

# Petroleum Fund of Timor-Leste

## Quarterly Report

30 September 2018

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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 July 2018 to 30 September 2018.

Key statistics for the quarter include:

- The capital of the Fund at the end of the previous quarter was \$16.93 billion while the current quarter was \$17.16 billion.
- Gross cash inflows to the fund from royalties and taxes were \$79.42 million.
- Outflows for the quarter were \$144.15 million, being transfers to the state budget of \$140 million while \$4.15 million was for management costs.
- The profit/loss for the quarter was \$288.83 million, representing a gross of fees return of 1.73% compared with the benchmark return of 1.73%.

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	1.73	1.51	3.71	5.75	4.27	4.22
Benchmark	1.73	1.32	3.40	5.65	4.19	4.17
<i>Excess</i>	<i>-0.01</i>	<i>0.18</i>	<i>0.31</i>	<i>0.09</i>	<i>0.08</i>	<i>0.05</i>
International Fixed Interest	-0.33	-1.29	-1.45	0.56	0.92	2.39
Benchmark	-0.41	-1.52	-1.73	0.45	0.84	2.36
<i>Excess</i>	<i>0.08</i>	<i>0.22</i>	<i>0.27</i>	<i>0.11</i>	<i>0.08</i>	<i>0.03</i>
International Equities	5.09	5.58	11.52	13.81	9.60	10.43
Benchmark	4.98	5.43	11.24	13.54	9.28	9.87
<i>Excess</i>	<i>0.11</i>	<i>0.14</i>	<i>0.29</i>	<i>0.27</i>	<i>0.31</i>	<i>0.56</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 2018 were as follows:

Table 2

	1-Jul-18	31-Aug-18	30-Sep-18
BOA Merrill Lynch 3-5 Years Treasury Bond Index	40%	40%	40%
BOA Merrill Lynch 5-10 Years Treasury Notes and Bond Index	10%	10%	10%
Barclays Global Treasury Developed Market ex US, 30% Eurozone and 10% Country Capped	10%	10%	10%
<b>Total Fixed Income</b>	<b>60%</b>	<b>60%</b>	<b>60%</b>
<b>Total Equity (MSCI World Index Net Dividends Reinvested)</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

Generally, global economic indicators remain positive but less synchronized like in recent quarters as the United States outpaced the rest of the world in terms of economic growth.

U.S economic fundamental remained intact despite the U.S Federal Reserve tightened monetary policy. The data showed the U.S economy created 185,000 jobs in average every month during the quarter. Monthly average of people filing for jobless claim fell to lowest level not seen in decades while unemployment rate in the country fell to multiyear low of 3.7%. Consequently, the Fed increased their short-term interest rate benchmark from 2% to 2.25% in September, marked three consecutive quarter increase for the year. Besides raising rate in September, the Fed reaffirmed their projection of another interest rate hike for the year and three to four times in 2019 if economic data remain supportive. The Fed increased their U.S economic growth outlook for 2018 and 2019 to 3.1% and 2.5% from 2.8% and 2.4% respectively.

Lower unemployment rate and prospect of higher inflation triggered the European Central Bank to scale back their monetary stimulus in the Euro area. The ECB monetary policy committee decided in September to reduce their asset purchase program from 30 to 15 billion Euros per month during last three months of 2018 and ultimately terminate the program after September. However, the ECB would

not raise interest rate until mid-2019. During his testimony to the European Parliament, the ECB governor Mario Draghi told the lawmakers that he believes that the tighter labor market would eventually push the inflation higher. Despite the projection, the ECB officials would continue to monitor political events such as the BREXIT and raising populism in Italy. Leading activity indicators continue to point toward expansion for the region notwithstanding at slower pace than it was in the start of the year. The flash Eurozone composite purchasing managers' index for September fell to 54.2 but still in expansion area. After increasing interest rate from 0.50% to 0.75% in August, Bank of England said in September that the U.K economy is broadly on track and inflation is fairly contained and unemployment rate fell further to 4% in July. However, BoE cautioned that events like BREXIT could influence household and business spending in the future. U.K is set to leave European Union in March 2019 but so far both parties yet to reach agreement on future relationship after BREXIT.

In Asia, the People's Bank of China cut the banks' reserve ratio in September in response to the prospect of weak economic growth stems from escalating trade war with the U.S. The U.S imposed 10% tariffs on Chinese goods exports to the U.S worth \$250 billion dollars. These tariffs would go up to 25% in 2019 if both parties fail to come to agreement before then. In contrast, China levied the same rate of tariffs in U.S goods exports to China worth \$110 billion dollars. Bank of Japan made tweak on its yield curve control policy to allow more flexibility on 10-year Japanese government bond yield movement.

### *Equities*

Global equity market finished the quarter with mixed performance as most developed market equity advanced while some developed and emerging market equity indices post decline. The prospect of trade war and tighten monetary policy tightening could be the main risk for equity market going forward.

U.S equity market enduring another strong quarter outperformed other major markets. Strong economy and corporate tax cut lift the corporate profits, which in turn increase the corporate earnings. The robust earnings supported performances of information technology, and healthcare sectors while the energy sector underperformed, with U.S oil companies affected by China's inclusion of crude oil as their tariff-targeted products.

Performance of equity markets in Europe varied during the quarter with France's CaC and broad MSCI EU index advanced while U.K's FTSE 100 and German's Dax ended the quarter in negative. Energy and industrial sectors were the leading gainers while real state, telecommunication, and consumer staples underperformed during the quarter. The financial sectors generally made positive contribution but the banks' shares experienced a sharp decline due to shock in emerging market, notably Turkey and concern over Italian budget. FTSE 100 declined for the quarter, as investors are anxious over looming BREXIT deadline and prospect of weak global growth because of escalating trade war between U.S and China.

Equity market indices across Asia Pacific and Emerging Market posted different result for the quarter as Japan's share prices increased while Australia and Emerging Market broad index MSCI EM ended the period with negative. The Japan's equity market positive performance was mostly driven by the acceleration of service sector activity and domestic currency's depreciation. On the other hand, emerging market indices closed the quarter in negative territory dragged down by the strength of USD and trade disputes. Strings of interest rate raises by the U.S central bank boosted the USD value against the emerging markets' currencies. Australian equity market underperformed during the quarter stems from weaker demand from China.

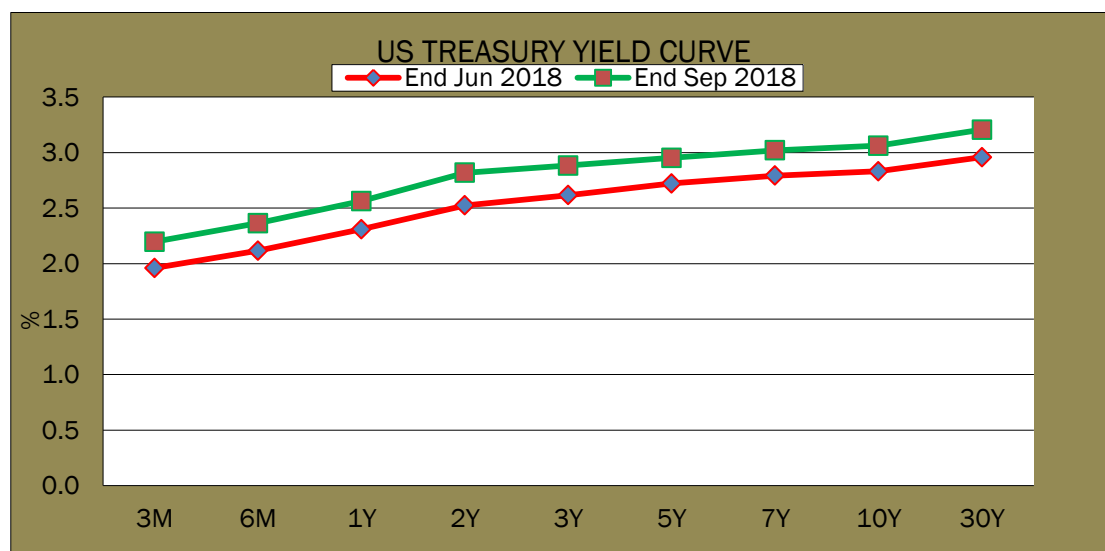
### *Bonds including US Treasuries*

Yield of global treasuries' bonds rose for the quarter due to the improving economic fundamentals and political events. The price of Italian government 10-year bond fell dramatically as yield rose 0.47% for the quarter as investors were startled by the political uncertainty in the country. The populist government in Italy has proposed budget with deficit is in contentious with the European Union fiscal

deficit rule. Following the Italy is U.K's government 10-year bond yield, which increased 0.30% during the quarter.

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 yield of U.S Treasury notes and bonds increased in average of 0.25% across the tenors during the quarter in response to the raising interest rates and positive economic outlook.

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	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%	39.41%	37.50%	42.50%
BOA Merrill Lynch 5-10 Years Treasury Notes and Bond Index	Bank for International Settlements	10%	± 1%	9.91%	9.00%	11.00%
Barclays Global Treasury Developed Market ex US, 30% Eurozone and 10% Country Capped	Alliance Bernstein	5%	± 0.5%	4.80%	4.50%	5.50%
	Wellington Management	5%	± 0.5%	4.82%	4.50%	5.50%
<b>Total Fixed Income</b>		<b>60%</b>		<b>58.94%</b>	<b>55.50%</b>	<b>64.50%</b>
MSCI Index ex Australia Net Dividends Reinvested	State Street Global Advisors	34%	± 4.0%	17.39%	13.00%	21.00%
	BlackRock			17.42%		
MSCI World Index Net Dividends Reinvested	Schroders Investment Management	5%	± 1.5%	5.11%	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>41.06%</b>	<b>30.00%</b>	<b>50.00%</b>

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 \$17.16 billion as follows:

Table 5

Capital Account	\$'000
Opening book value (01 July 2018)	16,927,324
Receipts during the period	79,424
Transfer to General State Budget	-140,000
Investment Return	288,829
<b>Closing book value (30 Sep 2018)</b>	<b>17,155,577</b>

The Fund was invested as follows:

Table 6

Assets	\$'000
Cash and Cash Equivalents	887,047
Other Receivables	37,837
Financial assets held at fair value through profit or loss	16,253,122
Less:	
Payable for Securities Purchased	-19,462
Accounts Payable	-2,966
<b>Total</b>	<b>17,155,577</b>

The income for the quarter was as follows:

Table 7

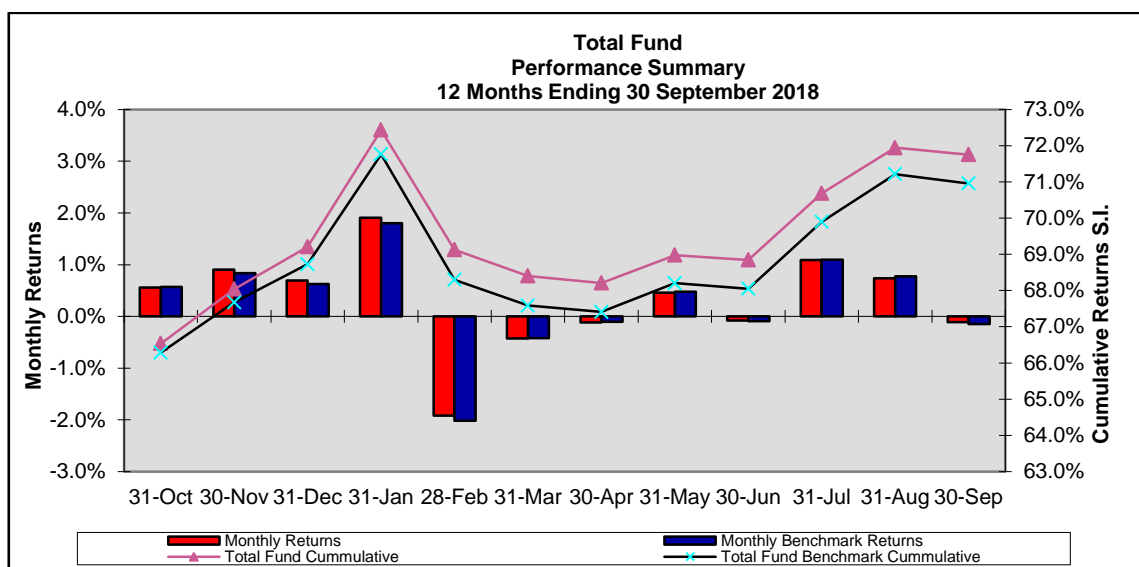
Income	\$'000
Interest income	50,745
Dividend income	36,735
Unit Trust distributions	2,383
Other Investment income	0
Net gains/(losses) on Financial Assets at fair value	226,355
Net foreign exchange gains/(losses)	-22,498
Less:	
External manager, custody fees	-2,270
Central Bank management expenses	-1,720
IAB Expenses	-46
Other expenses	-115
Withholding taxes	-741
<b>Total Investment Income</b>	<b>288,829</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>	-0.33	-1.29	-1.45	0.56	0.92	2.39
Benchmark	-0.41	-1.52	-1.73	0.45	0.84	2.36
<i>Excess</i>	<b>0.08</b>	<b>0.22</b>	<b>0.27</b>	<b>0.11</b>	<b>0.08</b>	<b>0.03</b>
<b>BCTL Cash Management (TLCM)</b>	0.50	1.36	1.65	n.a	n.a	1.33
3 Months USD Libor	0.58	1.64	2.02	n.a	n.a	1.84
<i>Excess</i>	<b>-0.08</b>	<b>-0.28</b>	<b>-0.37</b>	<b>n.a</b>	<b>n.a</b>	<b>-0.51</b>
<b>BCTL 3-5 yr US Treasury</b>	-0.16	-0.82	-1.38	0.11	0.96	0.87
BoA Merrill Lynch 3-5 Years US Treasury Passive	-0.16	-0.88	-1.45	0.13	0.95	0.83
<i>Excess</i>	<b>0.00</b>	<b>0.06</b>	<b>0.07</b>	<b>-0.02</b>	<b>0.02</b>	<b>0.04</b>
<b>Bank for International Settlements</b>	-0.55	-2.03	-2.38	0.00	1.48	1.24
BoA Merrill Lynch 5-10 Years US Treasury Enhanced Passive	-0.52	-2.09	-2.50	-0.06	1.49	1.22
<i>Excess</i>	<b>-0.02</b>	<b>0.06</b>	<b>0.12</b>	<b>0.06</b>	<b>-0.01</b>	<b>0.02</b>
<b>Alliance Bernstein</b>	-1.14	-3.41	-1.98	2.07	n.a	-1.51
Barclays Global Treasury DM ex US Enhanced Passive	-1.30	-3.55	-2.18	2.04	n.a	-1.60
<i>Excess</i>	<b>0.16</b>	<b>0.14</b>	<b>0.20</b>	<b>0.03</b>	<b>n.a</b>	<b>0.09</b>
<b>Wellington Management</b>	-1.28	-3.61	-2.25	1.94	n.a	-0.32
Barclays Global Treasury DM ex US Enhanced Passive	-1.30	-3.55	-2.18	2.04	n.a	-0.23
<i>Excess</i>	<b>0.02</b>	<b>-0.06</b>	<b>-0.07</b>	<b>-0.09</b>	<b>n.a</b>	<b>-0.09</b>

## 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>	5.09	5.58	11.52	13.81	9.60	10.43
Benchmark	4.98	5.43	11.24	13.54	9.28	9.87
<i>Excess</i>	<i>0.11</i>	<i>0.14</i>	<i>0.29</i>	<i>0.27</i>	<i>0.31</i>	<i>0.56</i>
<b>Schroders Investment Management</b>	5.63	5.35	11.76	13.69	9.57	10.54
MSCI World Enhanced Passive	4.98	5.43	11.24	13.54	9.28	9.87
<i>Excess</i>	<i>0.65</i>	<i>-0.08</i>	<i>0.52</i>	<i>0.15</i>	<i>0.29</i>	<i>0.67</i>
<b>SSgA International Equity</b>	5.21	5.83	11.67	13.91	9.66	11.60
MSCI World Passive	5.13	5.63	11.41	13.62	9.33	11.24
<i>Excess</i>	<i>0.08</i>	<i>0.19</i>	<i>0.25</i>	<i>0.30</i>	<i>0.33</i>	<i>0.37</i>
<b>BlackRock Investment Management</b>	5.22	5.92	11.78	14.00	9.69	10.80
MSCI World Passive	5.13	5.63	11.41	13.62	9.33	10.46
<i>Excess</i>	<i>0.09</i>	<i>0.28</i>	<i>0.37</i>	<i>0.38</i>	<i>0.36</i>	<i>0.34</i>
<b>BCTL Investment Management</b>	-0.95	-2.17	4.47	n.a	n.a	10.43
MXAU AU Index Passive	-0.94	-2.20	4.44	n.a	n.a	10.41
<i>Excess</i>	<i>-0.01</i>	<i>0.02</i>	<i>0.03</i>	<i>n.a</i>	<i>n.a</i>	<i>0.02</i>

## 5. MANAGEMENT COSTS

A management fee of \$4.15 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	2,270
Central Bank management expenses	1,720
IAB expenses	46
Other Expenses	115
<b>Total Cost</b>	<b>4,151</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 \$140 million was transferred to the State Budget account during the quarter. The transfers are summarized in table 11.



Table 11	In Thousand (\$)
Transfer July 2018	0
Transfer Aug 2018	140,000
Transfer Sep 2018	0
Transfer for this Quarter	<b>140,000</b>
Total Transfers previous quarters	70,000
<b>Total transfers this fiscal year to September 2018</b>	<b>210,000</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 2018.

## 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	2018	2017
In thousands of USD	September	September
<b>ASSETS</b>		
Cash and Cash Equivalents	887,047	487,167
Receivables	37,837	62,578
Financial assets held at fair value through profit or loss	16,253,122	16,212,563
<b>TOTAL ASSETS</b>	<b>17,178,006</b>	<b>16,762,308</b>
<b>LIABILITIES</b>		
Payables for securities purchased	-19,462	-72,696
Accounts payable	-2,966	-2,113
<b>TOTAL LIABILITIES</b>	<b>-22,428</b>	<b>-74,809</b>
<b>NET ASSETS</b>	<b>17,155,577</b>	<b>16,687,499</b>
<b>CAPITAL</b>		
Opening Balance (January)	16,799,313	15,844,327
PF Law Art. 6.1 (a) Revenue receipts	169,294	136,372
PF Law Art. 6.1 (b) DA receipts	156,092	184,032
PF Law Art. 6.1 (e) Other receipts	5,944	6,410
PF Law Art 7.1 Transfers to State Budget	-210,000	-735,000
Income for the period	234,934	1,251,357
<b>CAPITAL</b>	<b>17,155,577</b>	<b>16,687,499</b>

Table 13

STATEMENT OF PROFIT OR LOSS	Quarter		Year to Date	
In thousands of USD	Sep-18	Sep-17	Sep-18	Sep-17
<b>INVESTMENT INCOME</b>				
Interest income	50,745	43,919	146,046	124,955
Dividend income	36,735	38,763	126,600	132,022
Trust income	2,383	2,000	5,111	5,864
Other investment income	0	2	33	8
Net gains/(losses) on Financial Assets at fair value	226,355	202,955	92,998	713,499
Net foreign exchange gains/(losses)	-22,498	87,751	-114,431	293,689
<b>Total Investment Income</b>	<b>293,721</b>	<b>375,390</b>	<b>256,359</b>	<b>1,270,037</b>
<b>EXPENSES</b>				
External management, custody fees	2,270	2,389	7,608	5,465
Internal operational management fees	1,720	1,674	5,074	4,945
IAB Expenses	46	57	143	170
Other expenses	115	-621	467	-244
<b>Total expenses</b>	<b>4,151</b>	<b>3,499</b>	<b>13,292</b>	<b>10,337</b>
Profit before tax	289,570	371,891	243,067	1,259,700
Withholding taxes on investments	741	766	8,133	8,343
Profit/loss for the period	288,829	371,125	234,934	1,251,357
Other comprehensive income	0	0	0	0
<b>Total comprehensive income for the period</b>	<b>288,829</b>	<b>371,125</b>	<b>234,934</b>	<b>1,251,357</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 October 2018



**Venancio Alves Maria**  
Deputy Governor



**Abraão de Vasconcelos**  
Governor