

Petroleum Fund of Timor-Leste

Quarterly Report

31 March 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 January to 31 March 2013.

Key statistics for the quarter include:

- The capital of the Fund grew from \$11.8 billion to \$13.0 billion.
- Gross cash inflows to the fund from royalties and taxes were \$946.1 million.
- The profit for the quarter was \$264.8 million, representing a return of 2.18% compared with the benchmark return of 2.07%.

The performance of the Fund for the quarter was:

	Mkt Value \$'000	QTR	FYTD	1 Year	3 Years p.a	Since Inc p.a
Total Fund	12,980,594	2.18	2.18	5.51	3.97	4.21
Benchmark		2.07	2.07	5.35	3.89	4.20
<i>Excess</i>		<i>0.11</i>	<i>0.11</i>	<i>0.17</i>	<i>0.09</i>	<i>0.01</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 16 July 2012. The Minister has decided to increase the equity exposure gradually to 40% by June 2014. The benchmarks as of March 2013 were as follows:

	31-Mar-13	28-Feb-13	31-Jan-13	31-Dec-12
Merrill Lynch 1-3 Years US Treasury Bond Index	12.5%	13.3%	14.2%	15.0%
Merrill Lynch 3-5 Years US Treasury Bond Index	40.0%	40.0%	40.0%	40.0%
Merrill Lynch 5-10 Years US Treasury Notes & Bond Index	20.0%	20%	20%	20%
Total Fixed Interest	72.5%	73.3%	74.2%	75.0%
MSCI World Index Net Dividends Reinvested	27.5%	26.7%	25.8%	25.0%
Total Equities	27.5%	26.7%	25.8%	25.0%
Total	100.0%	100.0%	100.0%	100.0%

2. MARKET TRENDS DURING THE QUARTER

Global Market

Global equities rallied in January. Sentiment initially improved as the US managed to avoid the “fiscal cliff” and optimism about global growth started to build. Sovereign bond yields rose with the increase in risk appetite. However, talk about a “great rotation” from bonds to equities proved premature, as confidence waned in February and March. Political uncertainty following the Italian parliamentary elections and the banking crisis in Cyprus caused Eurozone concerns to re-emerge, thereby supporting bonds.

US economic news was generally positive over the quarter, with strength in housing and some signs of improvement in the labour market. While monetary policy was unchanged, the market focused on discussions in the FOMC minutes about the costs and benefits of the asset purchase programme. Another significant development over the quarter was Japan’s commitment to expansionary monetary and fiscal stimulus to try and raise inflation expectations and growth prospects. This led to strong performance of Japanese equities in local currency terms, although weakness in the Yen detracted from unhedged USD returns.

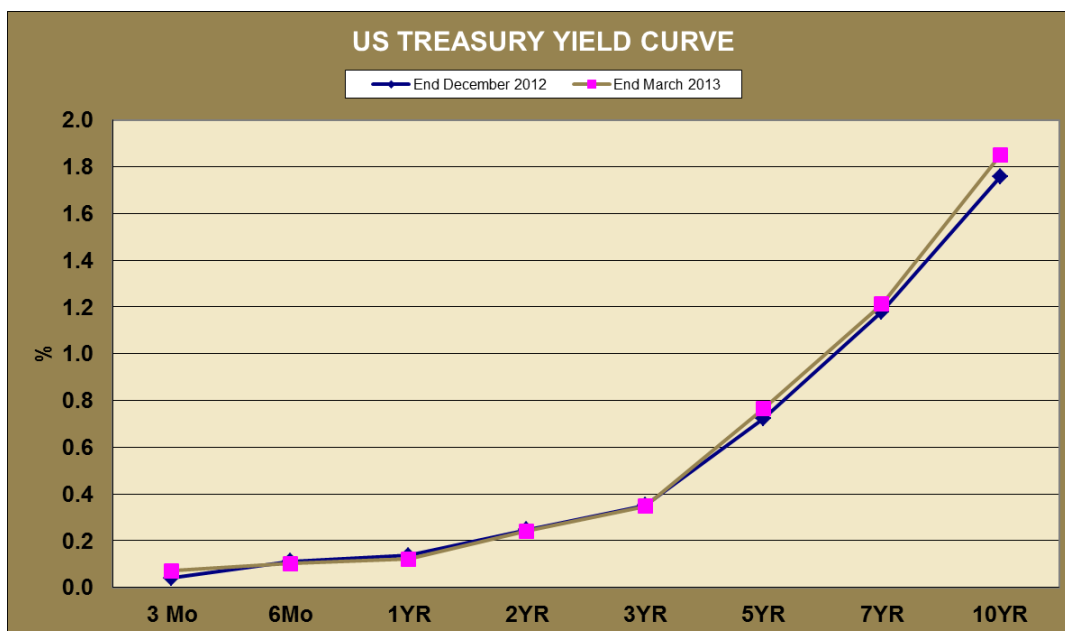
By the end of the quarter, the MSCI World benchmark index provided a total return of 7.79% and bond yields were generally higher.

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%.

Political uncertainty following the Italian parliamentary elections and the banking crisis in Cyprus caused Eurozone concerns to re-emerge, thereby supporting bonds.

The graph below shows the US Government yield curve out to 10 years for March 2013 compared to the previous quarter end 31 December 2012. The US Treasury yield curve steepened over the quarter. The short end of the curve was generally little changed, although 3 month bill yields rose 3 basis points. The 5 year yield rose by 4 basis points while 10 year yields rose by 9 basis points compared to the previous quarter.



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:

Mandate	Management Style	Authorised Managers	Tracking Error	Outperformance Target	Commencement Date
Merrill Lynch 1-3 Years US Treasury Bond Index	Passive	BCTL	n/a	Nil	19 Jan 2012
Merrill Lynch 3-5 Years US Treasury Bond Index	Passive	BCTL	n/a	Nil	19 Jan 2012
Merrill Lynch 5-10 Years US Treasury Notes & Bond Index	Enhanced passive	Bank for International Settlements	0.5%	0.25%	15 Dec 2011
MSCI World Index Net Dividends Reinvested	Passive	State Street Global Advisors	0.35%	Nil	18 Jan 2012
		BlackRock	0.35%	Nil	21 Feb 2013
	Enhanced passive	Schroder Investment Management	1.0%	1.0%	7 Oct 2010

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:

	Manager	Benchmark	Tolerance	Actual
Merrill Lynch 1-3 Years US Treasury Bond Index	BCTL	12.50%	±1.5%	11.2%
Merrill Lynch 3-5 Years US Treasury Bond Index	BCTL	40.00%	±2.5%	40.60%
Merrill Lynch 5-10 Years US Treasury Notes & Bond Index	Bank for International Settlements	20.00%	±1.5%	20.40%
Total Fixed Interest		72.50%		72.24%
MSCI World Index Net Dividends Reinvested	State Street Global Advisors	22.50%	±4.0%	17.30%
	BlackRock			5.00%
	Schroder Investment Management	5.00%	±1.5%	5.40%
Total Equities		27.50%		27.70%

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 \$11.8 billion to \$13.0 billion as follows:

Capital Account, Quarter Jan-March 2013	\$'000
Opening book value (1 Jan 2013)	11,775,349
Receipts during the period	937,850
Transfer to General State Budget during the period	-
Management Fees	(1,860)
Gross return in the period	266,614
Closing book value (31 March 2013)	12,977,953

The Fund was invested as follows:

Assets	\$'000
Cash and Cash Equivalents	44,425
Other receivables	14,145
Financial assets held at fair value through profit or loss	12,924,086
Less:	
Payables for securities purchased	(3,304)
Accounts payable	(1,409)
Total Assets	12,977,943

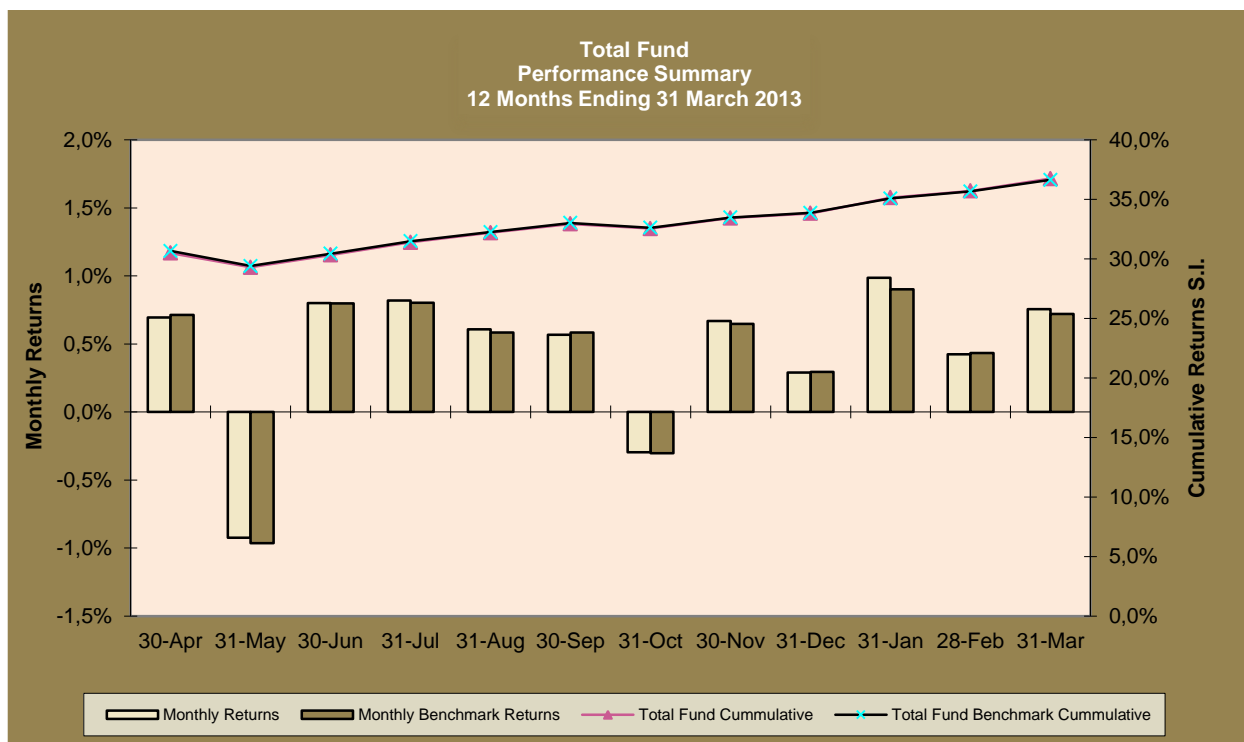
The Income for the quarter was as follows:

Income	\$'000
Interest income	36,579
Dividend income	21,433
Other investment income	646
Net gains/(losses) on Financial Asset at fair value	208,746
Net foreign exchange gains/(losses)	74
Less:	
External management, custody fees and other related cost	(1,423)
IAB Expenses	0
Central Bank management expenses	(438)
Withholding taxes	(863)
Total Income	264,753

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

	Mkt Value \$'000	QTR	(%)			
			FYTD	1 Year	3 Years p.a	Since Inc p.a
Total Fund	12,980,594	2.18	2.18	5.51	3.97	4.21
Benchmark		2.07	2.07	5.35	3.89	4.20
<i>Excess</i>		<i>0.11</i>	<i>0.11</i>	<i>0.17</i>	<i>0.09</i>	<i>0.01</i>
International Fixed Interest	9,377,395	0.22	0.22	2.51	2.63	3.68
Benchmark		0.17	0.17	2.39	2.57	3.68
<i>Excess</i>		<i>0.05</i>	<i>0.05</i>	<i>0.12</i>	<i>0.07</i>	<i>0.00</i>
International Equities	3,603,199	7.79	7.79	12.20	n.a	10.46
Benchmark		7.73	7.73	11.85	n.a	9.38
<i>Excess</i>		<i>0.06</i>	<i>0.06</i>	<i>0.35</i>	<i>n.a</i>	<i>1.08</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.



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:

	Mkt Value \$'000	QTR	FYTD	1 Year	3 Years p.a	Since Inc p.a
International Fixed Interest	9,377,395	0.22	0.22	2.51	2.63	3.68
Benchmark		0.17	0.17	2.39	2.57	3.68
<i>Excess</i>		<i>0.05</i>	<i>0.05</i>	<i>0.12</i>	<i>0.07</i>	<i>0.00</i>
BCTL 1-3 yr US Treasury	1,459,436	0.12	0.12	0.72	n.a	0.49
Benchmark		0.12	0.12	0.64	n.a	0.40
<i>Excess</i>		<i>0.00</i>	<i>0.00</i>	<i>0.08</i>	<i>n.a</i>	<i>0.09</i>
BCTL 3-5 yr US Treasury	5,265,112	0.24	0.24	2.15	n.a	1.50
Benchmark		0.20	0.20	2.14	n.a	1.34
<i>Excess</i>		<i>0.05</i>	<i>0.05</i>	<i>0.02</i>	<i>n.a</i>	<i>0.16</i>
Bank for International Settlement	2,652,845	0.19	0.19	4.97	n.a	3.23
Benchmark		0.12	0.12	4.80	n.a	3.07
<i>Excess</i>		<i>0.07</i>	<i>0.07</i>	<i>0.17</i>	<i>n.a</i>	<i>0.16</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:

	Mkt Value \$'000	QTR	(%) FYTD	1 Year	3 Years p.a	Since Inc p.a
International Equities	3,603,199	7.79	7.79	12.20	n.a	10.46
Benchmark		7.73	7.73	11.85	n.a	9.38
<i>Excess</i>		<i>0.06</i>	<i>0.06</i>	<i>0.35</i>	<i>n.a</i>	<i>1.08</i>
Schroder Investment Managem	703,354	8.04	8.04	13.15	n.a	10.72
Benchmark		7.73	7.73	11.85	n.a	9.38
<i>Excess</i>		<i>0.31</i>	<i>0.31</i>	<i>1.30</i>	<i>n.a</i>	<i>1.34</i>
SSgA International Equity	2,244,500	7.71	7.71	11.87	n.a	16.74
Benchmark		7.73	7.73	11.85	n.a	16.22
<i>Excess</i>		<i>-0.02</i>	<i>-0.02</i>	<i>0.03</i>	<i>n.a</i>	<i>0.52</i>
BlackRock International Equity	655,345	n.a	n.a	n.a	n.a	3.43
Benchmark		n.a	n.a	n.a	n.a	3.36
<i>Excess</i>		<i>n.a</i>	<i>n.a</i>	<i>n.a</i>	<i>n.a</i>	<i>0.07</i>

5. MANAGEMENT COSTS

Payment of management fee of \$2,760,806 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):

External Management and Custody expenses	2,322
Central Bank management expenses	438
IAB expenses	-
Accounts payable	-
Total Cost	2,761

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 modified duration of the Global Fixed Interest portfolio at the end of the quarter was 4.28% compared to the benchmark duration of 4.17%.

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 by 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 its most recent audit during the quarter.

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

NET ASSETS	Mar-13 \$'000	Dec-12 \$'000	Mar-12 \$'000
Cash and Cash Equivalent	44,205	60,884	9,405
Other receivables	14,145	6,478	3,159
Financial assets held at fair value through profit or loss	12,924,086	11,711,145	7,734,508
TOTAL ASSETS	12,982,436	11,778,507	7,747,072
LIABILITIES			
Payables for securities purchased	(3,304)	(811)	(1,826)
Account payable	(1,409)	(2,347)	-
TOTAL LIABILITIES	(4,713)	(3,158)	(1,826)
NET ASSETS	12,977,723	11,775,349	7,745,246
NET CAPITAL	12,977,723	11,775,349	7,745,246

Statement of other profit or loss and other comprehensive income

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME	Quarter		Year to Date (YTD)	
	Mar-13 \$'000	Mar-12 \$'000	Mar-13 \$'000	Mar-12 \$'000
INVESTMENT INCOME				
Interest income	36,579	50,794	36,579	50,794
Dividend income	21,433	7,975	21,433	7,975
Other investment income	646	159	646	159
Net gains/(losses) on Financial Assets at fair value	208,746	(2,596)	208,746	(2,596)
Net foreign exchange gains/(losses)	74	564	74	564
Tota Investment Income	267,477	56,895	267,477	56,895
EXPENSES				
External management, custody fees and other related cost	1,423	-	1,423	-
Central Bank management expenses	438	486	438	486
IAB Expenses	-	-	-	-
Total expenses	1,861	486	1,861	486
Profit before tax	265,616	56,409	265,616	56,409
Withholding taxes	(863)	-	(863)	-
Profit for the quarter:	264,753	56,409	264,753	56,409
Other comprehensive income	-	-	-	-
Total comprehensive income for the quarter	264,753	56,409	264,753	56,409

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, 02 May 2013



Abraão de Vasconcelos
Governor



Fernando da Silva Carvalho
A.i Executive Director