

# Petroleum Fund of Timor-Leste

## Quarterly Report

30 June 2013

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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 reports and has not been independently audited or reviewed 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 to 30 June 2013.

Key statistics for the quarter include:

- The capital of the Fund grew from \$13.0 billion to \$13.6 billion.
- Gross cash inflows to the fund from royalties and taxes were \$796.00 million.
- The loss for the quarter was \$149.93 million, representing a return of -1.02% compared with the benchmark return of -1.11%.

The performance of the Fund for the quarter was:

Table 1

Currency \$USD	QTR	FYTD	1 Year	3 Years	5 years	Since Inc
Total Fund	-1.02	1.14	3.85	3.04	3.44	3.94
Benchmark	-1.11	0.93	3.59	2.95	3.40	3.92
<i>Excess</i>	<i>0.09</i>	<i>0.21</i>	<i>0.27</i>	<i>0.09</i>	<i>0.04</i>	<i>0.02</i>

## 1. INVESTMENT MANDATE

A revised Management Agreement between the Ministry of Finance and the Central Bank was signed on 25 June 2009 and its annex 1 was further updated on 21 February 2013. The Minister has decided to increase the equity exposure gradually to 40% by June 2014. The benchmarks as of June 2013 were as follows:

Table 2

	30-Jun-13	31-May-13	30-April 2013	31-Mar-13
BOA Merrill Lynch 1-3 Years Treasury Bond Index	10.0%	10.8%	11.7%	12.5%
BOA Merrill Lynch 3-5 Years Treasury Bond Index	40.0%	40.0%	40.0%	40.0%
BOA Merrill Lynch 5-10 Years Treasury Notes and Bond Index	20.0%	20.0%	20.0%	20.0%
<b>Total Fixed Income</b>	<b>70.0%</b>	<b>70.8%</b>	<b>71.7%</b>	<b>72.5%</b>
MSCI World Index Dividends Reinvested	30.0%	29.2%	28%	27.50%
<b>Total Equities</b>	<b>30.0%</b>	<b>29.2%</b>	<b>28.3%</b>	<b>27.50%</b>
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

## 2. MARKET TRENDS DURING THE QUARTER

### Global Market

US Treasuries sold off in June with the 10-year yield increasing by 36 basis points to 2.49%. The slow pace of the recovery in the US labour market and the potential effect of fiscal tightening on a still fragile recovery remain the focus for financial markets. The US housing market, in the meantime, managed to show a durable recovery. However, it will be several years before the excess inventory are worked through and before home prices return to pre-crisis levels.

In the statement released after its December 2012 meeting, the FOMC articulated its policy tolerance with explicit thresholds for unemployment and inflation. It stated that the target rates for the federal rates would remain low for at least as long as the unemployment rate is above 6.5%, provided that inflation between one and two years ahead is projected to be no more than 2.5%, and that longer-term inflation expectations remain well-anchored. Initially, the Fed remained dovish and did not suggest any slowing in the pace of asset purchases of USD 85 billion per month.

The hawkish FOMC outcome of the June 2013 meeting, therefore, surprised markets and caused a substantial sell off in bonds and other securities. Starting April, a series of events have significantly reduced investor confidence: the sudden drop in the prices of gold and precious metals, the downward revision of growth expectations for some emerging market economies, the spike in interest rate volatility after the Bank of Japan had initiated its larger securities purchase program, as well as the apparent tilt within the FOMC to reduce the pace of its securities purchases, all contributed to a reversal of the market confidence.

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*The hawkish FOMC outcome of the June to reduce the pace of its securities purchases, 2013 meeting, therefore, surprised markets and caused a substantial sell off in bonds and other securities*

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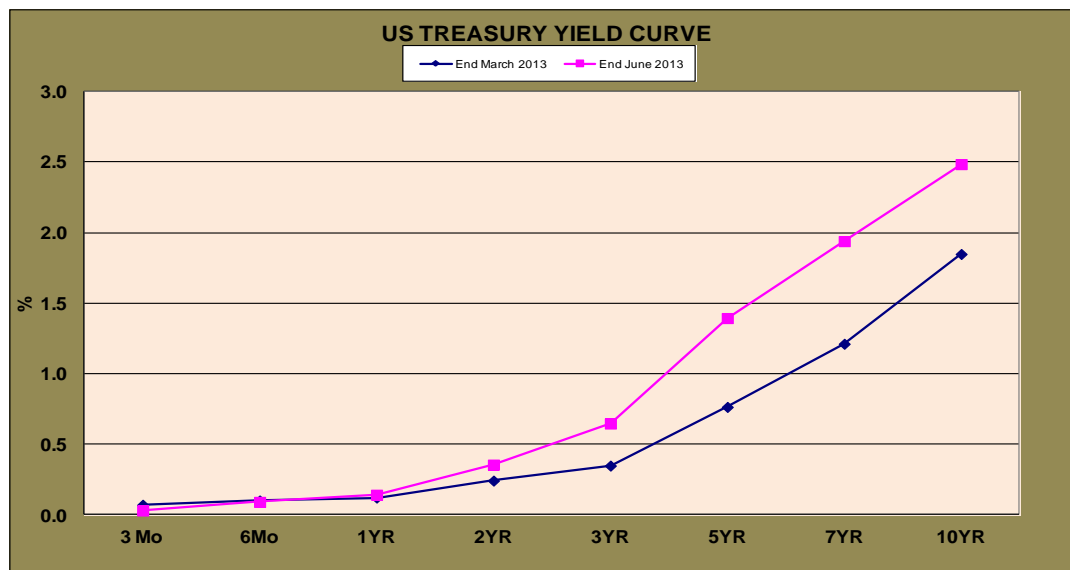
### US Treasury Market

There was no change to the U.S. Federal Reserve Bank's key overnight lending rate (the US Federal Funds target rate), which remained at 0–0.25%.

The graph below shows the US Government yield curve out to 10 years for June 2013 compared to the previous quarter end 31 March 2013. The US Treasury yield curve steepened

over the quarter. The short end of the curve was generally little changed, although 3 month bill yields down by 4 basis points. The 5 year yield rose by 6 basis points while 10 year yields rose by 6 basis points compared to the previous 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 1-3 Years US Treasury Bond Index	Passive	BCTL	n/a	Nil	19-Jan-12
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
MSCI World Index Net Dividends Reinvested	Passive	State Street Global Advisors	0.35%	Nil	18-Jan-12
		Black Rock	0.35%	Nil	21-Feb-13
	Enhanced Passive	Schroder Investment Management	1.00%	1.00%	7-Oct-10

The Central Bank, as operational manager of the Fund, has implemented the investment mandates through a combination of internal and external management.

Cash received by the Fund is invested or assigned to external managers in a timely manner, with the Central Bank being accountable for the returns on overnight investments.

### 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

	Manager	Benchmark	Tolerance	Actual
BOA Merrill Lynch 1-3 Years US Treasury Bond Index	BCTL	10.00%	± 1.5%	9.18%
BOA Merrill Lynch 3-5 Years US Treasury Bond Index	BCTL	40.00%	± 2.5%	40.62%
BOA Merrill Lynch 5-10 Years US Treasury Notes & Bond Index	Bank for International Settlements	20.00%	± 1.5%	20.05%
<b>Total Fixed Interest</b>		<b>70.00%</b>		<b>69.85%</b>
MSCI World Index Net Dividends Reinvested	State Street Global Advisors	25.00%	± 4.0%	17.58%
	Black Rock			7.36%
	Schroder Investment Management	5.00%	± 1.5%	5.21%
<b>Total Equities</b>		<b>30.00%</b>		<b>30.15%</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, and compare the result with the corresponding benchmark. The benchmark represents the investment strategy established by the Minister and is used to set a goal against which the performance of the actual investments is measured. The Minister's benchmarks for the Petroleum Fund mandates 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 increased from \$13.0 billion to \$13.6 billion as follows:

Table 5

<b>Capital Account, Quarter Apr-Jun 2013</b>	<b>\$' 000</b>
Opening book value (1 April 2013)	12,977,943
Receipts during the period	795,999
Transfer to General State Budget during the period	-
Management Fees	(2,250)
Gross return in the period	(147,679)
<b>Closing book value (30 June 2013)</b>	<b>13,624,013</b>

The Fund was invested as follows:

Assets	\$ 000
Cash and Cash Equivalents	36,797
Other Receivables	18,739
Financial assets held at fair value through profit or loss	13,583,907
Less:	
Payable for Securities Purchased	(13,664)
Accounts Payable	(1,766)
<b>Total</b>	<b>13,624,013</b>

The Income for the quarter was as follows:

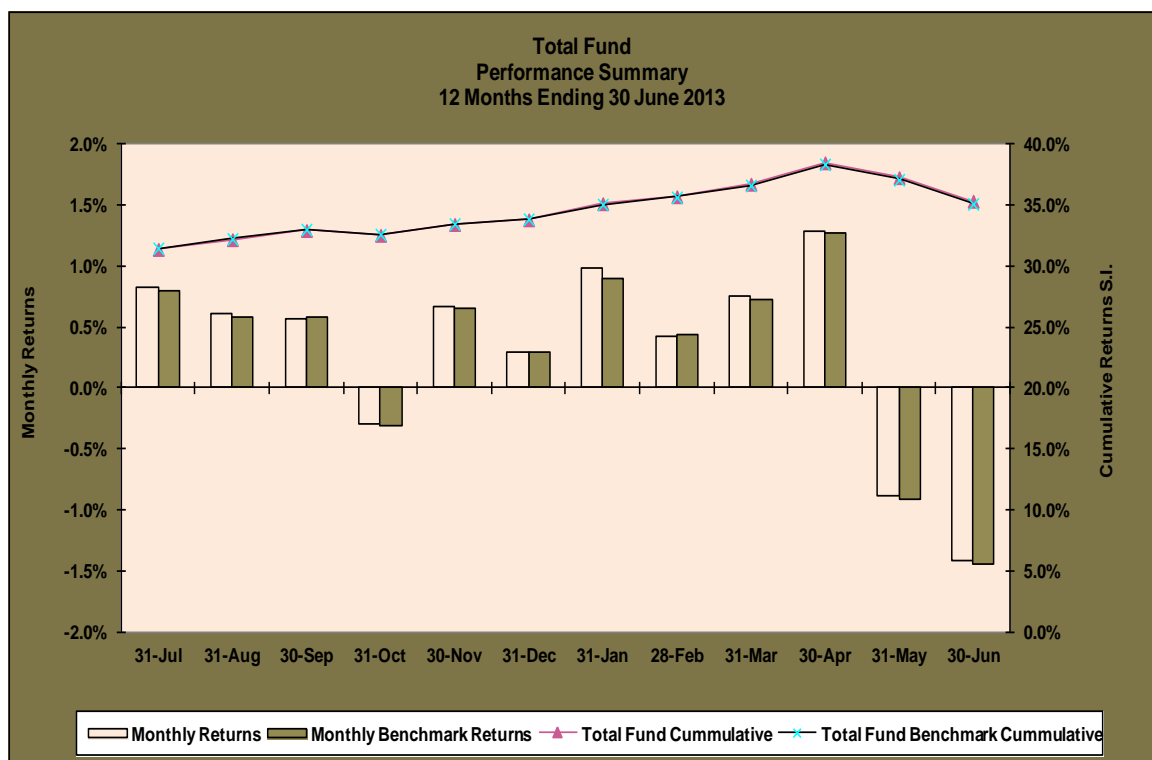
Income	\$'000
Interest income	34,498
Dividend income	31,705
Unit Trust distributions	1,100
Other Investment income	143
Net gains/(losses) on FAL at fair value through profit or loss	(214,313)
Net foreign exchange gains/(losses)	(812)
Less:	
External manager, custody fees	(1,758)
IAB Expenses	(53)
Central Bank management expenses	(438)
Other expenses	-
Withholding taxes	-
<b>Total Investment Income</b>	<b>(149,928)</b>

The Fund performance for the quarter, including the performance of the relative asset classes was as follows

Currency \$USD	QTR	FYTD	1 Year	3 Years	5 years	Since Inc
Total Fund	-1.02	1.14	3.85	3.04	3.44	3.94
Benchmark	-1.11	0.93	3.59	2.95	3.40	3.92
<i>Excess</i>	<i>0.09</i>	<i>0.21</i>	<i>0.27</i>	<i>0.09</i>	<i>0.04</i>	<i>0.02</i>
International Fixed Interest	-1.84	-1.62	-0.86	1.43	2.47	3.31
Benchmark	-1.81	-1.64	-0.95	1.41	2.47	3.32
<i>Excess</i>	<i>-0.03</i>	<i>0.02</i>	<i>0.09</i>	<i>0.02</i>	<i>0.00</i>	<i>0.00</i>
International Equities	0.76	8.61	18.95	n.a	n.a	9.77
Benchmark	0.65	8.43	18.58	n.a	n.a	8.75
<i>Excess</i>	<i>0.11</i>	<i>0.18</i>	<i>0.37</i>	<i>n.a</i>	<i>n.a</i>	<i>1.02</i>

The cumulative performance of the Petroleum Fund compared with the performance of the Global Benchmark over the same period is shown in the following graph.

Figure 2



**FIXED INTEREST**

The performance of the investments in Fixed Interest investments 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 Fixed Interest</b>	-1.84	-1.62	-0.86	1.43	2.47	3.31
Benchmark	-1.81	-1.64	-0.95	1.41	2.47	3.32
<i>Excess</i>	<i>-0.03</i>	<i>0.02</i>	<i>0.09</i>	<i>0.02</i>	<i>0.00</i>	<i>0.00</i>
<b>BCTL 1-3 yrs US Treasury</b>	-0.08	0.04	0.39	n.a	n.a	0.35
Benchmark	-0.11	0.00	0.33	n.a	n.a	0.26
<i>Excess</i>	<i>0.03</i>	<i>0.03</i>	<i>n.a</i>	<i>n.a</i>	<i>n.a</i>	<i>0.09</i>
<b>BCTL 3-5 yrs US Treasury</b>	-1.50	-1.26	-0.47	n.a	n.a	0.23
Benchmark	-1.44	-1.24	-0.48	n.a	n.a	0.15
<i>Excess</i>	<i>-0.06</i>	<i>-0.02</i>	<i>0.01</i>	<i>n.a</i>	<i>n.a</i>	<i>0.09</i>
<b>Bank for International Settlement</b>	-3.56	-3.37	-2.41	n.a	n.a	0.39
Benchmark	-3.45	-3.33	-2.41	n.a	n.a	0.33
<i>Excess</i>	<i>-0.11</i>	<i>-0.04</i>	<i>0.01</i>	<i>n.a</i>	<i>n.a</i>	<i>0.06</i>

## INTERNATIONAL EQUITIES

The performance of the investments in global equities for the quarter, including the performance of the managers responsible for those investments, was as follows:

Table 10

Currency \$USD	QTR	FYTD	1 Year	3 Years	5 Years	Since Inc
<b>International Equities</b>	0.76	8.61	18.95	n.a	n.a	9.77
Benchmark	0.65	8.43	18.58	n.a	n.a	8.75
<i>Excess</i>	<i>0.11</i>	<i>0.18</i>	<i>0.37</i>	<i>n.a</i>	<i>n.a</i>	<i>1.02</i>
<b>Schroder Investment Management</b>	1.01	9.14	19.85	n.a	n.a	10.10
Benchmark	0.65	8.43	18.58	n.a	n.a	8.75
<i>Excess</i>	<i>0.37</i>	<i>0.71</i>	<i>1.27</i>	<i>n.a</i>	<i>n.a</i>	<i>1.35</i>
<b>SSgA International Equity</b>	0.74	8.51	18.73	n.a	n.a	14.33
Benchmark	0.65	8.43	18.58	n.a	n.a	13.84
<i>Excess</i>	<i>0.09</i>	<i>0.08</i>	<i>0.16</i>	<i>n.a</i>	<i>n.a</i>	<i>0.49</i>
<b>Black Rock Investment Management</b>	0.61	n.a	n.a	n.a	n.a	4.06
Benchmark	0.65	n.a	n.a	n.a	n.a	4.02
<i>Excess</i>	<i>-0.03</i>	<i>n.a</i>	<i>n.a</i>	<i>n.a</i>	<i>n.a</i>	<i>0.04</i>

## 5. MANAGEMENT COSTS

Payment of management fee of \$2,249,870 for operational management was deducted from the fund during the quarter to cover the direct external expenses and internal operational expenses.

The fee covered the following services ( in "000"):

Table 11

External Management and Custody expenses	1,758
Central Bank management expenses	438
IAB expenses	53
<b>Total Expenses</b>	<b>2,250</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. There were no transfers made to the State Budget account during the quarter.

## 7. PORTFOLIO RISK

### 7.1 Tracking Error

The tracking error illustrates the manner in which the Fund portfolio tracked the benchmark index. It is the standard deviation of differences in the return earned by a portfolio and the return earned by the benchmark against which the portfolio is constructed. Mandates with a larger tracking error give the manager more discretion to depart from the benchmark.

### *7.2 Duration*

The modified duration of the Global Fixed Interest portfolio indicates the level of risk that the Fund takes relative to a 1% change in market interest rates. The duration was within the mandate during the quarter.

### *7.3. Credit Risk*

All fixed interest investments of the Petroleum Fund are required by law to be in investment grade securities. Ratings are not applicable to global equities.

Cash received by the Petroleum Fund pending investment is invested in an overnight repurchase pool operated by the Federal Reserve Bank of New York.

## **8. 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 portfolio 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.

### *Internal Mandate*

The Central Bank portfolios complied with the mandate throughout the quarter.

### *External Managers*

The Central Bank has received representations from the external managers, supported by a certificate from the global custodian, 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 performed audit up to quarter March 2013.



## 9. 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.

### Statement of Financial Position

Table 12

NET ASSETS	Jun-13 \$'000	Mar-13 \$'000	Jun-12 \$'000
Cash and Cash Equivalents	36,797	44,205	50,215
Other receivables	18,739	14,145	14,272
Financial assets held at fair value through profit or loss	13,583,907	12,924,306	10,551,988
<b>TOTAL ASSETS</b>	<b>13,639,443</b>	<b>12,982,656</b>	<b>10,616,474</b>
<b>LIABILITIES</b>			
Payables for securities purchased	(13,664)	(3,304)	(15,413)
Accounts payable	(1,766)	(1,409)	(325)
<b>TOTAL LIABILITIES</b>	<b>(15,430)</b>	<b>(4,713)</b>	<b>(15,738)</b>
<b>NET ASSETS</b>	<b>13,624,013</b>	<b>12,977,943</b>	<b>10,600,736</b>
Opening Balance	11,775,349	11,775,349	9,310,321
Receipts	1,733,840	937,841	1,695,202
Transfer to State Budget	-	-	(519,000)
Net Result for the period	114,825	264,753	114,212
<b>NET CAPITAL</b>	<b>13,624,013</b>	<b>12,977,943</b>	<b>10,600,736</b>

### Statement of Profit and Loss

Table 13

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME	Quarter		Year to Date (YTD)	
	Jun-13	Jun-12	Jun-13	Jun-12
	\$'000	\$'000	\$'000	\$'000
<b>INVESTMENT INCOME</b>				
Interest income	34,498	42,040	71,077	92,834
Dividend income	31,705	15,629	52,275	23,604
Trust income	1,100	466	1,751	684
Other investment income	143	(36)	138	(95)
Net gains/(losses) on FAL at fair value through profit or loss	(214,313)	3,792	(5,567)	1,196
Net foreign exchange gains/(losses)	(812)	(2,445)	(738)	(1,875)
<b>Total Investment Income</b>	<b>(147,679)</b>	<b>59,447</b>	<b>118,936</b>	<b>116,348</b>
<b>EXPENSES</b>				
External management and custody fees	(1,758)	(1,223)	(3,181)	(1,259)
Transaction costs	-	-	-	-
Internal operational management fees	(438)	(375)	(876)	(819)
IAB Expenses	(53)	(48)	(53)	(48)
Other expenses	-	(4)	(1)	(10)
<b>Total expenses</b>	<b>(2,250)</b>	<b>(1,650)</b>	<b>(4,111)</b>	<b>(2,136)</b>
Profit before tax	(149,928)	57,797	114,825	114,212
Withholding taxes	-	-	-	-
<b>Profit for the quarter:</b>	<b>(149,928)</b>	<b>57,797</b>	<b>114,825</b>	<b>114,212</b>
Other comprehensive income	-	-	-	-
<b>Total comprehensive income for the quarter</b>	<b>(149,928)</b>	<b>57,797</b>	<b>114,825</b>	<b>114,212</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, 25 July 2013



**Abraão de Vasconcelos**  
Governor



**Venancio Alves Maria**  
Executive Director