

Petroleum Fund of Timor-Leste

Quarterly Report

30 September 2017

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 2017 to 30 September 2017.

Key statistics for the quarter include:

- The capital of the Fund at the end of the previous quarter was \$16.50 billion while the current quarter was \$16.69 billion.
- Gross cash inflows to the fund from royalties and taxes were \$126.79 million.
- Outflows for the quarter were \$318.50 million, being transfers to the state budget were \$315 million while \$3.50 million was for management costs.
- The profit/loss for the quarter was \$371.13 million, representing a gross of fees return of 2.29% compared with the benchmark return of 2.38%.

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	2.29	8.02	6.78	4.27	4.50	4.26
Benchmark	2.38	8.02	6.50	4.25	4.42	4.24
<i>Excess</i>	<i>-0.09</i>	<i>0.00</i>	<i>0.29</i>	<i>0.02</i>	<i>0.07</i>	<i>0.02</i>
International Fixed Interest	0.67	2.87	-0.55	1.71	1.04	2.71
Benchmark	0.74	2.92	-0.74	1.69	1.01	2.70
<i>Excess</i>	<i>-0.08</i>	<i>-0.05</i>	<i>0.19</i>	<i>0.02</i>	<i>0.03</i>	<i>0.01</i>
International Equities	4.80	15.80	18.19	8.00	11.32	10.28
Benchmark	4.84	16.01	18.17	7.69	10.99	9.68
<i>Excess</i>	<i>-0.04</i>	<i>-0.22</i>	<i>0.02</i>	<i>0.31</i>	<i>0.33</i>	<i>0.60</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 2017 were as follows:

Table 2

	31-Jul-17	31-Aug-17	30-Sep-17
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 Index	10.00%	10.00%	10.00%
Barclays Global Treasury Developed Market ex US, 30% Eurozone	10.00%	10.00%	10.00%
Total Fixed Income	60%	60%	60%
MSCI World Index ex Australia Net Dividends Reinvested	39.00%	39.00%	39.00%
MSCI Australia Index	1.00%	1.00%	1.00%
Total Equities	40%	40%	40%
Total	100%	100%	100%

2. MARKET TRENDS DURING THE QUARTER

Global Market Trend

The economic data releasing during the third quarter continue to point toward a healthy global economy. Unemployment rate is at multiyear low in most developed countries, wages are picking up, businesses and consumer confidence are buoyant and manufacturing data also showing modest recovery in most developed market. Most asset prices experienced steady upward movement during the quarter because of synchronized global economic growth, low inflation and the accommodative monetary policy in developed economies. Consequently, the major central banks have signaled their intention to gradually reverse their monetary policy from accommodative to normal despite inflation is below their policy objectives. Monetary policy normalization would inspire volatility of financial assets price that have been very low relative to the historical record.

The U.S Federal Reserve is on track to reverse their monetary policy to normal. They have announced during September meeting to taper the reinvestment rate of \$4.5 trillion held in their balance sheet starting October. Market expects the Fed to raise interest rate one more time in December gauging from so-called dot-plots of the Fed's monetary policy makers released from recent meeting. In addition, the Fed projected three interest rate hike in 2018 should the economic data continue to be supportive.

The European Central Bank (ECB) has also indicated that they would announce relatively soon their plan to reduce the pace of their asset-purchasing program starting 2018. However, the ECB officials stated that any change in the monetary policy would be slow and assure that policy remain supportive for persistent economy recovery. The ECB is currently purchasing 60 billion euro value of on monthly basis to keep the economy.

Given the surging inflation, low unemployment rate and sharp declining of its currency value in the U.K, policy makers at the Bank of England (BoE) have strongly suggested that they would raise interest rate before the year ended or early next year. However, with Brexit negotiation is going on any decision may affect business and consumer sentiment, which in turn will affect BoE's policy going forward.

Bank of Japan (BoJ) is the only major central bank that signals to continue to use accommodative monetary policy to inspire the laggard inflation. Recently, the Chief of BoJ stated that they would focus on domestic data to drive the policy instead of being driven by policy elsewhere.

Equities

Global equity market post strong gain in third quarter led by emerging market and Europe. Equity market rose on the positive outlook for global economy and better-than-expected earnings report.

U.S equity market finished the quarter in positive territory and some indices marked the longest consecutive quarterly gain, boosted by better-than-expected earnings report. U.S equity market is expected to finish this year strong supported by robust business' borrowing trend in recent months and expectation of strong quarterly earnings report. In addition, the reviving tax talk in Washington expected to boost equity higher going forward should the policies are enacted.

European equity market closed the quarter high, supported by improving economic activities in the region, strong corporate earnings and diminishing political uncertainties. The equity market in the region is expected to continue perform well in last quarter of the year based on the strong economic data.

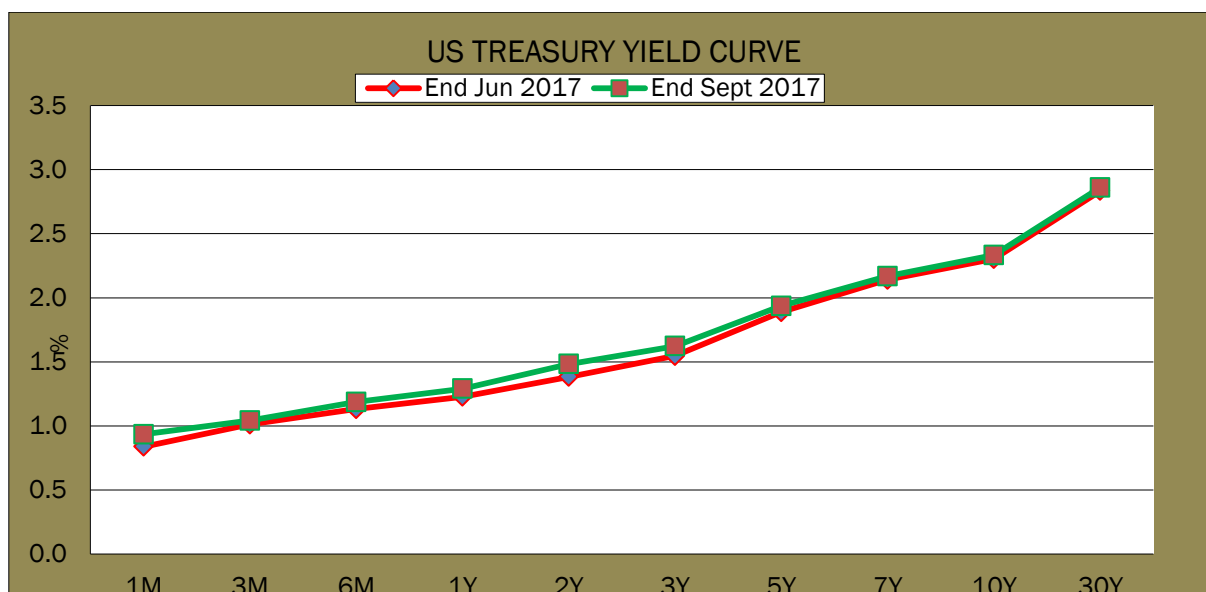
Across pacific, the equity market in Japan performed very well during the quarter, as the global growth boosted its export, which rose more than 18% so far this year. Japanese equity market proved this quarter that it does not only relying on weak Japanese yen, as even the yen appreciated against the USD this quarter. At the same time, Australian equity market also closed the quarter slightly higher this quarter, driven by material and energy sectors.

Bonds including US Treasuries

In fixed income markets, European government bonds generated modest returns as investors anticipated higher inflation levels and tighter monetary policy. The European Central Bank held short-term rates steady during the period, but officials suggested that the ECB's aggressive bond-buying initiative might start winding down soon. The yield on Germany's benchmark 10-year note declined by one basis point to end the quarter at 0.46%.

The graph below illustrates the U.S Treasury yield curve ranges from 3-month to 30-years compared to the previous quarter end. The graph indicates that the yield of short and medium tenor of the curve increased while moderate movement in the long end. The short-term U.S treasury yield such as 3, 6 and 12 months increased 4 basis point and medium tenor yield such as 2-Y note gained 10 basis points while 3 and 5-year bond yield raised 6 basis points. Long end tenor of U.S Treasury bond yield such as 10-Y and 30-Y added an average of 3 basis points in third quarter.

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 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
	Enhanced Passive	Wellington Management	0.50%	Nil	4-Dec-14
MSCI World index ex Australia Net Dividends Reinvested	Passive	State Street Global Advisors	0.35%	Nil	18-Jan-12
		BlackRock	0.35%	Nil	21-Feb-13
MSCI World index Net Dividends Reinvested	Enhanced Passive	Schroders Investment Management	1.00%	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%	38.32%	37.50%	42.50%
BOA Merrill Lynch 5-10 Years Treasury Notes and Bond Index	Bank for International Settlements	10%	± 1%	9.56%	9.00%	11.00%
Barclays Global Treasury Developed Market ex US, 30% Eurozone and 10% Country Capped	Alliance Bernstein	5%	± 0.5%	4.91%	4.50%	5.50%
	Wellington Management	5%	± 0.5%	4.93%	4.50%	5.50%
Total Fixed Income		60%		57.73%	55.50%	64.50%
MSCI Index ex Australia Net Dividends Reinvested	State Street Global Advisors	34%	± 4.0%	17.03%	13.00%	21.00%
	BlackRock			17.04%		
MSCI World Index Net Dividends Reinvested	Schroders Investment Management	5%	± 1.5%	5.10%	3.50%	6.50%
MSCI Australia Index	BCTL	1%	± 0.5%	1.07%	0.50%	1.50%
Total Equities		40%		40.24%	30.00%	50.00%

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 \$16.69 billion as follows:

Table 5

Capital Account	\$'000
Opening book value (01 July 2017)	16,504,588
Receipts during the period	126,786
Transfer to General State Budget	-315,000
Investment Return	371,125
Closing book value (30 September 2017)	16,687,499

The Fund was invested as follows:

Assets	\$'000
Cash and Cash Equivalents	487,167
Other Receivables	62,578
Financial assets held at fair value through profit or loss	16,212,563
Less:	
Payable for Securities Purchased	-72,696
Accounts Payable	-2,113
Total	16,687,499

The income for the quarter was as follows:

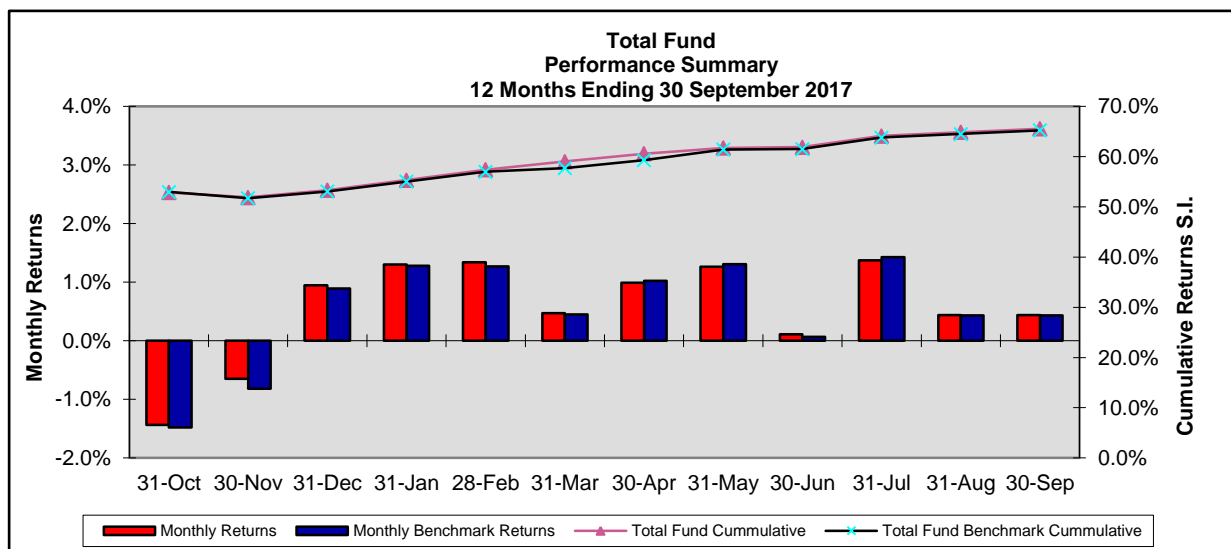
Income	\$'000
Interest income	43,919
Dividend income	38,763
Unit Trust distributions	2,000
Other Investment income	2
Net gains/(losses) on Financial Assets at fair value	202,955
Net foreign exchange gains/(losses)	87,751
Less:	
External manager, custody fees	-2,389
Central Bank management expenses	-1,674
IAB Expenses	-57
Other expenses	621
Withholding taxes	-766
Total Investment Income	371,125

The following notes are intended to assist in interpreting this information:

- Unit Trust distribution is the income received from listed property investment entities.
- Other Expenses relate to derivative trading costs which are deducted directly from the Fund.

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	0.67	2.87	-0.55	1.71	1.04	2.71
Benchmark	0.74	2.92	-0.74	1.69	1.01	2.70
<i>Excess</i>	<i>-0.08</i>	<i>-0.05</i>	<i>0.19</i>	<i>0.02</i>	<i>0.03</i>	<i>0.01</i>
BCTL Cash Management (TLCM)	0.24	1.11	1.26	n.a	n.a	1.08
3 Months USD Libor	0.33	n.a	n.a	n.a	n.a	0.43
<i>Excess</i>	<i>-0.09</i>	<i>n.a</i>	<i>n.a</i>	<i>n.a</i>	<i>n.a</i>	<i>0.64</i>
BCTL 3-5 yr US Treasury	0.30	1.53	-0.38	1.75	1.13	1.27
BoA Merrill Lynch 3-5 Years US Treasury Passive	0.35	1.50	-0.49	1.79	1.13	1.24
<i>Excess</i>	<i>-0.05</i>	<i>0.03</i>	<i>0.10</i>	<i>-0.05</i>	<i>0.01</i>	<i>0.03</i>
Bank for International Settlements	0.44	2.57	-1.90	2.57	1.34	1.87
BoA Merrill Lynch 5-10 Years US Treasury Enhanced Passive	0.45	2.49	-2.02	2.59	1.38	1.87
<i>Excess</i>	<i>-0.01</i>	<i>0.08</i>	<i>0.12</i>	<i>-0.03</i>	<i>-0.03</i>	<i>0.00</i>
Alliance Bernstein	2.50	8.90	-0.65	0.04	n.a	-1.37
Barclays Global Treasury DM ex US Enhanced Passive	2.62	9.06	-0.71	0.11	n.a	-1.42
<i>Excess</i>	<i>-0.12</i>	<i>-0.16</i>	<i>0.06</i>	<i>-0.07</i>	<i>n.a</i>	<i>0.06</i>
Wellington Management	2.63	8.99	-0.78	n.a	n.a	0.37
Barclays Global Treasury DM ex US Enhanced Passive	2.62	9.06	-0.71	n.a	n.a	0.47
<i>Excess</i>	<i>0.01</i>	<i>-0.07</i>	<i>-0.07</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	4.80	15.80	18.19	8.00	11.32	10.28
Benchmark	4.84	16.01	18.17	7.69	10.99	9.68
<i>Excess</i>	<i>-0.04</i>	<i>-0.22</i>	<i>0.02</i>	<i>0.31</i>	<i>0.33</i>	<i>0.60</i>
Schroders Investment Management	4.00	13.00	16.43	7.77	11.36	10.37
MSCI World Enhanced Passive	4.84	16.01	18.17	7.69	10.99	9.68
<i>Excess</i>	<i>-0.84</i>	<i>-3.01</i>	<i>-1.74</i>	<i>0.08</i>	<i>0.37</i>	<i>0.69</i>
SSgA International Equity	4.96	16.30	18.58	8.08	11.34	11.59
MSCI World Passive	4.88	16.11	18.30	7.70	11.00	11.21
<i>Excess</i>	<i>0.07</i>	<i>0.19</i>	<i>0.28</i>	<i>0.38</i>	<i>0.34</i>	<i>0.39</i>
BlackRock Investment Management	4.99	16.37	18.65	8.09	n.a	10.59
MSCI World Passive	4.88	16.11	18.30	7.70	n.a	10.26
<i>Excess</i>	<i>0.10</i>	<i>0.26</i>	<i>0.35</i>	<i>0.39</i>	<i>n.a</i>	<i>0.33</i>
BCTL Investment Management	3.18	12.37	13.12	n.a	n.a	15.44
MXAU AU Index Passive	3.14	12.31	13.09	n.a	n.a	15.43
<i>Excess</i>	<i>0.05</i>	<i>0.05</i>	<i>0.03</i>	<i>n.a</i>	<i>n.a</i>	<i>0.02</i>

5. MANAGEMENT COSTS

A management fee of \$3.50 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	2,389
Central Bank management expenses	1,674
IAB expenses	57
Other Expenses	(621)
Total Cost	3,499

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 \$315 million was transferred to the State Budget account during the quarter. The transfers are summarized in table 11.

Table 11	In Thousand (\$)
Transfer July 2017	165,000
Transfer August 2017	0
Transfer September 2017	150,000
Transfer for this Quarter	315,000
Total Transfers previous quarters	420,000
Total Transfers this fiscal year to September 2017	735,000

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 30 June 2017.

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	2017 September	2016 September
ASSETS		
Cash and Cash Equivalents	487,167	542,984
Receivables	62,578	30,780
Financial assets held at fair value through profit or loss	16,212,563	16,049,930
TOTAL ASSETS	16,762,308	16,623,694
LIABILITIES		
Payables for securities purchased	-72,696	-13,861
Accounts payable	-2,113	-4,922
TOTAL LIABILITIES	-74,809	-18,783
NET ASSETS	16,687,499	16,604,911
CAPITAL		
Opening Balance	15,844,327	16,217,573
PF Law Art. 6.1 (a) Revenue receipts	136,372	80,507
PF Law Art. 6.1 (b) DA receipts	184,032	101,067
PF Law Art. 6.1 (e) Other receipts	6,410	6,088
PF Law Art 7.1 Transfers to State Budget	-735,000	-644,800
Income for the period	1,251,357	844,477
CAPITAL	16,687,499	16,604,911

Table 13

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME - QUARTER				
In thousands of USD	Quarter		Year to Date	
	Sep-17	Sep-16	Sep-17	Sep-16
INVESTMENT INCOME				
Interest income	43,919	39,531	124,955	118,293
Dividend income	38,763	39,519	132,022	139,563
Trust income	2,000	1,734	5,864	5,544
Other investment income	2	510	8	546
Net gains/(losses) on Financial Assets at fair value	202,955	219,980	713,499	474,901
Net foreign exchange gains/(losses)	87,751	11,791	293,689	126,845
Total Investment Income	375,390	313,065	1,270,037	865,692
EXPENSES				
External management, custody fees	2,389	1,943	5,465	6,445
Internal operational management fees	1,674	2,221	4,945	4,934
IAB Expenses	57	62	170	112
Other expenses	-621	1	-244	1,216
Total expenses	3,499	4,228	10,337	12,707
Profit before tax	371,891	308,838	1,259,700	852,985
Withholding taxes on investments	766	777	8,343	8,508
Profit/loss for the period	371,125	308,061	1,251,357	844,477
Other comprehensive income	0	0	0	0
Total comprehensive income for the period	371,125	308,061	1,251,357	844,477

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, 17 October 2017



Venancio Alves Maria
Executive Director



Abraão de Vasconcelos
Governor