

Petroleum Fund of Timor-Leste

Quarterly Report

31 March 2018

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.
9. 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 January 2018 to 31 March 2018.

Key statistics for the quarter include:

- The capital of the Fund at the end of the previous quarter was \$16.80 billion while the current quarter was \$16.85 billion.
- Gross cash inflows to the fund from royalties and taxes were \$138.65 million.
- Outflows for the quarter were \$4.64 million for management cost. No transfers were made to the state budget during this quarter.
- The profit/loss for the quarter was -\$91.15 million, representing a gross of fees return of -0.47% compared with the benchmark return of -0.68%.

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	-0.47	-0.47	6.49	4.08	4.26	4.23
Benchmark	-0.68	-0.68	6.26	3.95	4.14	4.18
<i>Excess</i>	<i>0.20</i>	<i>0.20</i>	<i>0.23</i>	<i>0.14</i>	<i>0.11</i>	<i>0.05</i>
International Fixed Interest	-0.32	-0.32	1.53	1.07	0.89	2.56
Benchmark	-0.38	-0.38	1.47	1.04	0.85	2.55
<i>Excess</i>	<i>0.06</i>	<i>0.06</i>	<i>0.06</i>	<i>0.04</i>	<i>0.04</i>	<i>0.01</i>
International Equities	-1.28	-1.28	13.60	8.30	10.03	10.17
Benchmark	-1.28	-1.28	13.59	7.97	9.70	9.60
<i>Excess</i>	<i>0.00</i>	<i>0.00</i>	<i>0.01</i>	<i>0.33</i>	<i>0.33</i>	<i>0.58</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 2018 were as follows:

Table 2

	31-Dec-17	28-Feb-18	31-Mar-18
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

Global market started the year in strong footing elevated by the newly tax policy approval from U.S and global synchronized growth carried over from the previous year. The sentiment trembled as the quarter progressed, affected by perception of higher inflation, higher interest rate, and potential trade war between U.S and China and other trade partners, which adversely affected financial asset price for the quarter. Nonetheless, the growth indicators among the key markets remained strong, which should give a positive outlook on the year ahead.

Economy in Eurozone continued to perform well during the quarter benefitted from the strong domestic demands and accommodative monetary policy from European Central Bank. The manufacturing sectors in the region were solid during the period and there is a sign of continuation in months ahead. Labor markets were impressive; unemployment rate in the single currency region is at multiyear low. The data from the U.K were less impressive during the quarter as industrial production declining. The consumer and business confidence also fell during the quarter affected by the uncertainty on the government's ongoing breakout negotiation with the European Union. The Bank of England held their short-term interest rate unchanged but expected to move higher in the following months as inflation has been consistently above BoE's target of 2%.

The macroeconomics across Asia Pacific and emerging markets were strong, boosted by the exports as demand from developed markets were robust during the quarter. Industrial output rose moderately during the quarter and unemployment rate stays at multiyear lows in countries like Australia and Japan. Recent surveys showed that business and consumers confidence fell in those countries with significant exports, caused by the currency appreciation and potential trade war between countries with sizeable economy.

Equities

Global equity markets performed solidly during January but experienced setback the following months with most indices finished the quarter in negative territory.

U.S equity markets started 2018 strong with most indices reached all time high in January, supported by the tax reform package, solid labor market, and positive corporate earnings from last period. The perception of higher inflation and discussion on trade between U.S and China in February and March triggered high volatility in risky assets later in the period and unable to recuperate. The U.S' S&P 500 finished the quarter with almost 1% down. Nonetheless, the outlook for the U.S equity market remains promising, as macroeconomic data were broadly positive during the quarter. The Institute Supply Management's survey indicated that the companies in the service sector, which accounts for more than 70% of U.S economic activities, are still growing. The Fed upgraded their GDP growth forecast for 2018 and 2019 from 2.5% to 2.7% and 2.1% to 2.4%.

Likewise, the equity markets in Europe finished the quarter lower following the global downward trend. Stock market in the region begun the year on positive notes but worries about faster interest rate hikes in the U.S and global trade outlook resulted in the decline of the equity market in the region. In addition, several political events such as inconclusive election result in Italy where anti-European Union establishment Five-Star movement, garner the most votes in the election and delay of new government formation in Germany affected investors' sentiment.

Equity market in the Asia Pacific and emerging market produced a mixed performance during the quarter. Equity markets in Japan finished in negative territory as uncertainty were high with the yen's appreciation against most major currency. Corporate earnings from previous quarter were mostly positive but the investors' sentiments were dominated by the political events both domestically and globally. The most ubiquitous effect came from the raising U.S protectionism. However, the long-term trends of economic development are intact, and the reappointment of Shinzo Abe as Prime Minister and Haruhiko Kuroda as the Head of Bank of Japan should ensure the stable political environment and reform continuity in years ahead.

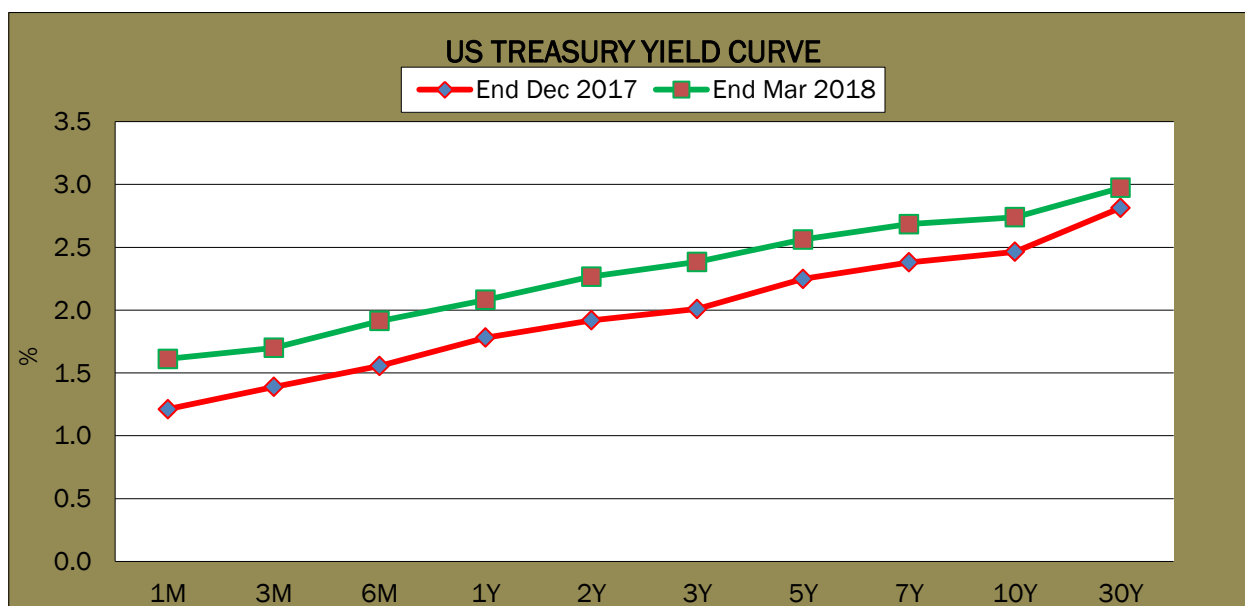
Bonds including US Treasuries

The global treasury yield curves were flattened as the yield of short-term and medium terms bonds were raising more compared to the long-term bonds. The yields of global sovereign bonds mostly increased during the quarter, fueled by the fear of higher inflation and rate hike acceleration and growth expectation. Yield of sovereign bonds in Europe were mixed during the quarter. Yield of German Bund 10-year rose

Slightly from 0.40% to 0.50%. While French and Spanish government 10-year bond yield fell slightly and the yield of Italy's 10-year bond fell from 2.02% to 1.79% as inconclusive election result generated higher demand for the government asset.

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 curve is somewhat flat as the short-term to medium-term bond yield increased more than the longer maturity. The yield of short-term notes range from three months to one year rose on average of 0.35%, the medium term bond yields two-five year each increased on average of 0.40%. On the other hand, the long-term bond yields such as 10-year and 30-year rose 0.33 and 0.23% respectively. Bond yield moves inversely to price.

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%	39.98%	37.50%	42.50%
BOA Merrill Lynch 5-10 Years Treasury Notes and Bond Index	Bank for International Settlements	10%	± 1%	10.19%	9.00%	11.00%
Barclays Global Treasury Developed Market ex US, 30% Eurozone and 10% Country Capped	Alliance Bernstein	5%	± 0.5%	5.20%	4.50%	5.50%
	Wellington Management	5%	± 0.5%	5.22%	4.50%	5.50%
Total Fixed Income		60%		60.59%	55.50%	64.50%
MSCI Index ex Australia Net Dividends Reinvested	State Street Global Advisors	34%	± 4.0%	16.69%	13.00%	21.00%
	BlackRock			16.71%		
MSCI World Index Net Dividends Reinvested	Schroders Investment Management	5%	± 1.5%	4.91%	3.50%	6.50%
MSCI Australia Index	BCTL	1%	± 0.5%	1.11%	0.50%	1.50%
Total Equities		40%		39.41%	30.00%	50.00%

The weights in Table 4 and those in the benchmark portfolio's asset allocation (Table 2) do not account for the Cash mandate.

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 \$16.85 billion as follows:

Table 5

Capital Account	\$'000
Opening book value (01 January 2018)	16,799,313
Receipts during the period	138,649
Transfer to General State Budget	0
Investment Return	-91,150
Closing book value (31 March 2018)	16,846,811

The Fund was invested as follows:

Table 6

Assets	\$'000
Cash and Cash Equivalents	817,728
Other Receivables	63,557
Financial assets held at fair value through profit or loss	16,032,682
Less:	
Payable for Securities Purchased	-62,702
Accounts Payable	-4,453
Total	16,846,811

The income for the quarter was as follows:

Table 7

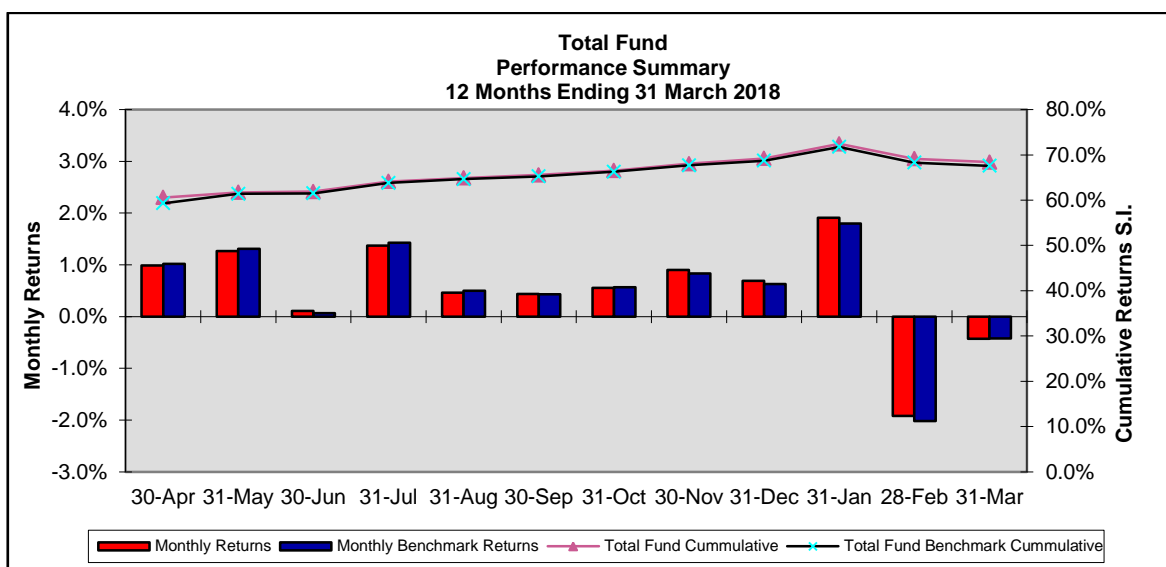
Income	\$'000
Interest income	48,252
Dividend income	38,696
Unit Trust distributions	912
Other Investment income	28
Net gains/(losses) on Financial Assets at fair value	-243,123
Net foreign exchange gains/(losses)	70,698
Less:	
External manager, custody fees	-2,693
Central Bank management expenses	-1,670
IAB Expenses	-27
Other expenses	-248
Withholding taxes	-1,974
Total Investment Income	-91,150

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	-0.32	-0.32	1.53	1.07	0.89	2.56
Benchmark	-0.38	-0.38	1.47	1.04	0.85	2.55
<i>Excess</i>	<i>0.06</i>	<i>0.06</i>	<i>0.06</i>	<i>0.04</i>	<i>0.04</i>	<i>0.01</i>
BCTL Cash Management (TLCM)	0.40	0.40	1.55	n.a	n.a	1.16
3 Months USD Libor	0.47	0.47	n.a	n.a	n.a	1.28
<i>Excess</i>	<i>-0.07</i>	<i>-0.07</i>	<i>n.a</i>	<i>n.a</i>	<i>n.a</i>	<i>-0.12</i>
BCTL 3-5 yr US Treasury	-0.68	-0.68	-0.25	0.50	0.83	0.96
BoA Merrill Lynch 3-5 Years US Treasury Passive	-0.72	-0.72	-0.31	0.54	0.82	0.93
<i>Excess</i>	<i>0.04</i>	<i>0.04</i>	<i>0.06</i>	<i>-0.05</i>	<i>0.01</i>	<i>0.04</i>
Bank for International Settlements	-1.46	-1.46	-0.18	0.47	0.95	1.43
BoA Merrill Lynch 5-10 Years US Treasury Enhanced Passive	-1.48	-1.48	-0.29	0.45	0.98	1.41
<i>Excess</i>	<i>0.02</i>	<i>0.02</i>	<i>0.11</i>	<i>0.03</i>	<i>-0.03</i>	<i>0.01</i>
Alliance Bernstein	2.10	2.10	10.61	3.35	n.a	-0.25
Barclays Global Treasury DM ex US Enhanced Passive	2.10	2.10	10.67	3.37	n.a	-0.31
<i>Excess</i>	<i>0.00</i>	<i>0.00</i>	<i>-0.06</i>	<i>-0.02</i>	<i>n.a</i>	<i>0.06</i>
Wellington Management	2.05	2.05	10.56	3.28	n.a	1.36
Barclays Global Treasury DM ex US Enhanced Passive	2.10	2.10	10.67	3.37	n.a	1.45
<i>Excess</i>	<i>-0.04</i>	<i>-0.04</i>	<i>-0.11</i>	<i>-0.10</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
International Equities	-1.28	-1.28	13.60	8.30	10.03	10.17
Benchmark	-1.28	-1.28	13.59	7.97	9.70	9.60
<i>Excess</i>	0.00	0.00	0.01	0.33	0.33	0.58
Schroders Investment Management	-1.54	-1.54	11.68	8.32	10.07	10.29
MSCI World Enhanced Passive	-1.28	-1.28	13.59	7.97	9.70	9.60
<i>Excess</i>	-0.26	-0.26	-1.91	0.35	0.37	0.69
SSgA International Equity	-1.11	-1.11	14.23	8.36	10.07	11.37
MSCI World Passive	-1.15	-1.15	13.93	8.02	9.73	11.00
<i>Excess</i>	0.04	0.04	0.29	0.34	0.34	0.37
BlackRock Investment Management	-1.06	-1.06	14.35	8.41	10.06	10.44
MSCI World Passive	-1.15	-1.15	13.93	8.02	9.73	10.11
<i>Excess</i>	0.10	0.10	0.42	0.39	0.33	0.34
BCTL Investment Management	-6.11	-6.11	1.56	n.a	n.a	10.97
MXAU AU Index Passive	-6.15	-6.15	1.42	n.a	n.a	10.93
<i>Excess</i>	0.04	0.04	0.14	n.a	n.a	0.04

5. MANAGEMENT COSTS

A management fee of \$4.64 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	2,693
Central Bank management expenses	1,670
IAB expenses	27
Other Expenses	248
Total Cost	4,639

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. No transfer were made to the State Budget account during this quarter. The transfers are summerized in table 11.

Table 11	In Thousand (\$)
Transfer January 2018	0
Transfer February 2018	0
Transfer March 2018	0
Transfer for this Quarter	0
Total Transfers previous quarters	0
Total Transfers this fiscal year to December 2018	0

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 December 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			
	2018		2017
	March		March
ASSETS			
Cash and Cash Equivalents	817,728		658,433
Receivables	63,557		40,380
Financial assets held at fair value through profit or loss	16,032,682		16,130,532
TOTAL ASSETS	16,913,966		16,829,346
LIABILITIES			
Payables for securities purchased	-62,702		-561,554
Accounts payable	-4,453		-1,886
TOTAL LIABILITIES	-67,155		-563,440
NET ASSETS	16,846,811		16,265,906
CAPITAL			
Opening Balance	16,799,313		15,844,327
PF Law Art. 6.1 (a) Revenue receipts	64,437		53,766
PF Law Art. 6.1 (b) DA receipts	74,212		50,609
PF Law Art. 6.1 (e) Other receipts	0		0
PF Law Art 7.1 Transfers to State Budget	0		-180,000
Income for the period	-91,150		497,204
CAPITAL	16,846,811		16,265,906

Table 13

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME - QUARTER				
In thousands of USD				
	Quarter		Year to Date	
	Mar-18	Mar-17	Mar-18	Mar-17
INVESTMENT INCOME				
Interest income	48,252	38,920	48,252	38,920
Dividend income	38,696	42,089	38,696	42,089
Trust income	912	2,102	912	2,102
Other investment income	28	1	28	1
Net gains/(losses) on Financial Assets at fair value	-243,123	341,861	-243,123	341,861
Net foreign exchange gains/(losses)	70,698	77,098	70,698	77,098
Total Investment Income	-84,538	502,071	-84,538	502,071
EXPENSES				
External management, custody fees	2,693	1,036	2,693	1,036
Internal operational management fees	1,670	1,635	1,670	1,635
IAB Expenses	27	0	27	0
Other expenses	248	229	248	229
Total expenses	4,639	2,900	4,639	2,900
Profit before tax	-89,176	499,171	-89,176	499,171
Withholding taxes on investments	1,974	1,968	1,974	1,968
Profit/loss for the period	-91,150	497,204	-91,150	497,204
Other comprehensive income	0	0	0	0
Total comprehensive income for the period	-91,150	497,204	-91,150	497,204

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, 18 April 2018



Venancio Alves Maria
Deputy Governor



Nur Aini Djafar Alkatiri
Deputy Governor