

# Petroleum Fund of Timor-Leste

## Quarterly Report

30 SEPTEMBER 2014

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### 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 1 July to 30 September 2014.

Key statistics for the quarter include:

- The capital of the Fund at previous quarter was \$16.6 billion while the current quarter was also \$ 16.6 billion.
- Gross cash inflows to the fund from royalties and taxes were \$522.35 million.
- The outflows in the quarter were \$340 million to the state budget and \$5 million for management expenses.
- The profit/loss for the quarter was -231.59 million, representing a gross of fees return of -1.35% compared with the benchmark return of -1.40%.

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

Table 1

Currency \$USD	(%)					
	QTR	FYTD	1 Year	3 Years	5 Years	Since Inc
<b>Total Fund</b>	-1.35	2.45	4.84	4.50	3.88	4.26
Benchmark	-1.40	2.47	4.80	4.38	3.78	4.24
<i>Excess</i>	<i>0.05</i>	<i>-0.03</i>	<i>0.03</i>	<i>0.12</i>	<i>0.10</i>	<i>0.03</i>
<b>International Fixed Interest</b>	-0.88	1.43	0.98	0.77	1.68	3.04
Benchmark	-0.92	1.43	0.93	0.70	1.63	3.04
<i>Excess</i>	<i>0.04</i>	<i>0.00</i>	<i>0.05</i>	<i>0.07</i>	<i>0.05</i>	<i>0.00</i>
<b>International Equities</b>	-2.06	4.11	12.53	18.40	n.a	12.01
Benchmark	-2.16	3.89	12.20	17.93	n.a	11.19
<i>Excess</i>	<i>0.10</i>	<i>0.23</i>	<i>0.34</i>	<i>0.47</i>	<i>n.a</i>	<i>0.82</i>

## 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 September 2014 were as follows:

Table 2

	30-Jun-14	31-Jul-14	31-Aug-14	30-Sep-14
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>60%</b>	<b>60%</b>	<b>60%</b>	<b>60%</b>
MSCI World Index Dividends Reinvested	40.00%	40.00%	40.00%	40%
<b>Total Equities</b>	<b>40%</b>	<b>40%</b>	<b>40%</b>	<b>40%</b>
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

## 2. MARKET TRENDS DURING THE QUARTER

### Equities

The third quarter of 2014 was a period of consolidation for many markets as investors weighed up the increasingly uneven global economic recovery. Equities fared better than credit as developed equities gained 0.9%, while the Barclays Global Aggregate Index fell by 3.1%. Market sentiment in the US continues to be driven by debate over the timing of the first interest rate rise, reflected in a strengthening US dollar and rising Treasury yields. Meanwhile, the Eurozone economy stalled over the summer months, forcing the ECB to announce additional stimulus measures.

MSCI EM was down 7.41% in September. Brazil was a driver of the negative performance in the month as it was down 19.22% in September alone. MSCI World was down 2.71% for the month and -2.16% for the quarter.

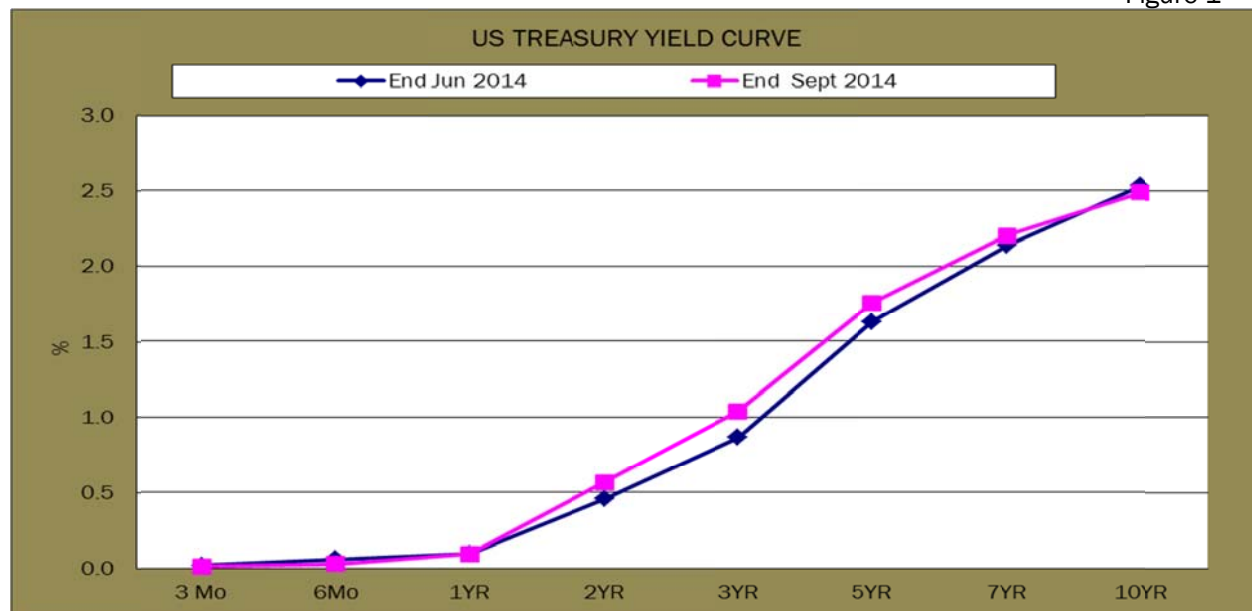
### Bonds including US Treasuries

In the US, the gap between moderate growth data and a booming job market seems to be widening. Second-quarter economic growth was confirmed at 4.6% quarter on quarter on an annualized basis, but some of this was a rebound from the first quarter's dismal figures. One of the beneficiaries of rising risk aversion was the

US dollar, which strengthened by more than 5% in trade weighted terms during the quarter but particularly in September (+3.4%).

The graph below shows the US Government yield curve compared to the previous quarter-end. There was no change to the US Federal Funds target rate, which remained at 0.25%. The yields of 2-7 years were slightly higher at the end of the quarter relative to the previous quarter, while the 1 and 10 years yields almost same to the previous quarter.

Figure 1



### 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 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
Barclays Global Treasury Developed Market ex US, 30% Eurozone and 10% Country Capped	Passive	AllianceBernstein	0.50%	Nil	3-Jul-14
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 3-5 Years Treasury Bond Index	BCTL	40%	± 2.5%	40.49%
BOA Merrill Lynch 5-10 Years Treasury Notes and Bond Index	Bank for International Settlements	10%	± 1%	10.16%
Barclays Global Treasury Developed Market ex US, 30% Eurozone and 10% Country Capped	Interim Manager	5%	± 0.5%	4.88%
Barclays Global Treasury Developed Market ex US, 30% Eurozone and 10% Country Capped	AllianceBernstein	5%	± 0.5%	4.95%
<b>Total Fixed Income</b>		<b>60%</b>		<b>60%</b>
	State Street Global Advisors			17.58%
	Black Rock	35%	± 4.0%	16.71%
MSCI World Index Net Dividends Reinvested	Schroder Investment Management	5%	± 1.5%	5.24%
<b>Total Equities</b>		<b>40%</b>		<b>40%</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 balance was \$16.6 billion, as follows:

Table 5

Capital Account, Quarter July-September 2014	\$'000
Opening book value (1 July 2014)	16,633,722
Receipts during the period	522,353
Transfer to General State Budget during the period	-340,000
Return in the period	-231,598
<b>Closing book value (30 September 2014)</b>	<b>16,584,477</b>

The Fund was invested as follows:

Table 6

Assets	\$'000
Cash and Cash Equivalents	68,045
Other Receivables	55,631
Financial assets held at fair value through profit or loss	16,503,220
Less:	
Payable for Securities Purchased	-39,447
Accounts Payable	-2,971
<b>Total</b>	<b>16,584,477</b>

The income for the quarter was as follows:

Table 7

Income	\$'000
Interest income	35,490
Dividend income	8,059
Unit Trust distributions	1,097
Other Investment income	24
Net gains/(losses) on Financial Assets at fair value	5,993
Net foreign exchange gains/(losses)	-275,996
Less:	
External manager, custody fees	-3,665
Central Bank management expenses	-1,655
IAB Expenses	-26
Other expenses	-2
Withholding taxes	-917
<b>Total Investment Income</b>	<b>-231,598</b>

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.



## 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 9

Currency \$USD	QTR	FYTD	% 1 Year	3 Years	5 Years	Since Inc
<b>International Equities</b>	-2,06	4,11	12,53	18,40	n.a	12,01
Benchmark	-2,16	3,89	12,20	17,93	n.a	11,19
<i>Excess</i>	<i>0,10</i>	<i>0,23</i>	<i>0,34</i>	<i>0,47</i>	<i>n.a</i>	<i>0,82</i>
<b>Schroder Investment Managemen</b>	-1,98	4,17	12,92	18,97	n.a	12,37
Benchmark	-2,16	3,89	12,20	17,93	n.a	11,19
<i>Excess</i>	<i>0,18</i>	<i>0,28</i>	<i>0,72</i>	<i>1,05</i>	<i>n.a</i>	<i>1,17</i>
<b>SSgA International Equity</b>	-2,07	4,11	12,46	n.a	n.a	15,55
Benchmark	-2,16	3,89	12,20	n.a	n.a	15,16
<i>Excess</i>	<i>0,09</i>	<i>0,22</i>	<i>0,26</i>	<i>n.a</i>	<i>n.a</i>	<i>0,39</i>
<b>BlacRock International Equity</b>	-2,06	4,09	12,46	n.a	n.a	15,24
Benchmark	-2,16	3,89	12,20	n.a	n.a	15,02
<i>Excess</i>	<i>0,09</i>	<i>0,20</i>	<i>0,26</i>	<i>n.a</i>	<i>n.a</i>	<i>0,23</i>

## 5. MANAGEMENT COSTS

A management fee of \$5,348 thousands for operational management costs was deducted from the fund during the quarter.

The fee covered the following services (in thousands \$):

Table 10

External Management and Custody expenses	3,665
Central Bank management expenses	1,655
IAB expenses	26
Other Expenses	2
<b>Total Cost</b>	<b>5,348</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. The amount of \$340 million was transferred to the State Budget account during the quarter .

Table 11	In Million (\$)
Transfers July 2014	100,000
Transfers August 2014	120,000
Transfers September 2014	120,000
Transfers for this Quarter	340,000
<b>Total Transfers previous quarters</b>	-
<b>Total Transfers this fiscal year to September 2014</b>	<b>340,000</b>

## 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, 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 June 2014.

## 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 September	2013 September
<b>ASSETS</b>		
Cash and Cash Equivalents	68,045	60,467
Receivables	55,631	16,102
Financial assets held at fair value through profit or loss	16,503,220	14,509,632
<b>TOTAL ASSETS</b>	<b>16,626,895</b>	<b>14,586,201</b>
<b>LIABILITIES</b>		
Payables for securities purchased	-39,447	-26,890
Accounts payable	-2,971	-1,245
<b>TOTAL LIABILITIES</b>	<b>-42,419</b>	<b>-28,135</b>
<b>NET ASSETS</b>	<b>16,584,477</b>	<b>14,558,066</b>
<b>CAPITAL</b>		
Opening Balance	14,952,099	11,775,349
PF Law Art. 6.1 (a) Revenue receipts	609,571	932,565
PF Law Art. 6.1 (b) DA receipts	990,566	1,496,288
PF Law Art. 6.1 (e) Other receipts	7,163	8,287
PF Law Art 7.1 Transfers to State Budget	-340,000	-180,000
Income for the period	365,077	525,577
<b>CAPITAL</b>	<b>16,584,477</b>	<b>14,558,066</b>

Table 13

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME - QUARTER				
In thousands of USD	Quarter		Year to Date	
	September-14	September-13	September-14	September-13
<b>INVESTMENT INCOME</b>				
Interest income	35,490	43,973	104,259	105,043
Dividend income	8,059	23,098	142,874	82,814
Trust income	1,097	1,029	4,324	2,563
Other investment income	24	4	32	128
Net gains/(losses) on Financial Assets at fair value	5,993	295,462	359,994	331,369
Net foreign exchange gains/(losses)	-275,996	-20,689	-225,963	14,219
<b>Total Investment Income</b>	<b>-225,333</b>	<b>342,877</b>	<b>385,521</b>	<b>536,137</b>
<b>EXPENSES</b>				
External management, custody fees	3,665	2,324	7,922	4,670
Internal operational management fees	1,655	548	4,209	1,315
IAB Expenses	26	54	107	99
Other expenses	2	3.28	104	77
<b>Total expenses</b>	<b>5,348</b>	<b>2,930</b>	<b>12,341</b>	<b>6,160</b>
Profit before tax	-230,681	339,947	373,179	529,976
Withholding taxes on investments	917	610	8,102	4,399
<b>Profit for the quarter:</b>	<b>-231,598</b>	<b>339,337</b>	<b>365,077</b>	<b>525,578</b>
Other comprehensive income	-	-	-	-
<b>Total comprehensive income for the period</b>	<b>-231,598</b>	<b>339,337</b>	<b>365,077</b>	<b>525,578</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, 16 October 2014



**Venancio Alves Maria**  
Executive Director



**Nur-Aini Alkatiri**  
Deputy Governor