

Petroleum Fund of Timor-Leste

Quarterly Report

30 September 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 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 2015 to 30 September 2015.

Key statistics for the quarter include:

- The capital of the Fund at the end of the previous quarter was \$16.86 billion while the current quarter was \$16.44 billion.
- Gross cash inflows to the fund from royalties and taxes were \$218.29 million
- Outflows for the quarter were \$198.01 million, being transfers to the state budget were \$193.50 million while \$4.51 million was for management costs.
- The profit/loss for the quarter was -\$450.94 million, representing a gross of fees return of -2.61% compared with the benchmark return of -2.70%.

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	-2.61	-1.41	-0.59	3.00	2.93	3.77
Benchmark	-2.70	-1.53	-0.68	2.86	2.83	3.74
<i>Excess</i>	<i>0.09</i>	<i>0.12</i>	<i>0.09</i>	<i>0.13</i>	<i>0.10</i>	<i>0.03</i>
International Fixed Interest	1.08	1.25	1.96	0.68	1.26	2.94
Benchmark	1.13	1.25	1.95	0.64	1.23	2.93
<i>Excess</i>	<i>-0.05</i>	<i>0.00</i>	<i>0.01</i>	<i>0.03</i>	<i>0.04</i>	<i>0.00</i>
International Equities	-8.27	-5.68	-4.69	8.95	n.a	8.45
Benchmark	-8.45	-6.04	-5.09	8.58	n.a	7.73
<i>Excess</i>	<i>0.18</i>	<i>0.36</i>	<i>0.40</i>	<i>0.37</i>	<i>n.a</i>	<i>0.72</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 September 2015 were as follows:

Table 2

	30-Jun-15	30-Sep-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%
Total Fixed Income	60%	60%
MSCI World Index Dividends Reinvested	40.00%	40%
Total Equities	40%	40%
Total	100%	100%

2. MARKET TRENDS DURING THE QUARTER

Global Market Trend

During third quarter initial trigger for the instability was China, where the authorities' management of the bursting of the country's stock market bubble and messy decision to devalue the currency in August left investors severely unimpressed. Fears over China's slowdown and subsequent falling demand for raw materials, coupled with excess supply, meant a further step down for commodity prices, with commodities the worst performing asset class of the quarter. The US Federal Reserve's (Fed's) decision to leave US interest rates unchanged, despite reasonably strong domestic economic indicators, further riled investors and revived uncertainty about the timing and pace of US rate increases. The Fed pointed to downward pressures on inflation in the near term as well as concerns about growth in China and other emerging markets.

Equities

Economic indicators from Europe have generally been positive, with business and consumer surveys providing reassurance about the euro area's growth momentum in the face of the Chinese slowdown. It is notable that European growth is now being driven by a recovery in pent-up domestic demand and less by net

trade. This was the ninth consecutive quarter of growth; the relative immunity of the European economy to the Greek crisis and the Chinese slowdown is encouraging. The market, however, was not immune to these concerns, with the MSCI Europe ex UK Index down 7.3%.

The quarter also saw weakness for Chinese equities, with a day (dubbed “Black Monday”) in which China suffered significant financial losses, with the Shanghai Composite Index closing down 8.49%. The chain of events began with the surprise devaluation of the yuan on 11 August, with instability compounded by unexpectedly weak economic indicators and concern over previous falls in the Chinese stock markets.

While disappointing economic data, such as consecutive falls in the manufacturing purchasing managers’ index, sparked fears around the slowdown in the Chinese economy, it is noted that the property market has stabilised and retail sales are still growing strongly. The Chinese slowdown is part of the process of the economy transitioning to a path of slower but more sustainable consumption- and service-based growth.

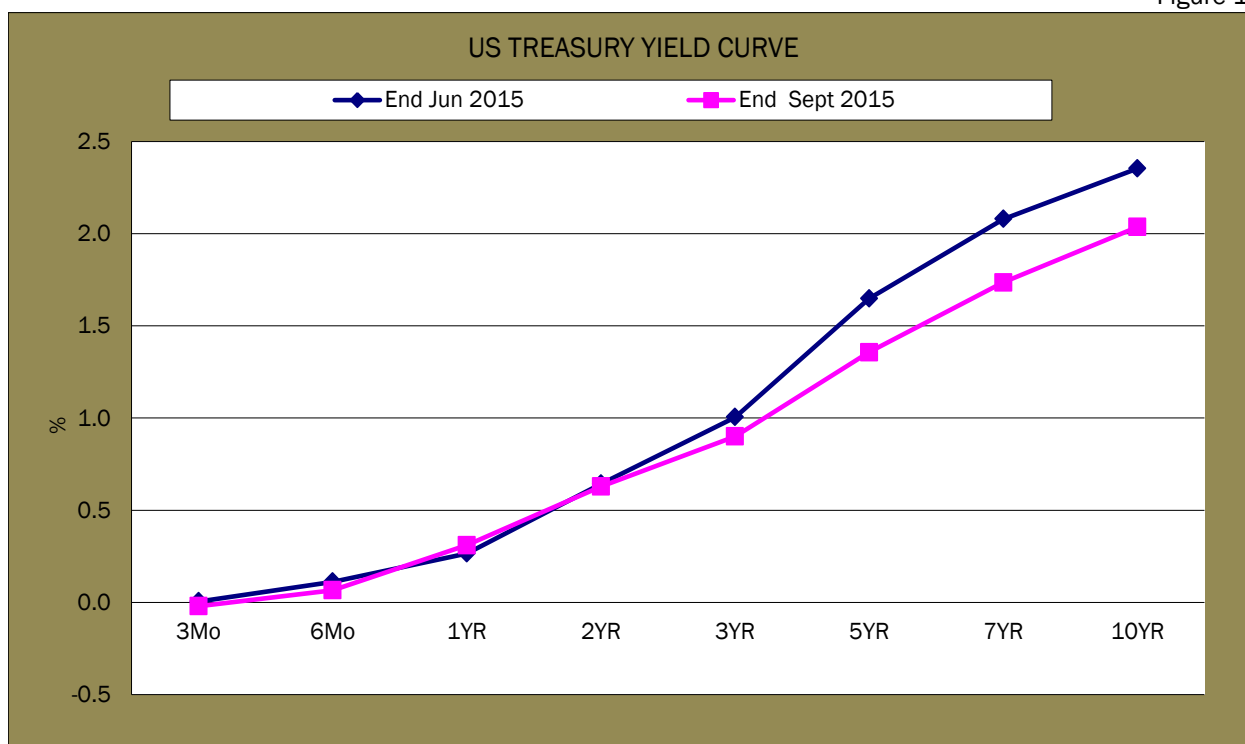
Inevitably, the slowdown in China, coupled with still-high supply, did not help falling commodity prices, which in turn continued to hurt commodity-exporting emerging markets. Commodities remain the worst performing asset class of the quarter, with emerging markets.

Bonds including US Treasuries

In third quarter Federal Open Market Committee decided not to raise interest rates, despite unemployment falling from 5.6% at the start of the year to 5.1% in August. Weak domestic inflation on the Fed’s preferred measure was part of the story, but the Fed also pointed to “recent global economic and financial developments” that may have the potential to restrain economic activity and “put further downward pressure on inflation in the near term and pushing down global yield decrease across the tenor. The US treasury 10-years treasury yield fell -27 basis points to 2.04%, the German 10 years bunds yield fell -17 basis point to 0.59% and Italy 10 years yield fell -60 basis points to 1.73%. The impact of slowdown in China and other emerging markets as well as the disinflationary influence of some further appreciation in the US dollar. Investors still expect the Fed to lift rates this year, but the speed at which rates rise could be slower than previously expected.

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 0-0.25%. Short term yields were almost remain the same as previous quarter, while the 5, 7 and 10 years yield decreased by 29, 34 and 32 basis points to 1.36%, 1.74% and 2.04% respectively at the end of the quarter. Bond prices and yield move in opposite direction.

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	Alliance Bernstein	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
		BlackRock	0.35%	Nil	21-Feb-13
	Enhanced Passive	Schroders Investment Management	1.00%	1.00%	7-Oct-10

Operational Implementation

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

Tabela 4

Gestores	Benchmark	Tolerância	Real	Limite Mínimo	Limite Máximo
BOA Merrill Lynch 3-5 Years Treasury Bond Index	BCTL	40%	± 2,5%	41.73%	37.50% 42.50%
BOA Merrill Lynch 5-10 Years Treasury Notes and Bond Index	Bank for International Settlements	10%	± 1%	10.81%	9.00% 11.00%
Barclays Tezouro Global Mercado Desenvolvido ex EUA, 30% zona Euro e 10% Nação Capped	Alliance Bernstein	5%	± 0,5%	5.13%	4.50% 5.50%
Barclays Tezouro Global Mercado Desenvolvido ex EUA, 30% zona Euro e 10% Nação Capped	Wellington Management	5%	± 0,5%	4.95%	4.50% 5.50%
Total do Rendimento Fixo		60%		62.62%	55.50% 64.50%
MSCI World Index Net Dividends Reinvested	State Street Global Advisors	35%	± 4,0%	16.31%	15.50% 19.50%
	BlackRock			16.41%	
	Schroders Investment Management	5%	± 1,5%	4.67%	3.50% 6.50%
Total Ações (títulos de rendimento variável)		40%		37.38%	34.50% 45.50%

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 \$16.44 billion as follows:

Table 5

Capital Account	\$'000
Opening book value (30 June 2015)	16,862,727
Receipts during the period	218,292
Transfer to General State Budget	-193,500
Investment Return	-450,937
Closing book value (30 September 2015)	16,436,582

The Fund was invested as follows:

Table 6

Assets	\$'000
Cash and Cash Equivalents	148,252
Other Receivables	50,538
Financial assets held at fair value through profit or loss	16,275,703
Less:	
Payable for Securities Purchased	-32,642
Accounts Payable	-5,269
Total	16,436,582

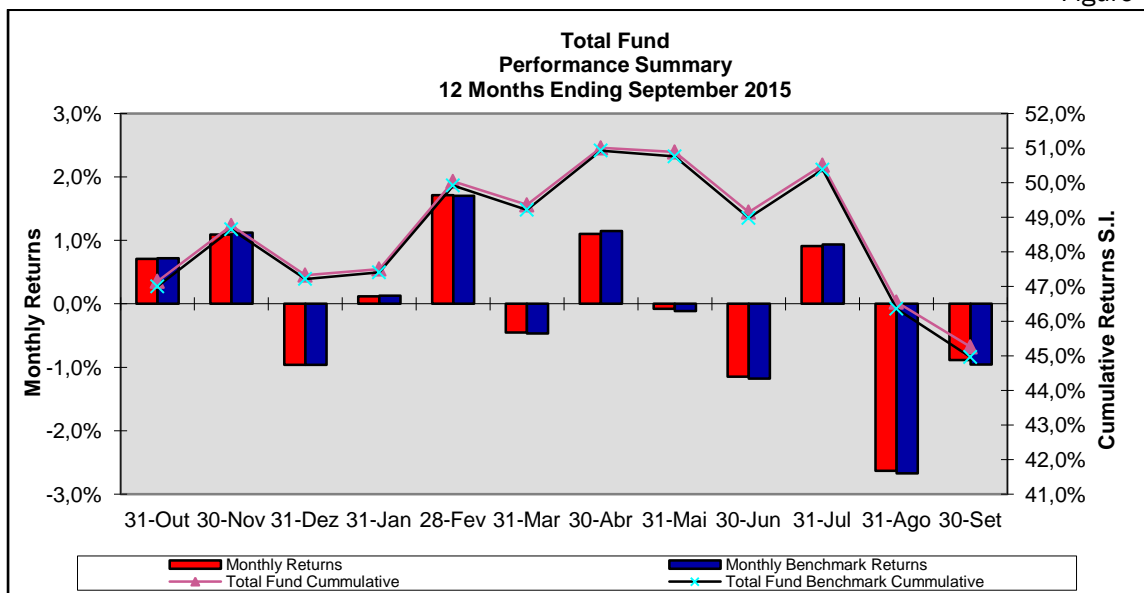
The income for the quarter was as follows:

Table 7

Income	\$'000
Interest income	40,951
Dividend income	36,338
Unit Trust distributions	1,343
Other Investment income	1
Net gains/(losses) on Financial Assets at fair value	-431,788
Net foreign exchange gains/(losses)	-92,517
Less:	
External manager, custody fees	-2,661
Central Bank management expenses	-1,701
IAB Expenses	-149
Other expenses	-1
Withholding taxes	-752
Total Investment Income	-450,937

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
International Fixed Interest	1.08	1.25	1.96	0.68	1.26	2.94
Benchmark	1.13	1.25	1.95	0.64	1.23	2.93
<i>Excess</i>	<i>-0.05</i>	<i>0.00</i>	<i>0.01</i>	<i>0.03</i>	<i>0.04</i>	<i>0.00</i>
BCTL 3-5 yr US Treasury	1.16	2.57	3.52	1.31	n.a	1.48
BoA Merrill Lynch 3-5 Years US Treasury Passive	1.23	2.58	3.54	1.26	n.a	1.40
<i>Excess</i>	<i>-0.07</i>	<i>-0.01</i>	<i>-0.02</i>	<i>0.05</i>	<i>n.a</i>	<i>0.08</i>
Bank for International Settlements	2.42	3.11	5.33	1.43	n.a	2.21
BoA Merrill Lynch 5-10 Years US Treasury Enhanced Passive	2.47	3.14	5.46	1.50	n.a	2.23
<i>Excess</i>	<i>-0.05</i>	<i>-0.03</i>	<i>-0.13</i>	<i>-0.07</i>	<i>n.a</i>	<i>-0.01</i>
Alliance Bernstein	-0.60	-5.98	-7.71	n.a	n.a	-9.60
Barclays Global Treasury DM ex US Enhanced Passive	-0.67	-5.88	-7.61	n.a	n.a	-9.81
<i>Excess</i>	<i>0.07</i>	<i>-0.11</i>	<i>-0.10</i>	<i>n.a</i>	<i>n.a</i>	<i>0.21</i>
Wellington Management	-0.67	-5.89	n.a	n.a	n.a	-6.75
Barclays Global Treasury DM ex US Enhanced Passive	-0.67	-5.88	n.a	n.a	n.a	-6.70
<i>Excess</i>	<i>0.00</i>	<i>-0.01</i>	<i>n.a</i>	<i>n.a</i>	<i>n.a</i>	<i>-0.06</i>

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
International Equities	-8.27	-5.68	-4.69	8.95	n.a	8.45
Benchmark	-8.45	-6.04	-5.09	8.58	n.a	7.73
<i>Excess</i>	<i>0.18</i>	<i>0.36</i>	<i>0.40</i>	<i>0.37</i>	<i>n.a</i>	<i>0.72</i>
Schroders Investment Management	-8.06	-5.63	-4.81	9.21	n.a	8.70
MSCI World Enhanced Passive	-8.45	-6.04	-5.09	8.58	n.a	7.73
<i>Excess</i>	<i>0.38</i>	<i>0.41</i>	<i>0.28</i>	<i>0.63</i>	<i>n.a</i>	<i>0.97</i>
SSgA International Equity	-8.27	-5.61	-4.61	8.93	n.a	9.79
MSCI World Passive	-8.45	-6.04	-5.09	8.58	n.a	9.37
<i>Excess</i>	<i>0.18</i>	<i>0.43</i>	<i>0.48</i>	<i>0.35</i>	<i>n.a</i>	<i>0.42</i>
Black Rock Investment Management	-8.32	-5.74	-4.71	n.a	n.a	7.31
MSCI World Passive	-8.45	-6.04	-5.09	n.a	n.a	7.02
<i>Excess</i>	<i>0.12</i>	<i>0.30</i>	<i>0.38</i>	<i>n.a</i>	<i>n.a</i>	<i>0.29</i>

5. MANAGEMENT COSTS

A management fee of \$4.51 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	2,661
Central Bank management expenses	1,701
IAB expenses	149
Other Expenses	1
Total Cost	4,512

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 \$193.5 million was transferred to the State Budget account during the quarter. The transfers are summarized in table 11.

Table 11	In Thousand (\$)
Transfer July 2015	0
Transfer August 2015	60,000
Transfer September 2015	133,500
Transfer for this Quarter	193,500
Total Transfers previous quarters	445,000
Total Transfers this fiscal year to September 2015	638,500

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. At the end of August, a temporary out of duration limit between the portfolio and benchmark duration for US Treasury 3-5 years occurred as a consequence of accumulating cash, but action was taken to rectify this within 2 weeks in September.

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 has performed an audit up to quarter ended June 2015.

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	2014
	September	September
ASSETS		
Cash and Cash Equivalents	148,252	68,045
Receivables	50,538	55,631
Financial assets held at fair value through profit or loss	16,275,703	16,503,220
TOTAL ASSETS	16,474,492	16,626,895
LIABILITIES		
Payables for securities purchased	-32,642	-39,447
Accounts payable	-5,269	-2,971
TOTAL LIABILITIES	-37,911	-42,419
NET ASSETS	16,436,582	16,584,477
CAPITAL		
Opening Balance	16,538,617	14,952,099
PF Law Art. 6.1 (a) Revenue receipts	366,012	609,571
PF Law Art. 6.1 (b) DA receipts	420,185	990,566
PF Law Art. 6.1 (e) Other receipts	-	7,163
PF Law Art 7.1 Transfers to State Budget	-638,500	-340,000
Income for the period	-249,733	365,077
CAPITAL	16,436,582	16,584,477

Table 13

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME - QUARTER				
In thousands of USD				
	Quarter		Year to Date	
	Sep-15	Sep-14	Sep-15	Sep-14
INVESTMENT INCOME				
Interest income	40,951	35,490	116,221	104,259
Dividend income	36,338	8,059	132,050	142,874
Trust income	1,343	1,097	5,086	4,324
Other investment income	1	24	19	32
Net gains/(losses) on Financial Assets at fair value	-431,788	5,993	-240,855	359,994
Net foreign exchange gains/(losses)	-92,517	-275,996	-241,476	-225,963
Total Investment Income	-445,673	-225,333	-228,955	385,521
EXPENSES				
External management, custody fees	2,661	3,665	7,445	7,922
Internal operational management fees	1,701	1,655	5,025	4,209
IAB Expenses	149	26	154	107
Other expenses	1	2	4	104
Total expenses	4,512	5,348	12,628	12,341
Profit before tax	-450,185	-230,681	-241,584	373,179
Withholding taxes on investments	752	917	8,149	8,102
Profit/loss for the period	-450,937	-231,598	-249,733	365,077
Other comprehensive income	-	-	-	-
Total comprehensive income for the period	-450,937	-231,598	-249,733	365,077


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, 22 October 2015



Venancio Alves Maria
Executive Director



Abraão de Vasconcelos
Governor