



República Democrática de Timor-Leste  
Ministério das Finanças  
Gabinete da Ministra



*“Adeus Conflito, Bemvindo Desenvolvimento”*

# Further diversification of the Petroleum Fund

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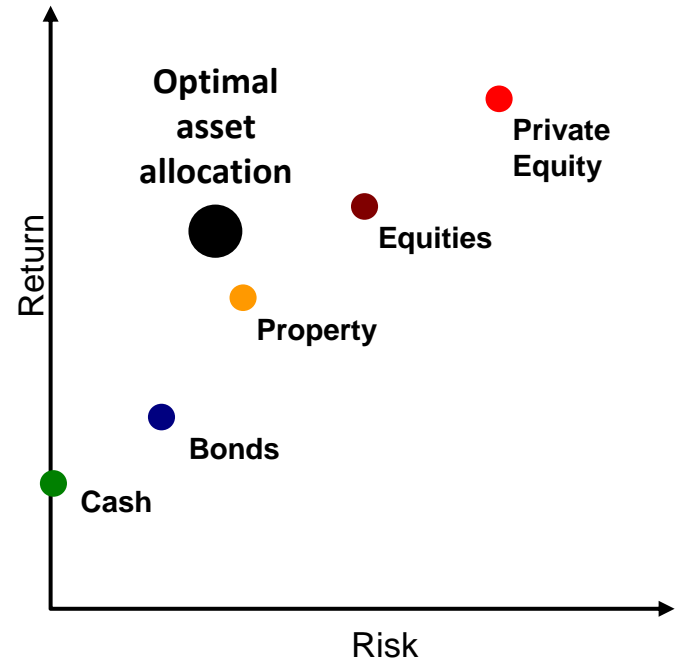
# The Management and Investment Policy 2005-2010

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- US Government bonds from the outset
  - due to lack of knowledge about the international financial market, a simple and prudent investment strategy was required to avoid exposure to risk and volatility in the first stage
  
- Some, but limited, flexibility to invest in non-USD instruments
  - 90% in cash deposits and high rated bonds denominated in US\$
  - 10% in equities and other financial instruments
  
- Portfolio diversification along with increased capacity
  - Investments in AUD, JPY, EUR and UK Government bonds from June 2009
  - Investments in global equities from Q4 2010
  - Currently the flexibility in the PF Law is fully exploited
  - Increased exposure to equities and further diversification as soon as the PF Law has been changed

# What is diversification?

- Mixes a variety of investments with different features in the same portfolio.
- Negative performance from some investments is offset by positive performance from others in the same portfolio.
- Provides higher expected return and lower risk than any single investment in the portfolio.
- Broad diversification requires capacity and skills.
- Diversification = Determining the **optimal asset allocation** subject to Timor-Leste's risk appetite.



Diversification is a main principle in asset management. Concentrated investments add risk with no additional expected return and should be avoided.

# Diversification minimizes risks

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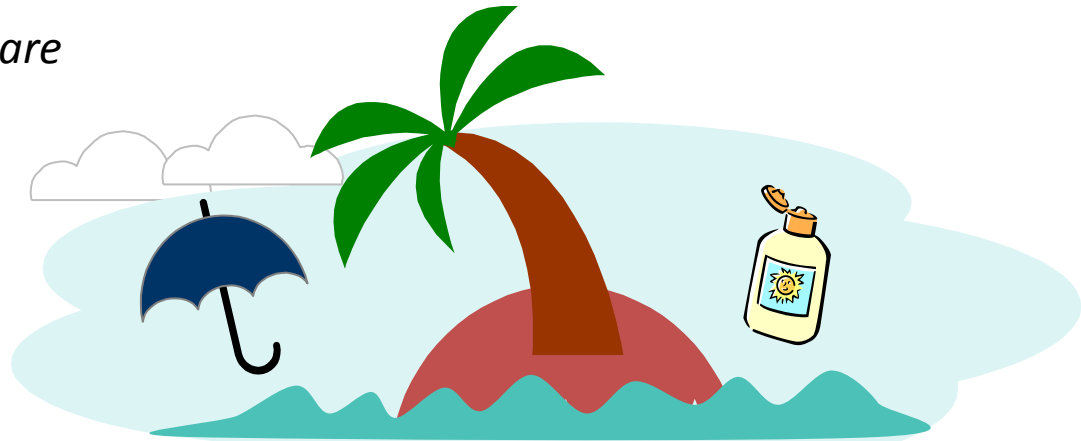
(Wikipedia) *“A simple example of diversification is this one:*

*On a particular island the entire economy consists of two companies: one that sells umbrellas and another that sells sunscreen.*

*If a portfolio is completely invested in the company that sells umbrellas, it will have strong performance during the rainy season, but poor performance when the weather is sunny. The reverse occurs if the portfolio is only invested in the sunscreen company, the alternative investment: the portfolio will be high performance when the sun is out, but will tank when clouds roll in.*

*To minimize the weather-dependent risk in the example portfolio, the investment should be split between the companies.*

*With this diversified portfolio, returns are decent no matter the weather, rather than alternating between excellent and terrible.”*



# Timeline for diversification

BIS hired as external manager

Appointment of Schroder as global equity manager

2005-June 2009

US Government bonds only

June 2009

AUD, JPY, EUR & GBP Government bonds added (4-5%)

October 2010

Global equities (4-5%)

Q4 2010

Exploited current flexibility in the PF Law

Q1 2011

PF Law amendments approved by Parliament

Q2 2011 and beyond

Further diversification of the PF

- more global equities
- more non-USD bonds

Continuously diversifying the PF portfolio to other asset classes, currencies and regions is the best way to enhance the return, better manage the risk, and avoid exposure to one asset class only

# Petroleum Fund Portfolio

## Petroleum Fund Balance:

- \$6.6 billion
- 10 x non-oil GDP

## Investment Performance:

- 2005-2010: 4.5 % p.a.

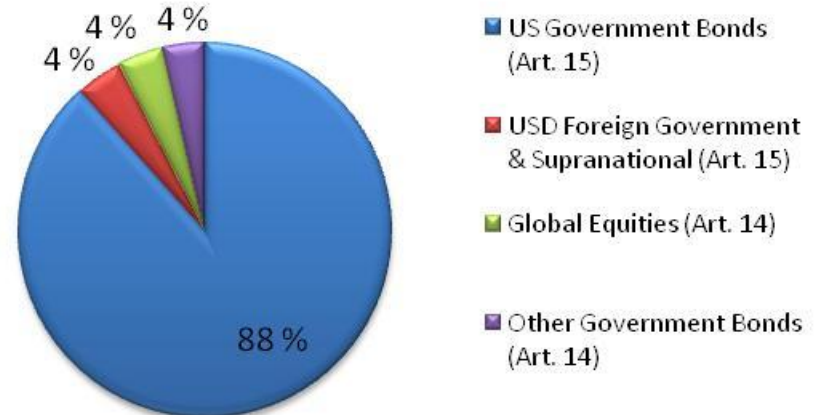
## Composition of the portfolio::

- 92% USD-denominated Government bonds
- 4% AUD, JPY, EUR and UK Government bonds
- 4% global equities

## Management structure:

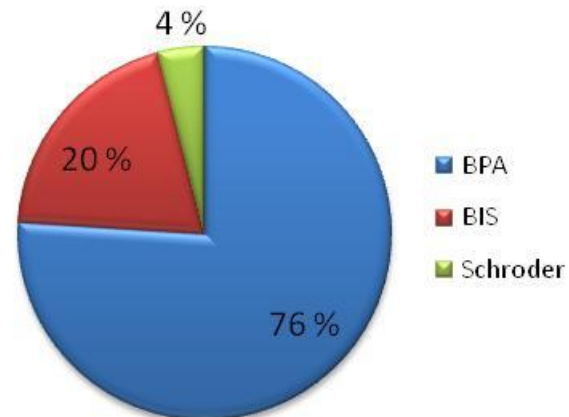
- 76% managed by the BPA
- 20% managed by the BIS
- 4% managed by Schrodgers

## PF Asset Allocation



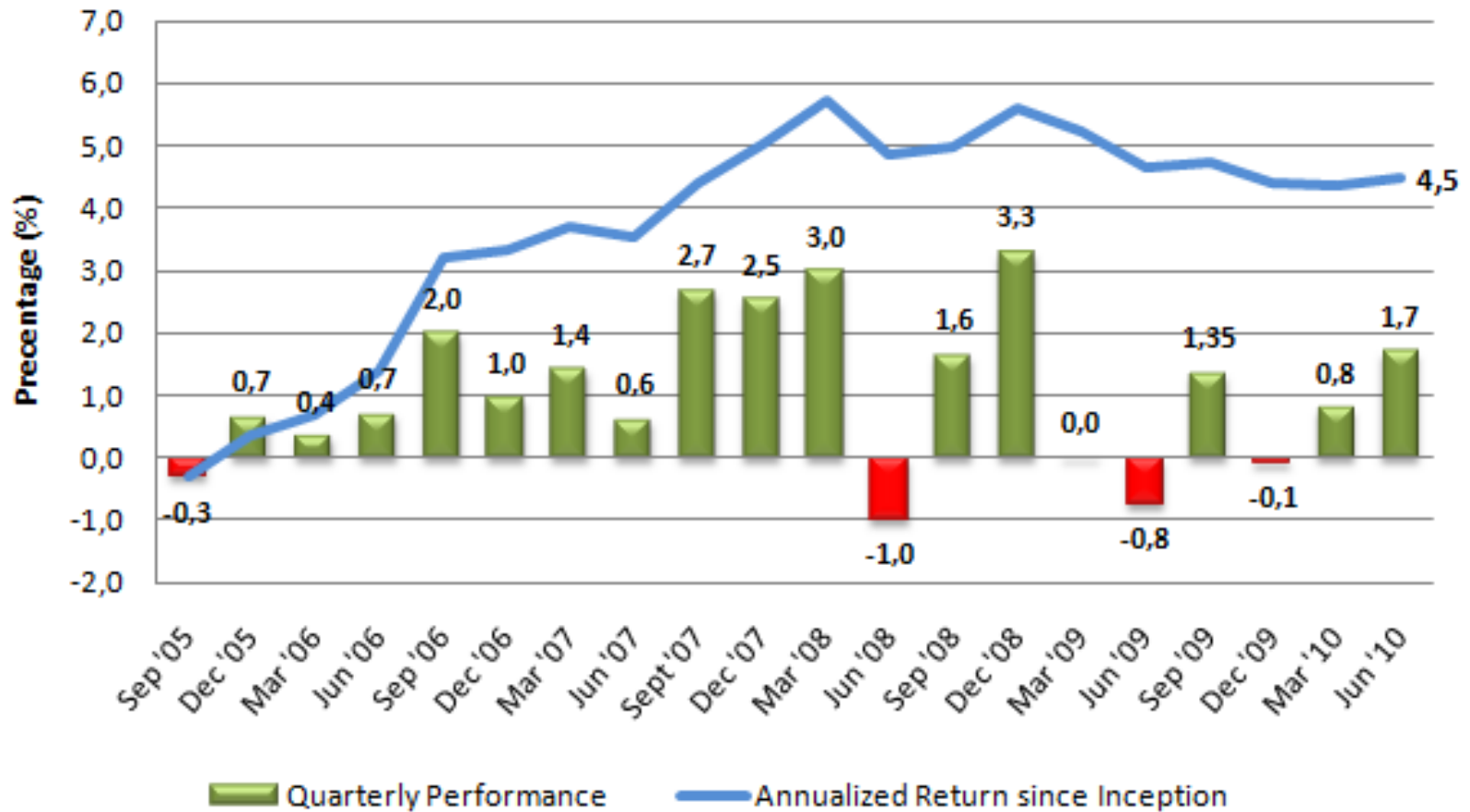
Art. 14: 10% non-USD bonds and equities  
Art. 15: 90% USD bonds

## PF Managers



# Investment Return of the portfolio

## Net Investment Return since Inception



	2005	2006	2007	2008	2009	2010 (YTD)
Nominal return (%)	0.4	4.1	7.2	6.9	0.6	2.5

# Performance since Inception

Performance Summary		Return (%)					
	Mkt Value	Weight	Monthly	QTR	1 Year	3 Years	Since Inception
<b>Total Portfolio</b>	6,488,585	100%	0.52	2.02	4.11	4.80	4.60
Benchmark			0.51	2.02	4.00	4.83	4.63
<b>Excess</b>			<b>0.01</b>	<b>0.00</b>	<b>0.11</b>	<b>-0.03</b>	<b>-0.03</b>
<b>International Fixed Interest</b>	6,488,585	100%	0.52	2.02	4.11	4.80	4.60
Benchmark			0.51	2.02	4.00	4.83	4.63
<b>Excess</b>			<b>0.01</b>	<b>0.00</b>	<b>0.11</b>	<b>-0.03</b>	<b>-0.03</b>
<b>BPA Portfolio</b>	5,199,680	80%	0.37	1.56	3.68	4.54	4.45
Benchmark			0.39	1.56	3.61	4.61	4.50
<b>Excess</b>			<b>-0.02</b>	<b>0.00</b>	<b>0.08</b>	<b>-0.06</b>	<b>-0.05</b>
<b>BIS Portfolio</b>	1,288,905	20%	1.14	3.89	5.84	-	6.56
Benchmark			0.98	3.85	5.58	-	6.35
<b>Excess</b>			<b>0.16</b>	<b>0.05</b>	<b>0.25</b>	<b>-</b>	<b>0.21</b>

Source: BPA Monthly Report for August 2010. available at [www.bancocentral.tl](http://www.bancocentral.tl)

- Diversification of the Fund increases expected return and diversifies the risk.
- The performance of BIS and BPA are different, due to the nature of their investment mandates (different assets, different markets).
- Adding equities to the portfolio will increase the expected return.
- Equity exposure will normally increase the risks and short-term volatility, but a small amount of equities (typically less than 15%) will reduce the overall risk of the portfolio due to the negative correlation between bonds and equities.



# The Equity Mandate

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## Investment Universe and Amount

- Global Equities
- Benchmark to MSCI World Index
- Listed investment in 23 developed countries
- 4% of Petroleum Fund = about \$260 million

## Investment Approach

- Enhanced indexing approach
- Tracking error no to exceed 100 basis points under normal circumstances
- Very limited use of derivatives permitted (will not be used in day-to-day management)

# The Investment Manager

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## Schroder Investment Management Limited

- Founded in 1804 with over 200 years of experience
- Public company listed on the London Stock of Exchange
- Asset management is Schroders' core business – i.e. no conflicts such as banking or brokerage services
- Funds under management £164.0 billion (€200.3 billion / \$245.4 billion) at June 2010
- Schroders employs about 2,700 staff operating from 32 offices in 25 countries