

# Petroleum Fund of Timor-Leste

## Quarterly Report

30 JUNE 2015

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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 April 2015 to 30 June 2015.

Key statistics for the quarter include:

- The capital of the Fund at the end of the previous quarter was \$16.82 billion while the current quarter was \$ 16.86 billion.
- Gross cash inflows to the fund from royalties and taxes were \$294.68 million
- Outflows for the quarter were \$234 million, being transfers to the state budget were \$230 million while \$4 million was for management costs.
- The profit for the quarter was -\$25 million, representing a gross of fees return of -0.14% compared with the benchmark return of -0.16%.

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

Table 1

	QTR	FYTD	1 Year	3 Years	5 years	Since Inc
Total Fund	-0.14	1.24	0.70	4.60	3.81	4.15
Benchmark	-0.16	1.20	0.65	4.49	3.74	4.13
<i>Excess</i>	<i>0.02</i>	<i>0.04</i>	<i>0.05</i>	<i>0.12</i>	<i>0.07</i>	<i>0.03</i>
International Fixed Interest	-0.52	0.17	-0.01	0.56	1.37	2.90
Benchmark	-0.52	0.12	-0.11	0.50	1.34	2.89
<i>Excess</i>	<i>0.01</i>	<i>0.05</i>	<i>0.10</i>	<i>0.06</i>	<i>0.03</i>	<i>0.01</i>
International Equities	0.44	2.82	1.76	14.61	n.a	10.91
Benchmark	0.31	2.63	1.43	14.27	n.a	10.18
<i>Excess</i>	<i>0.13</i>	<i>0.19</i>	<i>0.33</i>	<i>0.35</i>	<i>n.a</i>	<i>0.73</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 subsequently to reflect the latest developments. The benchmarks as of June 2015 were as follows:

Table 2

	31-Mar-15	30-Jun-15
BOA Merrill Lynch 3-5 Years Treasury Bond Index	40.00%	40.00%
BOA Merrill Lynch 5-10 Years Treasury Notes and Bond	10.00%	10.00%
Barclays Global Treasury Developed Market ex US, 30%	10.00%	10.00%
<b>Total Fixed Income</b>	<b>60%</b>	<b>60%</b>
MSCI World Index Dividends Reinvested	40.00%	40%
<b>Total Equities</b>	<b>40%</b>	<b>40%</b>
<b>Total</b>	<b>100%</b>	<b>100%</b>

## 2. MARKET TRENDS DURING THE QUARTER

### Global Market Trend

Markets in June were unsettled by a steady stream of worrying headlines from Europe as increasingly acrimonious negotiations between Greece and the Troika (European Commission, European Central Bank and International Monetary Fund) to extend an existing bailout agreement came to an impasse. Equity markets reacted negatively to the uncertainty created of the Greek's referendum, though contagion in debt markets was relatively contained with very modest widening in sovereign debt spreads in Spain and Italy. Fears of large scale debt defaults were not limited to Greece in June.

Market's current expectation is that the post financial crisis status quo is about to change; projections of Federal Reserve Board members and the market's futures pricing suggest a rate increase is quite possible within the next six months.

### Equities

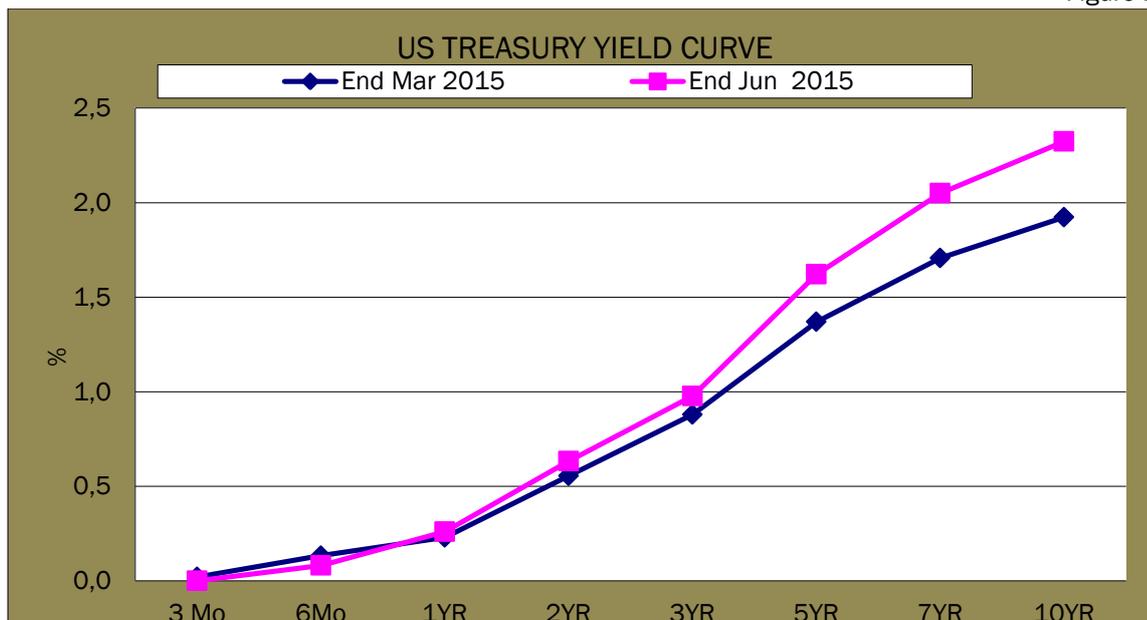
Global equity markets posted generally disappointing results for June. After holding gains for the month through June 26th, the MSCI Europe Index declined over 4% on the last two days of June following the collapse of Greek bailout negotiations and surprise announcement of a referendum by the Greek government, taking the index to a loss on the month of 3.07%. In other global equity indices the MSCI Pacific Index declined 2.4%, paced by a 4.6%

decline in Australia and moderated by 1.7% decline Japanese equities. The MSCI Emerging Markets Index declined by 2.6% led by a decline of 5.6% in Chinese Shares.

### *Bonds including US Treasuries*

US Treasuries fell during the quarter as investor anticipate to Fed hike the rate for the incoming month ECB peak in bond purchasing bail out push indexes to low in peripheral Euro Zone record in negative return German bund - 4.6%, Italy -6.3% also the Barclays U.S. Aggregate Index fell -1.2% . The yield on the benchmark 10-years treasury note raised 43 basis points to 2.36%, the German 10 years bunds raise 109 basis point to 2.33 and Italy 10 years yield running 58 basis points to 0.76%, the euro bond running across the long tenor during second 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	Enhanced Passive	AllianceBernstein	0.50%	Nil	3-Jul-14
Barclays Global Treasury Developed Market ex US, 30% Eurozone and 10% Country Capped	Enhanced Passive	Wellington Management	0.50%	Nil	4-Dec-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%	40.09%
BOA Merrill Lynch 5-10 Years Treasury Notes and Bond Index	Bank for International Settlements	10%	± 1%	10.46%
Barclays Global Treasury Developed Market ex US, 30% Eurozone and 10% Country Capped	AllianceBernstein	5%	± 0.5%	4.92%
Barclays Global Treasury Developed Market ex US, 30% Eurozone and 10% Country Capped	Wellington Management	5%	± 0.5%	4.92%
<b>Total Fixed Income</b>		<b>60%</b>		<b>60%</b>
MSCI World Index Net Dividends Reinvested	State Street Global Advisors			17.28%
	Black Rock	35%	± 4.0%	17.40%
	Schroder Investment Management	5%	± 1.5%	4.93%
<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 \$16.86 billion as follows:

Capital Account, Quarter 30 June 2015	\$'000
Opening book value (31 March 2015)	16,823,086
Receipts during the period	294,680
Transfer to General State Budget	-230,000
Investment Return	-25,039
<b>Closing book value (30 June 2015)</b>	<b>16,862,727</b>

The Fund was invested as follows:

Assets	\$'000
Cash and Cash Equivalents	93,073
Other Receivables	25,221
Financial assets held at fair value through profit or loss	16,787,039
Less:	
Payable for Securities Purchased	-35,683
Accounts Payable	-6,923
<b>Total</b>	<b>16,862,727</b>

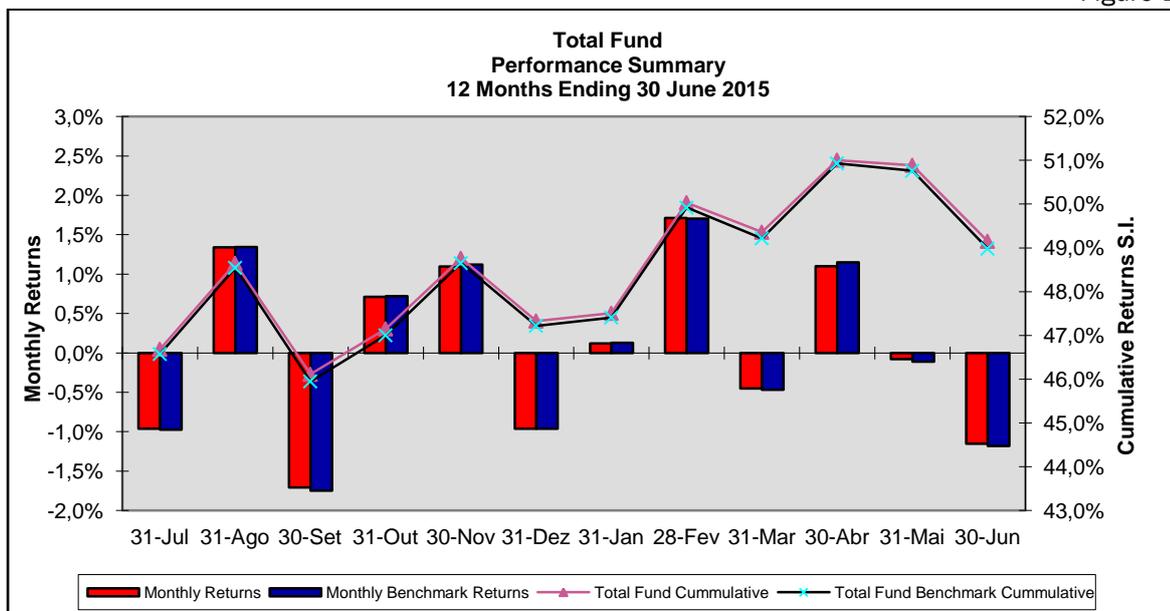
The income for the quarter was as follows:

Table 7

Income	\$'000
Interest income	39,845
Dividend income	53,329
Unit Trust distributions	2,456
Other Investment income	14
Net gains/(losses) on Financial Assets at fair value	-203,995
Net foreign exchange gains/(losses)	92,910
Less:	
External manager, custody fees	-2,378
Central Bank management expenses	-1,671
IAB Expenses	-5
Other expenses	-1
Withholding taxes	-5,543
<b>Total Investment Income</b>	<b>-25,039</b>

Global Benchmark over the same period is shown in the following graph.

Figure 2



**FIXED INTEREST**

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

Table 8

%	Qtr	FYTD	1 Year	3 Years	5 Years	Since Inc
<b>International Fixed Interest</b>	-0.52	0.17	-0.01	0.56	1.37	2.90
Benchmark	-0.52	0.12	-0.11	0.50	1.34	2.89
<i>Excess</i>	<b>0.01</b>	<b>0.05</b>	<b>0.10</b>	<b>0.06</b>	<b>0.03</b>	<b>0.01</b>
<b>BCTL 3-5 yr US Treasury</b>	-0.15	1.40	2.21	1.18	n.a	1.25
BoA Merrill Lynch 3-5 Years US Treasury Passive	-0.15	1.33	2.10	1.10	n.a	1.15
<i>Excess</i>	<b>-0.01</b>	<b>0.06</b>	<b>0.10</b>	<b>0.08</b>	<b>n.a</b>	<b>0.11</b>
<b>Bank for International Settlements</b>	-1.53	0.68	2.99	0.99	n.a	1.69
BoA Merrill Lynch 5-10 Years US Treasury Enhanced Passive	-1.55	0.65	3.05	1.01	n.a	1.69
<i>Excess</i>	<b>0.01</b>	<b>0.02</b>	<b>-0.06</b>	<b>-0.03</b>	<b>n.a</b>	<b>0.00</b>
<b>Alliance Bernstein</b>	-1.18	-5.41	n.a	n.a	n.a	-11.31
Barclays Global Treasury DM ex US Enhanced Passive	-1.10	-5.24	n.a	n.a	n.a	-11.51
<i>Excess</i>	<b>-0.08</b>	<b>-0.17</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>0.20</b>
<b>Wellington Management</b>	-1.13	-5.26	n.a	n.a	n.a	-6.12
Barclays Global Treasury DM ex US Enhanced Passive	-1.10	-5.24	n.a	n.a	n.a	-6.07
<i>Excess</i>	<b>-0.03</b>	<b>-0.02</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>-0.06</b>

## 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

	Qtr	FYTD	1 Year	3 Years	5 Years	Since Inc
<b>International Equities</b>	0.44	2.82	1.76	14.61	n.a	10.91
Benchmark	0.31	2.63	1.43	14.27	n.a	10.18
<i>Excess</i>	<b>0.13</b>	<b>0.19</b>	<b>0.33</b>	<b>0.35</b>	<b>n.a</b>	<b>0.73</b>
<b>Schroder Investment Management</b>	0.66	2.65	1.50	14.93	n.a	11.13
MSCI World Enhanced Passive	0.31	2.63	1.43	14.27	n.a	10.18
<i>Excess</i>	<b>0.35</b>	<b>0.02</b>	<b>0.07</b>	<b>0.67</b>	<b>n.a</b>	<b>0.95</b>
<b>SSgA International Equity</b>	0.41	2.90	1.83	14.54	n.a	13.28
MSCI World Passive	0.31	2.63	1.43	14.27	n.a	12.88
<i>Excess</i>	<b>0.10</b>	<b>0.27</b>	<b>0.40</b>	<b>0.28</b>	<b>n.a</b>	<b>0.40</b>
<b>Black Rock Investment Management</b>	0.41	2.82	1.79	n.a	n.a	12.06
MSCI World Passive	0.31	2.63	1.43	n.a	n.a	11.78
<i>Excess</i>	<b>0.10</b>	<b>0.19</b>	<b>0.36</b>	<b>n.a</b>	<b>n.a</b>	<b>0.27</b>

## 5. MANAGEMENT COSTS

A management fee of \$4 million for operational management costs was charged to the fund during the quarter.

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

Table 10

External Management and Custody expenses	2,378
Central Bank management expenses	1,671
IAB expenses	5
Other Expenses	1
<b>Total Cost</b>	<b>4,055</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. An amount of \$230 million was transferred to the State Budget account during the quarter.

	In Thousand (\$)
Transfer April 2015	0
Transfer May 2015	80,000
Transfer June 2015	150,000
Transfer for this Quarter	230,000
<b>Total Transfers previous quarters</b>	<b>215,000</b>
<b>Total Transfers this fiscal year to June 2015</b>	<b>445,000</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 December 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	2015 June	2014 June
<b>ASSETS</b>		
Cash and Cash Equivalents	93,073	62,787
Receivables	25,221	21,395
Financial assets held at fair value through profit or loss	16,787,039	16,554,585
<b>TOTAL ASSETS</b>	<b>16,905,333</b>	<b>16,638,767</b>
<b>LIABILITIES</b>		
Payables for securities purchased	-35,683	1,130
Accounts payable	-6,923	3,916
<b>TOTAL LIABILITIES</b>	<b>-42,606</b>	<b>5,045</b>
<b>NET ASSETS</b>	<b>16,862,727</b>	<b>16,633,722</b>
<b>CAPITAL</b>		
Opening Balance	16,538,617	16,316,734
PF Law Art. 6.1 (a) Revenue receipts	263,841	67,523
PF Law Art. 6.1 (b) DA receipts	304,064	131,500
PF Law Art. 6.1 (e) Other receipts	-	0
PF Law Art 7.1 Transfers to State Budget	-445,000	0
Income for the period	201,205	117,965
<b>CAPITAL</b>	<b>16,862,727</b>	<b>16,633,722</b>

Table 13

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME - QUARTER				
In thousands of USD	Quarter		Year to Date	
	June-15	June-14	June-15	June-14
<b>INVESTMENT INCOME</b>				
Interest income	39,845	35,282	75,271	68,770
Dividend income	53,329	81,854	95,712	134,816
Trust income	2,456	2,306	3,743	3,227
Other investment income	14	7	19	8
Net gains/(losses) on Financial Assets at fair value	-203,995	279,348	190,933	354,001
Net foreign exchange gains/(losses)	92,910	32,249	-148,959	50,033
<b>Total Investment Income</b>	<b>-15,441</b>	<b>431,046</b>	<b>216,717</b>	<b>610,854</b>
<b>EXPENSES</b>				
External management, custody fees	2,378	2,707	4,785	4,257
Internal operational management fees	1,671	1,059	3,324	2,554
IAB Expenses	5	0	5	81
Other expenses	1	101.27	3	102
<b>Total expenses</b>	<b>4,055</b>	<b>3,867</b>	<b>8,116</b>	<b>6,994</b>
Profit before tax	-19,496	427,179	208,601	603,860
Withholding taxes on investments	5,543	5,453	7,397	7,184
<b>Profit/loss for the period</b>	<b>-25,039</b>	<b>421,726</b>	<b>201,205</b>	<b>596,676</b>
Other comprehensive income	0	0	0	0
<b>Total comprehensive income for the period</b>	<b>-25,039</b>	<b>421,726</b>	<b>201,205</b>	<b>596,676</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.
- The revenue receipt in previous quarter was net of \$24.95 million refund of Taxes in February 2015.

Dili, 24 July 2015



**Venancio Alves Maria**  
Executive Director



**Abraão de Vasconcelos**  
Governor