VOLUME 5 ISSUE XII

Petroleum Fund of Timor-Leste

Quarterly Report

31 December 2009

Inside This Report

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. The law gives the Banking & Payments Authority (BPA) of Timor-Leste the responsibility for the operational management of the Fund.

This report covers the period from 1 October 31 December 2009.

Key statistics for the quarter include:

- The capital of the Fund grew from $5,301.57 million to 5,376.63 million

  Gross cash inflows to the fund from royalties, taxes and other receipt were $394.03 million.

- Cash outflows were $313. 34 million in which $312 million for transfers to State Budget while $1.34 million for direct external and internal management costs.
- Net cash inflows during the period was $80.69 million
- The portfolio return in the period was -0.10% compared with the benchmark return for the quarter of -0.10 %.

The returns by quarter, one year, FYTD, three years and since inception of the Fund up to 31 December 2009 as follows.

Currency $USD	(%) QTR	FYTD	1 Year	3 Years	Since Inc
Total Fund	-0.10	0.60	0.60	4.93	4.44
Benchmark	-0.10	0.67	0.67	5.01	4.49
Excess	0.00	-0.07	-0.07	-0.08	-0.06

1. PETROLEUM FUND MANAGEMENT MANDATE

A revised management agreement including a new investment mandate between the Ministry of Finance and the Banking & Payments Authority was signed on 25 June 2009. The complete investment mandate was published in the updated management agreement and the benchmarks may be summarized as follows:

- **Global Benchmark**
- US Government 0-5 years 90.4%
- US Government 5-10 years 2.0%
- Governments/Supranationals USD AAA 2.6%
- Governments/Supranationals USD AA 1.4%
- Australian Government 1.4%
- Euro Governments 1.4%
- United Kingdom Gilts 0.4%
- Japan Government 0.4%

- **Subsidiary Benchmarks**

BPA Internal Management (80% of global portfolio)

- US Government 0-5 years 100.0%

Bank for International Settlements (20% of global portfolio)

- US Government 0-5 years 52.0%
- US Government 5-10 years 10.0%
- Governments/Supranationals USD AAA 13.0%
- Governments/Supranationals USD AA 7.0%
- Australian Government 7.0%
- Euro Governments 7.0%
- United Kingdom Gilts 2.0%
- Japan Government 2.0%

2. MARKET TRENDS DURING THE QUARTER

Global Market

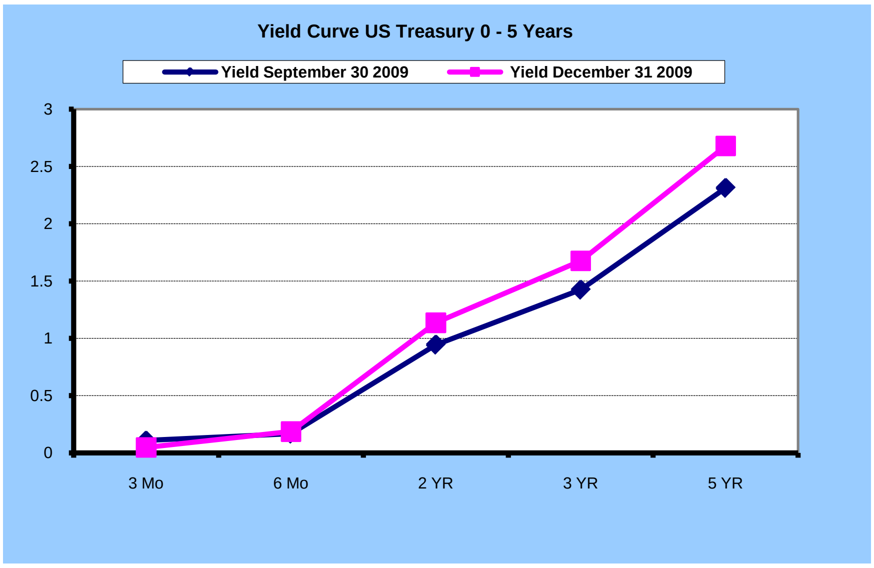
Macroeconomic fundamentals continued to improve, though the rebound varied significantly across economies. Stock price and bond yields trended up in a period of limited news. Stock price volatility declined in December indicating improved market sentiment. Forward yields indicate that some market participants might start pricing in central banks hikes. However, the longer terms economic remains uncertain and most central banks has not changed their policy stance or wording, though several of their earlier unconventional policy measures are due to expire on near future.

US Treasury Market

During the period from 30 September 2009 to 31 December 2009 US Treasury bonds 0 to 5 years yields increased significantly. At the short end 3 months US Treasury benchmark reference bills decreased by 6 basis points and 6 months US Treasury benchmark reference bills increased by 2 basis points, while 2 year bond yields increased by 19 basis points. The 3 and 5 year US Treasury benchmark reference notes increased by 25 and 37 basis points respectively compared to the previous quarter end. Bond prices and yields move in opposite directions.

US Treasury bond yields increased moderately. The 3 and 6 month US Treasury benchmark reference bills increased by 6 and 2 basis points, 2 year yields increased by 19basis points. The 3 and 5 year yield decreased by 25 and 37basis points respectively.

The graph below shows the 0-5 year US Government yield curve on 31 December 2009 compared to the previous quarter end 30 September 2009



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 December 2009.

3. MANAGEMENT DURING THE QUARTER

Objectives

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

For the BPA's internal mandate, 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 BPA by the Ministry of Finance. For the BIS portfolio, cash received by the BIS has been invested in the portfolio within the instruments allowed in the composite benchmark as described in the updated management agreement summarized in page 2 of this report.

Operational Implementation

The BPA internal mandate is operationalised by holding ten of the approximately 113 US Treasury Securities that form the defined benchmark index. The bonds are selected to best replicate the risk and return characteristics of the benchmark.

The BIS mandate is operationalised by holding bonds issued by supranational organisations and sovereign states, including the United States, European Union, Australia, Japan, United Kingdom and Canada.

Regular financial reports on the performance of the Fund under BPA management are produced for BPA management and regular position reports for the total Fund including the BIS mandate are produced by the Fund's custodian as part of the management process.

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.

Total receipts during the quarter was $394.03m consisting of tax receipts $155.30m & Royalties $233.49m.

The gross returns was (5.63) m of which $43.66m was coupon & interest and market valuation was ($49.30) m

GLOBAL PORTFOLIO

In the course of the quarter the Petroleum Fund increased from $5,301.57 million to $5,376.63 million, as follows:

Return, Quarter October-December 2009	Amount
Opening book value (1 October 2009)	$5,301.57
Receipts during the period	$394.03
Transfer to General State Budget during the period	($312.00)
Management Fees	($1.34)
Return in the period	($5.63)
Closing book value (31 Dec 09)	$5,376.63

This balance was invested in the following financial assets:

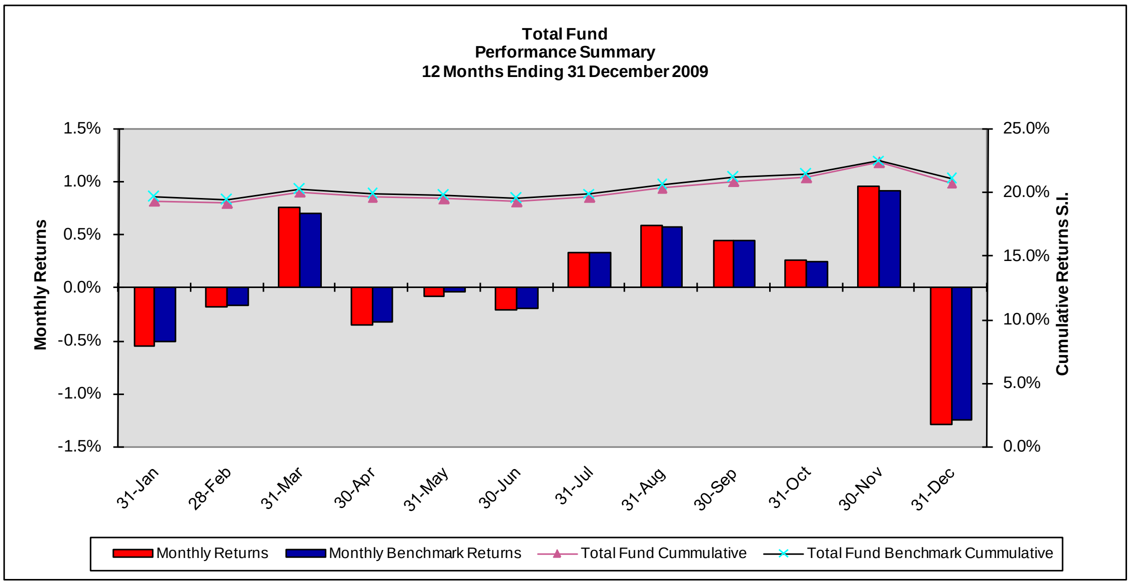
	USD thousands
Cash and Cash Equivalents	3,162
Marketable Debt Securities	5,341,393
Receivabes and Other Assets	32,071
Less: Pending Purchases of Securities	-
TOTAL	**5,376,626**

The Net Income for the quarter comprised the following:

	USD thousands
Investment Income	43,663
Income	**43,663**
Market revaluations	(49,296)
Less: Management fees	(1,337)
Net Result dor the Period	**(6,970)**

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	-0.10	0.60	0.60	4.93	4.44
Benchmark	-0.10	0.67	0.67	5.01	4.49
Excess	0.00	-0.07	-0.07	-0.08	-0.06
International Fixed Interest	-0.10	0.60	0.60	4.93	4.44
Benchmark	-0.10	0.67	0.67	5.01	4.49
Excess	0.00	-0.07	-0.07	-0.08	-0.06



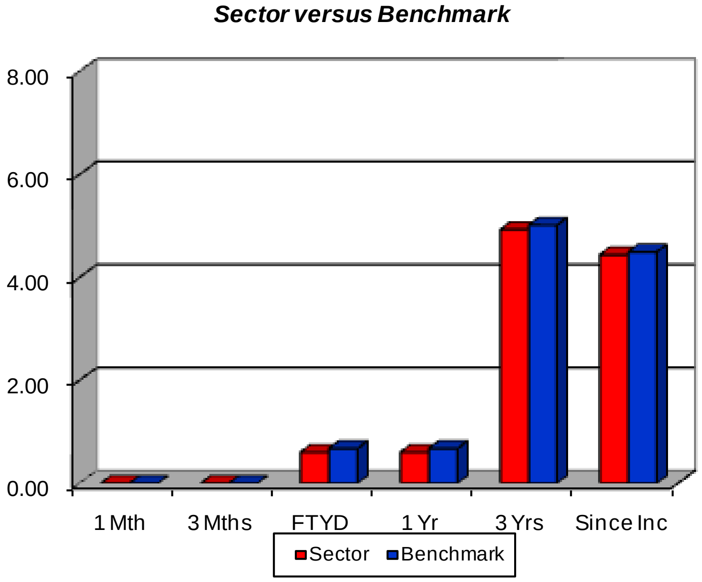
The cumulative performance of the Petroleum Fund compared with the performance of the Global Benchmark over the same period is shown in the above graph.

FIXED INTEREST

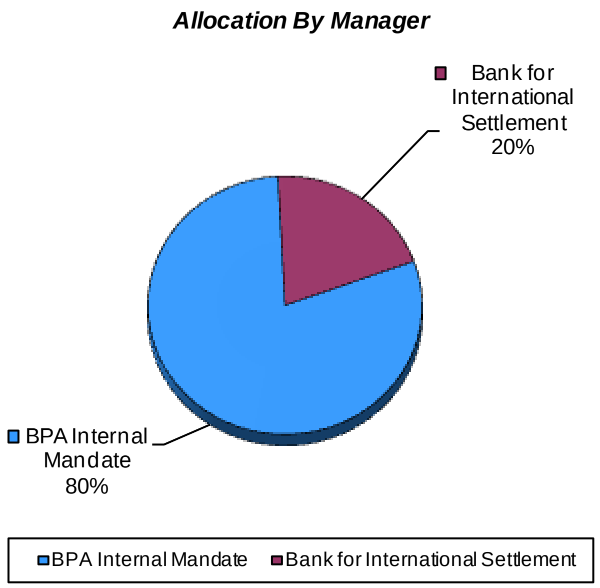
The performance of the investments in Fixed Interest investments for the quarter, including the performance of the managers responsible for those investments, was as follows:

Currency $USD	**QTR**	**FYTD**	**1 Year**	**3 Years**	**Since Inc**
International Fixed Interest	-0.10	0.60	0.60	4.93	4.44
Benchmark	-0.10	0.67	0.67	5.01	4.49
Excess	0.00	-0.07	-0.07	-0.08	-0.06
BPA Internal Mandate	-0.07	0.17	0.17	4.78	4.33
Benchmark	-0.06	0.30	0.30	4.88	4.40
Excess	-0.01	-0.13	-0.13	-0.10	-0.07
Bank for International Settlement	-0.23				2.47
Benchmark	-0.26				2.55
Excess	0.02				-0.08

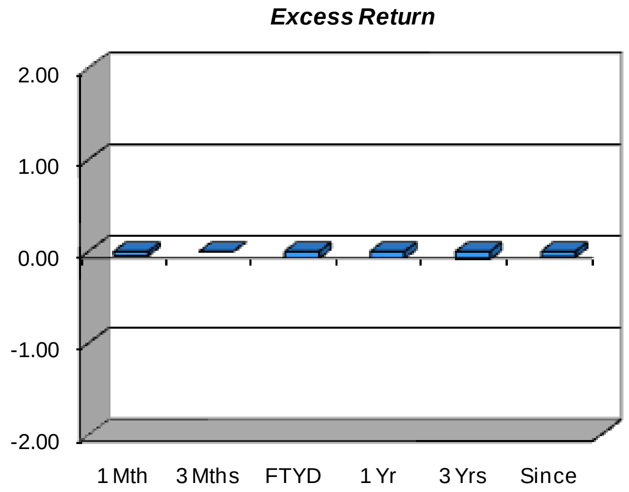
The performance of the Fixed Interest Sector against its benchmark was as follows:



The allocation of the Fixed Interest Sector by manager was as follows:



The excess return of the sector was as follows:



5. MANANGEMENT COSTS

A management fee of $1,337,187 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 & custody expenses	$874,916
BPA Internal mangement expenses	$462,271
Total	**$1,337,187**

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, an mount of $ 312 were transferred from the Fund to the State Budget. A summary of transfers to the State Budget Account is as follows:

The fee covered the following services: US$ Million

Transfer - October 2009	$60
Transfer - November 2009	$100
Transfer - December 2009	$152
Total transfer for this quarter	**$312**
Transfer for previous quarter	$200
Total trnasfer for this fiscal year to December 2009	**$512**

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 (zero) while the excess return of the BPA internal mandate and the BIS mandate were -0.01% or -1 basis point and 0.02% or 2 basis points respectively.

7.2 Duration

The modified duration of the BPA 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 highest credit rating (AAA) while the investments in other sovereign states and supranational fixed interest securities with the credit ratings of (NR-Not Rated to AAA) within the limit as provided in the BIS mandate. All investments reflected the new investment mandate as provided in the updated Management Agreement.

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

The BPA 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 -0.10 basis points compared with the benchmark performance of -0.10 basis points. The portfolio return was exactly same with the benchmark return.

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 Manager

The BPA portfolio complied with the mandate throughout the quarter.

External Managers

The external manager investment was within the mandate during the quarter.

Internal Audit

In accordance with the provisions of Article 22 of the Petroleum Fund law number 9/2005 that requires BPA's Internal Auditor to perform an audit of the Fund every six months the Internal Auditor has performed an audit on the Fund to 30 June 2009.

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	Dec-09	Sep-09	Dec-08
Cash and Cash Equivalents	3,162	1,172	635
Marketable Debt Securities	5,341,220	4,147,419	4,173,931
Receivables and Other Assets	32,244	61,080	22,406
Less: Peding Purchases of Securities	-	-	-
TOTAL	**5,376,626**	**4,209,671**	**4,196,972**
CAPITAL			
Opening Balance as at 31 December 2008	4,196,972	4,196,972	2,086,157
PF Law Art. 6.1(a) Revenue Receipts	661,235	505,935	895,797
PF Law Art. 6.1(b) DA Receipts	993,713	760,227	1,338,409
PF Law Art. 6.1(e) other Receipts	5,241	-	-
PF Law Art. 7.1 Transfer to General State Budget	(512,000)	(200,000)	(396,000)
Net Income	31,466	38,435	222,609
TOTAL	**5,376,626**	**5,301,569**	**4,146,972**

Profit & Loss Statement

INCOME	Quarter		Year To Date (YTD)	
	Dec-09	Dec-08	Dec-09	Dec-08
Investment Income	43,663	37,004	184,482	115,969
Income	**43,663**	**37,004**	**184,482**	**115,969**
Market Revaluations	(49,296)	92,364	(150,404)	107,693
Less: Management Fees	(1,337)	(532)	(2,612)	(1,053)
Net Result for the Period	**(6,970)**	**128,836**	**31,466**	**222,609**

Note: 1. The 2008 valuation numbers were on the basis of BPA's valuation based on Merrill Lynch pricing source while 2009 valuation numbers are based on FTID pricing source produced by the Fund's Custodian.

2. 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, 19 January 2010

Venâncio Alves Maria
Executive Director

Abraão de Vasconselos
General Manager