

# Petroleum Fund of Timor-Leste

## Quarterly Report

30 September 2016

### Inside This Report

- 1 Introduction
- 1 Executive Summary
- 2 Investment Mandate
- 2 Market Trends
- 4 Operational Management
- 5 Portfolio Performance
- 8 Management Costs
- 8 Transfers to State Budget
- 8 Compliance Statement
- 9 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 July 2016 to 30 September 2016.

Key statistics for the quarter include:

- The capital of the Fund at the end of the previous quarter was \$16.47 billion while the current quarter was \$16.60 billion.
- Gross cash inflows to the fund from royalties and taxes were \$35.58 million.
- Outflows for the quarter were \$209.03 million, being transfers to the state budget were \$204.80 million while \$4.23 million was for management costs.
- The profit/loss for the quarter was \$308 million, representing a gross of fees return of 1.89% compared with the benchmark return of 1.89%.

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	1.89	5.92	7.37	3.82	4.02	4.09
Benchmark	1.89	5.47	7.10	3.69	3.88	4.04
<i>Excess</i>	<i>0.00</i>	<i>0.45</i>	<i>0.27</i>	<i>0.13</i>	<i>0.14</i>	<i>0.05</i>
International Fixed Interest	-0.03	5.89	4.70	2.53	1.78	3.09
Benchmark	-0.08	5.05	3.91	2.25	1.58	3.02
<i>Excess</i>	<i>0.05</i>	<i>0.85</i>	<i>0.79</i>	<i>0.28</i>	<i>0.20</i>	<i>0.07</i>
International Equities	4.99	5.93	11.84	6.25	12.09	9.01
Benchmark	4.87	5.55	11.36	5.85	11.63	8.32
<i>Excess</i>	<i>0.12</i>	<i>0.38</i>	<i>0.48</i>	<i>0.41</i>	<i>0.46</i>	<i>0.69</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 September 2016 were as follows:

Table 2

	30-Jun-16	31-Aug-16	30-Sep-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%
<b>Total Fixed Income</b>	<b>60%</b>	<b>60%</b>	<b>60%</b>
MSCI World Index Dividends Reinvested	40.00%	39.00%	39.00%
MSCI Australia Index		1.00%	1.00%
<b>Total Equities</b>	<b>40%</b>	<b>40%</b>	<b>40.00%</b>
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

## 2. MARKET TRENDS DURING THE QUARTER

### *Global Market Trend*

Global market finished slightly higher in September in USD terms, recovered from Brexit fear. U.K economy is still growing in moderate pace, at least for the short run, after three months Britains voted to leave E.U. In addition, in the U.S, economic data such as solid payroll data, solid corporate gains during the quarter has reassured the investors that last quarter's weak payroll was nothing but seasonal thing. However, Brexit remained a top concern for the investors in the long run. Market showed sign of worry as the value of country's currency depreciated lowest level when U.K Prime Minister issued statements that U.K government is going to initiate Brexit talk with European Union March next year.

### *Equities*

Global equity markets performed well in the third quarter, gained around 5% (in USD term), recovered from the downturn caused by the U.K vote to leave European Union in late June, this year. The entire region reported equally strong performance.

U.K equities bounced back from last quarter sell off, and perform very well during third quarter with the help of sharp depreciation in pound. However, in the long run, uncertainty remain as the investors are yet to know what kind of deal U.K will get out of exit talks with European Union. Surveys indicated that investors are still cautious to invest because of Brexit uncertainty.

U.S. equities gained a modest return of 3.9 % during the third quarter although they are still the strongest year to date with a 7.3 % gain relative to the global market indices. Sectors such as consumer staples, financial, material, and industrials are the ones that contributed to the modest gain. On the other hand, sectors such as telecoms, utilities, health care, and real state were the ones underperform during the quarter. The uncertainty in the coming months is remained with the U.S presidential election in sight.

Japan was the top performer among the region during the quarter, with a total gained 1.6%. Bank of Japan left their interest rate unchanged but they did introduce a new policy to keep the long-term yield low. The sectors such as technology, resource (energy in particular), and materials contributed most to the strong performance in the region. Telecom and financial are the sectors that underperform in the third quarter.

### *Bonds including US Treasuries*

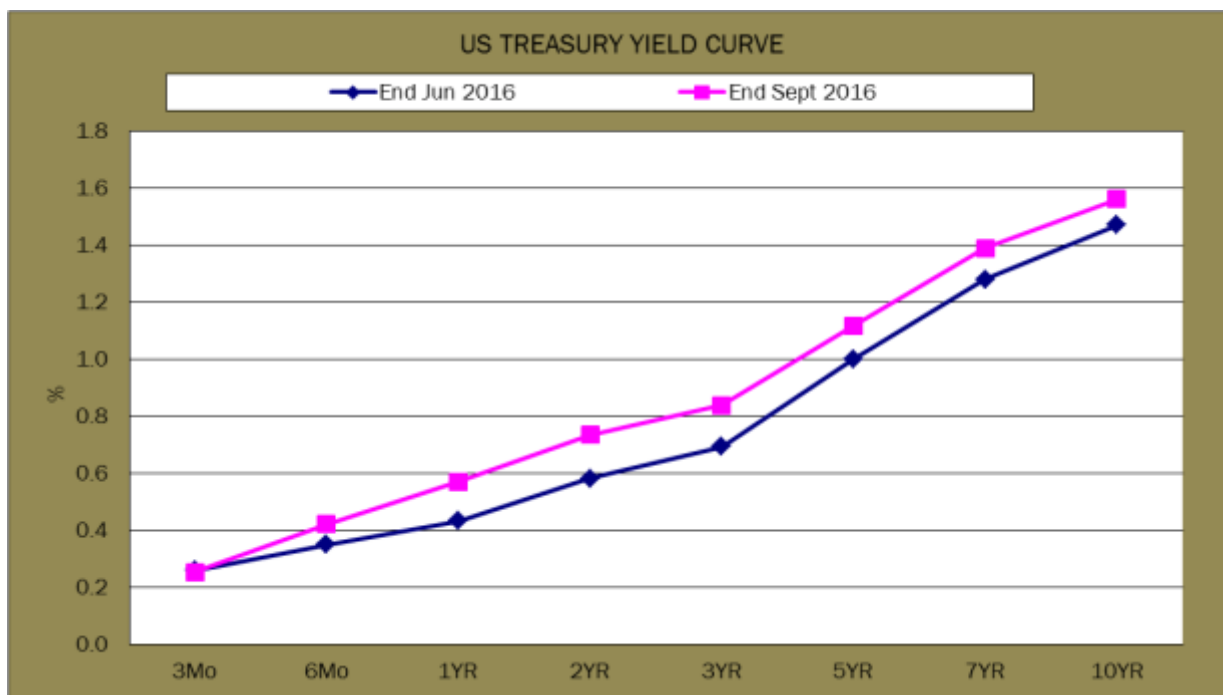
After weak payroll report in the second quarter, U.S economy has created job in average of 200,000 each month during the third quarter. Recent solid U.S payroll data combined with the positive retails sales and strong manufacturing data could prompt the Fed to increase interest rate as soon as December.

In Europe, overall market is still unaffected after three months U.K vote to leave European Union. However, the economic risk remains high for the U.K as the government now working on strategy on the Brexit talk. The top E.U government officials have reiterated that “hard Brexit” or no access to E.U single market is the most likely outcome Britain would get out of negotiation.

The Bank of Japan has increase their inflation target above 2 percent despite in reality they are struggling to reach their current target of 2%. In order to help financial sector and preventing the yield curve turning to negative the Bank of Japan has set policy to keep the yield on 10-years Japanese government debt at 0.0%.

The graph below illustrates the U.S Government yield curve out of 10 years compared to the previous quarter end. The short terms yield were almost unchanged, while the 1, 2, and 3 year yield increased in average of 16 basis points, and 5, 7, 10 year yield increased in average of 14 basis points respectively. Bond price moves inversely with the yield.

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%	1.00%	7-Oct-10
MSCI Australia Index	Passive	BCTL	0.50%	Nil	4-Jul-16

### 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%	39.34%	37.50%	42.50%
BOA Merrill Lynch 5-10 Years Treasury Notes and Bond Index	Bank for International Settlements	10%	± 1%	9.88%	9.00%	11.00%
Barclays Global Treasury Developed Market ex US, 30% Eurozone and 10% Country Capped	Alliance Bernstein	5%	± 0.5%	4.95%	4.50%	5.50%
Barclays Global Treasury Developed Market ex US, 30% Eurozone and 10% Country Capped	Wellington Management	5%	± 0.5%	4.95%	4.50%	5.50%
<b>Total Fixed Income</b>		<b>60%</b>		<b>59.12%</b>	<b>55.50%</b>	<b>64.50%</b>
MSCI World Index Net Dividends Reinvested	State Street Global Advisors	34%	± 4.0%	17.33%	13.00%	21.00%
	BlackRock			17.34%		
	Schroders Investment Management	5%	± 1.5%	5.24%	3.50%	6.50%
MSCI Australia Index	BCTL	1%	± 0.5%	0.97%	0.50%	1.50%
<b>Total Equities</b>		<b>40%</b>		<b>40.88%</b>	<b>30.00%</b>	<b>50.00%</b>

## 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 \$16.60 billion as follows:

Table 5

Capital Account	\$'000
Opening book value (30 June 2016)	16,466,073
Receipts during the period	35,576
Transfer to General State Budget	-204,800
Investment Return	308,061
<b>Closing book value (30 September 2016)</b>	<b>16,604,911</b>

The Fund was invested as follows:

Table 6

Assets	\$'000
Cash and Cash Equivalents	542,984
Other Receivables	30,780
Financial assets held at fair value through profit or loss	16,049,930
Less:	
Payable for Securities Purchased	-13,861
Accounts Payable	-4,922
<b>Total</b>	<b>16,604,911</b>

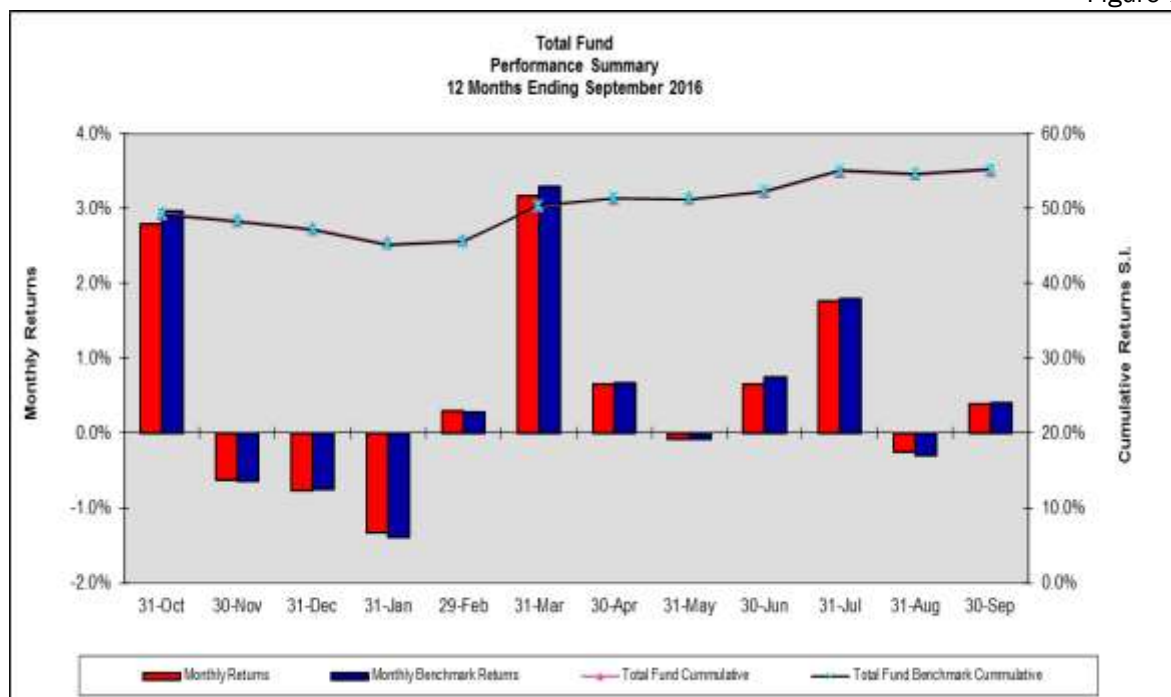
The income for the quarter was as follows:

Table 7

Income	\$'000
Interest income	39,531
Dividend income	39,519
Unit Trust distributions	1,734
Other Investment income	510
Net gains/(losses) on Financial Assets at fair value	219,980
Net foreign exchange gains/(losses)	11,791
Less:	
External manager, custody fees	-1,943
Central Bank management expenses	-2,221
IAB Expenses	-62
Other expenses	-1
Withholding taxes	-777
<b>Total Investment Income</b>	<b>308,061</b>

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
<b>International Fixed Interest</b>	-0.03	5.89	4.70	2.53	1.78	3.09
Benchmark	-0.08	5.05	3.91	2.25	1.58	3.02
<i>Excess</i>	<i>0.05</i>	<i>0.85</i>	<i>0.79</i>	<i>0.28</i>	<i>0.20</i>	<i>0.07</i>
<b>BCTL Cash Management (TLCM)</b>	0.08	n.a	n.a	n.a	n.a	0.08
<b>BCTL 3-5 yr US Treasury</b>	-0.25	3.29	2.14	2.21	n.a	1.62
BoA Merrill Lynch 3-5 Years US Treasury Passive	-0.28	3.36	2.36	2.24	n.a	1.60
<i>Excess</i>	<i>0.04</i>	<i>-0.07</i>	<i>-0.23</i>	<i>-0.03</i>	<i>n.a</i>	<i>0.02</i>
<b>Bank for International Settlements</b>	-0.36	5.78	4.42	3.97	n.a	2.67
BoA Merrill Lynch 5-10 Years US Treasury Enhanced Passive	-0.40	5.89	4.51	4.07	n.a	2.69
<i>Excess</i>	<i>0.04</i>	<i>-0.10</i>	<i>-0.08</i>	<i>-0.10</i>	<i>n.a</i>	<i>-0.03</i>
<b>Alliance Bernstein</b>	1.13	10.73	9.19	n.a	n.a	-1.68
Barclays Global Treasury DM ex US Enhanced Passive	1.03	10.93	9.38	n.a	n.a	-1.74
<i>Excess</i>	<i>0.10</i>	<i>-0.20</i>	<i>-0.19</i>	<i>n.a</i>	<i>n.a</i>	<i>0.05</i>
<b>Wellington Management</b>	1.00	10.83	9.24	n.a	n.a	1.01
Barclays Global Treasury DM ex US Enhanced Passive	1.03	10.93	9.38	n.a	n.a	1.11
<i>Excess</i>	<i>-0.03</i>	<i>-0.10</i>	<i>-0.14</i>	<i>n.a</i>	<i>n.a</i>	<i>-0.10</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
<b>International Equities</b>	4.99	5.93	11.84	6.25	12.09	9.01
Benchmark	4.87	5.55	11.36	5.85	11.63	8.32
<i>Excess</i>	<i>0.12</i>	<i>0.38</i>	<i>0.48</i>	<i>0.41</i>	<i>0.46</i>	<i>0.69</i>
<b>Schroders Investment Management</b>	5.23	6.87	12.93	6.67	12.60	9.39
MSCI World Enhanced Passive	4.87	5.55	11.36	5.85	11.63	8.32
<i>Excess</i>	<i>0.37</i>	<i>1.32</i>	<i>1.57</i>	<i>0.83</i>	<i>0.97</i>	<i>1.07</i>
<b>SSgA International Equity</b>	4.92	5.75	11.62	6.19	n.a	10.17
MSCI World Passive	4.78	5.47	11.27	5.82	n.a	9.77
<i>Excess</i>	<i>0.14</i>	<i>0.28</i>	<i>0.35</i>	<i>0.37</i>	<i>n.a</i>	<i>0.41</i>
<b>BlackRock Investment Management</b>	4.94	5.79	11.70	6.18	n.a	8.49
MSCI World Passive	4.78	5.47	11.27	5.82	n.a	8.16
<i>Excess</i>	<i>0.15</i>	<i>0.33</i>	<i>0.43</i>	<i>0.36</i>	<i>n.a</i>	<i>0.33</i>
<b>BCTL Investment Management</b>	2.42	n.a	n.a	n.a	n.a	5.78
MXAU AU Index Passive	2.45	n.a	n.a	n.a	n.a	5.80
<i>Excess</i>	<i>-0.03</i>	<i>n.a</i>	<i>n.a</i>	<i>n.a</i>	<i>n.a</i>	<i>-0.01</i>

## 5. MANAGEMENT COSTS

A management fee of \$4.23 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	1,943
Central Bank management expenses	2,221
IAB expenses	62
Other Expenses	1
<b>Total Cost</b>	<b>4,228</b>

## 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 \$208.80 million was transferred to the State Budget account during the quarter. The transfers are summarized in table 11.



Table 11	In Thousand (\$)
Transfer July 2016	0
Transfer August 2016	104,800
Transfer September 2016	100,000
Transfer for this Quarter	204,800
Total Transfers previous quarters	440,000
<b>Total Transfers this fiscal year to September 2016</b>	<b>644,800</b>

## 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 30 June 2016.

## 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 September	2015 September
<b>ASSETS</b>		
Cash and Cash Equivalents	542,984	148,252
Receivables	30,780	50,538
Financial assets held at fair value through profit or loss	16,049,930	16,275,703
<b>TOTAL ASSETS</b>	<b>16,623,694</b>	<b>16,474,492</b>
<b>LIABILITIES</b>		
Payables for securities purchased	-13,861	-32,642
Accounts payable	-4,922	-5,269
<b>TOTAL LIABILITIES</b>	<b>-18,783</b>	<b>-37,911</b>
<b>NET ASSETS</b>	<b>16,604,911</b>	<b>16,436,582</b>
<b>CAPITAL</b>		
Opening Balance	16,217,573	16,538,617
PF Law Art. 6.1 (a) Revenue receipts	80,507	366,012
PF Law Art. 6.1 (b) DA receipts	101,067	420,185
PF Law Art. 6.1 (e) Other receipts	6,088	0
PF Law Art 7.1 Transfers to State Budget	-644,800	-638,500
Income for the period	844,477	-249,733
<b>CAPITAL</b>	<b>16,604,911</b>	<b>16,436,582</b>

Table 13

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME - QUARTER				
In thousands of USD				
	Quarter		Year to Date	
	Sep-16	Sep-15	Sep-16	Sep-15
<b>INVESTMENT INCOME</b>				
Interest income	39,531	40,951	118,293	116,221
Dividend income	39,519	36,338	139,563	132,050
Trust income	1,734	1,343	5,544	5,086
Other investment income	510	1	546	19
Net gains/(losses) on Financial Assets at fair value	219,980	-431,788	474,901	-240,855
Net foreign exchange gains/(losses)	11,791	-92,517	126,845	-241,476
<b>Total Investment Income</b>	<b>313,065</b>	<b>-445,673</b>	<b>865,692</b>	<b>-228,955</b>
<b>EXPENSES</b>				
External management, custody fees	1,943	2,661	6,445	7,445
Internal operational management fees	2,221	1,701	4,934	5,025
IAB Expenses	62	149	112	154
Other expenses	1	1	1,216	4
<b>Total expenses</b>	<b>4,228</b>	<b>4,512</b>	<b>12,707</b>	<b>12,628</b>
Profit before tax	308,838	-450,185	852,985	-241,584
Withholding taxes on investments	777	752	8,508	8,149
Profit/loss for the period	308,061	-450,937	844,477	-249,733
Other comprehensive income	0	0	0	0
<b>Total comprehensive income for the period</b>	<b>308,061</b>	<b>-450,937</b>	<b>844,477</b>	<b>-249,733</b>

## Notes:

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, 26 October 2016



**Venancio Alves Maria**  
Executive Director



**Abraão de Vasconcelos**  
Governor