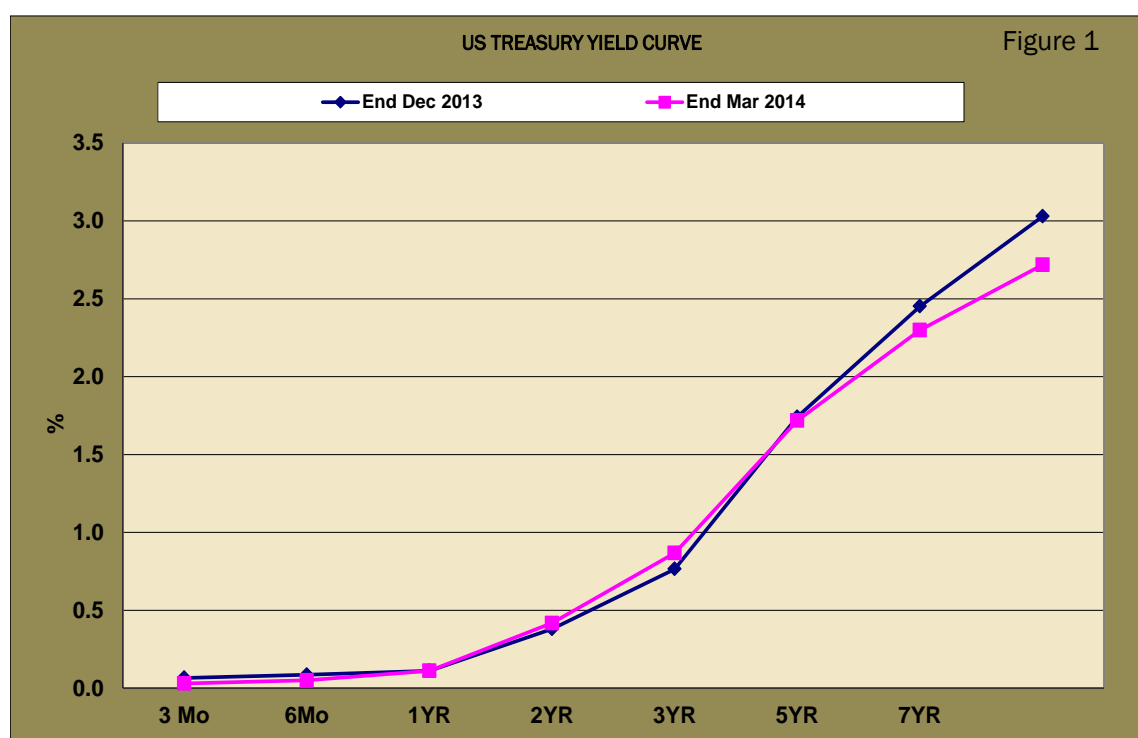
Because economic progress in early 2014 did not unfold quite as vigorously as late 2013 market action may have led many investors to expect, bonds around the world enjoyed a sustained rally through January. In addition, signs of slower growth in China became obvious enough to rattle equities, reinforcing downward pressure on fixed income yields. Even when equities recovered rapidly

during February, bond yields avoided any wholesale reversal of their earlier declines. Escalating tensions in Ukraine kept yields biased to the downside, and German yields sank to seven-month lows in early March. Later in the month, as low inflation readings in the US and Europe combined with continued asset purchase reductions by the Federal Reserve, term structures tended to flatten.

January was a strong month across the board, producing healthy positive results. February provided less robust gains for government bonds. Dollar-based holders of non-US issues did even better when foreign exchange effects worked in their favour.

Short-term yields in the developed world remained tightly anchored by central bank reluctance to remove accommodation. Even in the US, where the Federal Reserve tapering program remained on track to eliminate asset purchases later in the year, officials went out of their way to emphasize how cautiously they would implement eventual rate hikes.

The graph below shows the US Government yield curve out to 10 years compared to the previous quarter-end. There was no change to the US Federal Funds target rate, which remained at 0.25%. Short term yields were slightly higher by the end of the quarter, while the 10 year yield increased 31 basis points.



### 3. MANAGEMENT DURING THE QUARTER

#### *Objectives*

The Central Bank, as operational manager of the Fund, has implemented the investment mandates through a combination of internal and external management.

The following table shows how the investment mandates have been implemented:

Table 3

Mandate	Management Style	Authorised Managers	Tracking Error	Outperformance Target	Commencement date
BOA Merrill Lynch 1-3 Years US Treasury Bond Index	Passive	BCTL	n/a	Nil	19-Jan-12
BOA Merrill Lynch 3-5 Years US Treasury Bond Index	Passive	BCTL	n/a	Nil	19-Jan-12
BOA Merrill Lynch 5-10 Years US Treasury Notes & Bond index	Enhanced Passive	Bank for International Settlements	0.50%	0.25%	15-Dec-11
Barclays Global Treasury Developed Market ex US, 30% Eurozone and 10% Country Capped	Passive	Transition Manager	0.10%	Nil	26-Aug-13
MSCI World Index Net Dividends Reinvested	Passive	State Street Global Advisors	0.35%	Nil	18-Jan-12
		Black Rock	0.35%	Nil	21-Feb-13
	Enhanced Passive	Schroder Investment Management	1.00%	1.00%	7-Oct-10

Cash received by the Fund is invested or assigned to external managers in a timely manner, with the Central Bank being accountable for the returns on overnight investments.

### Operational Implementation

The allocation of the capital of the Fund to the various mandates as at the end of the quarter was as follows:

Table 4

	Managers	Benchmark	Tolerance	Actual
BOA Merrill Lynch 1-3 Years Treasury Bond Index	BCTL	2.50%	± 1.5%	2.53%
BOA Merrill Lynch 3-5 Years Treasury Bond Index	BCTL	40.00%	± 2.5%	39.69%
BOA Merrill Lynch 5-10 Years Treasury Notes and Bond Index	Bank for International Settlements	10.00%	± 1%	9.92%
Barclays Global Treasury Developed Market ex US, 30% Eurozone and 10% Country Capped	Interim Manager	10.00%	± 1%	9.98%
<b>Total Fixed Income</b>		<b>62.50%</b>		<b>62.13%</b>
MSCI World Index Net Dividends Reinvested	State Street Global Advisors			18.12%
	Black Rock	32.50%	± 4.0%	14.33%
	Schroder Investment Management	5.00%	± 1.5%	5.42%
<b>Total Equities</b>		<b>37.50%</b>		<b>37.87%</b>

## 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, which is compared with the performance of the corresponding benchmark. The benchmark represents the investment strategy established by the Minister and is used as a goal against which the performance of the actual investments is measured. The Minister's benchmarks for the Petroleum Fund are described earlier in this report.

- The excess is the difference (which may be 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 \$14.9 billion to \$15.7 billion as follows:

Table 5	
Capital Account, Quarter Jan - March 2014	\$'000
Opening book value (1 Jan 2014)	14,952,099
Receipts during the period	543,646
Transfer to General State Budget during the period	-
Gross return in the period	174,950
<b>Closing book value (31 March 2014)</b>	<b>15,670,695</b>

The Fund was invested as follows:

Table 6	
Assets	\$'000
Cash and Cash Equivalents	79,122
Other Receivables	34,927
Financial assets held at fair value through profit or loss	15,575,434
Less:	
Payable for Securities Purchased	(16,786)
Accounts Payable	(2,003)
<b>Total</b>	<b>15,670,695</b>

The Income for the quarter was as follows:

Table 7	
Income	\$'000
Interest income	33,488
Dividend income	52,961
Unit Trust distributions	921
Other Investment income	1
Net gains/(losses) on Financial Assets at fair value	74,653
Net foreign exchange gains/(losses)	17,784
Less:	
External manager, custody fees	(1,549)
Central Bank management expenses	(1,496)
IAB Expenses	(81)
Other expenses	0
Withholding taxes	(1,732)
<b>Total Investment Income</b>	<b>174,950</b>

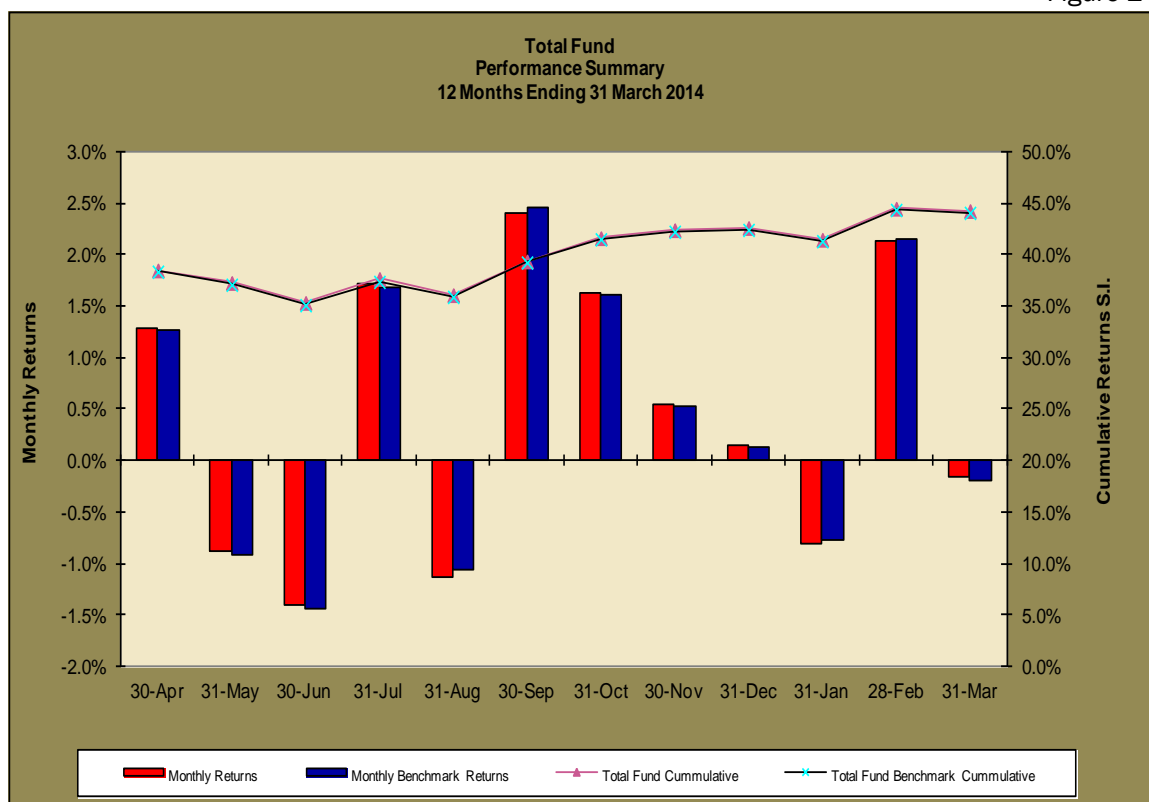
The Fund performance for the quarter, including the performance of the relative asset classes, was as follows:

Table 8

	QTR	FYTD	1 Year	3 Years	5 years	Since Inc
Total Fund	1.15	1.15	5.51	4.71	3.76	4.36
Benchmark	1.16	1.16	5.32	4.56	3.67	4.33
<i>Excess</i>	<i>-0.01</i>	<i>-0.01</i>	<i>0.19</i>	<i>0.16</i>	<i>0.09</i>	<i>0.03</i>
International Fixed Int	0.99	0.99	-0.61	1.49	1.73	3.17
Benchmark	0.98	0.98	-0.62	1.41	1.69	3.17
<i>Excess</i>	<i>0.01</i>	<i>0.01</i>	<i>0.02</i>	<i>0.08</i>	<i>0.04</i>	<i>0.00</i>
International Equities	1.39	1.39	19.54	10.95	n.a	12.98
Benchmark	1.26	1.26	19.07	10.23	n.a	12.07
<i>Excess</i>	<i>0.13</i>	<i>0.13</i>	<i>0.47</i>	<i>0.73</i>	<i>n.a</i>	<i>0.91</i>

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

Figure 2



**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:

Table 9

	Qtr	FYTD	1 Year	3 Years	5 Years	Since Inc
<b>International Fixed Interest</b>	0.99	0.99	-0.61	1.49	1.73	3.17
Benchmark	0.98	0.98	-0.62	1.41	1.69	3.17
<i>Excess</i>	0.01	0.01	0.02	0.08	0.04	0.00
<b>BCTL 1-3 yr US Treasury</b>	0.19	0.19	0.43	n.a	n.a	0.46
Benchmark	0.14	0.14	0.38	n.a	n.a	0.39
<i>Excess</i>	0.05	0.05	0.05	n.a	n.a	0.07
<b>BCTL 3-5 yrs US Treasury</b>	0.48	0.48	-0.59	n.a	n.a	0.57
Benchmark	0.43	0.43	-0.69	n.a	n.a	0.44
<i>Excess</i>	0.05	0.05	0.10	n.a	n.a	0.13
<b>Bank for International Settlements</b>	1.63	1.63	-3.02	n.a	n.a	0.51
Benchmark	1.69	1.69	-2.94	n.a	n.a	0.45
<i>Excess</i>	-0.06	-0.06	-0.08	n.a	n.a	0.05
<b>Barclays Customised Non US Sovereign Bonds</b>	2.84	2.84	n.a	n.a	n.a	5.28
Benchmark	2.93	2.93	n.a	n.a	n.a	5.77
<i>Excess</i>	-0.09	-0.09	n.a	n.a	n.a	-0.49

## INTERNATIONAL EQUITIES

The performance of the investments in global developed market equities for the quarter, including the performance of the managers responsible for those investments, was as follows:

Table 10

	Qtr	FYTD	1 Year	3 Years	5 Years	Since Inc
<b>International Equities</b>	1.39	1.39	19.54	10.95	n.a	12.98
Benchmark	1.26	1.26	19.07	10.23	n.a	12.07
<i>Excess</i>	0.13	0.13	0.47	0.73	n.a	0.91
<b>Schroder Investment Management</b>	1.73	1.73	20.70	11.60	n.a	13.48
Benchmark	1.26	1.26	19.07	10.23	n.a	12.07
<i>Excess</i>	0.47	0.47	1.63	1.37	n.a	1.42
<b>SSgA International Equity</b>	1.36	1.36	19.38	n.a	n.a	17.90
Benchmark	1.26	1.26	19.07	n.a	n.a	17.48
<i>Excess</i>	0.09	0.09	0.31	n.a	n.a	0.42
<b>Black Rock Investment Management</b>	1.30	1.30	19.19	n.a	n.a	19.65
Benchmark	1.26	1.26	19.07	n.a	n.a	19.47
<i>Excess</i>	0.04	0.04	0.12	n.a	n.a	0.18

## 5. MANAGEMENT COSTS

Payment of amount of \$3,126,075 has been made for operational management fees, IAB expenses and accrued during the quarter.

The fee covered the following services (\$ no rounding):

Table 11

External Management and Custody expenses	1,549,297
Central Bank management expenses	1,495,731
IAB expenses	81,047
<b>Total Cost</b>	<b>3,126,075</b>

## 6. TRANSFERS TO STATE BUDGET

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. There was no transfer made to the State Budget account during the quarter.

## 7. 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 universes specified in the various mandates at all times during the quarter.

### *Modified Duration*

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

### *Tracking Error*

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

### *External Managers*

The Central Bank has received representations from the external managers, supported by a certificate from the global custodian, that external managers' investments were within their mandates during the quarter.

### *Internal Audit*

The provisions of Article 22 of the Petroleum Fund law no. 9/2005 require the Central Bank's Internal Auditor to perform an audit of the Fund every six months. The Internal Auditor performed audit up to quarter December 2013.



## 8. 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

Table 12

BALANCE SHEET		
In thousands of USD	2014 March	2013 March
<b>ASSETS</b>		
Cash and Cash Equivalents	79,122	44,205
Receivables	34,927	14,145
Financial assets held at fair value through profit or loss	15,575,434	12,924,086
<b>TOTAL ASSETS</b>	<b>15,689,483</b>	<b>12,982,436</b>
<b>LIABILITIES</b>		
Payables for securities purchased	(16,786)	(3,304)
Accounts payable	(2,003)	(1,409)
<b>TOTAL LIABILITIES</b>	<b>(18,789)</b>	<b>(4,713)</b>
<b>NET ASSETS</b>	<b>15,670,695</b>	<b>12,977,723</b>
<b>CAPITAL</b>		
Opening Balance	14,952,099	11,775,349
PF Law Art. 6.1 (a) Revenue receipts	231,180	369,586
PF Law Art. 6.1 (b) DA receipts	312,465	559,969
PF Law Art. 6.1 (e) Other receipts	-	8,287
PF Law Art 7.1 Transfers to State Budget	-	-
Income for the period	174,950	264,533
<b>CAPITAL</b>	<b>15,670,695</b>	<b>12,977,723</b>

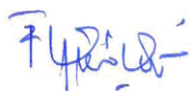
Table 13

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME - QUARTER				
In thousands of USD	Quarter		Year to Date	
	Mar-14	Mar-13	Mar-14	Mar-13
<b>INVESTMENT INCOME</b>				
Interest income	33,488	36,579	33,488	36,579
Dividend income	52,961	21,428	52,961	21,428
Trust income	921	660	921	660
Other investment income	1	(5)	1	(5)
Net gains/(losses) on Financial Assets at fair value	74,653	264,410	74,630	264,410
Net foreign exchange gains/(losses)	17,784	(55,590)	17,807	(55,590)
<b>Total Investment Income</b>	<b>179,808</b>	<b>267,481</b>	<b>179,808</b>	<b>267,481</b>
<b>EXPENSES</b>				
External management, custody fees	1,549	1,423	1,549	1,423
Internal operational management fees	1,496	437	1,496	438
IAB Expenses	81	-	81	-
Other expenses	0	1	0	-
<b>Total expenses</b>	<b>3,126</b>	<b>1,861</b>	<b>3,126</b>	<b>1,861</b>
<b>Profit before tax</b>	<b>176,682</b>	<b>265,620</b>	<b>176,682</b>	<b>265,620</b>
Withholding taxes	1,732	867	1,732	867
<b>Profit for the quarter:</b>	<b>174,950</b>	<b>264,753</b>	<b>174,950</b>	<b>264,753</b>
Other comprehensive income	-	-	-	-
<b>Total comprehensive income for the period</b>	<b>174,950</b>	<b>264,753</b>	<b>174,950</b>	<b>264,753</b>

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, 25 April 2014



Abraão de Vasconcelos  
Governor



Nur Aini Djafar Alkatiri  
Deputy Governor