

# Petroleum Fund of Timor-Leste

## Quarterly Report

30 June 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 April 2017 to 30 June 2017.

Key statistics for the quarter include:

- The capital of the Fund at the end of the previous quarter was \$16.26 billion while the current quarter was \$16.50 billion.
- Gross cash inflows to the fund from royalties and taxes were \$95.65 million.
- Outflows for the quarter were \$243.94 million, being transfers to the state budget were \$240 million while \$3.94 million was for management costs.
- The profit/loss for the quarter was \$383.03 million, representing a gross of fees return of 2.38% compared with the benchmark return of 2.41%.

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	2.38	5.60	6.37	3.02	4.44	4.16
Benchmark	2.41	5.51	5.99	2.95	4.34	4.12
<i>Excess</i>	<i>-0.03</i>	<i>0.09</i>	<i>0.38</i>	<i>0.07</i>	<i>0.10</i>	<i>0.03</i>
International Fixed Interest	1.35	2.18	-1.24	1.19	1.05	2.71
Benchmark	1.31	2.16	-1.55	1.12	1.00	2.70
<i>Excess</i>	<i>0.03</i>	<i>0.03</i>	<i>0.32</i>	<i>0.06</i>	<i>0.05</i>	<i>0.01</i>
International Equities	3.95	10.49	18.40	5.60	11.74	9.91
Benchmark	4.03	10.66	18.20	5.24	11.38	9.29
<i>Excess</i>	<i>-0.08</i>	<i>-0.16</i>	<i>0.21</i>	<i>0.36</i>	<i>0.36</i>	<i>0.62</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 2017 were as follows:

Table 2

	30-Apr-17	31-May-17	30-Jun-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%
<b>Total Fixed Income</b>	<b>60%</b>	<b>60%</b>	<b>60%</b>
MSCI World Index ex Australia Net Dividends Reinvested	39.00%	39.00%	39.00%
MSCI Australia Index	1.00%	1.00%	1.00%
<b>Total Equities</b>	<b>40%</b>	<b>40%</b>	<b>40%</b>
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

## 2. MARKET TRENDS DURING THE QUARTER

### Global Market Trend

Gradual improvement in economic fundamentals and industrial activity in most regions in the world triggered major central banks to signal their intention to slowly reducing accommodative monetary policy and upgrade their economic growth outlook.

U.S. Federal Reserve (FED) decided to add 0.25% to their short term lending benchmark during the Federal Reserve Open Market Committee meeting in June. It is the second time FED rise interest rate for the year. At the same time, the FED discussed to start reducing the assets hold in their balance sheet “relatively soon”. The FED noted that the labor market is solid. The U.S. economy created total of 581,000 jobs during the quarter and the unemployment rate is at the multiyear low of 4.4%. The U.S. wage growth remains tepid as the tightening job market has not translated to higher wage; this contributes to the low inflation. The FED has projected that the inflation would remain below their 2% target for the rest of the year, which gives another rate hike in doubt.

Bank of England kept their monetary unchanged despite the upsurge inflation. The monetary policy makers stated that an interest rate might be on the horizon if inflation continues to move upward. During the meeting held in June, 3 out of 8 members wanted to raise interest rate.

France elections highlighted the political uncertainty in Eurozone during the quarter. The concerns lessened as the market friendly candidate Emanuel Macron and his new party claimed an astounding victory on both presidential and parliament election. Combination of supportive market fundamentals such as manufacturing, declining in unemployment and less political risk across the region, boost the probability of European Central Bank to lessen their easing monetary policy.

The central banks of Japan, South Korea, Australia, and New Zealand kept their interest rate unchanged during the quarter. Nonetheless, the central bank of Japan and South Korea upgrade their GDP projection for the year.

### *Equities*

U.S equity market posted positive return for another quarter against the backdrop of political chaos at the White House. The three major equity indices such as S&P 500, Dow Jones and Nasdaq all posted 2 to 3% return respectively, supported by the strong earnings during the first quarter of the year. According to FactSet, 75% of companies in generic index S&P 500 surpass their earnings expectations.

U.K equity market index FTSE 100 closed the quarter barely positive in local currency but posted negative in USD term as U.K's pound continue to depreciate against the greenback. Economic and political outlook in U.K remain uncertain as The Conservative party lost majority at the general election, making the Brexit negotiations outcome unpredictable. At the same time, most Eurozone equity indices finished the quarter in negative territory as the market felt nervous on the ECB's message to taper easing monetary policy.

Asia equity market were mixed during the quarter; Japan and South Korean equity market performed very well while the Australian equity closed the quarter in negative territory. Equity market in South Korea and Japan benefited from the global economy improvement as the demand of goods and service from outside the world was strong. Supportive monetary policies from their respective central banks also help local companies.

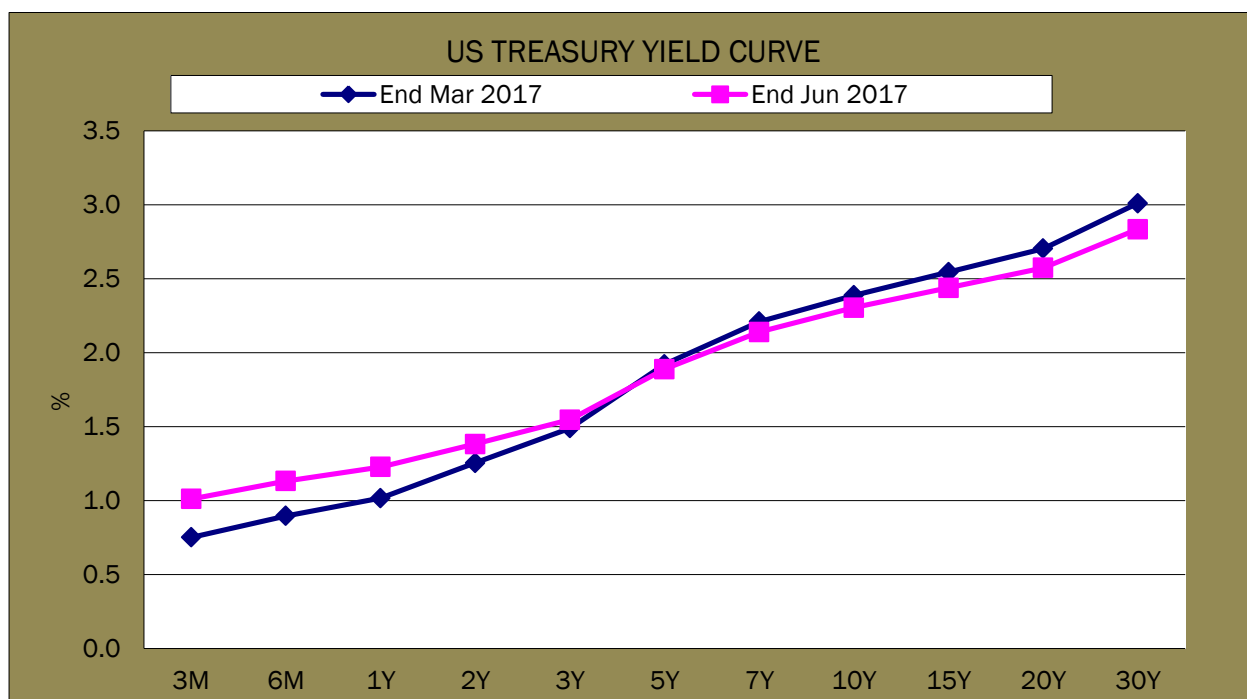
### *Bonds including US Treasuries*

The global government bond yields mixed for the quarter. In Eurozone the German and Italy 10-year government bond yield increased while the U.K and French 10-year government bond yield decline during the quarter. The spread between the U.K and German 10-y government bond has gone down from 0.81% first quarter (Q1) to 0.79% on the second quarter (Q2) and spread of German and France government security with same maturity decreased about 0.30% this quarter compare to the last one with France's security being the higher. On the other hand, the spread between the U.K and France Government 10-y bond yield widened to 0.44% in Q2 from 0.17% in Q1.

Similarly, across the Asia the government bond yield also mixed. The Japanese Government Bond 10-Y yields increase a mere 0.02% while Australian government security with same maturity closed the quarter with 0.10% down.

The graph below illustrates the U.S Treasury yield curve ranges from 3 month to 30 years compared to the previous quarter end. The graph indicates that the yields of short end curve increase, flat in the medium while decrease in the long end. The short-term U.S treasury yield such as 3, 6 and 12 months increased by 0.20% on average. In the medium tenor yield is mixed during the quarter as 2-Y note gained 0.13% while 5 year bond yield declined 0.03%. Long end tenor U.S Treasury bond yield decline for the quarter as 10-Y and 30-Y bond both lost 0.8% and 0.17% respectively.

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	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
	Enhanced Passive	Wellington Management	0.50%	Nil	4-Dec-14
MSCI World index ex Australia Net Dividends Reinvested	Passive	State Street Global Advisors	0.35%	Nil	18-Jan-12
		BlackRock	0.35%	Nil	21-Feb-13
MSCI World index Net Dividends Reinvested	Enhanced Passive	Schroders Investment Management	1%	1.00%	7-Oct-10
MSCI Austria 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%	41.58%	37.50%	42.50%
BOA Merrill Lynch 5-10 Years Treasury Notes and Bond Index	Bank for International Settlements	10%	± 1%	9.65%	9.00%	11.00%
Barclays Global Treasury Developed Market ex US, 30% Eurozone and 10% Country Capped	Alliance Bernstein	5%	± 0.5%	4.87%	4.50%	5.50%
	Wellington Management	5%	± 0.5%	4.88%	4.50%	5.50%
<b>Total Fixed Income</b>		<b>60%</b>		<b>60.97%</b>	<b>55.50%</b>	<b>64.50%</b>
MSCI Index ex Australia Net Dividends Reinvested	State Street Global Advisors	34%	± 4.0%	16.49%	13.00%	21.00%
	BlackRock			16.50%		
MSCI World Index Net Dividends Reinvested	Schroders Investment Management	5%	± 1.5%	4.99%	3.50%	6.50%
MSCI Australia Index	BCTL	1%	± 0.5%	1.05%	0.50%	1.50%
<b>Total Equities</b>		<b>40%</b>		<b>39.03%</b>	<b>30.00%</b>	<b>50.00%</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 \$16.50 billion as follows:

Table 5

Capital Account	\$'000
Opening book value (01 April 2017)	16.265.906
Receipts during the period	95.653
Transfer to General State Budget	-240.000
Investment Return	383.029
<b>Closing book value (30 June 2017)</b>	<b>16.504.588</b>

The Fund was invested as follows:

Assets	\$'000
Cash and Cash Equivalents	586,383
Other Receivables	40,599
Financial assets held at fair value through profit or loss	15,911,011
Less:	
Payable for Securities Purchased	-31,640
Accounts Payable	-1,766
<b>Total</b>	<b>16,504,588</b>

The income for the quarter was as follows:

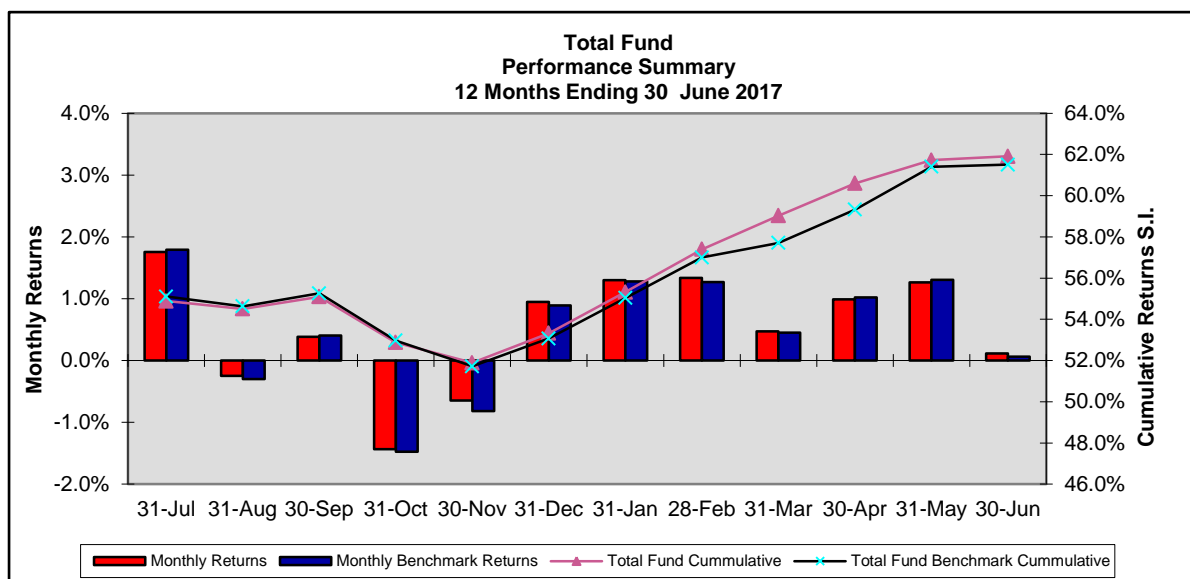
Income	\$'000
Interest income	42,116
Dividend income	51,170
Unit Trust distributions	1,762
Other Investment income	5
Net gains/(losses) on Financial Assets at fair value	168,684
Net foreign exchange gains/(losses)	128,840
Less:	
External manager, custody fees	-2,041
Central Bank management expenses	-1,635
IAB Expenses	-113
Other expenses	-149
Withholding taxes	-5,609
<b>Total Investment Income</b>	<b>383,029</b>

The following notes are intended to assist in interpreting this information:

- Unit Trust distribution is the income received from listed property investment entities.
- Other Expenses relate to derivative trading costs which are deducted directly from the Fund.

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>	1.35	2.18	-1.24	1.19	1.05	2.71
Benchmark	1.31	2.16	-1.55	1.12	1.00	2.70
<i>Excess</i>	<i>0.03</i>	<i>0.03</i>	<i>0.32</i>	<i>0.06</i>	<i>0.05</i>	<i>0.01</i>
<b>BCTL Cash Management (TLCM)</b>	0.61	0.87	1.10	n.a	n.a	1.10
3 Months USD Libor	-	-	-	n.a	n.a	0.10
<i>Excess</i>	<i>n.a</i>	<i>n.a</i>	<i>n.a</i>	<i>n.a</i>	<i>n.a</i>	<i>1.00</i>
<b>BCTL 3-5 yr US Treasury</b>	0.70	1.23	-0.93	1.60	1.23	1.27
BoA Merrill Lynch 3-5 Years US Treasury Passive	0.64	1.15	-1.11	1.61	1.21	1.23
<i>Excess</i>	<i>0.06</i>	<i>0.08</i>	<i>0.19</i>	<i>-0.01</i>	<i>0.02</i>	<i>0.04</i>
<b>Bank for International Settlements</b>	1.23	2.13	-2.68	2.47	1.47	1.87
BoA Merrill Lynch 5-10 Years US Treasury Enhanced Passive	1.18	2.04	-2.85	2.49	1.49	1.87
<i>Excess</i>	<i>0.05</i>	<i>0.09</i>	<i>0.17</i>	<i>-0.02</i>	<i>-0.02</i>	<i>0.00</i>
<b>Alliance Bernstein</b>	4.16	6.24	-1.98	n.a	n.a	-2.29
Barclays Global Treasury DM ex US Enhanced Passive	4.15	6.27	-2.25	n.a	n.a	-2.38
<i>Excess</i>	<i>0.01</i>	<i>-0.03</i>	<i>0.28</i>	<i>n.a</i>	<i>n.a</i>	<i>0.10</i>
<b>Wellington Management</b>	4.09	6.19	-2.36	n.a	n.a	-0.59
Barclays Global Treasury DM ex US Enhanced Passive	4.15	6.27	-2.25	n.a	n.a	-0.49
<i>Excess</i>	<i>-0.06</i>	<i>-0.08</i>	<i>-0.11</i>	<i>n.a</i>	<i>n.a</i>	<i>-0.10</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
<b>International Equities</b>	3.95	10.49	18.40	5.60	11.74	9.91
Benchmark	4.03	10.66	18.20	5.24	11.38	9.29
<i>Excess</i>	<i>-0.08</i>	<i>-0.16</i>	<i>0.21</i>	<i>0.36</i>	<i>0.36</i>	<i>0.62</i>
<b>Schroders Investment Management</b>	2.81	8.66	17.81	5.66	12.03	10.13
MSCI World Enhanced Passive	4.03	10.66	18.20	5.24	11.38	9.29
<i>Excess</i>	<i>-1.22</i>	<i>-2.00</i>	<i>-0.38</i>	<i>0.42</i>	<i>0.64</i>	<i>0.85</i>
<b>SSgA International Equity</b>	4.30	10.81	18.54	5.62	11.70	11.17
MSCI World Passive	4.19	10.71	18.19	5.24	11.38	10.78
<i>Excess</i>	<i>0.10</i>	<i>0.10</i>	<i>0.35</i>	<i>0.38</i>	<i>0.31</i>	<i>0.39</i>
<b>BlackRock Investment Management</b>	4.30	10.84	18.59	5.61	n.a	10.01
MSCI World Passive	4.19	10.71	18.19	5.24	n.a	9.68
<i>Excess</i>	<i>0.11</i>	<i>0.14</i>	<i>0.40</i>	<i>0.38</i>	<i>n.a</i>	<i>0.33</i>
<b>BCTL Investment Management</b>	-1.83	8.90	n.a	n.a	n.a	15.97
MXAU AU Index Passive	-1.87	8.90	n.a	n.a	n.a	16.00
<i>Excess</i>	<i>0.04</i>	<i>0.00</i>	<i>n.a</i>	<i>n.a</i>	<i>n.a</i>	<i>-0.03</i>

## 5. MANAGEMENT COSTS

A management fee of \$3.94 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	2,041
Central Bank management expenses	1,635
IAB expenses	113
Other Expenses	149
<b>Total Cost</b>	<b>3,938</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 \$240 million was transferred to the State Budget account during the quarter. The transfers are summarized in table 11.



Table 11	In Thousand (\$)
Transfer April 2017	120,000
Transfer May 2017	0
Transfer Jun 2017	120,000
Transfer for this Quarter	<b>240,000</b>
Total Transfers previous quarters	180,000
<b>Total Transfers this fiscal year to June 2017</b>	<b>420,000</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 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		2016
	June		June
<b>ASSETS</b>			
Cash and Cash Equivalents	586,383		709,559
Receivables	40,599		36,969
Financial assets held at fair value through profit or loss	15,911,011		15,759,278
<b>TOTAL ASSETS</b>	<b>16,537,993</b>		<b>16,505,806</b>
<b>LIABILITIES</b>			
Payables for securities purchased	-31,640		-34,905
Accounts payable	-1,766		-4,828
<b>TOTAL LIABILITIES</b>	<b>-33,406</b>		<b>-39,733</b>
<b>NET ASSETS</b>	<b>16,504,588</b>		<b>16,466,073</b>
<b>CAPITAL</b>			
Opening Balance	15,844,327		16,217,573
PF Law Art. 6.1 (a) Revenue receipts	95,527		70,420
PF Law Art. 6.1 (b) DA receipts	104,502		81,665
PF Law Art. 6.1 (e) Other receipts	0		0
PF Law Art 7.1 Transfers to State Budget	-420,000		-440,000
Income for the period	880,232		536,416
<b>CAPITAL</b>	<b>16,504,588</b>		<b>16,466,073</b>

Table 13

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME - QUARTER				
In thousands of USD				
	Quarter		Year to Date	
	Jun-17	Jun-16	Jun-17	Jun-16
<b>INVESTMENT INCOME</b>				
Interest income	42,116	38,844	81,035	78,762
Dividend income	51,170	57,151	93,259	100,043
Trust income	1,762	1,869	3,864	3,810
Other investment income	5	31	6	36
Net gains/(losses) on Financial Assets at fair value	168,684	154,542	510,544	254,921
Net foreign exchange gains/(losses)	128,840	-41,949	205,938	115,054
<b>Total Investment Income</b>	<b>392,576</b>	<b>210,488</b>	<b>894,647</b>	<b>552,627</b>
<b>EXPENSES</b>				
External management, custody fees	2,041	2,136	3,077	4,502
Internal operational management fees	1,635	1,109	3,270	2,713
IAB Expenses	113	49	113	49
Other expenses	149	3	378	1,215
<b>Total expenses</b>	<b>3,938</b>	<b>3,298</b>	<b>6,838</b>	<b>8,480</b>
Profit before tax	388,638	207,190	887,809	544,147
Withholding taxes on investments	5,609	5,722	7,577	7,731
Profit/loss for the period	383,029	201,468	880,232	536,416
Other comprehensive income	0	0	0	0
<b>Total comprehensive income for the period</b>	<b>383,029</b>	<b>201,468</b>	<b>880,232</b>	<b>536,416</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, 20 July 2017



**Venancio Alves Maria**  
Executive Director



**Abraão de Vasconcelos**  
Governor