

Petroleum Fund of Timor-Leste

Quarterly Report

31 March 2016

Inside This Report

- 1 Introduction
- 1 Executive Summary
- 2 Investment Mandate
- 2 Market Trends
- 4 Operational Management
- 5 Portfolio Performance
- 7 Management Costs
- 8 Transfers to State Budget
- 8 Compliance Statement
- 8 Financial Information

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 and custodial reports and has not been independently audited 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 as 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 January 2016 to 31 March 2016.

Key statistics for the quarter include:

- The capital of the Fund at the end of the previous quarter was \$16.22 billion while the current quarter was \$16.58 billion.
- Gross cash inflows to the fund from royalties and taxes were \$125.30 million.
- Outflows for the quarter were \$105.18 million, being transfers to the state budget were \$100 million while \$5.18 million was for management costs.
- The profit/loss for the quarter was \$334.95 million, representing a gross of fees return of 2.10% compared with the benchmark return of 2.14%.

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

Table 1

	QTR	FYTD	1 Year	3 Years	5 years	Since Inc
Total Fund	2.10	2.10	0.66	3.21	3.65	3.93
Benchmark	2.14	2.14	0.76	3.20	3.59	3.92
<i>Excess</i>	<i>-0.03</i>	<i>-0.03</i>	<i>-0.10</i>	<i>0.02</i>	<i>0.07</i>	<i>0.01</i>
International Fixed Interest	3.60	3.60	3.00	1.40	1.86	3.03
Benchmark	3.67	3.67	3.15	1.43	1.84	3.04
<i>Excess</i>	<i>-0.06</i>	<i>-0.06</i>	<i>-0.15</i>	<i>-0.03</i>	<i>0.03</i>	<i>-0.01</i>
International Equities	-0.19	-0.19	-2.90	7.23	7.09	8.69
Benchmark	-0.35	-0.35	-3.45	6.82	6.51	7.98
<i>Excess</i>	<i>0.16</i>	<i>0.16</i>	<i>0.55</i>	<i>0.41</i>	<i>0.58</i>	<i>0.71</i>

1. INVESTMENT MANDATE

A revised Management Agreement between the Ministry of Finance and the Central Bank was signed on 25 June 2009. Annex 1 was further updated subsequently to reflect the latest developments. The benchmarks as of March 2016 were as follows:

Table 2

	31-Jan-16	29-Feb-16	31-Mar-16
BOA Merrill Lynch 3-5 Years Treasury Bond Index	40.00%	40.00%	40.00%
BOA Merrill Lynch 5-10 Years Treasury Notes and Bond	10.00%	10.00%	10.00%
Barclays Global Treasury Developed Market ex US, 30%	10.00%	10.00%	10.00%
Total Fixed Income	60%	60%	60%
MSCI World Index Dividends Reinvested	40.00%	40.00%	40%
Total Equities	40%	40%	40%
Total	100%	100%	100%

2. MARKET TRENDS DURING THE QUARTER

Global Market Trend

Last year's volatile market ride has continued in the first quarter of this year. Equity markets in the US and UK are now close to where they started the year, with Europe slightly down. But that comes after much fretting over global growth, these fears started to ebb in the latter part of the quarter, when saw more stimulus from the ECB and dovish noises from Federal Reserve. This has all helped to restore some composure to markets. In China, the latest data continues to show the economy transitioning away from manufacturing and towards services and consumption. The rate of economic growth is slowing gradually, but the economy is not collapsing. Industrial production growth has slowed to 5.4% over year and retail sales continue to grow rapidly at over 10% a year. The reality is probably that China is growing at a slightly less spectacular pace than previously.

Equities

Developed equity markets ended the first quarter broadly flat in USD, this disguised a very volatile start to the year. By mid-February, the MSCI World Index had fallen by more than 11%, a decline that was widely attributed to concerns about the weakness of the global economy. As has recently been the case when investors take fright, policymakers once again marched to the rescue. Three key central banks (the People's

Bank of China, the Bank of Japan and the European Central Bank) loosened monetary policy further, whilst the Federal Reserve notably scaled back its intention to normalise US interest rates.

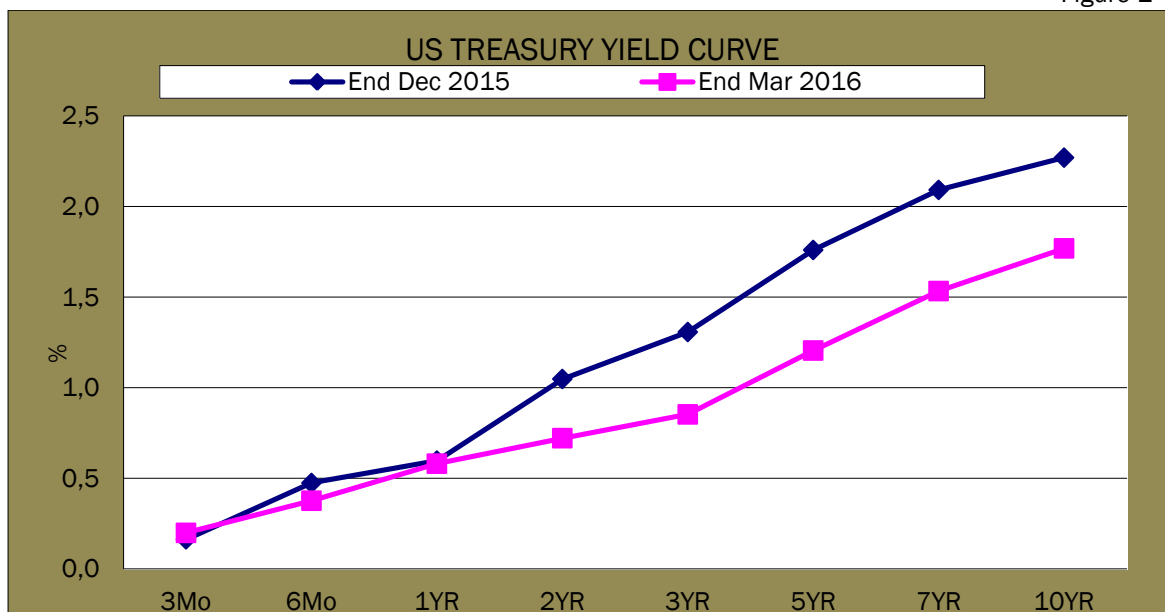
Over the quarter as a whole, however, low volatility was still the winning style. The MSCI AC World Minimum Volatility returned 5.9%, while its value counterpart was up only 0.8% and the Growth Index fell 0.3%. The dominance of low volatility over the quarter was evidenced by the position of utilities as the best performing sector, closely followed by telecoms, both of which benefited from the perception of offering defensive yield on less stretched valuations than consumer staples. The healthcare sector was the key laggard as it continues to suffer from both an unwinding of the biotech bubble and political risks ahead of the US election. Financials also performed poorly in the first quarter, particularly banks which have traded as a proxy for US interest rate expectations, and weakened with the more dovish Fed. Over the month of March specifically, the cyclical rebound theme was very much in evidence.

Bonds including US Treasuries

The first Quarter as a result of this uncertainty around the outlook for the US economy, the Fed lowered its median projected expectation for the pace of further rate rises, following its December increase. Instead of four more 0.25% increases this year, the dot plot now suggests only two. Core CPI inflation in the US is now above 2% year and the Fed's preferred core PCE inflation measure has also picked up sharply to 1.7%. Despite rising inflation and a low unemployment rate, Fed continues to emphasis the need for a cautious and gradual pace of policy tightening. That is because the Fed's "ability to use conventional monetary policy to respond to economic disturbances. Policymakers are more worried about tightening too fast than too slowly, because if they make a mistake, they have much more room to raise rates than to cut them. The European Central Bank (ECB) delivered a significant easingPackage in March to bolster its chances of raising inflation back to target and support the recovery. In addition to increasing the amount, the ECB will purchase by EUR 20 billion per month, ECB also announced that the central bank will buy non-financial investment grade corporate bonds. This could have a significant effect on corporate bond prices in the eurozone and make it cheaper for companies to raise money in the market.

The graph below shows the US Government yield curve out to 10 years compared to the previous quarter-end. There was changes in short term yields were almost remain the same as previous quarter, while the 2 and 3 years yield decreased by 33 and 45 basis points respectively. The 5 and 7 years yield decreased by 56 basis points and 10 years yield decreased by 50 basis points to 1.20%, 1.53% and 1.76% respectively at the end of the quarter. Bond prices and yield move in opposite direction.

Figure 1



3. MANAGEMENT DURING THE QUARTER

Objectives

The Central Bank, as operational manager of the Fund, has implemented the investment mandates through a combination of internal and external management.

The following table shows how the investment mandates have been implemented.

Table 3

Mandate	Management Style	Authorised Managers	Tracking Error	Outperformance Target	Commencement date
BOA Merrill Lynch 3-5 Years US Treasury Bond Index	Passive	BCTL	n/a	Nil	19-Jan-12
BOA Merrill Lynch 5-10 Years US Treasury Notes & Bond index	Enhanced Passive	Bank for International Settlements	0.50%	0.25%	15-Dec-11
Barclays Global Treasury Developed Market ex US, 30% Eurozone and 10% Country Capped	Enhanced Passive	Alliance Bernstein	0.50%	Nil	3-Jul-14
Barclays Global Treasury Developed Market ex US, 30% Eurozone and 10% Country Capped	Enhanced Passive	Wellington Management	0.50%	Nil	4-Dec-14
MSCI World Index Net Dividends Reinvested	Passive	State Street Global Advisors	0.35%	Nil	18-Jan-12
		BlackRock	0.35%	Nil	21-Feb-13
	Enhanced Passive	Schroders Investment Management	1.00%	1.00%	7-Oct-10

Operational Implementation

The allocation of the capital of the Fund to the various mandates as at the end of the quarter was as follows:

Table 4

Managers	Benchmark	Tolerance	Actual	Lower Boundary	Upper Boundary
BOA Merrill Lynch 3-5 Years Treasury Bond Index	BCTL	40%	± 2.5%	40.35%	37.50% 42.50%
BOA Merrill Lynch 5-10 Years Treasury Notes and Bond Index	Bank for International Settlements	10%	± 1%	10.11%	9.00% 11.00%
Barclays Global Treasury Developed Market ex US, 30% Eurozone and 10% Country Capped	Alliance Bernstein	5%	± 0.5%	5.37%	4.50% 5.50%
Barclays Global Treasury Developed Market ex US, 30% Eurozone and 10% Country Capped	Wellington Management	5%	± 0.5%	5.18%	4.50% 5.50%
Total Fixed Income		60%		61.00%	55.50% 64.50%
MSCI World Index Net Dividends Reinvested	State Street Global Advisors	35%	± 4.0%	17.16%	15.50% 19.50%
	BlackRock			16.98%	15.50% 19.50%
	Schroders Investment Management	5%	± 1.5%	4.86%	3.50% 6.50%
Total Equities		40%		39.00%	34.50% 45.50%

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, which is compared with the performance of the corresponding benchmark. The benchmark represents the investment strategy established by the Minister and is used as a goal against which the performance of the actual investments is measured. The Minister's benchmarks for the Petroleum Fund are described earlier in this report.
- The excess is the difference (which may be 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 balance was \$16.58 billion as follows:

Table 5

Capital Account	\$'000
Opening book value (31 December 2015)	16,217,573
Receipts during the period	125,299
Transfer to General State Budget	-100,000
Investment Return	334,948
Closing book value (31 March 2016)	16,577,819

The Fund was invested as follows:

Table 6

Assets	\$'000
Cash and Cash Equivalents	213,725
Other Receivables	50,407
Financial assets held at fair value through profit or loss	16,340,129
Less:	
Payable for Securities Purchased	-20,512
Accounts Payable	-5,929
Total	16,577,819

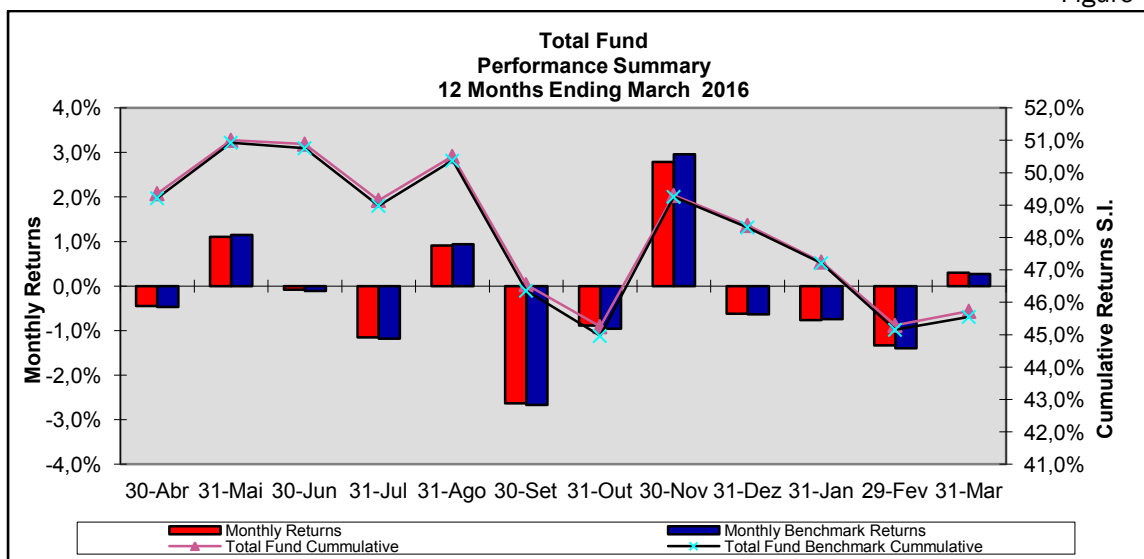
The income for the quarter was as follows:

Table 7

Income	\$'000
Interest income	39,919
Dividend income	42,893
Unit Trust distributions	1,940
Other Investment income	4
Net gains/(losses) on Financial Assets at fair value	100,379
Net foreign exchange gains/(losses)	157,004
Less:	
External manager, custody fees	-2,366
Central Bank management expenses	-1,604
IAB Expenses	0
Other expenses	-1,212
Withholding taxes	-2,009
Total Investment Income	334,948

Global Benchmark over the same period is shown in the following graph.

Figure 2



FIXED INTEREST

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

Table 8

%	Qtr	FYTD	1 Year	3 Years	5 Years	Since Inc
International Fixed Interest	3.60	3.60	3.00	1.40	1.86	3.03
Benchmark	3.67	3.67	3.15	1.43	1.84	3.04
<i>Excess</i>	<i>-0.06</i>	<i>-0.06</i>	<i>-0.15</i>	<i>-0.03</i>	<i>0.03</i>	<i>-0.01</i>
BCTL 3-5 yr US Treasury	2.42	2.42	2.30	1.65	n.a	1.61
BoA Merrill Lynch 3-5 Years US Treasury Passive	2.45	2.45	2.56	1.68	n.a	1.58
<i>Excess</i>	<i>-0.03</i>	<i>-0.03</i>	<i>-0.26</i>	<i>-0.03</i>	<i>n.a</i>	<i>0.03</i>
Bank for International Settlements	3.90	3.90	3.44	2.25	n.a	2.55
BoA Merrill Lynch 5-10 Years US Treasury Enhanced Passive	4.00	4.00	3.56	2.37	n.a	2.58
<i>Excess</i>	<i>-0.10</i>	<i>-0.10</i>	<i>-0.12</i>	<i>-0.11</i>	<i>n.a</i>	<i>-0.03</i>
Alliance Bernstein	8.14	8.14	4.74	n.a	n.a	-3.48
Barclays Global Treasury DM ex US Enhanced Passive	8.21	8.21	4.81	n.a	n.a	-3.60
<i>Excess</i>	<i>-0.07</i>	<i>-0.07</i>	<i>-0.07</i>	<i>n.a</i>	<i>n.a</i>	<i>0.13</i>
Wellington Management	8.20	8.20	4.72	n.a	n.a	-0.42
Barclays Global Treasury DM ex US Enhanced Passive	8.21	8.21	4.81	n.a	n.a	-0.34
<i>Excess</i>	<i>-0.01</i>	<i>-0.01</i>	<i>-0.09</i>	<i>n.a</i>	<i>n.a</i>	<i>-0.09</i>

INTERNATIONAL EQUITIES

The performance of the investments in global developed market equities for the quarter, including the performance of the managers responsible for those investments, was as follows:

Table 9

	Qtr	FYTD	1 Year	3 Years	5 Years	Since Inc
International Equities	-0.19	-0.19	-2.90	7.23	7.09	8.69
Benchmark	-0.35	-0.35	-3.45	6.82	6.51	7.98
<i>Excess</i>	<i>0.16</i>	<i>0.16</i>	<i>0.55</i>	<i>0.41</i>	<i>0.58</i>	<i>0.71</i>
Schroders Investment Management	0.15	0.15	-2.07	7.58	7.47	9.00
MSCI World Enhanced Passive	-0.35	-0.35	-3.45	6.82	6.51	7.98
<i>Excess</i>	<i>0.50</i>	<i>0.50</i>	<i>1.38</i>	<i>0.76</i>	<i>0.96</i>	<i>1.02</i>
SSgA International Equity	-0.23	-0.23	-3.00	7.20	n.a	9.92
MSCI World Passive	-0.35	-0.35	-3.45	6.82	n.a	9.50
<i>Excess</i>	<i>0.12</i>	<i>0.12</i>	<i>0.45</i>	<i>0.38</i>	<i>n.a</i>	<i>0.42</i>
BlackRock Investment Management	-0.24	-0.24	-3.03	7.12	n.a	7.88
MSCI World Passive	-0.35	-0.35	-3.45	6.82	n.a	7.57
<i>Excess</i>	<i>0.11</i>	<i>0.11</i>	<i>0.42</i>	<i>0.30</i>	<i>n.a</i>	<i>0.31</i>

5. MANAGEMENT COSTS

A management fee of \$5.18 million for operational management costs was charged to the fund during the quarter.

The fee covered the following services (in thousands \$):

Table 10

External Management and Custody expenses	2,366
Central Bank management expenses	1,604
IAB expenses	0
Other Expenses	1,212
Total Cost	5,182

6. TRANSFERS TO STATE BUDGET

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. an amount of \$100 million was transferred to the State Budget account during the quarter. The transfers are summarized in table 11.

Table 11

In Thousand (\$)

Transfer January 2016	0
Transfer February 2016	100,000
Transfer March 2016	0
Transfer for this Quarter	100,000
Total Transfers previous quarters	0
Total Transfers this fiscal year to March 2016	100,000

7. 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 universes specified in the various mandates at all times during the quarter.

Modified Duration

The modified duration of the Fund's fixed interest investment portfolios remained within the mandate during the quarter.

Tracking Error

The tracking error of each mandate in the Fund's investment portfolio was within the specified range during the quarter.

External Managers

The Central Bank has received representations from the external managers, that external managers' investments were within their mandates during the quarter.

Internal Audit

The provisions of Article 22 of the Petroleum Fund law no. 9/2005 require the Central Bank's Internal Auditor to perform an audit of the Fund every six months. The Internal Auditor has performed an audit up to quarter ended 31 Dezembro 2015.

8. 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.

Table 12

BALANCE SHEET In thousands of USD	2016 March	2015 March
ASSETS		
Cash and Cash Equivalents	213,725	135,177
Receivables	50,407	26,891
Financial assets held at fair value through profit or loss	16,340,129	16,076,302
TOTAL ASSETS	16,604,260	16,238,370
LIABILITIES		
Payables for securities purchased	-20,512	-15,627
Accounts payable	-5,929	-5,170
TOTAL LIABILITIES	-26,441	-20,798
NET ASSETS	16,577,819	16,217,573
CAPITAL		
Opening Balance	16,217,573	16,538,617
PF Law Art. 6.1 (a) Revenue receipts	56,402	450,032
PF Law Art. 6.1 (b) DA receipts	68,897	528,835
PF Law Art. 6.1 (e) Other receipts	0	0
PF Law Art 7.1 Transfers to State Budget	-100,000	-1,278,500
Income for the period	334,948	-21,412
CAPITAL	16,577,819	16,217,573

Table 13

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME - QUARTER				
In thousands of USD				
	Quarter		Year to Date	
	Mar-16	Mar-15	Mar-16	Mar-15
INVESTMENT INCOME				
Interest income	39,919	35,426	39,919	35,426
Dividend income	42,893	42,382	42,893	42,382
Trust income	1,940	1,287	1,940	1,287
Other investment income	4	5	4	5
Net gains/(losses) on Financial Assets at fair value	100,379	394,928	100,379	394,928
Net foreign exchange gains/(losses)	157,004	-241,869	157,004	-241,869
Total Investment Income	342,139	232,159	342,139	232,159
EXPENSES				
External management, custody fees	2,366	2,407	2,366	2,407
Internal operational management fees	1,604	1,653	1,604	1,653
IAB Expenses	0	0	0	0
Other expenses	1,212	2	1,212	2
Total expenses	5,182	4,061	5,182	4,061
Profit before tax	336,957	228,098	336,957	228,098
Withholding taxes on investments	2,009	1,854	2,009	1,854
Profit/loss for the period	334,948	226,244	334,948	226,244
Other comprehensive income	0	0	0	0
Total comprehensive income for the period	334,948	226,244	334,948	226,244

Notes:

1. 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.
2. Articles 6.1(a), 6.1(b) and 6.1(c) receipts should have been \$435,872, \$537,099 and \$5,897 respectively in previous quarter report. The receipts classification reported in previous quarter is hereby corrected. This correction does not affect the reported fund balance & the profit & loss.

Dili, 21 April 2016



Venancio Alves Maria
Executive Director



Abraão de Vasconcelos
Governor