

SEMINAR ORGANIZED BY
LUTA HAMUTUK



CHALLENGES OF DIVERSIFYING THE INVESTMENT UNIVERSE

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Outline of the Presentation

- ❑ Current investment strategy
- ❑ Diversification
- ❑ A review of the current operational settings
- ❑ The challenges...
- ❑ Some final words...

The PFL provides specific investment strategy:

- ❑ Not less than 90% invest in USD cash and fixed interest, rated AA- or higher and average duration less than 6 years.
- ❑ Not more than 10% invest in other assets, provided that:
 - It is issued abroad;
 - Liquid and transparent.
 - Traded in well-regulated financial markets

Where are the Fund invested today?

<input type="checkbox"/>	US Government 0-5 years	90.4%
<input type="checkbox"/>	US Government 5-10 years	2.0%
<input type="checkbox"/>	Governments/Supranational USD AAA	2.6%
<input type="checkbox"/>	Governments/Supranational USD AA	1.4%
<input type="checkbox"/>	Australian Government	1.4%
<input type="checkbox"/>	Euro Governments	1.4%
<input type="checkbox"/>	United Kingdom Gilts	0.4%
<input type="checkbox"/>	Japan Government	0.4%

Diversification

STRATEGIC MANAGEMENT



Objectives when setting the strategic benchmark

- ❑ Reduce concentration risk to an asset class, a country or region, or another risk factor like duration, credit, etc.
- ❑ The need to sustain the real rate of return of 3%.
- ❑ To get the best expected long term return for a given level of risk.
- ❑ To ensure that there is necessary liquidity in the portfolio for withdrawals.

Minister of Finance decides what assets to invest in



Diversification

MANAGEMENT

Existing system in place



Exist system to select external manager



System in place for trade execution and settlement



Custody appointed



Fund accounting



Global performance reporting



Global compliance monitoring

The BPA has already been tested as the operational manager of the Petroleum Fund!

- ❑ BPA has successfully managed more than 90% of the portfolio since 2005 as a passive portfolio (0-5year treasury bonds).
- ❑ The BPA was able to manage the portfolio during the 2006 crisis.
- ❑ The BPA has successfully been through a process of hiring BIS and has just completed the process for commercial equity and fixed interest managers.
 - ⊕ This includes; designing RFP's, assessing and ranking all candidates, designing and negotiating the investment management contracts, setting up performance attribution systems, accounting and custodian operations.
- ❑ Towers Watson has reviewed the operational process in BPA for managing the passive portfolio (December 2009).

“... we were very impressed by the investment operations of the BPA and the management of the existing nominal US Government bond portfolio. The overall process appears to be of a high quality and the historically close to benchmark performance of the nominal portfolio reflects this”.

The operational manager need to be protected by law, good systems, skilled staff and a high degree of independence



The challenges...

The operational challenges for BPA In the next years

- ❑ The operational complexity will depend on the investment philosophy set by the Minister of Finance and the implementation of this in the form of a strategic benchmark

- ❑ **Continuation scenario (a very simplistic investment philosophy);**
 - ⊕ **The asset classes is restricted to just sovereign bonds and global developed marked stocks (as today) but more stocks in the portfolio and more passive enhanced external managers.**
 - ⊕ **The BPA has already proved that it can manage this situation**

- ❑ A semi-complex scenario (a more ambitious investment strategy)
 - ➡ Sovereign bonds, mortgages bonds, investment graded credit bonds, TIPS, Real estate and all equities included emerging markets

- ❑ A highly complex scenario (a highly complex investment strategy)
 - ➡ Bonds and stocks of all sorts. Private equity, infrastructure, commodities, real estate, hedge funds, equity style exposures, highly use of derivatives to gain exposures. Highly use of external managers

The strategic investment ambitions and the operational capability should be in alignment

- ❑ The BPA sees the need to change articles 14 and 15 in the law to improve the expected return in the Fund.
- ❑ The BPA is comfortable with “the continuation scenario”. But even this requires continue efforts by all stakeholders to improve internal processes and inform the public continually.
- ❑ Improve understanding on governance and communications mechanism among key stakeholders like parliament (include KKFP), government, ministry of finance, BPA, civil society, etc.

There are many investment challenges to Timor going forward!

We need a prudent strategy as well as a waterproof management operation!

Watch the purchasing power of the fund



Watch the people that borrows our money



THE SORCERER'S STIMULUS