

# Petroleum Fund of Timor-Leste

## Quarterly Report

31 MARCH 2009

### Inside This Report

- 1 Introduction
- 1 Executive Summary
- 2 Investment Mandate
- 3 Market Trend
- 4 Operational Management
- 5 Portfolio Performance
- 5 Management Costs
- 6 Transfer to State Budget
- 6 Portfolio Risk
- 8 Compliances
- 9 Summary Financial Statements

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*During the quarter the Fund grew from \$4.2bn to \$4.8bn and the portfolio return in the period was 0.01% while benchmark return was 0.02%. Excess return was -1 bps.*

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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 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 January to 31 March 2009.

During this period, 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 is specified together with defined performance measures.

In the course of the quarter the capital of the Fund grew from \$4,196.97<sup>1</sup>million to \$4,750.08 million, including gross cash inflows to the fund of \$549.88 million comprising taxpayer contributions to the fund of \$232.77 million and Royalties of \$317.11 million. The net capital flow was \$549.88 million.

The portfolio return in the period was 0.01 % or 1 basis point while the benchmark return for the quarter was 0.02% or 2 basis points. The excess return was 1 basis points below the benchmark within the mandated target  $\pm 25$  basis points<sup>2</sup>.

<sup>1</sup> Previous reported market value was BPA's valuation based on Merrill Lynch pricing source while starting this quarter the market value of the Fund will be based on Fund's custodian valuation because going forward it will not be practical to use BPA's valuation when new managers are added to the Fund. The change affects the allocation of income between reporting periods, and does not change the overall profit of the Fund.

<sup>2</sup> This performance numbers use the Fund's custodian performance figures based on FT pricing source while the BPA's performance numbers is 0.04% for the portfolio and the benchmark is 0.02% using the pricing source of Merrill Lynch as reported previously.

	Monthly	QTR	(%) 1 Year	3 Years	Since Inc
<b>Portfolio Return</b>	0.76	0.01	3.95	6.01	5.22
<b>Benchmark Return</b>	0.70	0.02	4.07	6.06	5.27
<b>Excess</b>	0.06	-0.01	-0.12	-0.05	-0.05

The table shows the returns by month, quarter, one year, three years and the since inception of the Fund.

## 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.

The management agreement was negotiated and agreed between the Ministry of Finance and the Banking & Payments Authority, and signed on 12 October 2005.

This mandate set out in the Management Agreement has not changed since the previous report, and is as follows:

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*The 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*

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### QUALIFYING INSTRUMENTS

*The assets of the Fund shall be invested in the classes of instruments as described below. The indices indicated with each asset class shall be used to measure the performance of the Fund.*

*Debt instruments issued by the United States and other qualifying sovereign governments:*

*Index: Merrill Lynch 0-5 year government bond index*

*Short-term liquidity instruments maintained by the Fund limited to budgeted monthly appropriations from the Fund to the state budget account described in Article 13 based on cash projections supplied to the Central Bank by the Minister shall be excluded from the Fund for the purpose of benchmark comparison, but the Central Bank shall otherwise be accountable for the return on these instruments.*

### MANDATE

- 1. The nature of the mandate established by the Minister shall be to passively manage the Fund close to the benchmark, so that in normal circumstances the objective shall be to achieve a return within 25 basis points of the benchmark.*
- 2. The difference in the modified duration between the portfolio and the benchmark shall be less than 0.2 years.*

*To enable the orderly acquisition of suitable investments, the parameters in this Annex 1 shall apply only from thirty (30) days after the date of entering into force of this Management Agreement.*

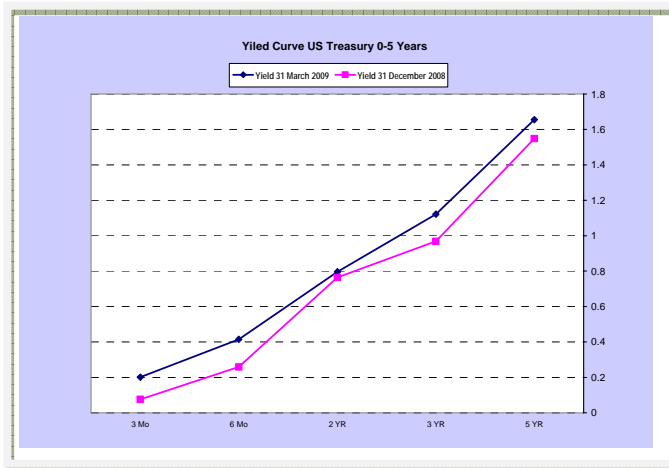
All royalty payments and funds received from taxpayers, other than small amounts that do not collectively reach the minimum investment threshold set by the BPA, have been invested in the mandated benchmark from the day following receipt.

## 2. Market Trends during the Quarter

During the period from 31 December 2008 to 31 March 2009 US Treasury bond yields increased moderately. At the short end 3 and 6 month US Treasury benchmark reference bills increased by 12 and 16 basis points respectively, while 2 year bond yields increased by 3 basis points. The 3 and 5 year US Treasury benchmark reference notes increased by 15 and 11 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 the securities held in the PF portfolio.

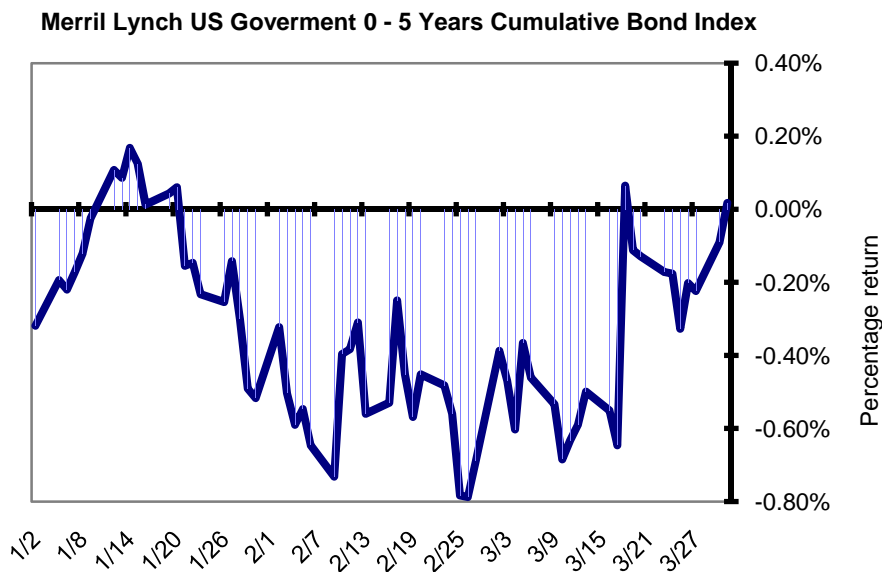
*US Treasury bond yields increased moderately. The 3 and 6 month US Treasury benchmark reference bills increased by 12 and 16 basis points respectively, 2 year yields increased by 3 bps. The 3 and 5 year yield by 15 and 11 bps respectively.*

The graph shows the 0-5 year US Government yield curve on 31 March 2009 compared with the previous quarter end 31 December 2008.

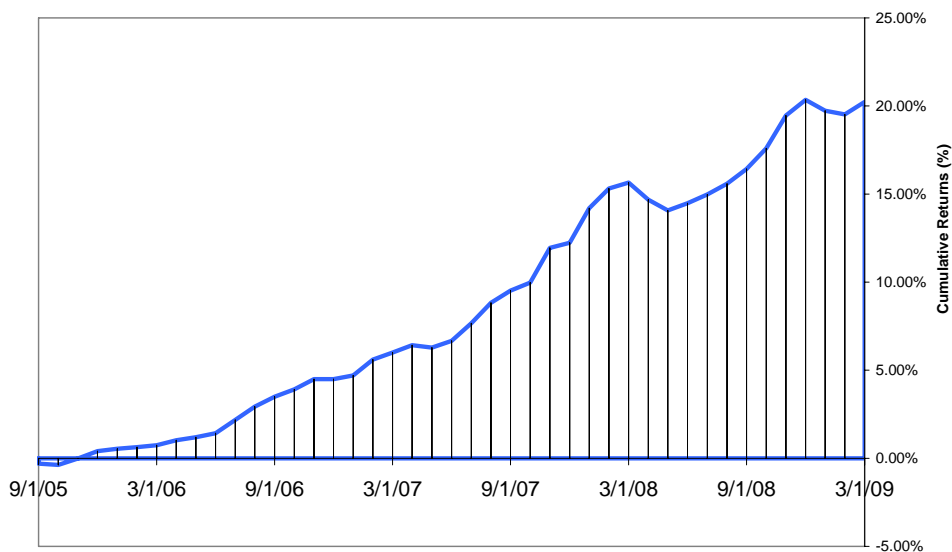


There has been no change to the U.S. Federal Reserve Bank's key overnight lending rate (the US Federal Funds target rate), with the current level target rate remaining at 0 – 0.25% as of March 2009.

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



### Monthly Cumulative Index Return Since Inception September 2005 - March 2009




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*The objective is to achieve the portfolio return close to the benchmark within +/- 25 bps*

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## 3. MANAGEMENT DURING THE QUARTER

### 3.1. Objectives

The BPA's objective in managing the Fund is to achieve a portfolio return close to the return of the agreed benchmark. 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.

### 3.2. Operational Implementation

The mandate is operationalised by holding ten of the approximately 106 US Treasury Securities that form the defined benchmark index. The bonds are selected to best replicate the risk and return characteristics of the benchmark.

Daily financial reports on the performance of the Fund are produced for BPA management as part of the management process.

### 3.3. External Managers

Contract negotiations with the Bank for International Settlements as a non-commercial external manager has been concluded and submitted for approval in accordance with Article 12 of the Petroleum Fund Law.

### 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.

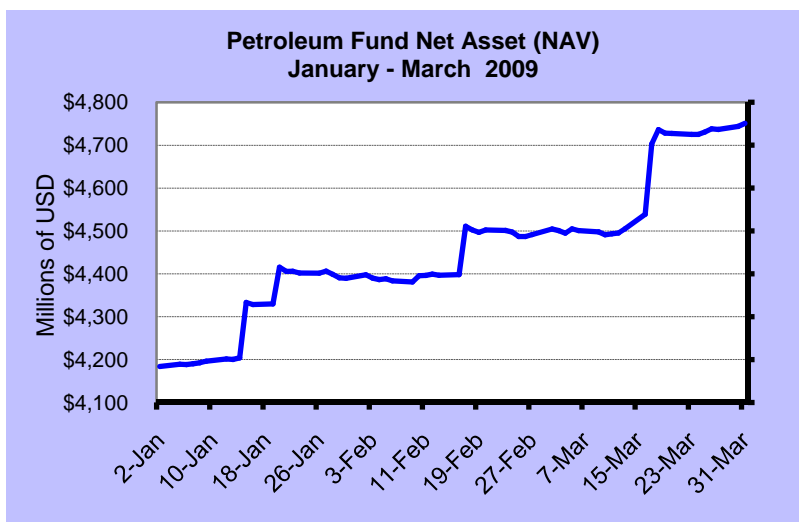
#### 4. PORTFOLIO PERFORMANCE

The performance of the Fund relative to the benchmark is calculated and reported using the same basis as the benchmark.

The opening value of the Fund at the beginning of the quarter was \$4,196.97 million and the closing value as at 31 March 2009 was \$4,750.08 million. The petroleum revenue during the quarter was \$549.88 million comprising petroleum taxpayer contributions to the fund of \$232.77 million and royalties of \$317.11 million. The dollar return (gross of fees) was \$3.22 million during the quarter, of which coupons and interest received was \$40.10 million and the change in the security valuation was negative \$36.89 million. This represents a return to the Fund based on the Modified Dietz Method of 0.01 percent or 1 basis point for the quarter.

In million \$	
<b>Absolute return for the Quarter Jan-Mar 09</b>	
Opening book value (31-Dec-08)	4,196.97
Receipts during the period	549.88
Transfer to General State Budget	-
Management Fees	-
Return in the period	3.22
Closing book value (31-Mar-09)	4,750.08

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



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.

#### 5. MANAGEMENT COSTS

The means by which the management costs of the Fund are to be recognized 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. There has been no deduction from the Fund for management fee during the period

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*Total receipts during the quarter was \$549.88m consisting of tax receipts \$232.77m & Royalties \$317.11m.*

*The returns was \$3.22m of which \$40.10m was coupon & interest and market valuation was (\$36.89)*

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*There has been no deduction from the Fund for the management fee during the period.*

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because there has been delay in confirming the BPA’s proposed management fees.

## 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, on request of the government and within the amount appropriated by the Parliament an amount of \$256.00 million has been deducted from the Fund and transferred to the General State Budget account. During the calendar year 2008, the total transfer to the State Budget was \$396 million. There was no transfer to the State Budget during the first quarter of 2009.

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*There was no transfer to the State Budget during the first quarter of 2009*

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## 7. RISK EXPOSURE OF PORTFOLIO

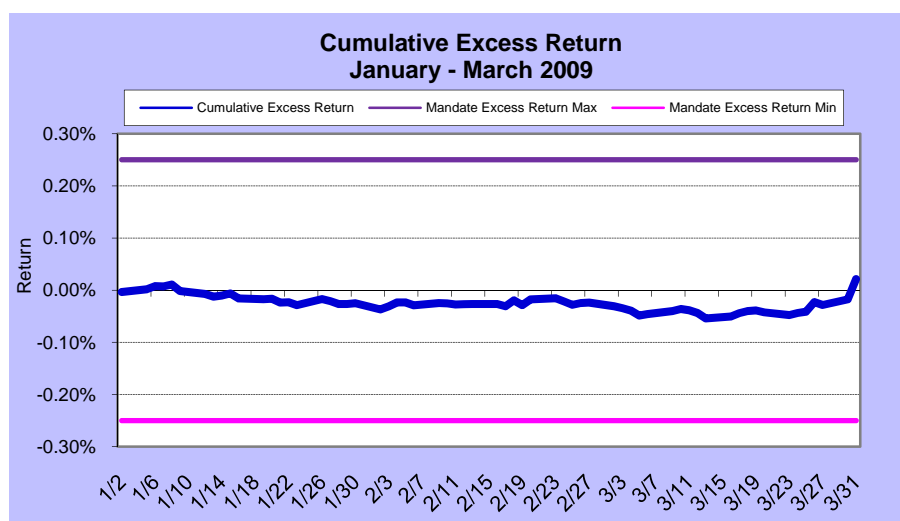
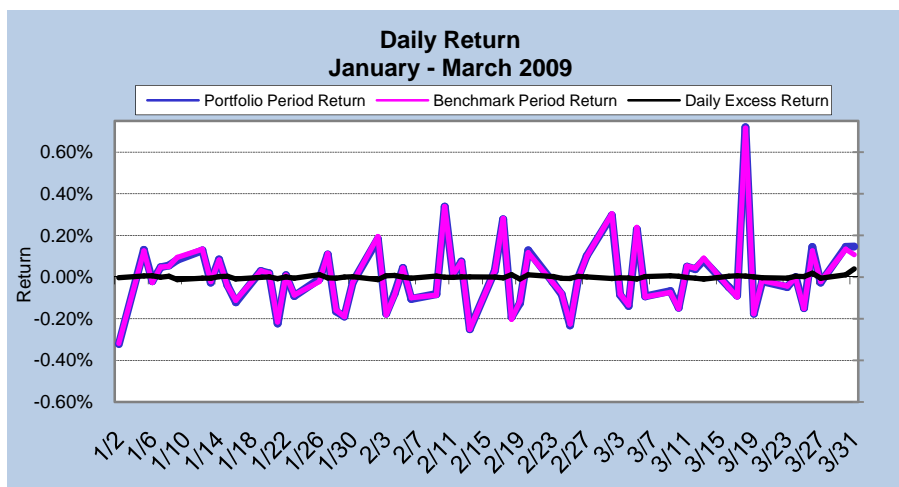
### 7.1. Tracking Error

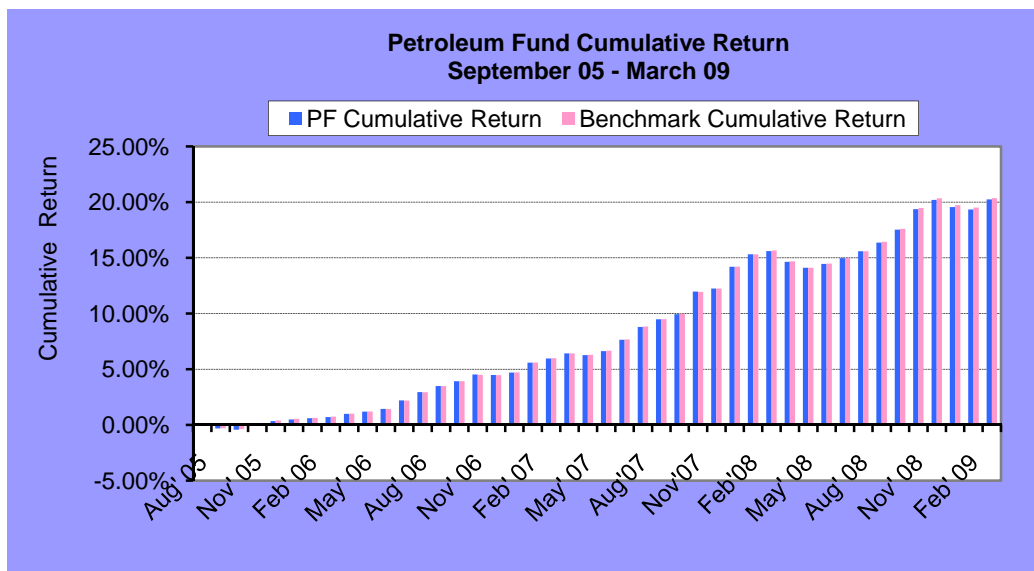
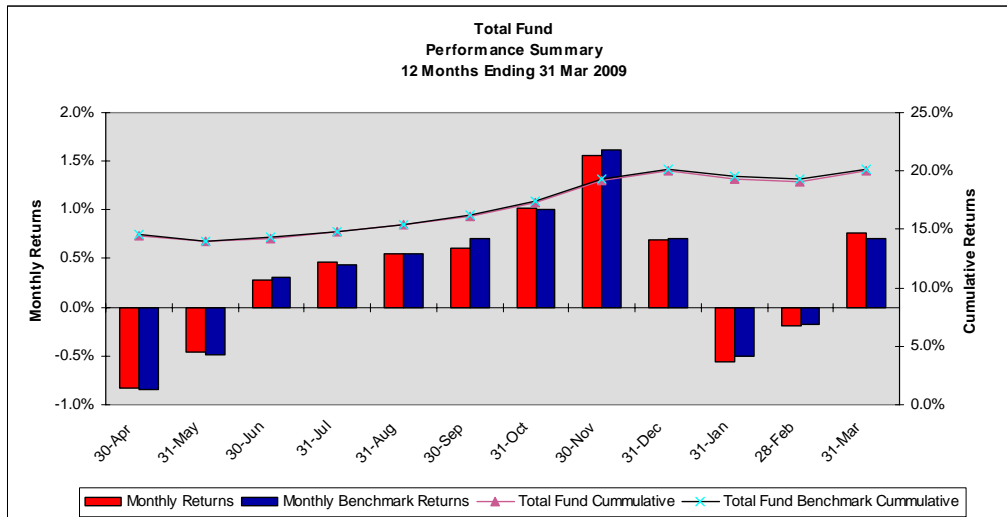
The following graphs illustrate the manner in which the Fund portfolio tracked the benchmark index. The line “Daily Excess Return” measures the difference between the return of the Fund’s portfolio and the benchmark. The excess return for the quarter was 1 basis point below the benchmark, within the  $\pm 25$  basis points in the investment mandate.

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*The excess return for the quarter was 1 basis point below the benchmark, within the  $\pm 25$  basis points in the investment mandate*

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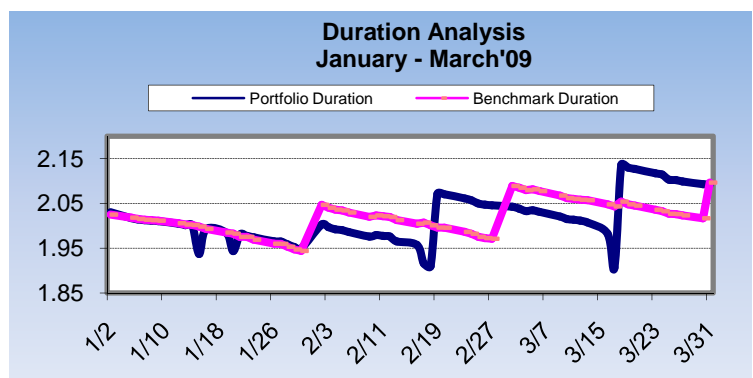




The cumulative performance of the Petroleum Fund compared with the cumulative performance of the benchmark over the same period is shown in the above graph. The graph indicates that the cumulative performance of the portfolio is almost identical to the cumulative performance of the benchmark with almost 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.

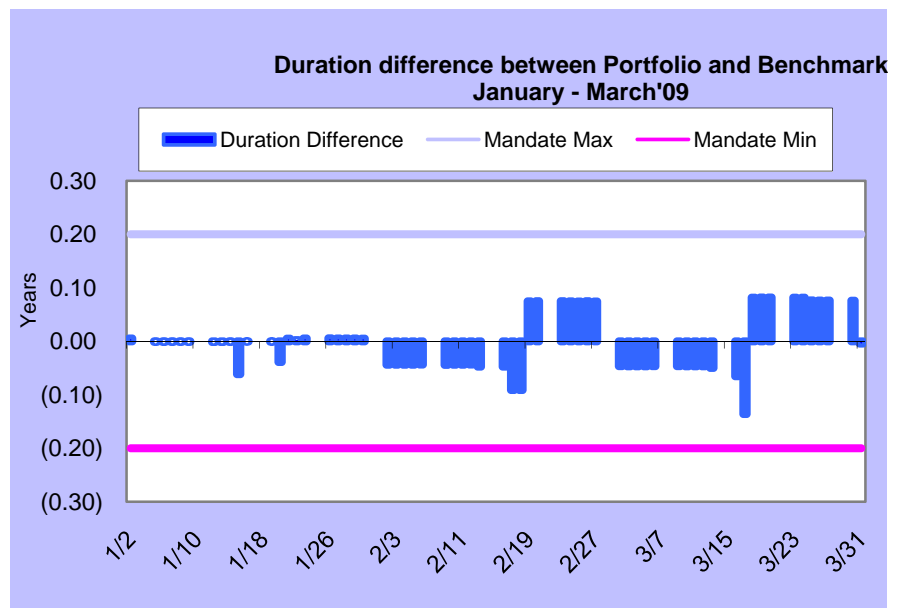
### 7.2. Duration

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  $\pm 0.2$  years.



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

The 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  $\pm 0.2$  years of the modified duration of the benchmark. The duration was within the mandate during the quarter.



### 7.3. Credit Risk

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*US Government Securities which is rated  
AAA*

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The Merrill Lynch index comprises Treasury Securities issued by the United States Government, which is rated AAA. All investments by the Petroleum Fund were also in US Treasury Securities with the highest credit rating (AAA). 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

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

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

### 8.1. Qualifying Instruments

The Fund was invested in the qualifying instruments within the investment universe specified in the mandate at all times during the quarter. At no time was the Fund invested in instruments other than those disclosed in this report.

### 8.2. Return on the Portfolio

The performance on the portfolio for the quarter was 1basis point compared with the benchmark performance of 2 basis points. The difference of 1basis point lower than the benchmark is within the mandated target of  $\pm 25$  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.

### 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.

#### Balance Sheet

	in thousands \$		
<b>NET ASSETS</b>	<b>Mar-09</b>	<b>Dec-08</b>	<b>Mar-08</b>
Cash and Cash Equivalents	14,114	635	565
US Treasury Notes (Market Value)	4,667,170	4,173,931	2,592,399
Accrued Interest	68,796	22,406	36,999
Less: Peding Purchases of Securities	-	-	-
<b>TOTAL</b>	<b>4,750,080</b>	<b>4,196,972</b>	<b>2,629,963</b>
<b>CAPITAL</b>			
Opening Balance as at 1 January 2008	4,196,972	2,086,157	2,086,157
PF Law Art. 6.1(a) Revenue Receipts	232,771	895,797	221,736
PF Law Art. 6.1(b) DA Receipts	317,113	1,388,409	258,010
PF Law Art. 7.1 Transfer to General State Budget	-	(396,000)	
Net Income	3,224	222,609	64,060
<b>TOTAL</b>	<b>4,750,080</b>	<b>4,196,972</b>	<b>2,629,963</b>

#### Profit and Loss Statement

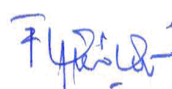
	in thousands \$			
<b>INCOME</b>	<b>Quarter</b>		<b>Year to Date (YTD)</b>	
	<b>Mar-09</b>	<b>Dec-08</b>	<b>Mar-09</b>	<b>Mar-08</b>
Money Market Interest	11	18	11	150
Treasury Note Coupons	40,102	36,986	40,102	20,146
<b>Income</b>	<b>40,113</b>	<b>37,004</b>	<b>40,113</b>	<b>20,295</b>
Market Revaluations	(36,889)	92,365	(36,889)	44,025
Less: Management Fees	-	(532)	-	(261)
<b>Net Result for the Period</b>	<b>3,224</b>	<b>128,837</b>	<b>3,224</b>	<b>64,060</b>

*Note: The 2008 valuation numbers were on the basis of BPA's valuation based on Merrill Lynch pricing source while 2009 onward, valuation numbers are based on Custodian's pricing source.*

Dili, 17 April 2009



**Venâncio Alves Maria**  
Executive Director



**Abraão de Vasconcelos**  
General Manager