VOLUME 5 ISSUE X

Petroleum Fund of Timor-Leste

Quarterly Report

30 June 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 has not been independently audited or reviewed and is subject to change, in which case 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 April to 30 June 2009.

Up to 26 June 2009 when a portion of the Fund was placed under the management of the Bank for International Settlements the BPA continued to invest all funds received according to the investment mandate agreed with the Ministry of Finance in which a benchmark index of United States Treasury Securities with maturities up to five years and others foreign Government Bonds that specified together with defined performance measures.

In the course of the quarter the capital of the Fund grew from $4,750.08 million to $4,901.52 million, of which 20.20% was under the BIS management at 30 June. The gross cash inflows to the fund were $383.98 million comprising taxpayer contributions to the fund of $116.91 million and Royalties of $267.07 million. The outflows were $200.92 million of which $200 million was transferred to the State Budget and $922,766 paid to the BPA to cover the operational management costs from January to June 2009. The net capital flow was $183.06 million.

The portfolio return in the period was -0.76 %. or -76 basis points while the benchmark return for the quarter was -0.63% or -63 basis points. The excess return was 14 basis points[1] below the benchmark within the mandated target ±25 basis points and fully attributable to the cost of converting part of the portfolio to the new investment mandate to be managed by the Bank for International Settlements.

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[1] a. The performance numbers are using the Fund's custodian performance figures based on FTID pricing source while using the BPA's performance numbers based on Merrill Lynch pricing source consistent with the benchmark, the portfolio return is -0.70% and the benchmark return is -0.62%. The excess return is -0.08%.

b. The performance numbers reported in this report does not include the Bank for International Settlements (BIS") performance yet because the BIS started its mandate on 26 June 2009 (partial month) and will be included in next report.

	(%) QTR	1 Year	3 Years	Since Inception
BPA Portfolio	-0.76	4.20	5.49	4.66
Benchmark	-0.63	4.48	5.60	4.75
Excess	-0.14	-0.29	-0.11	-0.09

The table shows the returns by quarter, one year, three years and the since inception of the Fund using the Fund's custodian performance calculation based on FT Interactive Data (FTID)[2] pricing source.

1. PETROLEUM FUND MANAGEMENT MANDATE

The Banking and Payments Authority has been appointed to undertake the operational management of the Fund in accordance with Article 11.3 of the Petroleum Fund Law which states that the Minister shall enter into an agreement with the Central Bank for the operational management of the Petroleum Fund and the Central Bank shall be responsible for the operational management of the Petroleum Fund.

An updated management agreement was negotiated and agreed between the Ministry of Finance and the Banking & Payments Authority, and signed on 25 June 2009.

The mandate set out in the Management Agreement has changed since the previous report, and, with effect from 25 June 2009 is as follows:

The BPA's Internal Mandate is to passively manage the fund close to the benchmark to achieve a return within 25 bps of the benchmark with the modified duration of less than 0.2 years

The objective of the BIS mandate 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.

Qualifying Instruments, Benchmark and Investment Mandate

This mandate has a hierarchical structure.

The Global Mandate describes the Minister's overall investment strategy for the Petroleum Fund in terms of a benchmark and eligible instruments, including applicable constraints and limitations.

The Sub Mandates describe in more detail the manner in which the Minister expects the investment of the Fund to be implemented. They describe the management structure of investment portfolios that shall be created, including the style of investment management, risk tolerances, and benchmark against which the performance of each sub-mandate shall be measured and reported, and as at the date of the Management Agreement, the managers appointed to manage the sub-mandates.

A. Global Mandate
The BPA is responsible for the operational management of the aggregate Fund according to the following mandate;

Aggregate Benchmark
The benchmark for the global mandate is the weighted ratio of the two benchmarks included in Mandate 1 and 2 below:

- 80 per cent of the benchmark defined under Mandate 1
- 20 per cent of the benchmark defined under Mandate 2

[2] The performance numbers using the Merrill Lynch pricing source consistent with the benchmark is shown below:

	Quarter	1 year	2 yrs	3 yrs	since inception
BPA Portfolio	-0.70%	4.70%	6.01%	5.71%	4.64%
Benchmark	-0.62%	4.86%	6.08%	5.77%	4.65%
Excess	-0.08%	-0.15%	0.07%	-0.05%	0.01%

Eligible Instruments

Asset Class	Allocation
A. Qualifying Fixed Interest Investments under Article 15.1 of the Petroleum Fund Law	Up to 100%
B. Fixed Interest Instruments meeting the conditions in Article 14 of the Petroleum Fund Law	No more than 10%

Eligible currencies for fixed interest investments shall be United States dollars, Australian Dollars, Euro, Great Britain Pounds, and Japanese Yen.

B. Sub mandates

An initial portfolio of $1 billion shall be assigned to the Bank for International Settlements, and the balance thereafter shall be maintained between 19% and 21% of the value of the Fund, excluding amounts held for cash management purposes.

MANDATE 1

Manager Banking & Payments Authority of Timor-Leste

Benchmark Merrill Lynch US Government Bond 0-5 years index

Eligible instruments US Government fixed interest instruments

Objective The investment objective shall be to passively manage the portfolio close to the benchmark, so that in normal circumstances the objective shall be to achieve a return within 25 basis points of the benchmark.

The difference in the modified duration between the portfolio and the benchmark shall be less than 0.2 year.

MANDATE 2

Manager Bank for International Settlements

Benchmark The following group of indexes will, together, form the composite benchmark for the Portfolio:

(a) 52% Merrill Lynch 0-5 Years US Treasury Notes and Bonds Index (“GVQA”);

(b) 10% Merrill Lynch 5-10 Year US Treasury Notes and Bonds Index (“G6O2”);

(c) 7% Merrill Lynch Australian Governments Index (“G0T0”);

(d) 7% Merrill Lynch EMU Direct Government Index (“EG00”);

(e) 2% Merrill Lynch U.K. Gilts Index (“G0L0”);

(f) 2% Merrill Lynch Japanese Governments Index (“G0Y0”);

(g) 13% Merrill Lynch US Dollar Foreign Government and Supra National, AAA Rated Index (“GS1O”); and

(h) 7% Merrill Lynch US Dollar Foreign Government and Supra National, AA Rated Index (“GS2O”).

Eligible instruments	BIS must invest at least 80 % of the portfolio in accordance with the qualifying instruments defined in Article 15.1 of the Petroleum Fund Law. The BIS may invest a maximum of 20% of the Portfolio in deposits with, or debt instruments denominated in Australian Dollar (AUD), Euro (EUR). Japanese Yen (JPY) and Pounds Sterling (GBP) and issued by, entities that have been designated with a long-term foreign currency rating of Baa3 or higher by the Moody's rating agency or BBB- or higher by the Standard & Poor's rating agency, provided that the debt instruments are issued outside of Timor-Leste, are liquid and transparent, and traded in a financial market of the highest regulatory standard.
Objective	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.

C. Cash management

Short-term liquidity may be maintained by the Fund for operational purposes but shall be limited to cash received pending investment or allocation to external managers, cash and securities in transition to or between external managers and short-term instruments held to fund appropriations to the state budget account. The Central Bank shall be accountable for the return on these instruments.

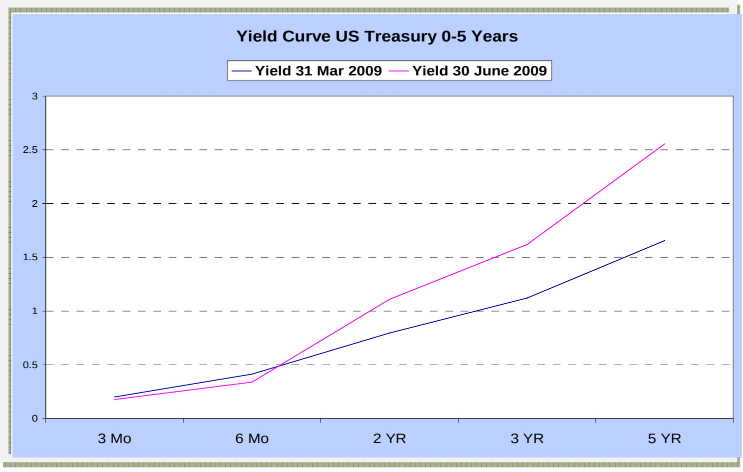
The BIS's benchmark weights will be rebalanced at the beginning of each month to return to the above described percentages and than allowed to drift according to market movements throughout the month.

All royalty payments and funds received from taxpayers, other than small amounts that do not collectively reach the minimum investment threshold set by the BPA, have been invested in the mandated benchmark from the day following receipt.

2. Market Trends during the Quarter

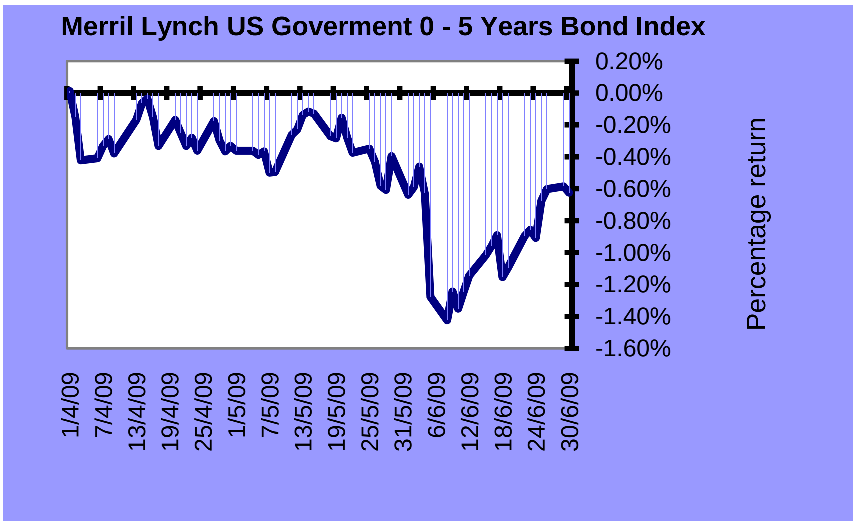
The 3 and 6 month US Treasury benchmark reference bills decreased by 2 and 7 basis points, 2 year yields increased by 31 basis points. The 3 and 5 year yield by 50 and 90 basis points respectively.

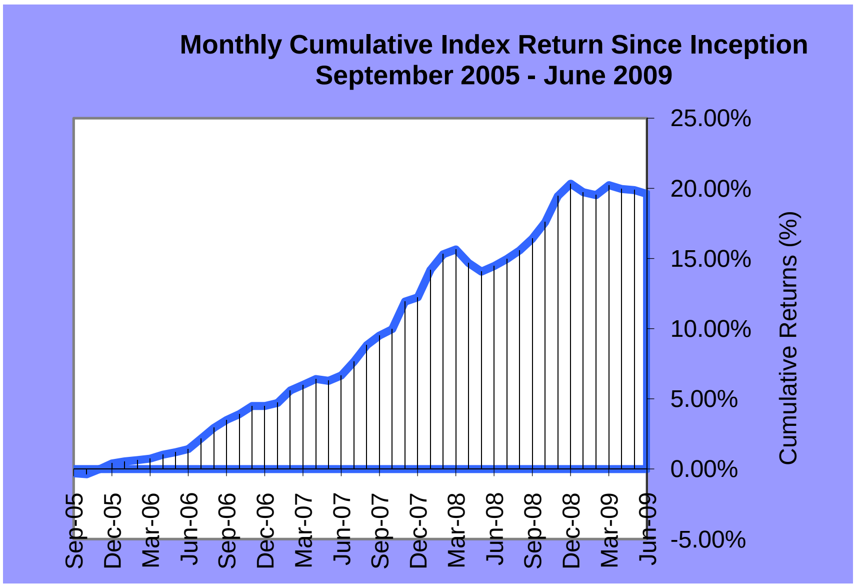
During the period from 31 March 2009 to 30 June 2009 US Treasury bond 2 to 5 years yields increased significantly while 3 and 6 months slightly decreased. At the short end 3 and 6 month US Treasury benchmark reference bills decreased by 2 and 7 basis points respectively, while 2 year bond yields increased by 31 basis points. The 3 and 5 year US Treasury benchmark reference notes increased by 50 and 90 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 lower prices for 2 to 5 years securities held in the PF portfolio and higher price for 3-6 months securities.



The above graph shows the 0-5 year US Government yield curve on 30 June 2009 compared to the previous quarter end 31 March 2009.

The following graphs show firstly, the daily performance of the Merrill Lynch US Government bond 0-5 year index during the quarter and secondly, the monthly cumulative performance of the Merrill Lynch US Government Bond 0-5 years index since inception of the Fund.





3. MANAGEMENT DURING THE QUARTER

3.1. Operational Implementation

The objective of the BPA's internal mandate is to achieve the portfolio return close to the benchmark within +/- 25 bps

The objective of the BIS mandate 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 Internal Mandate, the BPA's objective in managing the portfolio is to achieve a portfolio return close to the return of the agreed benchmarks 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.

3.2. Operational Implementation

The BPA internal mandate is operationalised by holding ten of the approximately 108 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.

3.3. External Managers

Following the contract negotiations reported in previous reports, an Investment Management Agreement (IMA) with the Bank for International Settlements (BIS) as a non-commercial external manager was signed on 3 June 2009. To facilitate the operational arrangements, a transition manager was engaged to execute the liquidation of the legacy portfolio to construct a target portfolio for the BIS mandate. A transition Advisor was also engaged to monitor and oversee the transition execution. The transition of the BIS portfolio finalized within the time frame and the portfolio of securities was transferred to the BIS on 26 June 2009.

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Total receipts during the quarter was $383.98m consisting of tax receipts $116.91m & Royalties $267.07m.

The returns was - $31.61m of which $42.92 was coupon & interest and market valuation was -$74.53m

3.4. Capacity Building

Staff assigned to the related Petroleum Fund operational management continued to engage in capacity building, primarily in the form of on-the job training in various institutions including other Central Banks, and the long term capacity building programs.

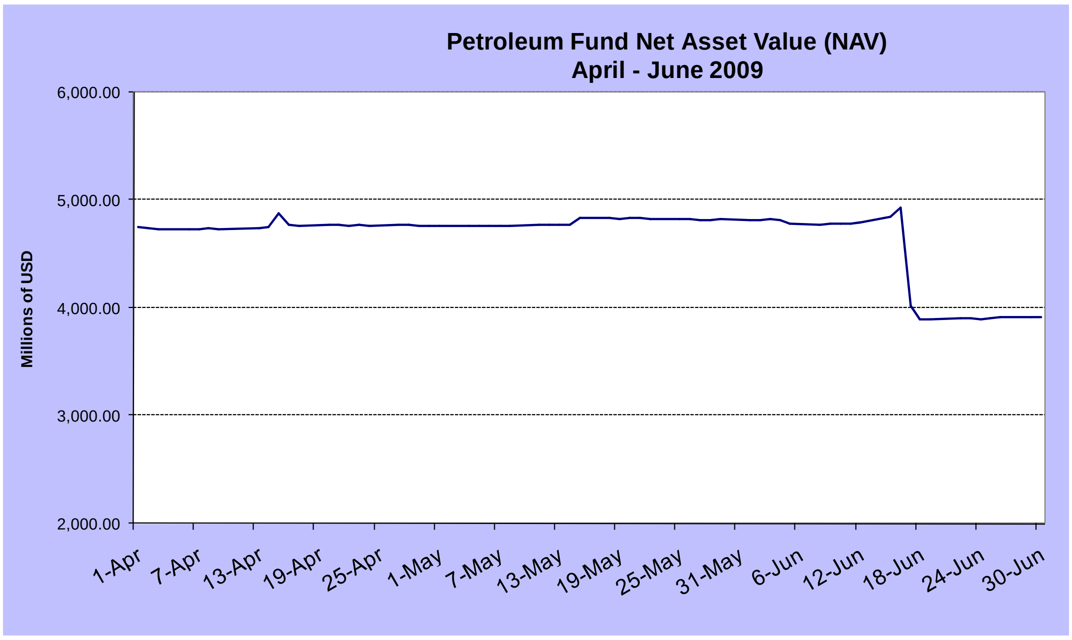
4. PORTFOLIO PERFORMANCE

The opening value of the Fund at the beginning of the quarter was $$4,750.08 million and the closing value as at 30 June 2009 was $4,901.52. Petroleum revenue during the quarter was $383.98 million comprising petroleum **taxpayer** contributions to the fund of $116.91 million and **royalties** of $267.07 million. The dollar return (gross of fees) was ($31.61) million during the quarter, of which coupons and interest received was $42.92 million and the change in the security valuation was negative ($74.53) million. This represents a return to the Fund using FTID pricing source based on the Modified Dietz Method of -0.76 percent or -76 basis point[3] for the quarter.

Return, Quarter Apr-Jun 2009	Amount
Opening book value (1 April 2009)	$4,750.08
Receipts during the period	$383.98
Transfer to General State Budget during the period	-200.00
Management Fees	-0.92
Return in the period	-31.61
Closing book value (30 June 09)	$4,901.52

[3] Please see footnote 1 and 2 in page 1 & 2 for details of performance using Merrill Lynch pricing source.

A graphical presentation of the growth in the NAV (Net Asset Value) of the Fund under the BPA management during the quarter is as follows:



The graphical presentation only covers the NAV under BPA management and excludes the NAV under transition to BIS management. The major movements in the value of the Fund took place as a result of the taxpayer receipts that are usually received around the middle of each month. The significant movement in June 2009 was due to the transfer of funds for transition to the BIS mandate.

5. MANAGEMENT COSTS

An amount of $922, 766 has been deducted from the fund during the quarter to cover the operational expenses of January to June 2009.

The means by which the management costs of the Fund are to be recognised is determined in the Petroleum Fund law. Article 6.3 of the law states "From the amount received in accordance with Section 6.1, the Central Bank shall be entitled to deduct, by direct debit of the Petroleum Fund account, any reasonable management expenses, as provided for in the operational management agreement referred to in Section 11.3".

The management fee is intended to cover the actual expenses incurred by the BPA in managing the Fund. An amount of $922, 766 has been deducted from the fund during the quarter to cover the operational expenses of January to June 2009.

6. TRANSFERS FROM THE PETROLEUM FUND

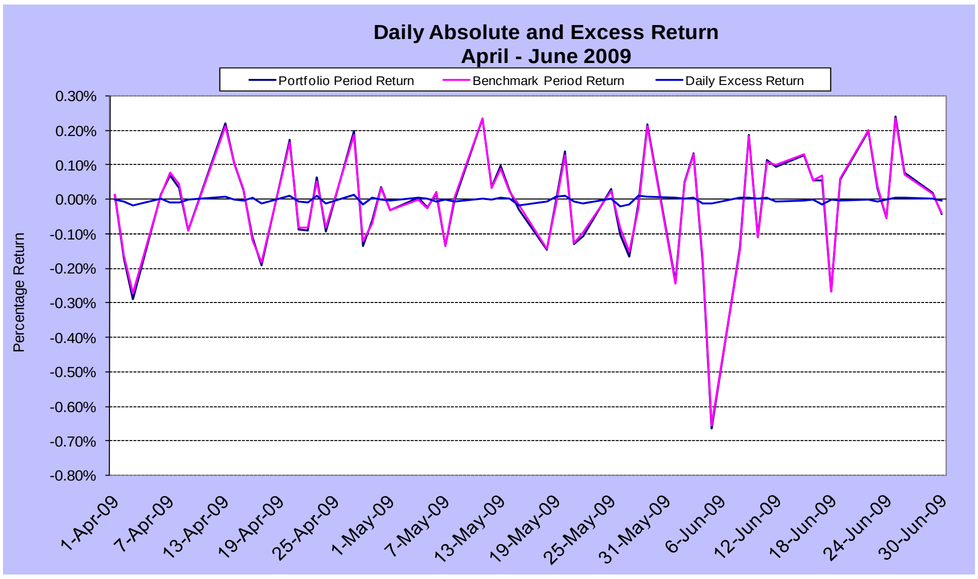
An amount of $200 million been deducted and transferred to the State Account

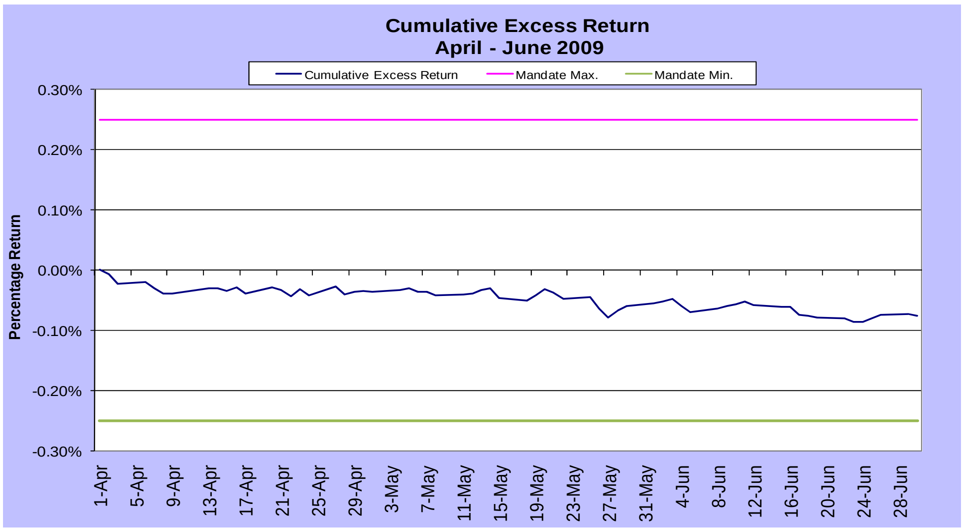
According to Article 7.1 of the Petroleum Fund law transfers from the Fund may only be made to the credit of a single State Budget account. During the quarter, an amount of $200 million was transferred from the Fund to the State Budget.

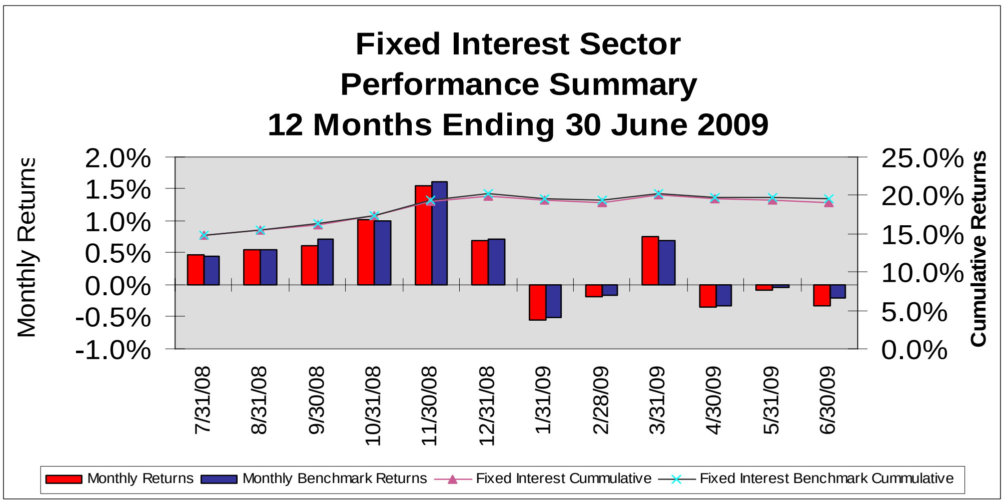
7. RISK EXPOSURE OF PORTFOLIO

7.1. Tracking Error

The following graphs illustrate the manner in which the Fund portfolio tracked the benchmark index. The line "Daily Excess Return" measures the difference between the return of the Fund's portfolio and the benchmark. The cumulative excess return for the quarter was 8 basis points below the benchmark based on Merrill Lynch pricing source[4], within the ±25 basis points in the investment mandate

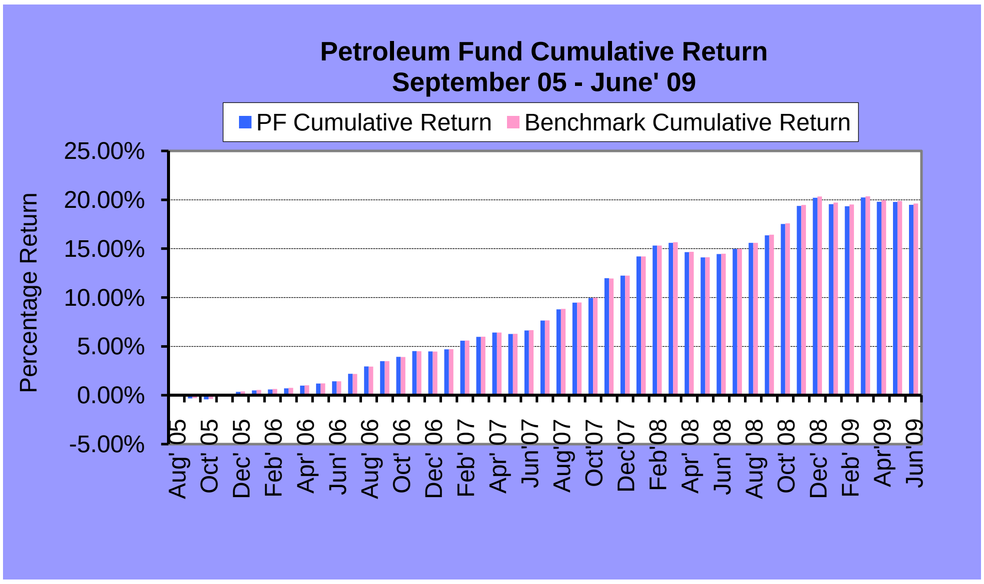






[4] Merrill Lynch pricing source is used in this section for the purpose of measuring the return and tracking error of the portfolio.

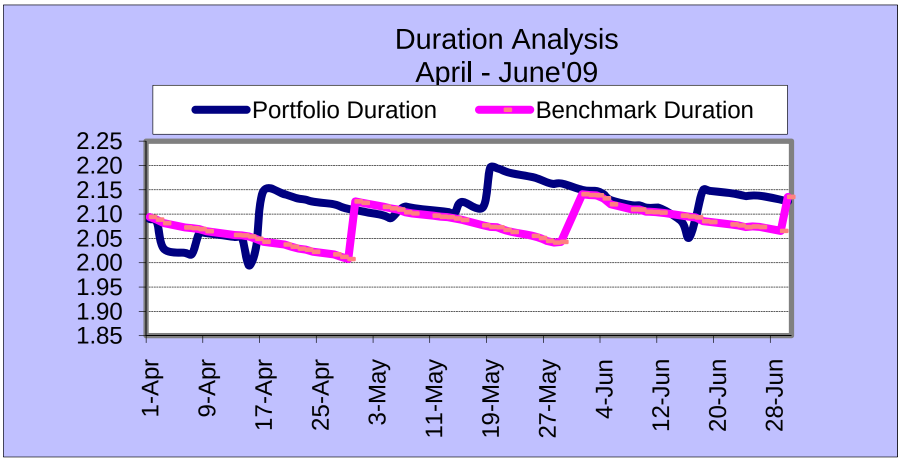
The cumulative performance of the Petroleum Fund compared with the cumulative performance of the Benchmark over the same period is shown in the following graph.



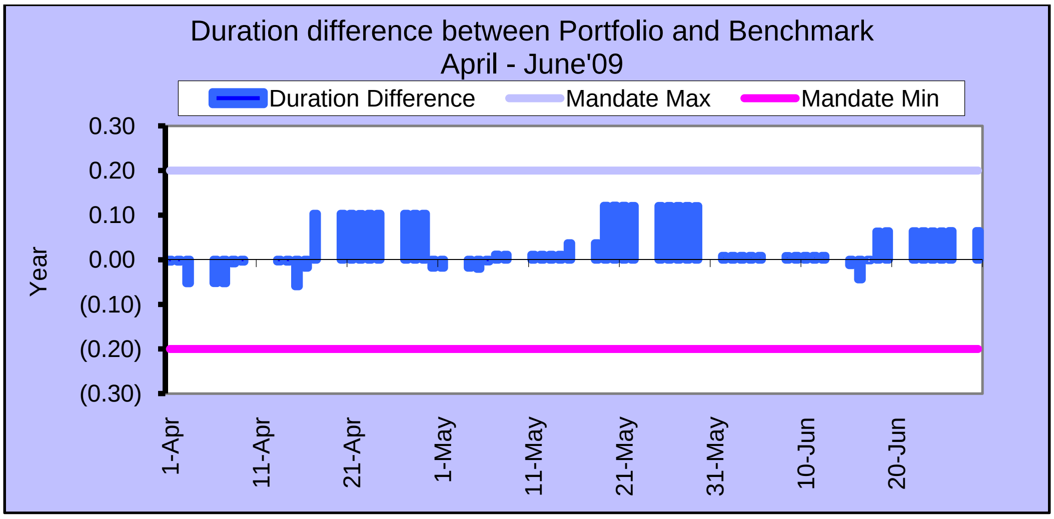
The graph indicates that the cumulative performance of the portfolio is almost identical to the cumulative performance of the benchmark with almost zero point tracking errors. A zero tracking error means that the Petroleum Fund portfolio is performing exactly the same as the benchmark performance over the period.

7.2. Duration

The mandate given by the Ministry of Planning and Finance to the BPA specifies that the Fund portfolio shall have a Modified Duration within 0.2 years of the benchmark index. The following graphs show, *firstly*, the modified durations of the portfolio and the index, and *secondly*, the difference between the portfolio and the index compared with the mandated maximum of ±0.2 years.



The above graph shows the modified duration of the Petroleum Fund investment portfolio compared with the modified duration of the benchmark index.



The above graph shows the daily difference in modified duration between the investment portfolio and the benchmark. The Management Agreement states that the modified duration of the portfolio shall be managed within ±0.2 years of the modified duration of the benchmark. The duration was within the mandate during the quarter.

7.3. Credit Risk

Up to 26 June, US Government Securities which is rated AAA. From 26 to 30 June the investments reflect the new investment mandate

Up to 26 June 2009 all investments by the Petroleum Fund were in US Treasury Securities with the highest credit rating (AAA). From 26 June to 30 June 2009 the investments reflected the new investment mandate.

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 has undertaken the operational management of the Petroleum Fund within the terms of the mandate set out in the Management Agreement.

The BPA has managed the Fund in compliance with the terms of the mandate

8.1. Qualifying Instruments

The Fund was invested in the instruments within the investment universe specified in the mandate at all times during the quarter.

8.2. Return on the Portfolio

The performance on the portfolio for the quarter was -76 basis points compared with the benchmark performance of -63 basis points based on FTID pricing source. The difference of -14 basis points[5] below the benchmark is within the mandated target of ±25 basis points.

8.3. Modified Duration of the Portfolio

The modified duration of the Fund's investment portfolio and the mandated index are measured by the BPA daily. The modified duration of the Petroleum Fund portfolio was within the mandate during the quarter.

8.4. 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 31 December 2008.

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9. SUMMARY 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.

[5] Please see footnote 1 and 2 in page 1& 2 for details of performance using Merrill Lynch pricing source.

Balance Sheet

in thousands $

NET ASSETS	Jun-09	Mar-09	Jun-08
Cash and Cash Equivalents	866	14,114	385
US Treasury Notes (Market Value)	3,888,747	4,667,170	3,185,709
Accrued Interest	21,703	68,796	16,978
Less: Peding Purchases of Securities	-	-	-
Asset under External Management	990,209	-	-
TOTAL	**4,901,525**	**4,750,080**	**3,203,073**
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	344,439	232,771	455,205
PF Law Art. 6.1(b) DA Receipts	589,425	317,113	623,350
PF Law Art. 7.1 Transfer to General State	-200,000	-	-
Net Income	-29,311	3,224	38,362
TOTAL	**4,901,525**	**4,750,080**	**3,203,073**

Profit and Loss Statement

in thousands $

	Quarter		Year to Date (YTD)	
INCOME	Jun-09	Jun-08	Jun-09	Jun-08
Money Market Interest	10	120	21	269
Treasury Note Coupons	42,908	26,472	83,010	46,618
Income	**42,918**	**26,592**	**83,031**	**46,887**
Market Revaluations	-74,531	-52,030	-111,420	-8,004
Less: Management Fees	-922	-261	-922	-521
Net Result for the Period	**-32,535**	**-25,699**	**-29,311**	**38,362**

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, 17 July 2009

Venâncio Alves Maria
Executive Director

Abraão de Vasconselos
General Manager