

Petroleum Fund of Timor-Leste

Quarterly Report

31 DECEMBER 2014

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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 October to 31 December 2014.

Key statistics for the quarter include:

- The capital of the Fund at previous quarter was \$16.6 billion while the current quarter was \$ 16.5 billion.
- Gross cash inflows to the fund from royalties and taxes were \$209.67 million.
- The outflows in the quarter were \$396.22 million where \$392 million to the state budget and \$4.22 million for management expenses.
- The profit/loss for the quarter was 136.48 million, representing a gross of fees return of 0.83% compared with the benchmark return of 0.87%.

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	0.83	3.30	3.30	4.58	4.07	4.24
Benchmark	0.87	3.36	3.36	4.45	3.98	4.22
<i>Excess</i>	<i>-0.04</i>	<i>-0.06</i>	<i>-0.06</i>	<i>0.13</i>	<i>0.09</i>	<i>0.02</i>
International Fixed Interest	0.70	2.14	2.14	0.89	1.84	3.04
Benchmark	0.69	2.13	2.13	0.81	1.79	3.03
<i>Excess</i>	<i>0.01</i>	<i>0.01</i>	<i>0.01</i>	<i>0.08</i>	<i>0.05</i>	<i>0.00</i>
International Equities	1.04	5.20	5.20	15.81	n.a	11.54
Benchmark	1.01	4.94	4.94	15.47	n.a	10.76
<i>Excess</i>	<i>0.04</i>	<i>0.27</i>	<i>0.27</i>	<i>0.34</i>	<i>n.a</i>	<i>0.78</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 2014 were as follows:

Table 2

	30-Sep-14	31-Oct-14	30-Nov-14	31-Dec-14
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	10.00%	10.00%	10.00%	10.00%
Barclays Global Treasury Developed Market ex US, 30%	10.00%	10.00%	10.00%	10.00%
Total Fixed Income	60%	60%	60%	60%
MSCI World Index Dividends Reinvested	40.00%	40.00%	40.00%	40%
Total Equities	40%	40%	40%	40%
Total	100%	100%	100%	100%

2. MARKET TRENDS DURING THE QUARTER

Equities

The 4th quarter began as the 3rd quarter ended with stocks sliding and bond markets rallying. The IMF cut its global growth forecasts and interest rates moved lower. Oil traded to new lows, only to move much lower later in the quarter, on a perceived lack of demand which only added to fears that growth is not materializing.

For the quarter, the S&P 500 was up 4.92%, Russell 2000 was up 9.72%, MSCI EAFE was down 3.46%, MSCI Emerging Markets Index was down 4.55% and MSCI World was up 1.16%. For the year end, equities rolled over in December as the weakness in oil prices continued to put global growth into question. December proved to be a soft end to the year for global equity markets with the MSCI World Index declining 1.6% in US Dollar terms.

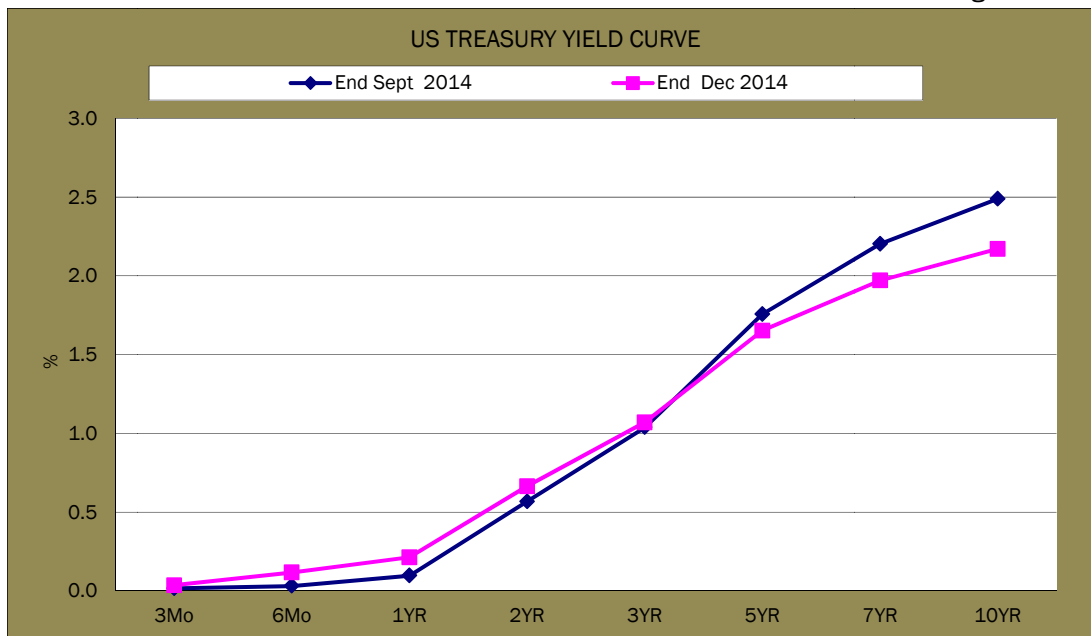
Oil was the talk of the commodity complex as prices fell throughout the quarter. Brent oil was down 40% in the 4th quarter and the weakness was blamed on weak global demand, lack of production cuts by OPEC, and expanded production by Russia as it tries to blunt the impact of Western sanctions.

Bonds including US Treasuries

Government bonds benefitted from safe haven bids as the October equity market rout was on. Yields on US ten year bonds fell through 2% and 10 year German bunds traded with yields as low as 0.75%. As the equity markets began to improve though, those yields started to rise. Bonds held onto their gains in November as economic growth remains elusive. High yield spreads widened as expectations rise of defaults from the oil patch. The continued weakness in the Eurozone and Japan, sovereign debt continued to rally. US Treasuries benefitted from a global search for yield and in mid-December, 10 year US Treasuries traded lowest interest rate of the year at 2.06%. Also interesting to note that at year end, 5 year German Bunds traded at a yield of 0.00% as investors sought out the relative safety of Bunds.

US treasury yield changes during the month were mixed, with two- to five-year note yields rising about 20 basis points, while thirty year bond yields declined 13 basis points. The graph below shows the US Government yield curve compared to the previous quarter-end. There was no change to the US Federal Funds target rate, which remained at 0.25%. The yields of 3-10 years were slightly lower at the end of the quarter relative to the previous quarter, while the 1-2 years yields slightly higher and the 3 years yield remain the same to the previous 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 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	Enhanced Passive	Wellington Management	0.50%	Nil	04-Dec-14
Barclays Global Treasury Developed Market ex US, 30% Eurozone and 10% Country Capped	Enhanced Passive	AllianceBernstein	0.50%	Nil	03-Jul-14
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%	07-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 3-5 Years Treasury Bond Index	BCTL	40%	± 2.5%	39.87%
BOA Merrill Lynch 5-10 Years Treasury Notes and Bond Index	Bank for International Settlements	10%	± 1%	10.41%
Barclays Global Treasury Developed Market ex US, 30% Eurozone and 10% Country Capped	Wellington Management	5%	± 0.5%	4.79%
Barclays Global Treasury Developed Market ex US, 30% Eurozone and 10% Country Capped	AllianceBernstein	5%	± 0.5%	4.87%
Total Fixed Income		60%		60%
MSCI World Index Net Dividends Reinvested	State Street Global Advisors			17.82%
	Black Rock	35%	± 4.0%	16.94%
	Schroder Investment Management	5%	± 1.5%	5.30%
Total Equities		40%		40%

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 \$16.5 billion, as follows:

	\$'000
Opening book value (1 October 2014)	16,584,477
Receipts during the period	209,665
Transfer to General State Budget during the period	-392,000
Return in the period	136,476
Closing book value (31 December 2014)	16,538,617

The Fund was invested as follows:

Assets	\$'000
Cash and Cash Equivalents	66,842
Other Receivables	20,062
Financial assets held at fair value through profit or loss	16,466,484
Less:	
Payable for Securities Purchased	-11,281
Accounts Payable	-3,489
Total	16,538,617

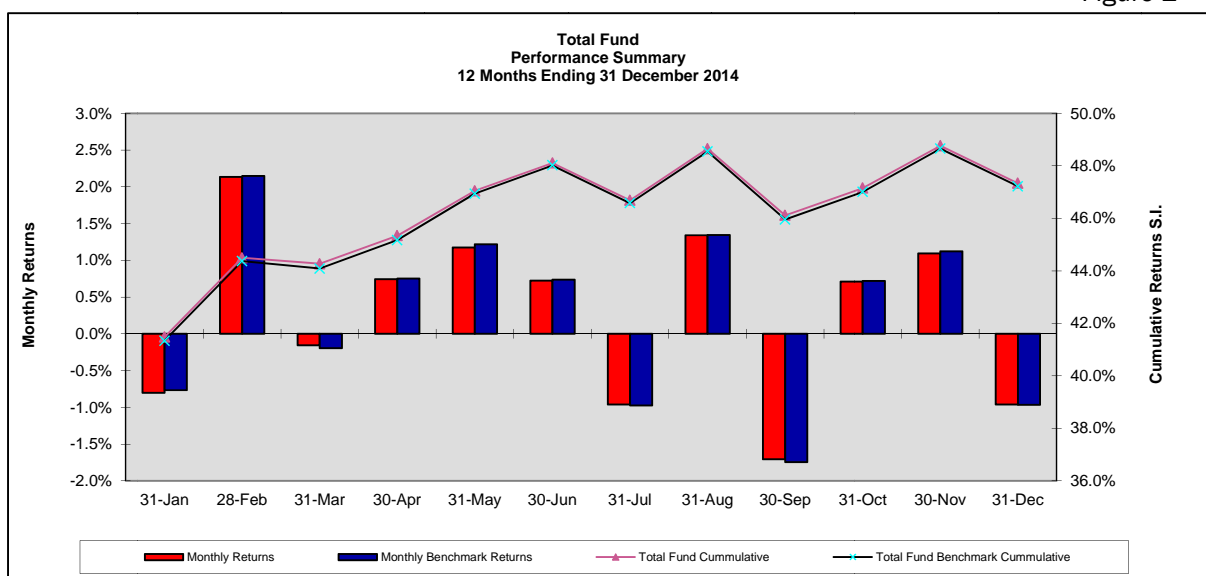
The income for the quarter was as follows:

Table 7

Income	\$'000
Interest income	38,068
Dividend income	34,593
Unit Trust distributions	1,476
Other Investment income	3
Net gains/(losses) on Financial Assets at fair value	267,319
Net foreign exchange gains/(losses)	-199,580
Less:	
External manager, custody fees	-2,259
Central Bank management expenses	-1,684
IAB Expenses	-271
Other expenses	-7
Withholding taxes	-1,182
Total Investment Income	136,476

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 8

%	Qtr	FYTD	1 Year	3 Years	5 Years	Since Inc
International Fixed Interest	0.70	2.14	2.14	0.89	1.84	3.04
Benchmark	0.69	2.13	2.13	0.81	1.79	3.03
<i>Excess</i>	0.01	0.01	0.01	0.08	0.05	0.00
BCTL 3-5 yr US Treasury	0.93	2.20	2.20	n.a	n.a	1.00
BoA Merrill Lynch 3-5 Years US Treasury Passive	0.94	2.14	2.14	n.a	n.a	0.89
<i>Excess</i>	-0.01	0.07	0.07	n.a	n.a	0.10
Bank for International Settlements	2.15	5.94	5.94	1.62	n.a	1.74
BoA Merrill Lynch 5-10 Years US Treasury Enhanced Passive	2.25	6.15	6.15	1.66	n.a	1.75
<i>Excess</i>	-0.10	-0.21	-0.21	-0.04	n.a	-0.01
Wellington Management	n.a	n.a	n.a	n.a	n.a	-0.91
Barclays Global Treasury DM ex US Enhanced Passive	n.a	n.a	n.a	n.a	n.a	-0.87
<i>Excess</i>	n.a	n.a	n.a	n.a	n.a	-0.05
Alliance Bernstein	-1.84	n.a	n.a	n.a	n.a	-6.24
Barclays Global Treasury DM ex US Enhanced Passive	-1.85	n.a	n.a	n.a	n.a	-6.62
<i>Excess</i>	0.01	n.a	n.a	n.a	n.a	0.38

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	1.04	5.20	5.20	15.81	n.a	11.54
Benchmark	1.01	4.94	4.94	15.47	n.a	10.76
<i>Excess</i>	0.04	0.27	0.27	0.34	n.a	0.78
Schroder Investment Management	0.87	5.07	5.07	16.31	n.a	11.83
MSCI World Enhanced Passive	1.01	4.94	4.94	15.47	n.a	10.76
<i>Excess</i>	-0.14	0.14	0.14	0.83	n.a	1.06
SSgA International Equity	1.06	5.21	5.21	n.a	n.a	14.57
MSCI World Passive	1.01	4.94	4.94	n.a	n.a	14.19
<i>Excess</i>	0.05	0.28	0.28	n.a	n.a	0.37
Black Rock Investment Management	1.09	5.22	5.22	n.a	n.a	13.77
MSCI World Passive	1.01	4.94	4.94	n.a	n.a	13.53
<i>Excess</i>	0.08	0.29	0.29	n.a	n.a	0.24

5. MANAGEMENT COSTS

A management fee of \$4,221 thousands for operational management costs was deducted from the fund during the quarter.

The fee covered the following services (in thousands \$):

Table 10

External Management and Custody expenses	2,259
Central Bank management expenses	1,684
IAB expenses	271
Other Expenses	7
Total Cost	4,221

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 \$392 million was transferred to the State Budget account during the quarter .

Table 11	In Million (\$)
Transfers October 2014	100,000
Transfers November 2014	100,000
Transfers December 2014	192,000
Transfers for this Quarter	392,000
Total Transfers previous quarters	340,000
Total Transfers this fiscal year to December 2014	732,000

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 performed audit up to quarter June 2014.

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	2014 December	2013 December
ASSETS		
Cash and Cash Equivalents	66,842	70,185
Receivables	20,062	11,112
Financial assets held at fair value through profit or loss	16,466,484	14,904,679
TOTAL ASSETS	16,553,387	14,985,976
LIABILITIES		
Payables for securities purchased	-11,281	-31,549
Accounts payable	-3,489	-2,328
TOTAL LIABILITIES	-14,770	-33,877
NET ASSETS	16,538,617	14,952,099
CAPITAL		
Opening Balance	14,952,099	11,775,349
PF Law Art. 6.1 (a) Revenue receipts	752,264	1,167,261
PF Law Art. 6.1 (b) DA receipts	1,057,538	1,866,288
PF Law Art. 6.1 (e) Other receipts	7,163	8,287
PF Law Art 7.1 Transfers to State Budget	-732,000	-730,000
Income for the period	501,554	864,915
CAPITAL	16,538,617	14,952,099

Table 13

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME - QUARTER				
In thousands of USD	Quarter		Year to Date	
	December-14	December-13	December-14	December-13
INVESTMENT INCOME				
Interest income	38,068	43,973	142,327	149,016
Dividend income	34,593	23,098	177,467	105,912
Trust income	1,476	1,029	5,800	3,592
Other investment income	3	4	35	132
Net gains/(losses) on Financial Assets at fair value	267,319	295,462	627,314	640,007
Net foreign exchange gains/(losses)	-199,580	-20,689	-425,543	-19,646
Total Investment Income	141,879	342,877	527,400	879,013
EXPENSES				
External management, custody fees	2,259	2,324	10,181	6,993
Internal operational management fees	1,684	548	5,893	1,863
IAB Expenses	271	54	378	153
Other expenses	7	3.28	111	80
Total expenses	4,221	2,930	16,563	9,089
Profit before tax	137,658	339,947	510,837	869,924
Withholding taxes on investments	1,182	610	9,284	5,009
Profit for the quarter:	136,476	339,337	501,554	864,915
Other comprehensive income	-	-	-	-
Total comprehensive income for the period	136,476	339,337	501,554	864,915

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, 22 January 2015

Venancio Alves Maria
Executive Director

Abraão de Vasconcelos
Governor