

Petroleum Fund of Timor-Leste

Quarterly Report

30 September 2013

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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 or reviewed 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 to 30 September 2013.

Key statistics for the quarter include:

- The capital of the Fund grew from \$13.6 billion to \$ 14.6 billion.
- Gross cash inflows to the fund from royalties and taxes were \$703.30 million.
- The profit for the quarter was \$410.75 million, representing a return of 2.98% compared with the benchmark return of 3.07%.

The performance of the Fund for the quarter was:

Table 1

Currency \$USD	QTR	FYTD	1 Year	3 Years	5 years	Since Inc
Total Fund	2.98	4.16	4.84	3.50	3.71	4.19
Benchmark	3.07	4.00	4.66	3.41	3.67	4.18
<i>Excess</i>	<i>-0.08</i>	<i>0.16</i>	<i>0.18</i>	<i>0.09</i>	<i>0.05</i>	<i>0.01</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 on 21 February 2013 to incorporate the Minister's decision to increase the equity exposure gradually to 40% by June 2014. Annex 1 was also updated on 29 August 2013 to reflect the introduction of a new allocation for non-US developed market bonds. The benchmarks as of September 2013 were as follows:

Table 2

	30-Jun-13	31-Jul-13	31-Aug-13	30-Sep-13
BOA Merrill Lynch 1-3 Years Treasury Bond Index	10.00%	9.17%	8.33%	7.50%
BOA Merrill Lynch 3-5 Years Treasury Bond Index	40.00%	40.00%	40.00%	40.00%
BOA Merrill Lynch 5-10 Years Treasury Notes and Bond Index	20.00%	20.00%	10.00%	10.00%
Barclays Global Treasury Developed Market ex US, 30% Eurozone and 10% Country Capped	-	-	10.00%	10.00%
Total Fixed Income	70.00%	69.17%	68.33%	67.50%
MSCI World Index Dividends Reinvested	30.00%	30.83%	31.67%	32.50%
Total Equities	30.00%	30.83%	31.67%	32.50%
Total	100.00%	100.00%	100.00%	100.00%

2. MARKET MOVES OVER THE QUARTER

Equities

Equities made strong returns over the September quarter. Our benchmark index for developed market equities, the MSCI World, reported a total return of 8.2 per cent over the 3 month period.

Stronger than expected macroeconomic data contributed to the broad-based gains in developed market equities. The Eurozone emerged from recession, posting second quarter growth of 0.3% and leading indicators suggested stronger growth in future. US economic data was positive on balance, although Payrolls data for August disappointed.

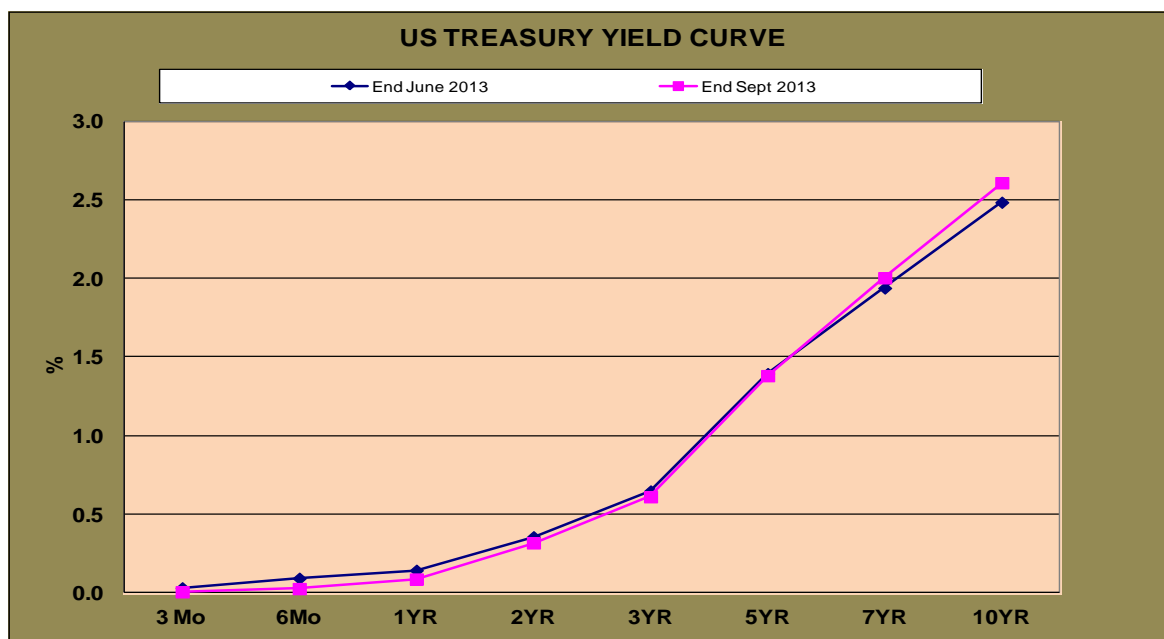
The gains in equities were made in June and September. Equities fell in August, weighed down by the possibility of Western military action in Syria and the likelihood that the Federal Reserve would begin to taper its quantitative easing in September. The FOMC's decision on September 18 to maintain its level of bond purchases surprised the market, adding further support to equities.

Bonds including US Treasuries

US Treasury bond yields continued to edge higher in July and August, after last quarter's sharp rise. Yields rose on the generally positive economic data and the expectation that the Federal Reserve would commence tapering in September. The 10 year Treasury yield peaked at close to 3% in early September, prior to the weaker than expected Payrolls release. Yields fell further following the FOMC's decision to wait for more evidence of strength in the broader economy before it commences tapering.

The graph below shows the US Government yield curve out to 10 years compared to the previous quarter-end. There was no change to the US Federal Funds target rate, which remained at 0-0.25%. Short term yields were slightly lower by the end of the quarter, while the 10 year yield increased 12 basis points to 2.61%.

Figure 1



The major global government bond markets generally followed the same direction as US Treasuries, with yields rising in August and falling in September. Japan was an exception where yields fell steadily over the quarter with continued quantitative easing by the Bank of Japan and positive macroeconomic data.

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 1-3 Years US Treasury Bond Index	Passive	BCTL	n/a	Nil	19-Jan-12
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	Passive	Interim Manager	0.10%	Nil	26-Aug-13
MSCI World Index Net Dividends Reinvested	Passive	State Street Global Advisors	0.35%	Nil	18-Jan-12
		Black Rock	0.35%	Nil	21-Feb-13
	Enhanced Passive	Schroder Investment Management	1.00%	1.00%	7-Oct-10

Cash received by the Fund is invested or assigned to external managers in a timely manner, with the Central Bank being accountable for the returns on overnight investments.

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
BOA Merrill Lynch 1-3 Years Treasury Bond Index	BCTL	7.50%	± 1.5%	7.45%
BOA Merrill Lynch 3-5 Years Treasury Bond Index	BCTL	40.00%	± 2.5%	40.11%
BOA Merrill Lynch 5-10 Years Treasury Notes and Bond Index	Bank for International Settlements	10.00%	± 1%	10.11%
Barclays Global Treasury Developed Market ex US, 30% Eurozone and 10% Country Capped	Interim Manager	10.00%	± 1%	10.10%
Total Fixed Income		67.50%		67.76%
MSCI World Index Net Dividends Reinvested	State Street Global Advisors	27.50%	± 4.0%	17.81%
	Black Rock			9.14%
	Schroder Investment Management	5.00%	± 1.5%	5.29%
Total Equities		32.50%		32.24%

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, and compare the result with the corresponding benchmark. The benchmark represents the investment strategy established by the Minister and is used to set a goal against which the performance of the actual investments is measured. The Minister's benchmarks for the Petroleum Fund mandates 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 increased from \$13.6 billion to \$14.6 billion as follows:

Table 5

Capital Account, Quarter Jul-Sept 2013	\$'000
Opening book value (1 Jul 2013)	13,624,013
Receipts during the period	703,300
Transfer to General State Budget during the period	(180,000)
Gross return in the period	410,753
Closing book value (30 Sept 2013)	14,558,066

The Fund was invested as follows:

Table 6

Assets	\$'000
Cash and Cash Equivalents	60,467
Other Receivables	16,102
Financial assets held at fair value through profit or loss	14,509,632
Less:	
Payable for Securities Purchased	(26,890)
Accounts Payable	(1,245)
Total	14,558,066

The Income for the quarter was as follows:

Table 7

Income	\$'000
Interest income	33,966
Dividend income	26,645
Unit Trust distributions	778
Other Investment income	(10)
Profit /loss	262,631
Net foreign exchange gains/(losses)	89,263
Less:	
External manager, custody fees	(1,489)
Central Bank management expenses	(438)
IAB Expenses	(46)
Other expenses	(76)
Withholding taxes	(471)
Total Investment Income	410,753

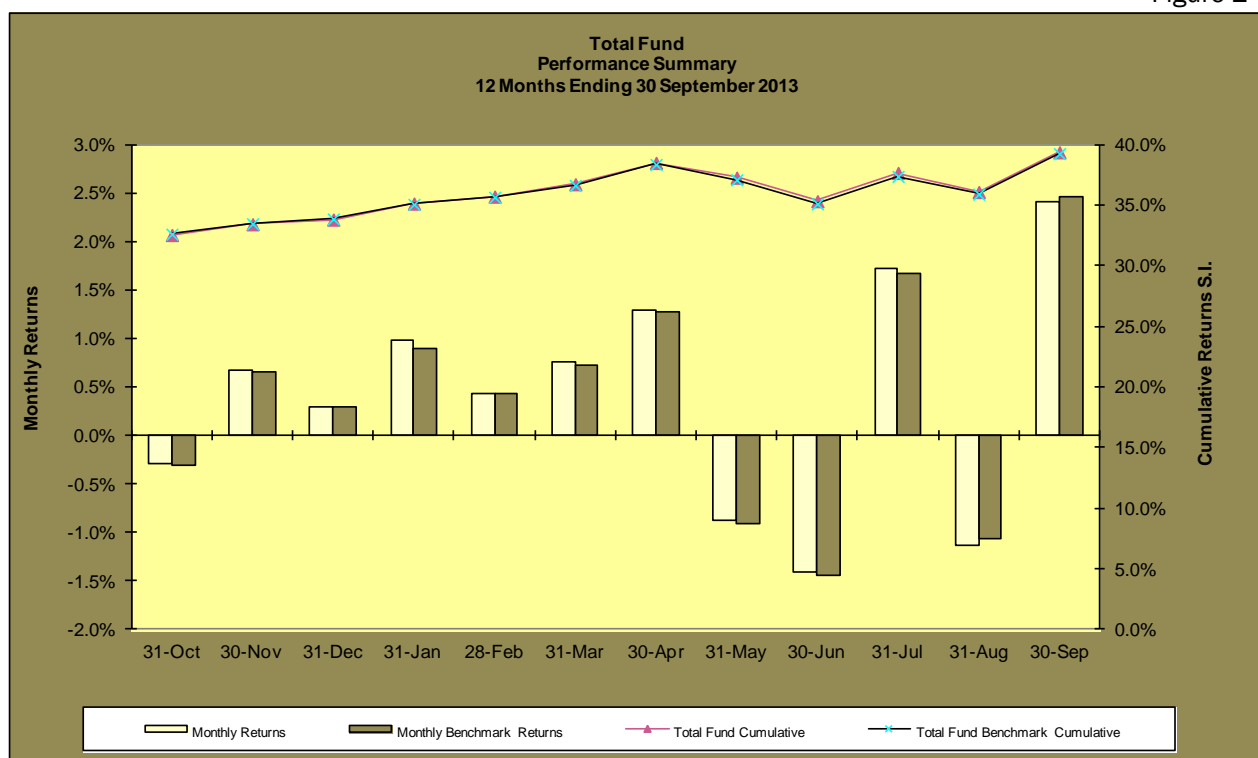
The Fund performance for the quarter, including the performance of the relative asset classes, was as follows

Table 8

Currency \$USD						
	QTR	FYTD	1 Year	3 Years	5 years	Since Inc
Total Fund	2.98	4.16	4.84	3.50	3.71	4.19
Benchmark	3.07	4.00	4.66	3.41	3.67	4.18
<i>Excess</i>	<i>-0.08</i>	<i>0.16</i>	<i>0.18</i>	<i>0.09</i>	<i>0.05</i>	<i>0.01</i>
International Fixed Interest	0.71	-0.93	-0.89	1.13	2.28	3.30
Benchmark	0.86	-0.80	-0.79	1.13	2.30	3.32
<i>Excess</i>	<i>-0.15</i>	<i>-0.13</i>	<i>-0.10</i>	<i>-0.01</i>	<i>-0.01</i>	<i>-0.02</i>
International Equities	8.26	17.57	20.59	n.a	n.a	11.84
Benchmark	8.18	17.29	20.21	n.a	n.a	10.86
<i>Excess</i>	<i>0.08</i>	<i>0.28</i>	<i>0.38</i>	<i>n.a</i>	<i>n.a</i>	<i>0.98</i>

The cumulative performance of the Petroleum Fund compared with the performance of the Global Benchmark over the same period is shown in the following graph.

Figure 2



FIXED INTEREST

The performance of the investments in Fixed Interest investments 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 Fixed Interest	0.71	-0.93	-0.89	1.13	2.28	3.30
Benchmark	0.86	-0.80	-0.79	1.13	2.30	3.32
<i>Excess</i>	<i>-0.15</i>	<i>-0.13</i>	<i>-0.10</i>	<i>-0.01</i>	<i>-0.01</i>	<i>-0.02</i>
BCTL 1-3 yr US Treasury	0.28	0.31	0.39	n.a	n.a	0.46
Benchmark	0.29	0.30	0.37	n.a	n.a	0.39
<i>Excess</i>	<i>-0.02</i>	<i>0.02</i>	<i>0.02</i>	<i>n.a</i>	<i>n.a</i>	<i>0.07</i>
BCTL 3-5 yrs US Treasury	0.71	-0.56	-0.54	n.a	n.a	0.61
Benchmark	0.68	-0.57	-0.56	n.a	n.a	0.52
<i>Excess</i>	<i>0.03</i>	<i>0.01</i>	<i>0.01</i>	<i>n.a</i>	<i>n.a</i>	<i>0.09</i>
Bank for International Settlements	0.41	-2.97	-3.04	n.a	n.a	0.57
Benchmark	0.35	-2.99	-3.05	n.a	n.a	0.48
<i>Excess</i>	<i>0.07</i>	<i>0.02</i>	<i>0.01</i>	<i>n.a</i>	<i>n.a</i>	<i>0.09</i>
Barclays Customised Non US Sovereign Bonds*	n.a	n.a	n.a	n.a	n.a	2.75
Benchmark	n.a	n.a	n.a	n.a	n.a	2.85
<i>Excess</i>	<i>n.a</i>	<i>n.a</i>	<i>n.a</i>	<i>n.a</i>	<i>n.a</i>	<i>-0.10</i>

* The Performance started from 26th August 2013.

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 10

Currency \$USD						
	Qtr	FYTD	1 Year	3 Years	5 Years	Since Inc
International Equities	8.26	17.57	20.59	n.a	n.a	11.84
Benchmark	8.18	17.29	20.21	n.a	n.a	10.86
<i>Excess</i>	<i>0.08</i>	<i>0.28</i>	<i>0.38</i>	<i>n.a</i>	<i>n.a</i>	<i>0.98</i>
Schroder Investment Management	8.35	18.25	21.18	n.a	n.a	12.18
Benchmark	8.18	17.29	20.21	n.a	n.a	10.86
<i>Excess</i>	<i>0.17</i>	<i>0.96</i>	<i>0.97</i>	<i>n.a</i>	<i>n.a</i>	<i>1.32</i>
SSgA International Equity	8.23	17.45	20.49	n.a	n.a	17.35
Benchmark	8.18	17.29	20.21	n.a	n.a	16.88
<i>Excess</i>	<i>0.06</i>	<i>0.15</i>	<i>0.28</i>	<i>n.a</i>	<i>n.a</i>	<i>0.47</i>
Black Rock Investment Management	8.24	n.a	n.a	n.a	n.a	12.64
Benchmark	8.18	n.a	n.a	n.a	n.a	12.53
<i>Excess</i>	<i>0.06</i>	<i>n.a</i>	<i>n.a</i>	<i>n.a</i>	<i>n.a</i>	<i>0.11</i>

5. MANAGEMENT COSTS

Payment of management fee of \$2,049,137 for operational management and accrued fee was deducted from the fund during the quarter to cover the direct external expenses and internal operational expenses.

The fee covered the following services (\$ no rounding):

Table 11

External Management and Custody expenses	1,489,139
Central Bank management expenses	438,324
IAB expenses	45,868
Other Expenses	75,806
Total Cost	2,049,137

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. The amount of \$180,000,000 was transferred to the State Budget account during the quarter.

Table 12	In Million (\$)
Transfers July 2013	(180)
Transfers August 2013	0
Transfers September 2013	0
Transfers for this Quarter	(180)
Total Transfers previous quarters	0
Total Transfers this fiscal year to September 2013	(180)

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, supported by a certificate from the global custodian, 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 performed audit up to quarter September 2013.

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

STATEMENT OF FINANCIAL POSITION	Sep-13	Jun-13	Sep-12
	\$'000	\$'000	\$'000
NET ASSETS			
Cash and Cash Equivalents	60,467	36,797	22,479
Other receivables	16,102	18,739	63,101
Financial assets held at fair value through profit or loss	14,509,632	13,583,907	10,974,037
TOTAL ASSETS	14,586,201	13,639,443	11,059,617
LIABILITIES			
Payables for securities purchased	(26,890)	(13,664)	(4,878)
Accounts payable	(1,245)	(1,766)	(325)
TOTAL LIABILITIES	(28,135)	(15,430)	(5,204)
NET ASSETS	14,558,066	13,624,013	11,054,413
Opening Balance	11,775,349	11,775,349	9,310,321
PF Law Art. 6.1 (a) Revenue Receipts	932,565	663,255	957,919
PF Law Art. 6.1 (b) DA Receipts	1,496,288	1,062,298	1,357,876
PF Law Art. 6.1 (e) Other Receipts	8,287	8,287	8,877
PF Law Art. 7.1 Transfer to General State Budget	(180,000)	-	(908,000)
Income for the period	525,578	114,825	327,419
CAPITAL	14,558,066	13,624,013	11,054,413

Table 13

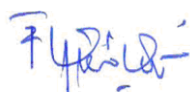
STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME	Quarter		Year to Date (YTD)	
	Sep-13	Sep-12	Sep-13	Sep-12
	\$'000	\$'000	\$'000	\$'000
INVESTMENT INCOME				
Interest income	33,966	37,806	105,043	130,640
Dividend income	26,645	15,051	82,814	38,655
Trust income	778	444	2,529	1,128
Other investment income	(10)	22	128	(72)
Net gains/(losses) on FAL at fair value through profit or loss	262,631	137,523	348,203*	150,149
Net foreign exchange gains/(losses)	89,263	23,676	(2,614)*	10,360
TOTAL INVESTMENT INCOME	413,273	214,523	536,103	330,860
EXPENSES				
External management and custody fees	(1,489)	(857)	(4,670)	(2,116)
Internal operational management fees	(438)	(459)	(1,314)	(1,277)
IAB Expenses	(46)	-	(99)	(48)
Other expenses	(76)	-	(77)	-
TOTAL EXPENSES	(2,049)	(1,315)	(6,160)	(3,441)
Profit before tax	411,224	213,207	529,943	327,419
Withholding taxes	(471)	-	(4,365)	-
Profit for the quarter:	410,753	213,207	525,578	327,419
Other comprehensive income	-	-	-	-
TOTAL COMPREHENSIVE INCOME FOR THE PERIOD	410,753	213,207	525,578	327,419

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.

* Revised from previous quarters

Dili, 23 October 2013



Abraão de Vasconcelos
Governor



Nur-Aini Alkatiri
Deputy Governor