

Petroleum Fund of Timor-Leste

Quarterly Report For the Quarter ended 30 September 2012

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Quarterly Report

30 September 2012

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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 and 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 July to 30 September 2012.

Key statistics for the quarter include:

- The capital of the Fund grew from \$10,600.74 million to US\$ 11,054.41 million.
- Gross cash inflows to the fund from royalties and taxes were US\$ 629.47 million.
- Cash outflows were US\$ 390.32 million of which \$389 million for transfers to State Budget and \$1.32 million for direct external and internal management costs.
- Net cash inflows during the period were US\$ 239.15 million.
- The portfolio return in the period was 2.01% compared with the benchmark return for the quarter of 1.98%.

The total Fund's returns by quarter, one year, FYTD, three years and since inception of the Fund up to 30 September 2012 as follows:

Currency \$USD	(%)				Since Inc
	QTR	FYTD	1 Year	3 Years	
Total Fund	2.01	3.20	3.81	3.24	4.10
Benchmark	1.98	3.06	3.75	3.17	4.11
<i>Excess</i>	<i>0.03</i>	<i>0.15</i>	<i>0.07</i>	<i>0.07</i>	<i>-0.01</i>

1. PETROLEUM FUND MANAGEMENT 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. Following Minister's decision on increase of equity exposure, the existing equities manager' exposure was increased gradually and achieved 23% target in September 2012. The new benchmarks as of September 2012 may be summarized as follows:

<i>Global Benchmark</i>	
<i>US Government Bonds</i>	77%
<i>Global Equity Mandate</i>	23%
<i>Subsidiary Benchmarks</i>	
1. <i>BCTL 1-3 Years US Treasury (16% of global portfolio)</i>	
Merrill Lynch 1-3 Years US Treasury Bond Index	100%
2. <i>BCTL 3 - 5 Years US Treasury (41% of global portfolio)</i>	
Merrill Lynch 3-5 Years US Treasury Bond Index	100%
3. <i>Bank for International Settlements (20% of global portfolio)</i>	
Merrill Lynch 5-10 Years US Treasury Bond Index	100%
4. <i>Schroder Investment Management Limited (5% of global portfolio)</i>	
Global Equities listed in developed market	
Exchange - MSCI World Index Net Dividend Reinvested	100%
5. <i>State Street Global Advisors (18% of global portfolio)</i>	
Global Equities listed in developed market	
Exchange - MSCI World Index Net Dividend Reinvested	100%

2. MARKET TRENDS DURING THE QUARTER

Global Market

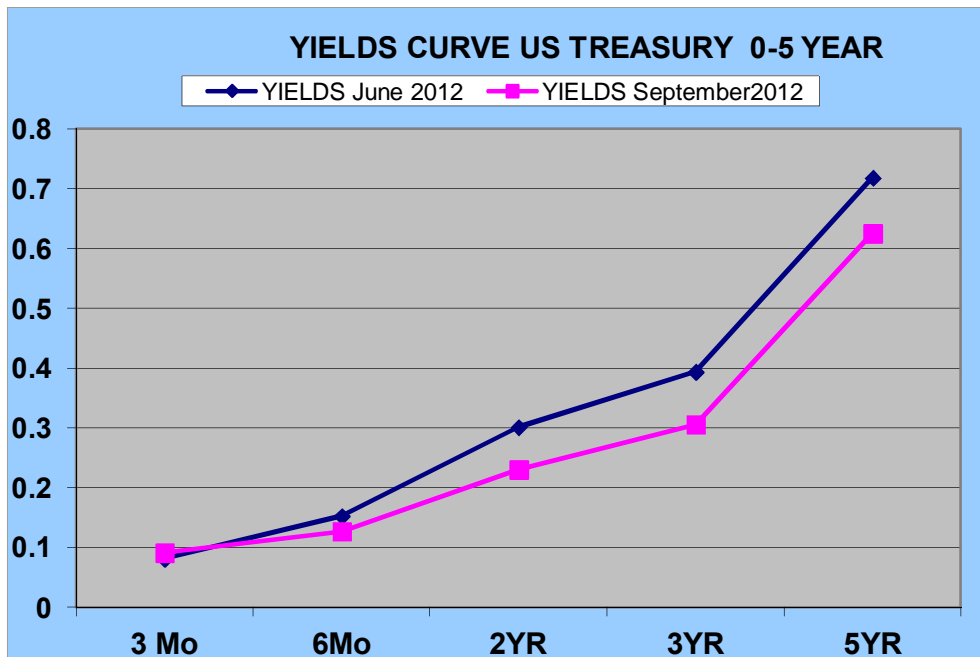
The global economy continued to show uncertainty, especially over the European region. In United States, the recovery was still weak. In China, the possibility of overcapacity has become apparent, which caused the steel industry to cut output. Despite the negatives, the Chinese government has approved substantial infrastructure projects worth at least \$150 bn.

The equity markets rose over September, the S&P 500 was up 2.42%, the FTSE 100 was up 0.54%, and the Topix has increased 0.79% whilst the All Ordinaries increased by 1.55%.

US Treasury Market

During the period from 30 June 2012 to 30 September 2012 US Treasury bonds 0 to 5 years yields decreased significantly. At the short end 3 months US Treasury benchmark reference bills increased by 1 basis point and 6 months US Treasury benchmark reference bills decreased by 3 basis points, while 2 year bond yields decreased by 7 basis points. The 3 year US Treasury benchmark reference notes decreased by 9 basis points while, the 5 year US Treasury benchmark reference notes decreased by 9 basis points respectively compared to the previous quarter end. Bond prices and yields move in opposite directions.

The graph below shows the 0-5 year US Government yield curve on 30 September 2012 compared to the previous quarter end 30 June 2012.



US Treasury bond yields decreased significantly. The 3 month US Treasury benchmark reference bills increased 1 basis point, 6 month US Treasury benchmark reference bills decreased by 3 basis points, 2 and 3 years yields decreased by 7 and 9 basis points while, 5 years decreased 9 basis points respectively.

There has been no change to the U.S. Federal Reserve Bank's key overnight lending rate (the US Federal Funds target rate), with the current level target range remaining at 0 - 0.25% as of September 2012.

3. MANAGEMENT DURING THE QUARTER

Objectives

For the Internal Mandate, the Central Bank's objective in managing the portfolio is to achieve a portfolio return close to the return of the agreed benchmark; while the BIS's portfolio will be managed in an active manner and the objective is the expected outperformance of the portfolio gross of management fees is 25 basis points over the Benchmark performance, on an annual basis over a rolling three year period, while maintaining the ex ante tracking error within 100 basis points.

The objective of Schroders mandate is to manage the portfolio in an enhanced passive indexing style and maintained within a tracking error relative to the benchmark that does not normally exceed 100 basis points, and with load differences maintained within 0.5% (security level) and 2.5% (country and sector levels). At no time shall the ex-ante tracking error exceed 150 basis points.

The objective of State Street Global Advisor (SSgA) mandate shall be managed in a passive indexing style to seek to closely match the Performance Benchmark, before tax and fees and maintained within an ex ante tracking error relative to the benchmark that does not normally exceed 35 basis points.

For the Central Bank's internal mandates, cash received by the Fund has been invested in the portfolio in a timely manner, normally within two working days. This policy is consistent with the passive investment mandate given to the Central Bank by the Ministry of Finance.

For the BIS portfolio, cash received by the BIS has been invested in the portfolio within the benchmark as described in Subsidiary Benchmark section in page 2 of this report.

For Schroders and State Street Global Advisors mandates, cash received invested in equities listed on developed market exchange (i.e. in countries belonging to developed markets as defined by the MSCI market classification framework).

Operational Implementation

The Central Bank internal mandates are operationalised by holding 8 of the approximately 128 US Treasury Securities that form the defined benchmark indexes. The bonds are selected to best replicate the risk and return characteristics of the benchmarks.

The BIS mandate is operationalised by holding US Treasury bonds of 5-10 Years per BIS's new benchmark.

Schroders and State Street Global Advisors mandates operationalized by holding equities in equities listed in developed market exchange.

Regular financial reports on the performance of the Fund under Central Bank management are produced for Central Bank management and regular position reports for the total Fund

The objective of the internal mandate is to achieve the portfolio return close to the benchmark within +/- 25 bps while the objective of BIS mandate is the expected outperformance of the portfolio gross of management fees is 25 basis points over a rolling 3 yrs period.

The objective of Schroder mandate is to manage the portfolio in an enhanced passive indexing style and maintained within a tracking error relative to the benchmark that does not normally exceed 100 basis points.

including the BIS, Schrodgers and SSgA mandates are produced by the Fund's custodian as part of the management process.

External Managers

Following Minister's decision on increase of equity exposure, the existing equities manager' exposure was increased gradually and achieved 23% target in September 2012.

The Fund as of September 2012 has 3 external managers namely Bank for International Settlements (BIS) managing 20% of the total portfolio, Schroder Investment Management Limited (Schrodgers) managing about 5% of the total portfolio and State Street Global Advisors (SSgA) managing about 18% of the total portfolio.

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 a 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 (even if 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 \$10,600.74 million to \$11,054.41 million as follows:

Capital Account, Quarter July-Sept 2012	In thousand \$
Opening book value (1 July 2012)	10,600,736
Receipts during the period	629,469
Transfer to General State Budget during the period	(389,000)
Management Fees	(1,315)
Gross return in the period	214,523
Closing book value (30 Sept 2012)	11,054,413

The balance was invested in the following financial assets:

Assets	In Thousand (\$)
Cash and Cash Equivalent	22,479
Marketable Deb Securities	8,440,212
Global Equities	2,533,825
Receivables and other Assets	63,101
Less; Pending Purchase of Securities	(4,878)
Other Liabilities	(325)
Total	11,054,413

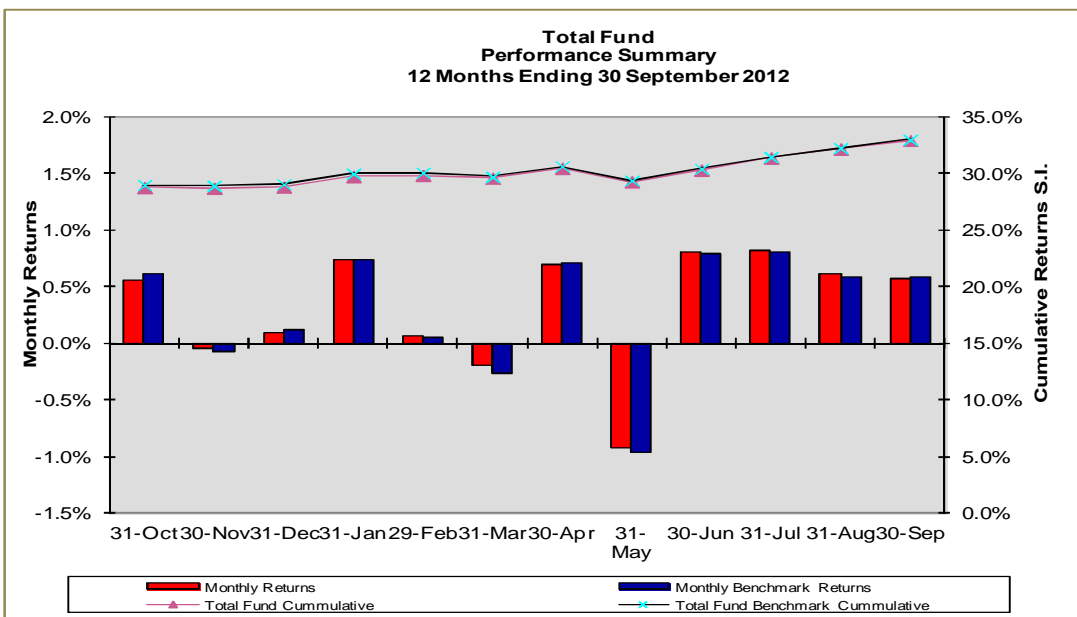
The Net Income for the quarter comprised the following:

INCOME	In thousand (\$)
Investment Income	53,323
Income	53,323
Market Revaluations	161,199
Less: Management Fees	(1,315)
Net Result for the Period	213,207

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

Currency \$USD	QTR	FYTD	(%)		
			1 Year	3 Years	Since Inc
Total Fund	2.01	3.20	3.81	3.24	4.10
Benchmark	1.98	3.06	3.75	3.17	4.11
<i>Excess</i>	<i>0.03</i>	<i>0.15</i>	<i>0.07</i>	<i>0.07</i>	<i>-0.01</i>
International Fixed Interest	0.74	1.90	2.24	2.78	3.91
Benchmark	0.70	1.76	2.12	2.73	3.92
<i>Excess</i>	<i>0.04</i>	<i>0.14</i>	<i>0.12</i>	<i>0.06</i>	<i>-0.01</i>
International Equities	6.78	13.27	22.30	n.a	7.70
Benchmark	6.71	13.01	21.59	n.a	6.46
<i>Excess</i>	<i>0.08</i>	<i>0.26</i>	<i>0.70</i>	<i>n.a</i>	<i>1.24</i>

The cumulative performance of the Petroleum Fund compared with the performance of the Global Benchmark over the same period is shown in the next 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:

Currency \$USD	QTR	FYTD	1 Year	3 Years	Since Inc
International Fixed Interest	0.74	1.90	2.24	2.78	3.91
Benchmark	0.70	1.76	2.12	2.73	3.92
<i>Excess</i>	<i>0.04</i>	<i>0.14</i>	<i>0.12</i>	<i>0.06</i>	<i>-0.01</i>
BCTL 1-3 yr US Treasury	0.28	n.a	n.a	n.a	0.41
Benchmark	0.26	n.a	n.a	n.a	0.32
<i>Excess</i>	<i>0.02</i>	<i>n.a</i>	<i>n.a</i>	<i>n.a</i>	<i>0.09</i>
BCTL 3-5 yr US Treasury	0.78	n.a	n.a	n.a	1.62
Benchmark	0.76	n.a	n.a	n.a	1.47
<i>Excess</i>	<i>0.02</i>	<i>n.a</i>	<i>n.a</i>	<i>n.a</i>	<i>0.15</i>
Bank for International Settler	1.07	3.68	n.a	n.a	4.21
Benchmark	1.00	3.62	n.a	n.a	4.05
<i>Excess</i>	<i>0.07</i>	<i>0.07</i>	<i>n.a</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:

Currency \$USD	QTR	FYTD	(%)		
			1 Year	3 Years	Since Inc
International Equities	6.78	13.27	22.30	n.a	7.70
Benchmark	6.71	13.01	21.59	n.a	6.46
<i>Excess</i>	<i>0.08</i>	<i>0.26</i>	<i>0.70</i>	<i>n.a</i>	<i>1.24</i>
Schroder Investment Management	7.16	13.99	23.07	n.a	7.94
Benchmark	6.71	13.01	21.59	n.a	6.46
<i>Excess</i>	<i>0.46</i>	<i>0.98</i>	<i>1.48</i>	<i>n.a</i>	<i>1.48</i>
SSgA International Equity*	6.66	n.a	n.a	n.a	9.81
Benchmark	6.71	n.a	n.a	n.a	9.29
<i>Excess</i>	<i>-0.05</i>	<i>n.a</i>	<i>n.a</i>	<i>n.a</i>	<i>0.52</i>

* Commenced from COB 18th January 2012.

5. MANAGEMENT COSTS

A management fee of \$ 1,315,499 for operational management costs was deducted from the fund during the quarter to cover the direct external expenses and internal operational expenses.

The fee covered the following services:

External Management and Custody expenses	856,930
Central Bank management expenses	458,569
IAB expenses	-
Total Fees	1,315,499

6. TRANSFERS FROM THE PETROLEUM FUND

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. During the quarter, total amount of US\$ 389 million has been transferred from the Fund to the State Budget.

A summary of transfers to the State Budget Account is as follows:

	In Million (\$)
Transfer - July 2012	163
Transfer - August 2012	113
Transfer September 2012	113
Transfer for this quarter	389
Total transfers previous quarters	519
Total transfer this fiscal year until September 2012	908

7. RISK EXPOSURE OF PORTFOLIO

7.1 Tracking Error

The tracking error illustrates the manner in which the Fund portfolio tracked the benchmark index. The "Excess Return" measures the difference between the return of the Fund's portfolio and the benchmark. The excess return for the Fund's global portfolio is (0.03% or 3 basis points) while the excess return for the BIS and Schroders mandates were 0.07% (or 7 basis points) and 0.46% (or 46 basis points) respectively. The excess return for State Street Global Advisors (SSgA) mandate was -0.05% (or -5 basis point) while the excess return for the BCTL mandates 1-3 years and 3-5 years were 0.02% (or 2 basis points) and 0.02% (or 2 basis points) respectively.

7.2 Duration

The modified duration of the Central Bank internal portfolio shall be managed within ± 0.2 years of the modified duration of the benchmark. The Modified duration of the BIS portfolio shall be less than six years. The duration was within the mandate during the quarter.

7.3. Credit Risk

The investments by the Petroleum Fund in US Treasury Securities with the high credit rating (AA+) or higher. Investments in global equities are not rated. All investments reflected the new investment mandate as reported in page 2 of this report

Cash received by the Petroleum Fund pending investment is invested at overnight money market interest rates 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 universe specified in the mandate at all times during the quarter.

Return

The performance on the global portfolio for the quarter was 201 basis points compared with the benchmark performance of 198 basis points.

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 the Fund's investment portfolio was within the mandate during the quarter.

Internal Mandate

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

External Managers

The external managers investments was within the mandate during the quarter.

Internal Audit

In accordance with the provisions of Article 22 of the Petroleum Fund law no. 9/2005 that requires Central Bank's Internal Auditor to perform an audit of the Fund every six months. The Internal Auditor has performed an audit on the Fund to 31 December 2011.

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.

Balance Sheet

	in thousand \$		
NET ASSETS	Sep-12	Jun-12	Sep-11
Cash and Cash Equivalent	22,479	49,176	16,080
Marketable Debt Securities	8,440,212	8,338,391	8,508,126
Equities at market value	2,533,825	2,183,751	283,856
Receivable and Other Assets	63,101	45,156	112,523.00
Less: Pending Purchase of Securities	(4,878)	(15,413)	(17,444)
Other Liabilities	(325)	(325)	-
TOTAL	11,054,413	10,600,736	8,903,141
CAPITAL			
Opening Balance	9,310,321	9,310,321	6,903,996
PF Law Art. 6.1 (a) Revenue Receipts	957,919	628,505	990,461
PF Law Art. 6.1 (b) DA Receipts	1,357,876	1,058,063	1,380,695
PF Law Art. 6.1 (e) Other Receipts	8,877	8,634	7,978
PF Law Art. 7.1 Transfer to General State Budget	(908,000)	(519,000)	(550,000)
Net Income	327,419	114,212	170,010
TOTAL	11,054,413	10,600,736	8,903,141

Profit & Loss Statement

	in thousand \$			
INCOME	Quarter		Year To Date (YTD)	
	Sep-12	Sep-11	Sep-12	Sep-11
Investment Income	53,323	61,627	170,351	178,908
Income	53,323	61,627	170,351	178,908
Market Revaluations	161,199	(18,859)	160,510	(5,664)
Less: Management Fees	(1,315)	(1,264)	(3,441)	(3,233)
Net Result for the Period	213,207	41,504	327,419	170,010

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 October 2012



Venancio Alves Maria
Executive Director



Abraão de Vasconcelos
Governor