Timor-Leste Petroleum Fund
2005-2010

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Saturday 6 March 2010
Key Petroleum Fund Principles

- All petroleum revenues flow into the Fund (receipts and return).
- Long term financial saving mechanism to ensure petroleum revenues benefitting current and future generations.
- The savings invested only in the international financial market based on diversification and a long term investment horizon.
- The fund integrated with the state budget and resources spent domestically are subject to decisions made by the Parliament.
- The Fund managed with a high level of transparency.

The PF Law does not prevent the Government from pursuing its political objectives to promote domestic investments and economic growth.
Mechanism for Domestic Spending

- ESI is a benchmark showing what is the long term sustainable withdrawals
- The Government may transfer more than ESI as seen fit, provided that justification and certification reports are provided to Parliament
- The Petroleum Fund, as a saving instrument, has financial objectives only, while economic development objectives should be taken care of by the State Budget

Source: Towers Watson
The investment Policy I

Investment universe according to the Petroleum Fund Law (Art. 14 and 15)

US Government bonds

Bonds guaranteed by World Bank or by a sovereign State
Bonds issued by BIS, ECB or a Central Bank of a sovereign State
Bonds issued by a bank
Up to 10% of the portfolio in equities

Equities and bonds denominated in other currencies than US Dollars
More than 10% in equities

Strategy from the outset

Future strategy

Investment universe outside the Petroleum Fund Law
The Investment Policy II

2005-June 2009: US Government bonds only

June 2009: AUD, JPY, EUR & GBP Government bonds added (4-5%)

Q1/Q2 2010: Global equities (4-5%)

Q2 2010: Exploited current flexibility in the PF Law

Q3 2010: PF Law amendments approved by Parliament

Q4 2010 and beyond: Further diversification of the PF
  - more global equities
  - more non-USD bonds

Continuously diversifying the PF portfolio to other asset classes, currencies and regions is the best way of reducing exposure to USD.
Petroleum Fund Performance

- **Petroleum Fund Balance:**
  - $5.8 billion
  - 10 x non-oil GDP

- **Investment Performance:**

- **Composition of the portfolio:**
  - 96% US Government bonds
  - 4% AUD, JPY, EUR and UK Government bonds
2005-10: No other strategies would have performed better

- Simulations of the PF performance 2005-2010, subject to different investment strategies show:
  - No other investment strategies than the current one have performed better
  - 100% exposure to equities would have resulted in $500m lower PF balance
  - Significant drawdown during the financial crisis for investment strategies with high exposure to equities

Selecting another time period would have given a different outcome
The current strategy is not appropriate for the future

A successful policy in the past is not necessarily the right strategy for the future, because:

- Since 1900 investing 100% Government bonds has given an annual real return of 1.7%
- The adopted investment policy including a small amount of equities (4%) has given an investment return of 2.0%
- Hence, the current investment strategy underperforms the 3% real return target assumed in the PF Law by 1% point
- To achieve 3% real rate of return at least 25% equity exposure is required.

<table>
<thead>
<tr>
<th>Annual Return (%)</th>
<th>100% Govt. bonds</th>
<th>96% bonds + 4% eq.</th>
<th>25% equities</th>
<th>40% equities</th>
<th>60% equities</th>
<th>80% equities</th>
<th>100% equities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Historical real return</td>
<td>1,7</td>
<td>2,0</td>
<td>3,1</td>
<td>3,8</td>
<td>4,7</td>
<td>5,5</td>
<td>6,1</td>
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<td>since 1900</td>
<td></td>
<td></td>
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<tr>
<td>Forward looking real return</td>
<td>1,8</td>
<td>2,1</td>
<td>3,2</td>
<td>4,0</td>
<td>5,1</td>
<td>6,1</td>
<td>7,2</td>
</tr>
</tbody>
</table>

Source: Towers Watson