

Petroleum Fund of Timor-Leste

Quarterly Report

31 March 2017

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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 January 2017 to 31 March 2017.

Key statistics for the quarter include:

- The capital of the Fund at the end of the previous quarter was \$15.84 billion while the current quarter was \$16.26 billion.
- Gross cash inflows to the fund from royalties and taxes were \$104.37 million.
- Outflows for the quarter were \$182.90 million, being transfers to the state budget were \$180 million while \$2.90 million was for management costs.
- The profit/loss for the quarter was \$497.20 million, representing a gross of fees return of 3.14% compared with the benchmark return of 3.03%.

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	3.14	3.14	5.77	3.30	4.18	4.09
Benchmark	3.03	3.03	4.89	3.06	3.96	4.00
<i>Excess</i>	<i>0.11</i>	<i>0.11</i>	<i>0.88</i>	<i>0.24</i>	<i>0.22</i>	<i>0.09</i>
International Fixed Interest	0.83	0.83	-0.36	1.48	1.27	2.73
Benchmark	0.83	0.83	-1.46	1.15	1.04	2.64
<i>Excess</i>	<i>0.00</i>	<i>0.00</i>	<i>1.09</i>	<i>0.34</i>	<i>0.23</i>	<i>0.09</i>
International Equities	6.30	6.30	15.14	5.90	9.76	9.65
Benchmark	6.38	6.38	14.77	5.52	9.37	9.00
<i>Excess</i>	<i>-0.08</i>	<i>-0.08</i>	<i>0.37</i>	<i>0.38</i>	<i>0.39</i>	<i>0.66</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 March 2017 were as follows:

Tabela 2

	31-Jan-17	28-Feb-17	31-Mar-17
BOA Merrill Lynch 3-5 Years Treasury Bond Index	40.00%	40.00%	40.00%
BOA Merrill Lynch 5-10 Years Treasury Notes and Bond Index	10.00%	10.00%	10.00%
Barclays Global Treasury Developed Market ex US, 30% Eurozone	10.00%	10.00%	10.00%
Total de Rendimento Fixo	60%	60%	60%
MSCI World Index Dividends Reinvested	39.00%	39.00%	39.00%
MSCI Australia Index	1.00%	1.00%	1.00%
Total Acções	40%	40%	40%
Total	100%	100%	100%

2. MARKET TRENDS DURING THE QUARTER

Global Market Trend

The year 2017 kicked off with different expectations across the regions. In the U.S, the optimism on new administration to bring huge change through tax reform, massive infrastructure spending and loosen regulation in financial industry sent the stock markets to hit their highest level in history. On the other hand, in Europe the Brexit and political events in countries with biggest economic influence such as France, Germany, and the Netherlands highlighted the political risk in the region. The export oriented Asia and emerging markets were left uncertain over the new U.S administration's potential protectionism policy toward the region. Despite started the year with uncertain expectations, the global economy has fared well during the first quarter of the year. Robust labor market, fast pace business expansion and near target inflation rate in U.S prompted the Fed to add 25bps to its interest rate in March 2017. The Fed interest rate

now at the range of 0.75 – 1%. U.S unemployment now at 4.7% and inflation is at 1.9% just slightly below Fed's 2% target.

The European Central Bank decided to hold interest rate unchanged at 0.0% despite the inflation rate within their target range of 2%. However, the ECB have reduced their asset-purchasing program and lift their growth forecast due to the improving economic data released recently. The Bank of England also held their interest rate due to the political uncertainties but lift their growth expectation to 2% from last year's projection of 1.4%. Britain has kicked off the 2-year divorce negotiation with European Union. In Japan, the BoJ continue applying its negative interest rate monetary policy as the inflation in the country still very low. Japan's inflation is at 0.4%, well below 2% target. While, the Reserve Bank of Australia and Reserve Bank of New Zealand decided to keep their interest rate accommodative cited the higher global risk.

Equities

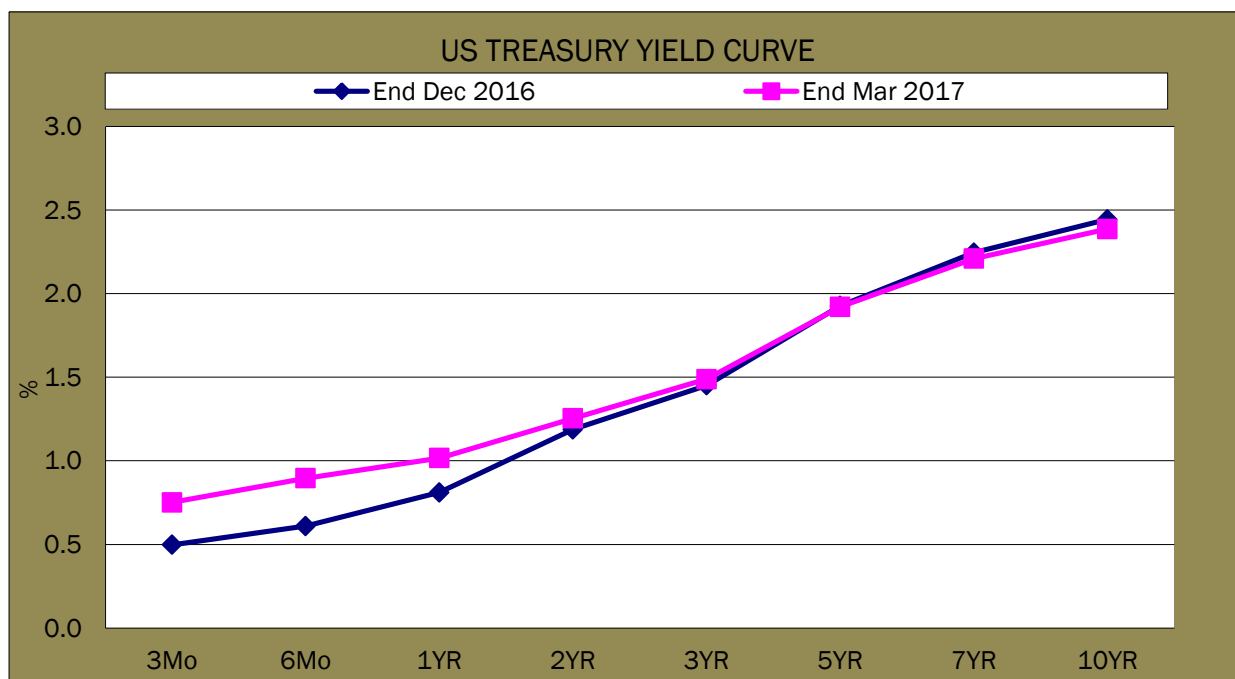
Despite posted negative return in March, the U.S equity closed the quarter strong. The U.S S&P 500 ended the quarter with 5.53% gain. The U.S equity markets have performed well since the U.S election mostly contributed by the sentiment on U.S new administration pro-growth agenda and supportive economic data. The U.K's FTSE 100 posted 2.52% gain during the quarter in spite of the Brexit uncertainties. The U.K equity markets have done well since the Brexit vote back in June 2016 as it supported by weak pound in most part of the quarter. European equity market also performed well as MSCI Europe closed the quarter with 4.76% gain. Surveys in businesses and consumers confidence have risen to the highest level in last five year. The improvement in confidence is well spread across the Eurozone and the European companies are finally starting to show the broad-based earning growth. This is a big boost to the European equities to recover from their underperformance in recent years. Across pacific, Japanese equity market is mixed as Nikkei 225 Index posted 1.10% loss while the Topix index posted a modest gain of 0.6% during the quarter. Japan economic data released during the period mostly supportive, which contributed to the appreciation of the Japanese yen. Strong yen tends to have negative effect on Japanese exporters. However, New Zealand and Australia equity market closed in positive territory supported by high commodity prices.

Bonds including US Treasuries

Global government bond yields are mixed for the quarter. Optimism over the strengthening global economy and potential pro-growth effects from President Trump's fiscal stimulus plans continued to drive markets in Q1. The shift toward monetary policy normalization also continued. In Europe, government bond yields increased as investors' demand for safe haven asset raise due to the elections in the region. 10-Y German government bond yield added 13bps to end the quarter at 0.33%. Meanwhile, in France the security with same maturity posted 30bps higher, finish the quarter at 0.99%. 10-Y Italian Government bond yield rose 30bps, ended the quarter at 2.13%. Across pacific, the Japan government bond 10-Y yield was flat, gained only half percentage, ended the month at 0.074%. The Bank of Japan is continuing their yield curve control policy by keep the short-term bond yield in negative territory and long-term bond positive. The objective of BoJ's policy is to raise money by selling the longer maturity bond, while purchasing security with shorter maturity in order to bring up the ultra-low inflation in the country.

The graph below illustrates the U.S Treasury yield curve ranges from 3 month to 10 years compared to the previous quarter end. The short-term U.S treasury yield such as 3, 6 and 12 months increased by 25 basis points on average. In the medium tenor yield is mixed during the quarter as 2-Y note gained 6 basis points while 5 year note closed the quarter barely negative. Long end tenor U.S Treasury bond yield decline for the quarter as 10-Y and 30-Y bond both lost 5 basis points respectively for the 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 Bond Index	Enhanced Passive	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
	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%	1.00%	7-Oct-10
MSCI Australia Index	Passive	BCTL	0.50%	Nil	4-Jul-16

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	Lower Boundary	Upper Boundary
BOA Merrill Lynch 3-5 Years Treasury Bond Index	BCTL	40%	± 2.5%	40.23%	37.50%	42.50%
BOA Merrill Lynch 5-10 Years Treasury Notes and Bond Index	Bank for International Settlements	10%	± 1%	10.01%	9.00%	11.00%
Barclays Global Treasury Developed Market ex US, 30% Eurozone and 10%	Alliance Bernstein	5%	± 0.5%	5.01%	4.50%	5.50%
	Wellington Management	5%	± 0.5%	5.00%	4.50%	5.50%
Total Fixed Income		60%		60.25%	55.50%	64.50%
MSCI World Index Net Dividends Reinvested	State Street Global Advisors	34%	± 4.0%	16.84%	13.00%	21.00%
	BlackRock			16.86%		
	Schroders Investment Management	5%	± 1.5%	4.97%	3.50%	6.50%
MSCI Australia Index	BCTL	1%	± 0.5%	1.08%	0.50%	1.50%
Total Equities		40%		39.75%	30.00%	50.00%

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 \$16.26 billion as follows:

Table 5

Capital Account	\$'000
Opening book value (31 December 2016)	15,844,327
Receipts during the period	104,375
Transfer to General State Budget	-180,000
Investment Return	497,204
Closing book value (31 March 2017)	16,265,906

The Fund was invested as follows:

Table 6

Assets	\$'000
Cash and Cash Equivalents	658,433
Other Receivables	40,380
Financial assets held at fair value through profit or loss	16,130,532
Less:	
Payable for Securities Purchased	-561,554
Accounts Payable	-1,886
Total	16,265,906

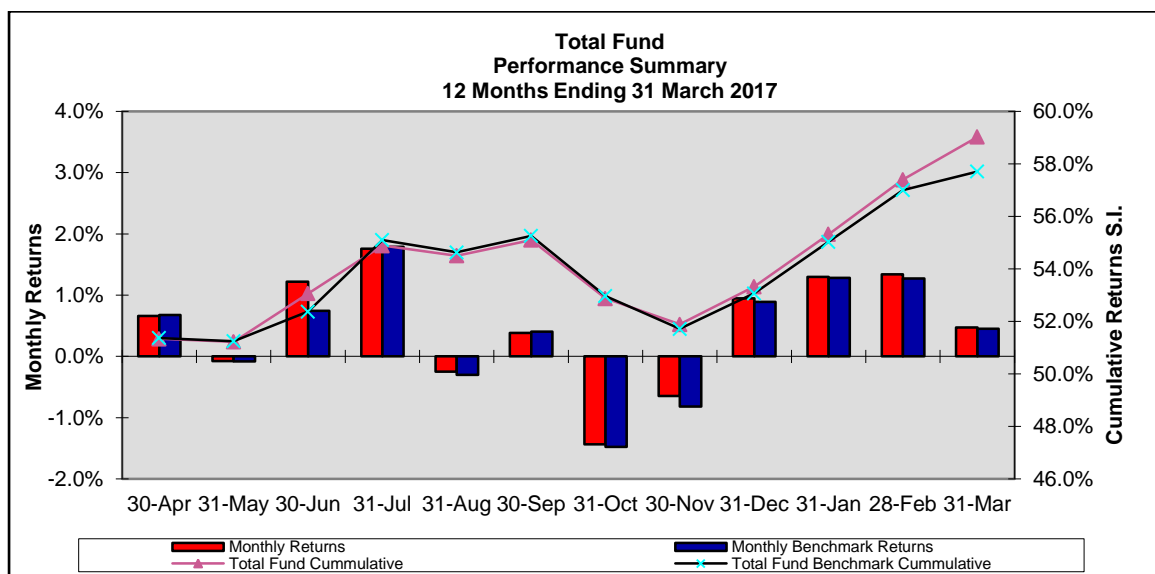
The income for the quarter was as follows:

Table 7

Income	\$'000
Interest income	38,920
Dividend income	42,089
Unit Trust distributions	2,102
Other Investment income	1
Net gains/(losses) on Financial Assets at fair value	341,861
Net foreign exchange gains/(losses)	77,098
Less:	
External manager, custody fees	-1,036
Central Bank management expenses	-1,635
IAB Expenses	0
Other expenses	-229
Withholding taxes	-1,968
Total Investment Income	497,204

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	0.83	0.83	-0.36	1.48	1.27	2.73
Benchmark	0.83	0.83	-1.46	1.15	1.04	2.64
<i>Excess</i>	0.00	0.00	1.09	0.34	0.23	0.09
BCTL Cash Management (TLCM)	0.25	0.25	n.a	n.a	n.a	0.48
BCTL 3-5 yr US Treasury	0.53	0.53	-0.54	1.67	1.31	1.20
BoA Merrill Lynch 3-5 Years US Treasury Passive	0.51	0.51	-0.59	1.71	1.31	1.16
<i>Excess</i>	0.02	0.02	0.05	-0.04	0.00	0.03
Bank for International Settlements	0.89	0.89	-1.77	2.69	1.97	1.73
BoA Merrill Lynch 5-10 Years US Treasury Enhanced Passive	0.84	0.84	-1.86	2.75	1.99	1.74
<i>Excess</i>	0.04	0.04	0.09	-0.06	-0.02	-0.01
Alliance Bernstein	2.00	2.00	-4.71	n.a	n.a	-3.93
Barclays Global Treasury DM ex US Enhanced Passive	2.04	2.04	-4.76	n.a	n.a	-4.03
<i>Excess</i>	-0.04	-0.04	0.06	n.a	n.a	0.10
Wellington Management	2.02	2.02	-4.86	n.a	n.a	-2.35
Barclays Global Treasury DM ex US Enhanced Passive	2.04	2.04	-4.76	n.a	n.a	-2.26
<i>Excess</i>	-0.02	-0.02	-0.09	n.a	n.a	-0.09

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	6.30	6.30	15.14	5.90	9.76	9.65
Benchmark	6.38	6.38	14.77	5.52	9.37	9.00
<i>Excess</i>	<i>-0.08</i>	<i>-0.08</i>	<i>0.37</i>	<i>0.38</i>	<i>0.39</i>	<i>0.66</i>
Schroders Investment Management	5.69	5.69	16.20	6.22	10.36	10.07
MSCI World Enhanced Passive	6.38	6.38	14.77	5.52	9.37	9.00
<i>Excess</i>	<i>-0.69</i>	<i>-0.69</i>	<i>1.43</i>	<i>0.71</i>	<i>0.99</i>	<i>1.08</i>
SSgA International Equity	6.24	6.24	14.82	5.82	9.61	10.84
MSCI World Passive	6.25	6.25	14.58	5.46	9.33	10.45
<i>Excess</i>	<i>-0.01</i>	<i>-0.01</i>	<i>0.25</i>	<i>0.36</i>	<i>0.28</i>	<i>0.39</i>
BlackRock Investment Management	6.27	6.27	14.90	5.82	n.a	9.52
MSCI World Passive	6.25	6.25	14.58	5.46	n.a	9.21
<i>Excess</i>	<i>0.03</i>	<i>0.03</i>	<i>0.33</i>	<i>0.36</i>	<i>n.a</i>	<i>0.32</i>
BCTL Investment Management	10.93	10.93	n.a	n.a	n.a	18.13
MXAU AU Index Passive	10.98	10.98	n.a	n.a	n.a	18.22
<i>Excess</i>	<i>-0.05</i>	<i>-0.05</i>	<i>n.a</i>	<i>n.a</i>	<i>n.a</i>	<i>-0.09</i>

5. MANAGEMENT COSTS

A management fee of \$2.90 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	1,036
Central Bank management expenses	1,635
IAB expenses	0
Other Expenses	229
Total Cost	2,900

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 \$180 million was transferred to the State Budget account during the quarter. The transfers are summarized in table 11.

Table 11	In Thousand (\$)
Transfer January 2017	0
Transfer February 2017	100,000
Transfer March 2017	80,000
Transfer for this Quarter	180,000
Total Transfers previous quarters	0
Total Transfers this fiscal year to March 2017	180,000

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 has performed an audit up to quarter ended 31 December 2016.

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	2017 March	2016 March
ASSETS		
Cash and Cash Equivalents	658,433	213,725
Receivables	40,380	50,407
Financial assets held at fair value through profit or loss	16,130,532	16,340,129
TOTAL ASSETS	16,829,346	16,604,260
LIABILITIES		
Payables for securities purchased	-561,554	-20,512
Accounts payable	-1,886	-5,929
TOTAL LIABILITIES	-563,440	-26,441
NET ASSETS	16,265,906	16,577,819
CAPITAL		
Opening Balance	15,844,327	16,217,573
PF Law Art. 6.1 (a) Revenue receipts	53,766	56,402
PF Law Art. 6.1 (b) DA receipts	50,609	68,897
PF Law Art. 6.1 (e) Other receipts	0	0
PF Law Art 7.1 Transfers to State Budget	-180,000	-100,000
Income for the period	497,204	334,948
CAPITAL	16,265,906	16,577,819

Table 13

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME - QUARTER				
In thousands of USD	Quarter		Year to Date	
	Mar-17	Mar-16	Mar-17	Mar-16
INVESTMENT INCOME				
Interest income	38,920	39,919	38,920	39,919
Dividend income	42,089	42,893	42,089	42,893
Trust income	2,102	1,940	2,102	1,940
Other investment income	1	4	1	4
Net gains/(losses) on Financial Assets at fair value	341,861	100,379	341,861	100,379
Net foreign exchange gains/(losses)	77,098	157,004	77,098	157,004
Total Investment Income	502,071	342,139	502,071	342,139
EXPENSES				
External management, custody fees	1,036	2,366	1,036	2,366
Internal operational management fees	1,635	1,604	1,635	1,604
IAB Expenses	0	0	0	0
Other expenses	229	1,212	229	1,212
Total expenses	2,900	5,182	2,900	5,182
Profit before tax	499,171	336,957	499,171	336,957
Withholding taxes on investments	1,968	2,009	1,968	2,009
Profit/loss for the period	497,204	334,948	497,204	334,948
Other comprehensive income	0	0	0	0
Total comprehensive income for the period	497,204	334,948	497,204	334,948

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, 20 April 2017



Venancio Alves Maria
Executive Director



Nur Aini Djafar Alkatiri
Deputy Governor