

Petroleum Fund of Timor-Leste

Quarterly Report

30 September 2009

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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. 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 July to 30 September 2009.

Key statistics for the quarter include:

- The capital of the Fund grew from \$4,901.52 million to \$5,301.57 million
- Gross cash inflows to the fund from royalties and taxes were \$332.30 million
- Cash outflows \$351,750 for operational management costs
- Net cash inflows during the period was \$331.95 million
- The portfolio return in the period was 1.35% compared with the benchmark return for the quarter of 1.34%.

The returns by quarter, one year, FYTD, three years and since inception of the Fund up to 30 September 2009 as follows.

\$USD	Mkt Value	QTR	1 Year	3 Years	Since Inc
Total Fund	5,303,381,254	1.35	4.02	5.29	4.74
Benchmark		1.34	4.15	5.37	4.80
Excess		0.01	-0.13	-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 summarised 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

Macro economic fundamentals continued to improve and the longer term outlook remains uncertain. Stock prices rose further while government bond yields trended slightly downwards. Central Banks indicated that their current policy stances would remain broadly unchanged in the near future and although exit strategies were being discussed publicly, a departure from highly accommodative policies is considered premature. The fixed interest markets were relatively stable and with a positive trend in the third quarter of 2009. Credit spreads in the corporate market and other market segments like emerging market debt is steadily declining as earnings and equity prices are rising and confidence is building up again among international investors.

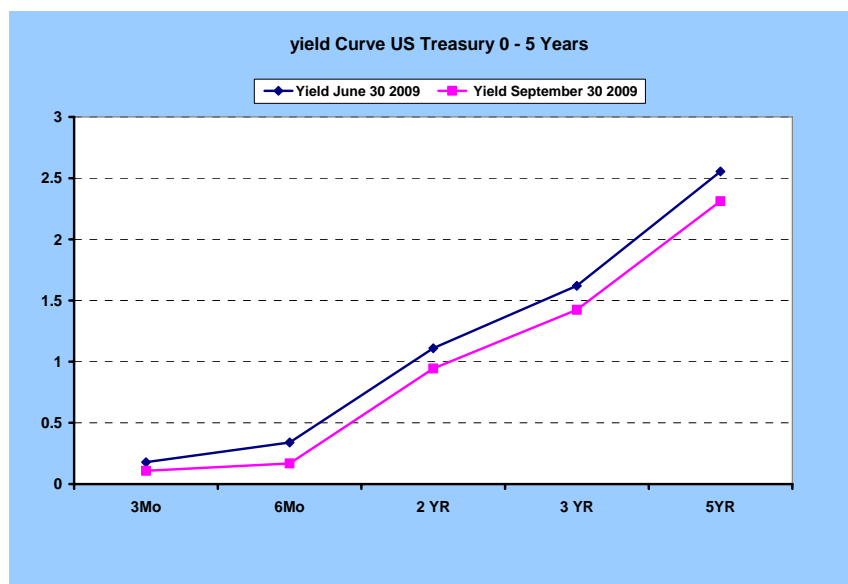
Government bond yields trended slightly downwards, while Stock prices rose further. The fixed interest markets were relative stable with a positive trend in the third quarter of 2009. Confidence is building up among the international investors and earning and equity prices are rising as the emerging market debt is steadily declining.

US Treasury Market

During the period from 30 June 2009 to 30 September 2009 US Treasury bonds 0 to 5 years yields decreased significantly. At the short end 3 and 6 month US Treasury benchmark reference bills decreased by 7 and 17 basis points respectively, while 2 year bond yields decreased by 16 basis points. The 3 and 5 year US Treasury benchmark reference notes decreased by 20 and 24 basis points respectively compared to the previous quarter end. Bond prices and yields move in opposite directions. The changes in the yields during the quarter have therefore resulted in higher prices treasury bonds securities held in the PF portfolio.

US Treasury bond yields decreased moderately. The 3 and 6 month US Treasury benchmark reference bills decreased by 7 and 17 basis points, 2 year yields increased by 16 basis points. The 3 and 5 year yield decreased by 20 and 24 basis points respectively.

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

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 100 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.

GLOBAL PORTFOLIO

In the course of the quarter the Petroleum Fund increased from \$4,901.52 million to \$5,301.57 million, as follows:

Descriptions	USD Million	
	Amount	
Opening Balance (1 July 2009)	\$4,901.52	
Receipts during the period	\$332.30	
Transfer to General State Budget during the period	\$0.00	
Management Fees	(\$0.35)	
Return in the period	\$68.10	
Closing Balance (30 Sept 09)	\$5,301.57	

This balance was invested in the following financial assets¹:

	USD millions
Cash and Cash Equivalents	6,084
Fixed Interest Investments	5,225,341
Accrued Interest	70,143
Less: Pending Purchases of Securities	-
TOTAL	5,301,568

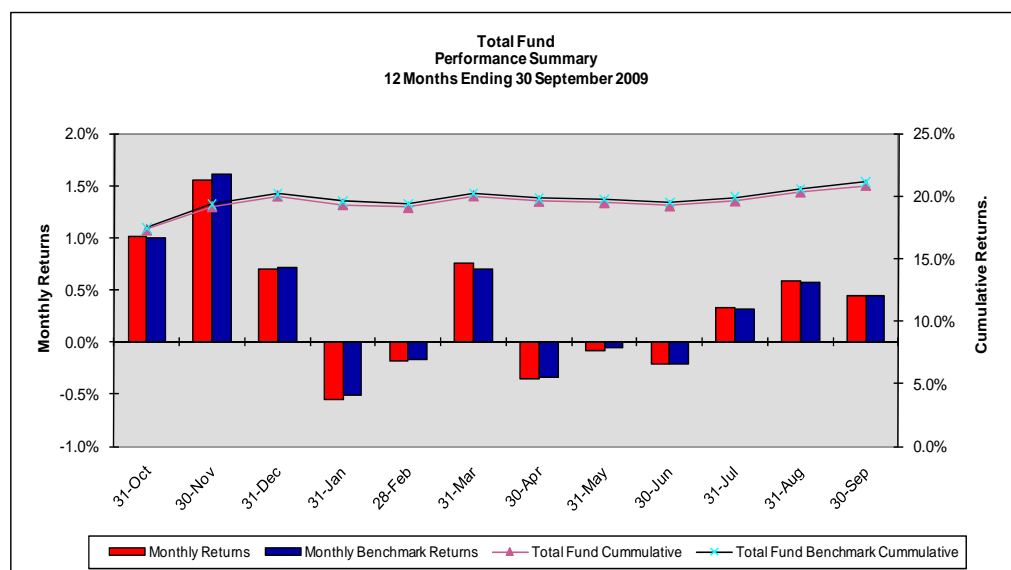
¹ This is consolidated investment, while Financial Information in note 9 (p11) reflect the details of BPA investment by also recognizing the aggregate of assets under external management.

The Net Income for the quarter comprised the following:

	<i>USD millions</i>
Money Market Interest	5
Treasury Note coupons	52,869
Market revaluations	15,224
Management fees	(352)
Net Income/(Loss)	67,747

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

Currency \$USD	QTR	1 Year	3 Years	Since Inc
Total Fund	1.35	4.02	5.29	4.74
Benchmark	1.34	4.15	5.37	4.80
<i>Excess</i>	<i>0.01</i>	<i>-0.13</i>	<i>-0.08</i>	<i>-0.06</i>
International Fixed Interest	1.35	4.02	5.29	4.74
Benchmark	1.34	4.15	5.37	4.80
<i>Excess</i>	<i>0.01</i>	<i>-0.13</i>	<i>-0.08</i>	<i>-0.06</i>



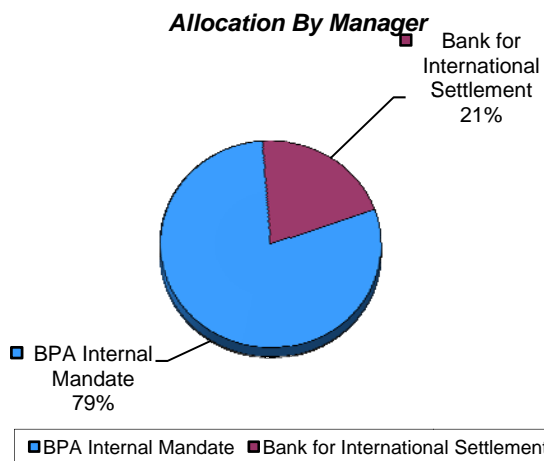
The cumulative performance of the Petroleum Fund compared with the performance of the Global Benchmark over the same period is shown in the above graph.

FIXED INTEREST

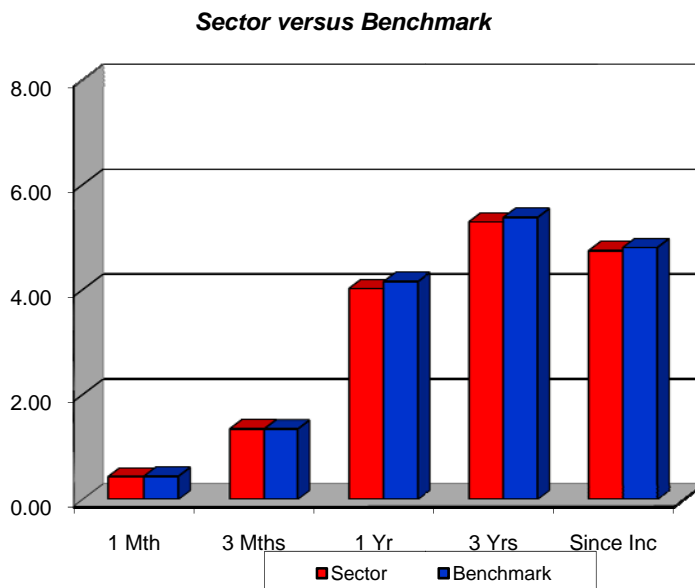
The performance of the investments in Fixed Interest investments for the quarter, including the performance of the managers responsible for those investments, was as follows: The allocation of the Fixed Interest Sector by manager was as follows:

Currency \$USD				
	QTR	1 Year	3 Years	Since Inc
International Fixed Interest	1.35	4.02	5.29	4.74
Benchmark	1.34	4.15	5.37	4.80
<i>Excess</i>	0.01	-0.13	-0.08	-0.06
BPA Internal Mandate	1.00	3.55	5.13	4.62
Benchmark	0.98	3.73	5.23	4.70
<i>Excess</i>	0.03	-0.18	-0.10	-0.07
Bank for International Settlement	2.71			0.62
Benchmark	2.82			2.82
<i>Excess</i>	-0.11			-2.19

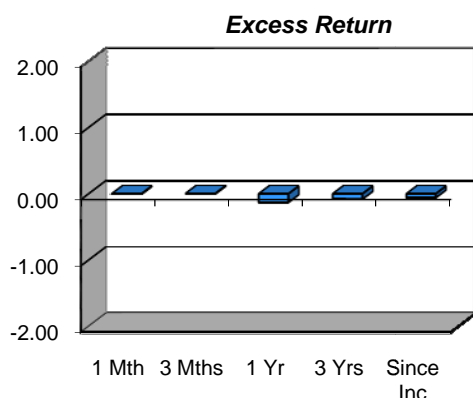
The allocation of the Fixed Interest Sector by manager was as follows:



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



The excess return for the sector was as follows:



5. MANAGEMENT COSTS

A management fee of \$351,750 for operational management costs was deducted from the fund during the quarter to cover the internal operational expenses while the external expenses will be charged at cost.

The fee covered the following services:

	<i>USD thousands</i>
External management & custody expenses	0
BPA Internal management expenses	351,700
Total	351,700

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, there was no transfer from the Fund to the State Budget. A summary of previous transfers to the State Budget Account is as follows:

	<i>USD millions</i>
Transfer – July 2009	0
Transfer – August 2009	0
Transfer – September 2009	0
Total transfers for this quarter	0
Transfers for previous quarters	200
Total transfer for this Fiscal Year to Sept 09	200

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 0.01% or 1 basis point while the excess return of the BPA internal mandate and the BIS mandate were 0.03% or 3 basis points and -0.11% or 11 basis points respectively within the mandate during the quarter.

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 35 basis points compared with the benchmark performance of 34 basis points. The excess return of 1 basis point above the benchmark.

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 thousands \$		
NET ASSETS	Sep-09	Jun-09	Sep-08
Cash and Cash Equivalents	1,172	866	979
US Treasury Notes (Market Value)	4,147,419	3,888,747	3,683,115
Accrued Interest	61,080	21,703	54,259
Less: Pending Purchases of Securities	-	-	-
Asset under External Management	1,091,896	990,209	-
TOTAL	5,301,568	4,901,525	3,738,353
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	505,935	344,439	712,038
PF Law Art. 6.1(b) DA Receipts	760,227	589,425	986,386
PF Law Art. 7.1 Transfer to General State Budget	(200,000)	(200,000)	(140,000)
Net Income	38,435	(29,311)	93,772
TOTAL	5,301,568	4,901,525	3,738,353

Profit and Loss Statement

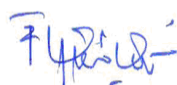
	In thousands \$			
INCOME	Quarter		Year to Date (YTD)	
	Sep-09	Sep-08	Sep-09	Sep-08
Money Market Interest	5	75	26	344
Treasury Note Coupons	36,555	32,004	119,565	78,621
Income	36,560	32,078	119,591	78,965
Market Revaluations	15,224	23,332	(96,196)	15,328
Income under External Manager	16,315	-	16,315	
Less: Management Fees	(352)	-	(1,275)	(521)
Net Result for the Period	67,747	55,411	38,435	93,772

- 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, 16 October 2009



Venâncio Alves Maria
Executive Director



Abraão de Vasconcelos
General Manager