

# Petroleum Fund of Timor-Leste

## Quarterly Report

31 December 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 October 2015 to 31 December 2015.

Key statistics for the quarter include:

- The capital of the Fund at the end of the previous quarter was \$16.44 billion while the current quarter was \$16.22 billion.
- Gross cash inflows to the fund from royalties and taxes were \$192.67 million
- Outflows for the quarter were \$642.80 million, being transfers to the state budget were \$640 million while \$2.80 million was for management costs.
- The profit/loss for the quarter was \$228.32 million, representing a gross of fees return of 1.37% compared with the benchmark return of 1.55%.

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	1.37	-0.06	-0.06	3.24	3.29	3.82
Benchmark	1.55	-0.01	-0.01	3.17	3.22	3.80
<i>Excess</i>	<i>-0.18</i>	<i>-0.05</i>	<i>-0.05</i>	<i>0.07</i>	<i>0.06</i>	<i>0.01</i>
International Fixed Interest	-1.13	0.11	0.11	0.28	1.16	2.75
Benchmark	-1.09	0.15	0.15	0.28	1.14	2.75
<i>Excess</i>	<i>-0.05</i>	<i>-0.05</i>	<i>-0.05</i>	<i>0.01</i>	<i>0.03</i>	<i>0.00</i>
International Equities	5.58	-0.41	-0.41	10.01	8.23	9.16
Benchmark	5.50	-0.87	-0.87	9.63	7.59	8.45
<i>Excess</i>	<i>0.08</i>	<i>0.46</i>	<i>0.46</i>	<i>0.38</i>	<i>0.64</i>	<i>0.71</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 December 2015 were as follows:

Table 2

	31-Oct-15	31-Dec-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%
<b>Total Fixed Income</b>	<b>60%</b>	<b>60%</b>
MSCI World Index Dividends Reinvested	40.00%	40%
<b>Total Equities</b>	<b>40%</b>	<b>40%</b>
<b>Total</b>	<b>100%</b>	<b>100%</b>

## 2. MARKET TRENDS DURING THE QUARTER

### *Global Market Trend*

December was a pivotal month for markets. Within two weeks of each other, the ECB provided more stimulus and lowered interest rates further into negative territory and the Fed decided to head in the opposite direction and begin increasing interest rates. With global policy pulling in different directions, government bond returns were neither exciting nor as bad as the most pessimistic forecasters had expected, with the asset class managing to deliver low but positive returns. The continued fall in the oil price was behind much of the underperformance of US high yield and inflation-linked bonds, as default risk in the energy sector rose and inflation remained weak.

Global Equities experienced renewed weakness in December and the MSCI World finished the month down 1.8%. Although the index staged a recovery over Q4, rising 5.5%, for the year as a whole it posted a decline of -0.9%. During December, concerns about energy and mining stocks weighed heavily on investors as the rout in commodity prices continued. The Federal Reserve raised interest rates by 0.25% mid-month; the hike had been well-signposted and investors currently seem to believe there will be a cautious approach to raising rates going forward. Many of the themes that dominated in December also characterised the quarter, and indeed the year as a whole.

### Equities

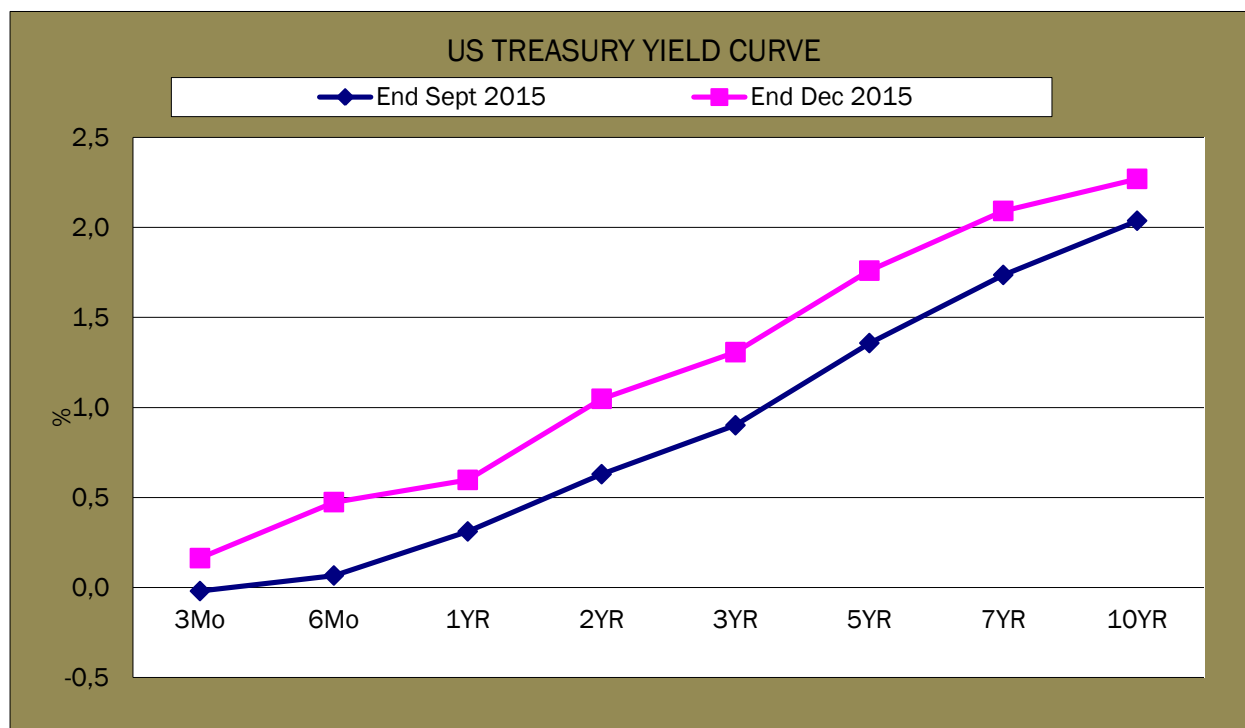
Markets in 2015 were challenging and returns were relatively weak (in price terms). Almost flat returns in developed equity markets, but weak emerging and Asian markets.

Global equities had a rollercoaster ride, starting the year strongly but ending with low single-digit returns, only narrowly beating government bonds. In a low-growth world still clouded with uncertainty, investors favoured growth stocks over value. Looking at 2015 as a whole, energy and materials were savaged, declining by 22.8% and 15.3% in MSCI World respectively. Due to over-supply and worries about slowing demand from China, the Bloomberg Commodity Index, based on the value of 22 different futures contracts, has fallen 25 per cent in 2015, the worst of five straight years of declines.

### Bonds including US Treasuries

The year ended with a volatile month as global policy divergence, declining commodity prices and stress in the high-yield sector kept markets on edge during December. Global government bond yields and the US dollar ended mixed, while credit spreads generally widened. Fixed-income markets generally performed poorly in December, amid heightened volatility and diverging global central bank action. Fourth quarter investor busy with market behavior related to Central Bank strategy such as, quantitative easing (QE) from the European Central Bank (ECB), then the spike in bond yields, the Greek drama, concerns over China and emerging markets, more ECB stimulus and then the Federal Reserve (Fed) finally increasing interest rates. After seen economy continuing improvement in the US labour market—with jobs growth running consistently above 200,000 a month this is pushing US yield move across the tenor. The graph below shows the US Government yield curve out to 10 years compared to the previous quarter-end. There were changes. Short term yields were almost remain the same as previous quarter, while the 5, 7 and 10 years yield decreased by 40, 34 and 35 basis points to 1.76%, 2.09% and 2.27% 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:

Table 4

Managers	Benchmark	Tolerance	Actual	Lower Boundary	Upper Boundary
BOA Merrill Lynch 3-5 Years Treasury Bond Index	BCTL	40%	± 2.5%	40.17%	37.50% 42.50%
BOA Merrill Lynch 5-10 Years Treasury Notes and Bond Index	Bank for International Settlements	10%	± 1%	9.97%	9.00% 11.00%
Barclays Global Treasury Developed Market ex US, 30% Eurozone and 10% Country Capped	Alliance Bernstein	5%	± 0.5%	5.10%	4.50% 5.50%
Barclays Global Treasury Developed Market ex US, 30% Eurozone and 10% Country Capped	Wellington Management	5%	± 0.5%	4.92%	4.50% 5.50%
<b>Total Fixed Income</b>		<b>60%</b>		<b>60.17%</b>	<b>55.50%</b> <b>64.50%</b>
MSCI World Index Net Dividends Reinvested	State Street Global Advisors	35%	± 4.0%	17.38%	15.50% 19.50%
	BlackRock			17.48%	
	Schroders Investment Management	5%	± 1.5%	4.98%	3.50% 6.50%
<b>Total Equities</b>		<b>40%</b>		<b>39.83%</b>	<b>34.50%</b> <b>45.50%</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 \$16.22 billion as follows:

Capital Account	\$'000
Opening book value (30 September 2015)	16,436,582
Receipts during the period	192,670
Transfer to General State Budget	-640,000
Investment Return	228,321
<b>Closing book value (31 December 2015)</b>	<b>16,217,573</b>

The Fund was invested as follows:

Assets	\$'000
Cash and Cash Equivalents	135,177
Other Receivables	26,891
Financial assets held at fair value through profit or loss	16,076,302
Less:	
Payable for Securities Purchased	-15,627
Accounts Payable	-5,170
<b>Total</b>	<b>16,217,573</b>

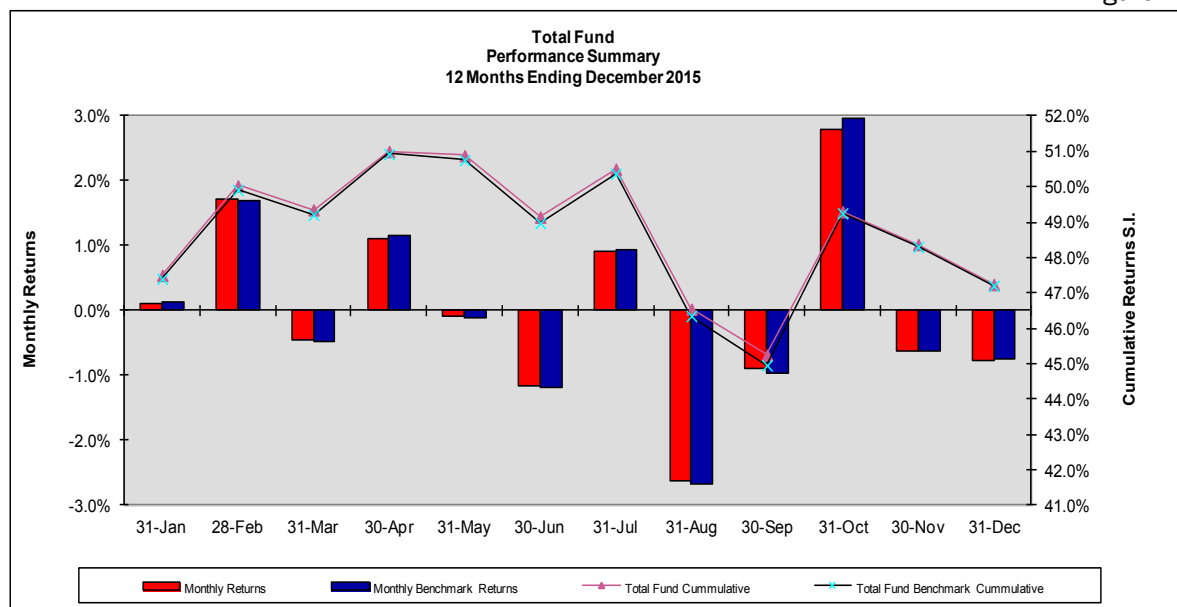
The income for the quarter was as follows:

Table 7

Income	\$'000
Interest income	40,568
Dividend income	30,964
Unit Trust distributions	1,800
Other Investment income	1
Net gains/(losses) on Financial Assets at fair value	219,559
Net foreign exchange gains/(losses)	-60,551
Less:	
External manager, custody fees	-2,138
Central Bank management expenses	-581
IAB Expenses	-11
Other expenses	-73
Withholding taxes	-1,218
<b>Total Investment Income</b>	<b>228,321</b>

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>	-1.13	0.11	0.11	0.28	1.16	2.75
Benchmark	-1.09	0.15	0.15	0.28	1.14	2.75
<i>Excess</i>	<i>-0.05</i>	<i>-0.05</i>	<i>-0.05</i>	<i>0.01</i>	<i>0.03</i>	<i>0.00</i>
<b>BCTL 3-5 yr US Treasury</b>	-1.11	1.43	1.43	0.93	n.a	1.10
BoA Merrill Lynch 3-5 Years US Treasury Passive	-0.97	1.59	1.59	0.93	n.a	1.07
<i>Excess</i>	<i>-0.15</i>	<i>-0.16</i>	<i>-0.16</i>	<i>0.00</i>	<i>n.a</i>	<i>0.04</i>
<b>Bank for International Settlements</b>	-1.28	1.79	1.79	1.02	n.a	1.75
BoA Merrill Lynch 5-10 Years US Treasury Enhanced Passive	-1.30	1.80	1.80	1.08	n.a	1.76
<i>Excess</i>	<i>0.02</i>	<i>-0.01</i>	<i>-0.01</i>	<i>-0.05</i>	<i>n.a</i>	<i>-0.01</i>
<b>Alliance Bernstein</b>	-1.39	-7.29	-7.29	n.a	n.a	-8.92
Barclays Global Treasury DM ex US Enhanced Passive	-1.40	-7.20	-7.20	n.a	n.a	-9.10
<i>Excess</i>	<i>0.01</i>	<i>-0.10</i>	<i>-0.10</i>	<i>n.a</i>	<i>n.a</i>	<i>0.18</i>
<b>Wellington Management</b>	-1.44	-7.25	-7.25	n.a	n.a	-7.50
Barclays Global Treasury DM ex US Enhanced Passive	-1.40	-7.20	-7.20	n.a	n.a	-7.41
<i>Excess</i>	<i>-0.04</i>	<i>-0.05</i>	<i>-0.05</i>	<i>n.a</i>	<i>n.a</i>	<i>-0.09</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>	5.58	-0.41	-0.41	10.01	8.23	9.16
Benchmark	5.50	-0.87	-0.87	9.63	7.59	8.45
<i>Excess</i>	<i>0.08</i>	<i>0.46</i>	<i>0.46</i>	<i>0.38</i>	<i>0.64</i>	<i>0.71</i>
<b>Schroders Investment Management</b>	5.67	-0.28	-0.28	10.33	8.54	9.41
MSCI World Enhanced Passive	5.50	-0.87	-0.87	9.63	7.59	8.45
<i>Excess</i>	<i>0.17</i>	<i>0.59</i>	<i>0.59</i>	<i>0.70</i>	<i>0.95</i>	<i>0.97</i>
<b>SSgA International Equity</b>	5.55	-0.36	-0.36	9.97	n.a	10.64
MSCI World Passive	5.50	-0.87	-0.87	9.63	n.a	10.22
<i>Excess</i>	<i>0.05</i>	<i>0.51</i>	<i>0.51</i>	<i>0.34</i>	<i>n.a</i>	<i>0.41</i>
<b>BlackRock Investment Management</b>	5.58	-0.48	-0.48	n.a	n.a	8.67
MSCI World Passive	5.50	-0.87	-0.87	n.a	n.a	8.37
<i>Excess</i>	<i>0.08</i>	<i>0.40</i>	<i>0.40</i>	<i>n.a</i>	<i>n.a</i>	<i>0.30</i>

## 5. MANAGEMENT COSTS

A management fee of \$2.80 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	2,138
Central Bank management expenses	581
IAB expenses	11
Other Expenses	73
<b>Total Cost</b>	<b>2,803</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 \$640 million was transferred to the State Budget account during the quarter. The transfers are summarized in table 11.

	In Thousand (\$)
Transfer October 2015	190,000
Transfer November 2015	100,000
Transfer December 2015	350,000
Transfer for this Quarter	640,000
<b>Total Transfers previous quarters</b>	<b>638,500</b>
<b>Total Transfers this fiscal year to December 2015</b>	<b>1,278,500</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 30 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 December	2014 December
<b>ASSETS</b>		
Cash and Cash Equivalents	135,177	66,842
Receivables	26,891	20,062
Financial assets held at fair value through profit or loss	16,076,302	16,466,484
<b>TOTAL ASSETS</b>	<b>16,238,370</b>	<b>16,553,387</b>
<b>LIABILITIES</b>		
Payables for securities purchased	-15,627	-11,281
Accounts payable	-5,170	-3,489
<b>TOTAL LIABILITIES</b>	<b>-20,798</b>	<b>-14,770</b>
<b>NET ASSETS</b>	<b>16,217,573</b>	<b>16,538,617</b>
<b>CAPITAL</b>		
Opening Balance	16,538,617	14,952,099
PF Law Art. 6.1 (a) Revenue receipts	450,032	752,264
PF Law Art. 6.1 (b) DA receipts	528,835	1,057,538
PF Law Art. 6.1 (e) Other receipts	-	7,163
PF Law Art 7.1 Transfers to State Budget	-1,278,500	-732,000
Income for the period	-21,412	501,554
<b>CAPITAL</b>	<b>16,217,573</b>	<b>16,538,617</b>

Table 13

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME - QUARTER				
In thousands of USD	Quarter		Year to Date	
	Dec-15	Dec-14	Dec-15	Dec-14
<b>INVESTMENT INCOME</b>				
Interest income	40,568	38,068	156,790	142,327
Dividend income	30,964	34,593	163,014	177,467
Trust income	1,800	1,476	6,887	5,800
Other investment income	1	3	20	35
Net gains/(losses) on Financial Assets at fair value	219,559	267,319	-21,296	627,314
Net foreign exchange gains/(losses)	-60,551	-199,580	-302,027	-425,543
<b>Total Investment Income</b>	<b>232,342</b>	<b>141,879</b>	<b>3,387</b>	<b>527,400</b>
<b>EXPENSES</b>				
External management, custody fees	2,138	2,259	9,584	10,181
Internal operational management fees	581	1,684	5,606	5,893
IAB Expenses	11	271	164	378
Other expenses	73	7	77	111
<b>Total expenses</b>	<b>2,803</b>	<b>4,221</b>	<b>15,431</b>	<b>16,563</b>
Profit before tax	229,539	137,658	-12,044	510,837
Withholding taxes on investments	1,218	1,182	9,367	9,284
Profit/loss for the period	228,321	136,476	-21,412	501,554
Other comprehensive income	-	-	-	-
<b>Total comprehensive income for the period</b>	<b>228,321</b>	<b>136,476</b>	<b>-21,412</b>	<b>501,554</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, 27 January 2016



**Venancio Alves Maria**  
Executive Director



**Abraão de Vasconcelos**  
Governor