

# Petroleum Fund of Timor-Leste

## Quarterly Report

31 December 2017

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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 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 October 2017 to 31 December 2017.

Key statistics for the quarter include:

- The capital of the Fund at the end of the previous quarter was \$16.69 billion while the current quarter was \$16.80 billion.
- Gross cash inflows to the fund from royalties and taxes were \$94.88 million.
- Outflows for the quarter were \$346.88 million, being transfers to the state budget were \$343.80 million while \$3.08 million was for management costs.
- The profit/loss for the quarter was \$360.73 million, representing a gross of fees return of 2.17% compared with the benchmark return of 2.04%.

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	2.17	10.36	10.36	4.72	4.81	4.36
Benchmark	2.04	10.23	10.23	4.65	4.71	4.32
<i>Excess</i>	<i>0.12</i>	<i>0.13</i>	<i>0.13</i>	<i>0.07</i>	<i>0.10</i>	<i>0.03</i>
International Fixed Interest	-0.16	2.70	2.70	1.42	1.00	2.64
Benchmark	-0.21	2.70	2.70	1.38	0.96	2.63
<i>Excess</i>	<i>0.05</i>	<i>0.00</i>	<i>0.00</i>	<i>0.03</i>	<i>0.03</i>	<i>0.01</i>
International Equities	5.63	22.32	22.32	9.61	11.98	10.74
Benchmark	5.51	22.40	22.40	9.26	11.64	10.14
<i>Excess</i>	<i>0.13</i>	<i>-0.08</i>	<i>-0.08</i>	<i>0.35</i>	<i>0.34</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 December 2017 were as follows:

Table 2

	31-Oct-17	30-Nov-17	31-Dec-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%
<b>Total Fixed Income</b>	<b>60%</b>	<b>60%</b>	<b>60%</b>
MSCI World Index ex Australia Net Dividends Reinvested	39.00%	39.00%	39.00%
MSCI Australia Index	1.00%	1.00%	1.00%
<b>Total Equities</b>	<b>40%</b>	<b>40%</b>	<b>40%</b>
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

## 2. MARKET TRENDS DURING THE QUARTER

### Global Market Trend

Global economy continued to experience the most synchronized growth in the fourth quarter of the year. Manufacturing indicators were positive in most developed countries, unemployment rates are declining persistently in most developed economies, and business and consumer confidence are buoyant, which underscore another strong year ahead. The only laggard data is the wage growth, which resulted in inflation below most major central banks' target.

Against the backdrop of solid macro, the major central banks starting to unwind their ultra-easy monetary policies; some raising interest rate and others started cutting back their asset-purchasing program.

The U.S. Federal Reserve completed the three rate hikes in December 2017 as forecasted, moves the interest rate from 0.75% at the beginning of the year to current rate of 1.5%. The Fed also decided to reduce the assets held in their balance sheet by reducing the reinvestment of their matured assets at pace on US\$10 billion every month and will increase every quarter up to \$50 billion a month starting October. The Fed targets to bring down its balance sheet holding from US\$4.5 trillion to US\$2 – 3 trillion. In addition, the

Fed policy makers have forecasted three rate hikes for 2018 and lifted the GDP growth forecast for 2018 from 2.1 to 2.5% during recent meeting.

The stronger than expected economic data in Eurozone during the quarter triggered the European Central Bank (ECB) to scale back their quantitative easing program. The ECB decided in November to reduce the amount of bond purchase program from current pace of 60 billion euro to 30 billion euro per month and extended it to September 2018. Real economic activity such as industrial production and retail sales are expanding strongly combined with easy financial condition and high level of producers and consumer confidence should maintain the growth momentum in year ahead.

Bank of England (BoE) added 0.25% to their interest rate in November as the inflation went as high as 3.1%, overshoot BoE's upper limit of 3%. According to the letter from the BoE governor to the Chambers cited the latest energy price appreciation and pound depreciation since Brexit vote as the main reason for the above-target inflation. Although Brexit negotiation has made decent progress, the risk of no-deal scenario remains a possibility as both parties started on trade deal negotiation.

### *Equities*

Global equity had a banner year in 2017 with most equity indices increased double digit and set to continue the momentum in 2018 with supportive legislation in the U.S and strong fundamentals globally.

In U.S, the equity market performed very well in last quarter of 2017, supported by the strong fundamentals and robust corporate earnings. Three major indices such as S&P 500, Dow Jones, and Nasdaq Index all posted positive return in fourth quarter and added double-digit percentage for the whole year. The U.S policy makers passed the most anticipated tax reform bill, which reduce the corporate tax from 35% to 21%, at the end of 2017 and enacted by the U.S President into law. The tax bill is expected to boost the equity market further as reduced tax to corporates would leave more cash with the companies also hoping to encourage companies to repatriate the cash stored overseas. Consequently, those cash would boost capital reinvestment in order to improve the productivity that has been lacking.

In Europe, equity market indices' performances were mixed during the quarter due to the appreciation of the region's currency Euro, which adversely affect the export from the region. In addition, the unexpected election result in Germany, which no party gained absolute majority made the new government formation stalled. While, U.K's FTSE 100 index, which derived close to 70% of its revenue from overseas, underperformed the more domestic index consist of small and mid-cap during the quarter due to sterling's appreciation.

Equity market across Asia Pacific rose during the quarter led by Japan. Current Prime Minister Abe's victory in October's snap election enables investors to form conviction on likely continuation of both fiscal and monetary policies going forward. Another reason is the corporate earnings seen in previous three month, as most companies in Japan reported earnings exceeded estimates. Likewise, equity in Australia and South Korea also posted strong return during the quarter resulted from the strong demand from China.

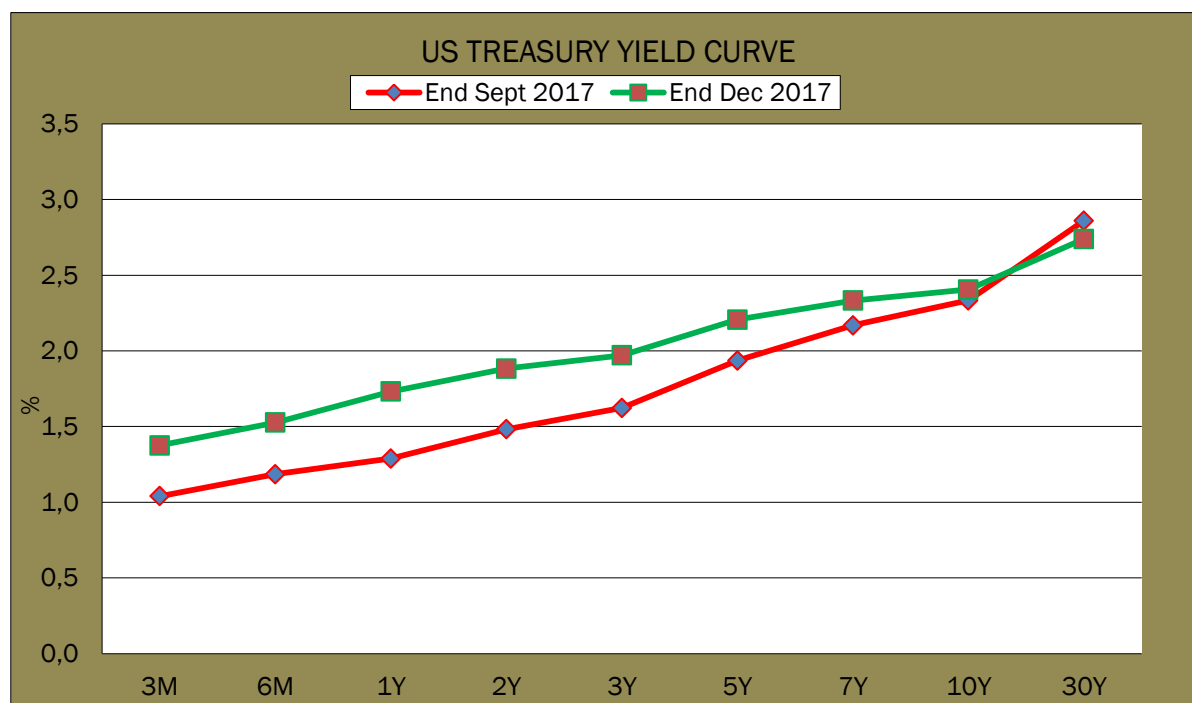
### *Bonds including US Treasuries*

The combination of positive economic data in Eurozone and reduction of quantitative easing by the European Central Bank boosted the sovereign bonds' yield in the region during the quarter. However, the political events in Germany and Catalonia, Spain reduced some bond yield as investors demand to the safe haven assets increased. The U.K's 10-Y sovereign bond yields decreased materially, and less pronounced decrease on the shorter maturity such as 5-Y and 2-Y as economic activities remained subdued and political uncertainty continue to be high.

The graph below is yield curve illustrates U.S Treasury bond yield movement ranges from 3-month to 30-years compared to the previous quarter end. The graph indicates the yield of the short-term to medium-term

increased, while yield of the long-term bond muted or contracted during the quarter. The yield on U.S Treasury bonds range from 3-month to 5-Y yield increased from 0.20% to 0.30% during the quarter. Yield on 10-Y bond increase a mere 0.07% while yield on 30-Year bond declined 0.12% during fourth quarter. Bond yield moves inversely to price.

Figure



### 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%	37.96%	37.50%	42.50%
BOA Merrill Lynch 5-10 Years Treasury Notes and Bond Index	Bank for International Settlements	10%	± 1%	9.53%	9.00%	11.00%
Barclays Global Treasury Developed Market ex US, 30% Eurozone and 10% Country Capped	Alliance Bernstein	5%	± 0.5%	4.97%	4.50%	5.50%
	Wellington Management	5%	± 0.5%	4.99%	4.50%	5.50%
<b>Total Fixed Income</b>		<b>60%</b>		<b>57.45%</b>	<b>55.50%</b>	<b>64.50%</b>
MSCI Index ex Australia Net Dividends Reinvested	State Street Global Advisors	34%	± 4.0%	17.98%	13.00%	21.00%
	BlackRock			18.01%		
MSCI World Index Net Dividends Reinvested	Schroders Investment Management	5%	± 1.5%	5.42%	3.50%	6.50%
MSCI Australia Index	BCTL	1%	± 0.5%	1.14%	0.50%	1.50%
<b>Total Equities</b>		<b>40%</b>		<b>42.55%</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 \$16.80 billion as follows:

Table 5

Capital Account	\$'000
Opening book value (01 October 2017)	16,687,499
Receipts during the period	94,883
Transfer to General State Budget	-343,800
Investment Return	360,731
<b>Closing book value (31 December 2017)</b>	<b>16,799,313</b>

The Fund was invested as follows:

Table 6

Assets	\$'000
Cash and Cash Equivalents	318,007
Other Receivables	31,422
Financial assets held at fair value through profit or loss	16,462,178
Less:	
Payable for Securities Purchased	-10,169
Accounts Payable	-2,125
<b>Total</b>	<b>16,799,313</b>

The income for the quarter was as follows:

Table 7

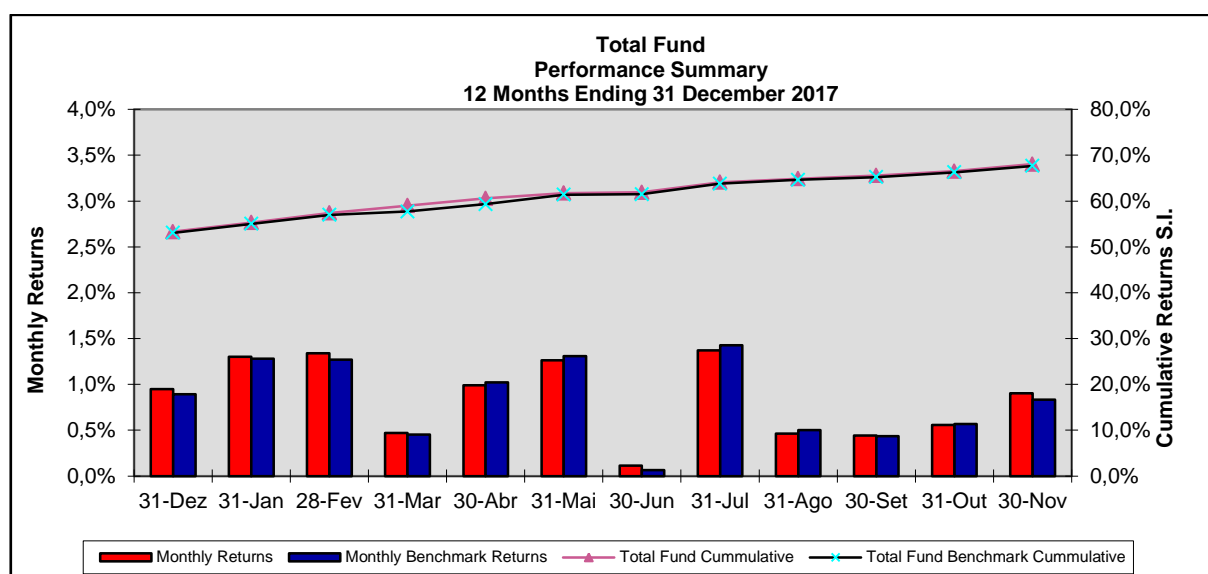
Income	\$'000
Interest income	44,549
Dividend income	30,765
Unit Trust distributions	1,727
Other Investment income	2
Net gains/(losses) on Financial Assets at fair value	269,469
Net foreign exchange gains/(losses)	18,716
Less:	
External manager, custody fees	-2,183
Central Bank management expenses	-573
IAB Expenses	-91
Other expenses	-237
Withholding taxes	-1,413
<b>Total Investment Income</b>	<b>360,731</b>

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
<b>International Fixed Interest</b>	-0.16	2.70	2.70	1.42	1.00	2.64
Benchmark	-0.21	2.70	2.70	1.38	0.96	2.63
<i>Excess</i>	<i>0.05</i>	<i>0.00</i>	<i>0.00</i>	<i>0.03</i>	<i>0.03</i>	<i>0.01</i>
<b>BCTL Cash Management (TLCM)</b>	0.28	1.40	1.40	n.a	n.a	1.09
3 Months USD Libor	0.37	n.a	n.a	n.a	n.a	0.80
<i>Excess</i>	<i>-0.08</i>	<i>n.a</i>	<i>n.a</i>	<i>n.a</i>	<i>n.a</i>	<i>0.28</i>
<b>BCTL 3-5 yr US Treasury</b>	-0.56	0.96	0.96	1.24	1.02	1.12
BoA Merrill Lynch 3-5 Years US Treasury Passive	-0.57	0.93	0.93	1.28	1.01	1.09
<i>Excess</i>	<i>0.01</i>	<i>0.04</i>	<i>0.04</i>	<i>-0.04</i>	<i>0.01</i>	<i>0.03</i>
<b>Bank for International Settlements</b>	-0.36	2.20	2.20	1.72	1.29	1.73
BoA Merrill Lynch 5-10 Years US Treasury Enhanced Passive	-0.42	2.06	2.06	1.69	1.30	1.72
<i>Excess</i>	<i>0.06</i>	<i>0.14</i>	<i>0.14</i>	<i>0.03</i>	<i>-0.02</i>	<i>0.01</i>
<b>Alliance Bernstein</b>	1.48	10.51	10.51	1.15	n.a	-0.85
Barclays Global Treasury DM ex US Enhanced Passive	1.42	10.61	10.61	1.21	n.a	-0.92
<i>Excess</i>	<i>0.06</i>	<i>-0.10</i>	<i>-0.10</i>	<i>-0.06</i>	<i>n.a</i>	<i>0.07</i>
<b>Wellington Management</b>	1.41	10.52	10.52	1.13	n.a	0.80
Barclays Global Treasury DM ex US Enhanced Passive	1.42	10.61	10.61	1.21	n.a	0.89
<i>Excess</i>	<i>-0.01</i>	<i>-0.08</i>	<i>-0.08</i>	<i>-0.08</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
<b>International Equities</b>	5.63	22.32	22.32	9.61	11.98	10.74
Benchmark	5.51	22.40	22.40	9.26	11.64	10.14
<i>Excess</i>	<i>0.13</i>	<i>-0.08</i>	<i>-0.08</i>	<i>0.35</i>	<i>0.34</i>	<i>0.60</i>
<b>Schroders Investment Management</b>	6.08	19.87	19.87	9.59	12.13	10.90
MSCI World Enhanced Passive	5.51	22.40	22.40	9.26	11.64	10.14
<i>Excess</i>	<i>0.58</i>	<i>-2.53</i>	<i>-2.53</i>	<i>0.33</i>	<i>0.49</i>	<i>0.76</i>
<b>SSgA International Equity</b>	5.52	22.72	22.72	9.65	11.97	12.08
MSCI World Passive	5.47	22.47	22.47	9.27	11.64	11.70
<i>Excess</i>	<i>0.05</i>	<i>0.25</i>	<i>0.25</i>	<i>0.39</i>	<i>0.33</i>	<i>0.38</i>
<b>BlackRock Investment Management</b>	5.54	22.82	22.82	9.65	n.a	11.24
MSCI World Passive	5.47	22.47	22.47	9.27	n.a	10.91
<i>Excess</i>	<i>0.07</i>	<i>0.36</i>	<i>0.36</i>	<i>0.39</i>	<i>n.a</i>	<i>0.33</i>
<b>BCTL Investment Management</b>	6.79	19.99	19.99	n.a	n.a	17.76
MXAU AU Index Passive	6.79	19.93	19.93	n.a	n.a	17.74
<i>Excess</i>	<i>0.00</i>	<i>0.06</i>	<i>0.06</i>	<i>n.a</i>	<i>n.a</i>	<i>0.02</i>

## 5. MANAGEMENT COSTS

A management fee of \$3.08 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	2,183
Central Bank management expenses	573
IAB expenses	91
Other Expenses	237
<b>Total Cost</b>	<b>3,084</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 \$343.80 million was transferred to the State Budget account during the quarter. The transfers are summarized in table 11.



Table 11	In Thousand (\$)
Transfer October 2017	60,000
Transfer November 2017	60,000
Transfer December 2017	223,800
Transfer for this Quarter	<b>343,800</b>
Total Transfers previous quarters	735,000
<b>Total Transfers this fiscal year to December 2017</b>	<b>1,078,800</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 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		2016
	December		December
<b>ASSETS</b>			
Cash and Cash Equivalents	318,007		108,985
Receivables	31,422		27,853
Financial assets held at fair value through profit or loss	16,462,178		15,715,654
<b>TOTAL ASSETS</b>	<b>16,811,607</b>		<b>15,852,492</b>
<b>LIABILITIES</b>			
Payables for securities purchased	-10,169		-3,212
Accounts payable	-2,125		-4,953
<b>TOTAL LIABILITIES</b>	<b>-12,294</b>		<b>-8,165</b>
<b>NET ASSETS</b>	<b>16,799,313</b>		<b>15,844,327</b>
<b>CAPITAL</b>			
Opening Balance	15,844,327		16,217,573
PF Law Art. 6.1 (a) Revenue receipts	181,295		90,494
PF Law Art. 6.1 (b) DA receipts	233,992		127,136
PF Law Art. 6.1 (e) Other receipts	6,410		6,242
PF Law Art 7.1 Transfers to State Budget	-1,078,800		-1,244,800
Income for the period	1,612,088		647,682
<b>CAPITAL</b>	<b>16,799,313</b>		<b>15,844,327</b>

Table 13

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME - QUARTER				
In thousands of USD				
	Quarter		Year to Date	
	Dec-17	Dec-16	Dec-17	Dec-16
<b>INVESTMENT INCOME</b>				
Interest income	44,549	39,504	169,503	157,797
Dividend income	30,765	35,751	162,787	175,313
Trust income	1,727	1,671	7,591	7,215
Other investment income	2	-0	11	546
Net gains/(losses) on Financial Assets at fair value	269,469	-27,912	982,968	446,990
Net foreign exchange gains/(losses)	18,716	-242,641	312,405	-115,796
<b>Total Investment Income</b>	<b>365,228</b>	<b>-193,627</b>	<b>1,635,265</b>	<b>672,065</b>
<b>EXPENSES</b>				
External management, custody fees	2,183	1,812	7,649	8,257
Internal operational management fees	573	0	5,518	4,934
IAB Expenses	91	92	261	204
Other expenses	237	4	-6	1,220
<b>Total expenses</b>	<b>3,084</b>	<b>1,908</b>	<b>13,421</b>	<b>14,615</b>
Profit before tax	362,144	-195,535	1,621,844	657,450
Withholding taxes on investments	1,413	1,260	9,756	9,768
Profit/loss for the period	360,731	-196,795	1,612,088	647,682
Other comprehensive income	0	0	0	0
<b>Total comprehensive income for the period</b>	<b>360,731</b>	<b>-196,795</b>	<b>1,612,088</b>	<b>647,682</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, 24 January 2018



**Venancio Alves Maria**  
Deputy Governor



**Abraão de Vasconcelos**  
Governor