

Petroleum Fund of Timor-Leste

Quarterly Report

30 June 2021

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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 01 April to 30 June 2021.

Key statistics for the quarter include:

- The capital of the Fund at the end of the Current quarter was \$19.49 billion while the previous quarter was \$18.98 billion.
- Gross cash inflows to the fund from royalties and taxes were \$73.74 million.
- Outflow for the quarter were \$156.45 million, being transfers to the state budget of \$150 million while \$6.45 million was for management costs.
- The profit for the quarter was \$589.76 million, representing a gross of fees return of 3.15%. The return on financial market investments was 3.24% compared with the benchmark return of 3.05%.

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	3.15	3.95	12.53	8.33	7.12	4.94
International Fixed Interest	0.51	-1.36	-1.16	3.50	1.74	2.66
International Equities	7.83	13.79	39.55	14.77	14.76	11.37
Private debt instrument for Petroleum Operations	1.10	2.21	4.50	n.a	n.a	4.50

Table 2

%	QTR	FYTD	1 Year	3 Years	5 years	Since Inc
Total Financial Market Investments	3.24	4.02	12.86	8.48	7.20	4.97
Benchmark	3.05	3.52	11.56	7.99	6.79	4.84
Excess	0.19	0.51	1.30	0.49	0.41	0.13
International Fixed Interest	0.51	-1.36	-1.16	3.50	1.74	2.66
Benchmark	0.57	-1.38	-1.20	3.66	1.74	2.67
Excess	-0.06	0.02	0.04	-0.16	0.00	-0.01
International Equities	7.83	13.79	39.55	14.77	14.76	11.37
Benchmark	7.74	13.05	39.04	14.99	14.83	11.02
Excess	0.08	0.75	0.50	-0.22	-0.07	0.35

1. INVESTMENT MANDATE

A revised Management Agreement between Ministry of Finance and the Central Bank was signed on 25 June 2009. The Annexes of the Management Agreement has subsequently amended to reflect the actual investments. A revised Annex 1 was signed on 25 October 2020 where the Private Debt Instrument is separated from the financial market investments portfolio. The benchmarks as of June 2021 were as follows:

Table 3

	Apr-21	May-21	Jun-21
3 Month US Treasury Bills/Cash	5%	5%	5%
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, Measured on a hedged basis	10%	10%	10%
Total Fixed Income	65%	65%	65%
Total equity (MSCI World Index Net Dividends Reinvested)	35%	35%	35%
Total Financial market Investments	100%	100%	100%

2. MARKET TRENDS DURING THE QUARTER

Global Macroeconomic Trend

Global economic growth continues to gain traction despite the spread of the new variants of COVID-19 during the quarter. However, the growth trends appeared to be uneven between the developed and emerging countries reflecting the vaccines distribution. The high rate of inoculated people in developed countries allowed the authorities to lift the COVID-19 related restrictions and economic activities to gradually resume. On the other hand, in developing countries where the vaccination rate is low, the cases have been increasing thus preventing the authorities from safely resuming economic activities.

The economic data from the U.S pointed to massive improvement coinciding with the pace of vaccines distribution in the country. By the end of June, more than 50% of population in U.S has received at least one dose of vaccines. According to the Bureau of Economic Analysis, the U.S economy grew at 6.4% year on year in the first quarter of 2021. The economy was boosted by the fact that the authorities continue to ease the Covid-19 restrictions and allow the economic activities to gradually return to pre-pandemic level. The labor market however has not improved to the extent expected during the last three months as workers have not returned to the labor market despite the record high in job openings. Analysts have pointed to generous government supports and kids yet to return to schools as among the factors holding back the workers from returning to the labor market. The slack in the labor market has caused constraint in the supply side, which makes it even more complicated to cope with the post pandemic high demand. The combinations of high demand and supply constraints have pushed prices higher. The inflation in the U.S went up 5% year on year in May. Despite the U.S Federal Reserve officials' belief that the rising inflation in the U.S is transitory, there was a notable shift from previous projections of no rate hikes until 2023. In its recent meeting, the Fed discussed rewinding its asset purchases and the projection of interest rate now includes two rate hikes by the end of 2023. The news from the Fed in late June boosted the USD value against major currencies in June but was not enough to make up the decline in previous months, as the currency closed the quarter down -0.85% against currencies of peer developed countries.

The leading economic indicators in the Eurozone strengthened and IHS Markit's composite Purchasing Managers' Index increased to 59.5 in June from 57.10 in May. Composite PMI above 50 points indicates that the economic activities are expected to expand. Therefore, the economy in the region is expected to rebound in the second quarter after it contracted -0.6% in the previous quarter. This corresponds to the massive improvement in vaccination distribution during the quarter compared to the last quarter. The data showed that the proportion of people who have received at least one dose of vaccines in most countries in the region exceeded 50% by the end of June. Consequently, the confinement measures are being gradually lifted. According to the OECD, the prospect of improvement in private consumption, considerable fiscal support and vigorous external demand will boost the economic growth in the region to 4.3% in 2021.

The growth in Asia Pacific and developing countries lagged behind the US and Europe due to slow vaccines pace. Low vaccination rates led to increasing Covid-19 cases in Japan. While that dimmed the near-term economic prospects, the measures were targeted and projected to have a low effect on consumption, which is also constrained by subdued wage and employment growth. Stronger external demand is expected to boost exports and support stronger investment

Global Equity Market Trends

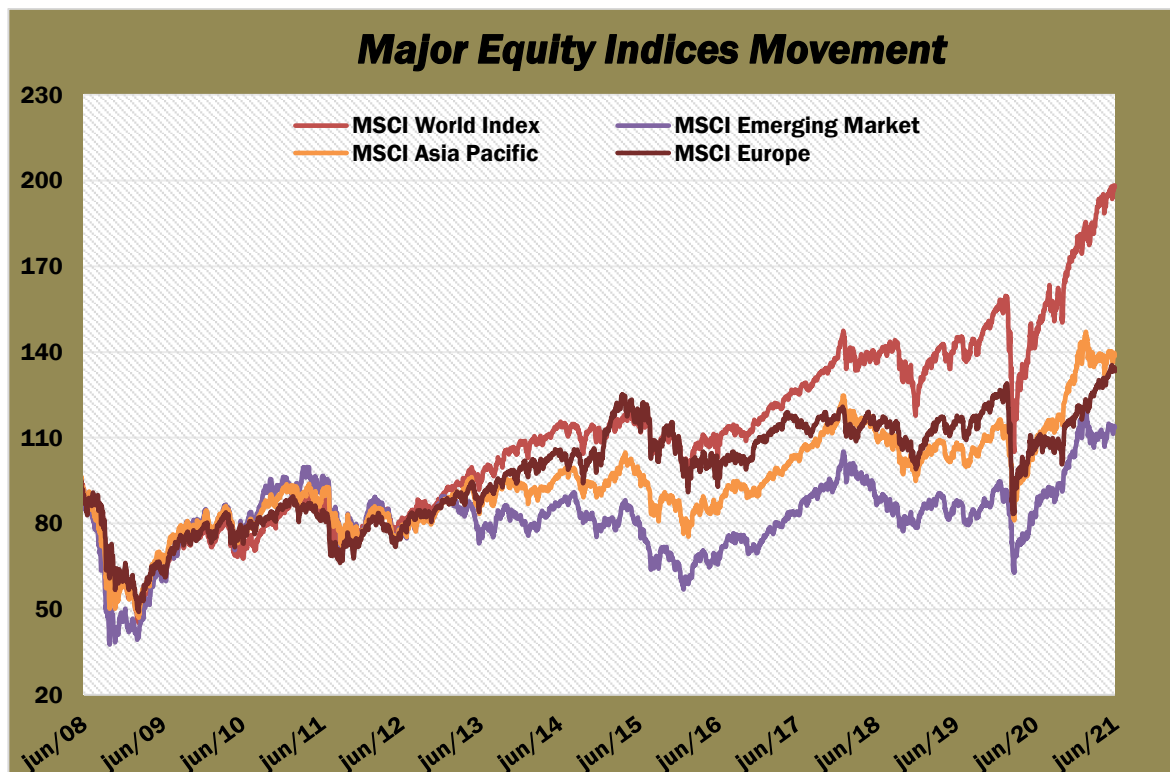
Global equity market continued to perform well during the quarter boosted by the resumption of economic activities in most developed countries. However, the performance among the regions varied as the U.S outperformed other peer developed markets. At the same time, the sector performance shifted during the quarter as growth stocks outperformed the value stocks.

Equity markets in the U.S were supported by the news around the reopening of economic activities despite the spread of Covid-19 new variants. Fiscal and monetary policies are also remaining supportive and there is little evidence that those measures will be lifted anytime soon. In terms of the sectors, the reopening trade has benefited the performance of the financial, energy and real estate sectors. However, the US financial sector has receded toward the end of the quarter due to declining long-term government bond yields, caused by rising inflation expectations and the Fed's signal to rewind the monetary policy supports.

Major equity markets in Europe ended the quarter with gains and the U.K outperformed other markets in the region. The high rate of vaccinated people in the region allows the restrictions to be progressively eased. However, in the U.K, reports have suggested that businesses continued to face hurdles across the border between the U.K and European Union after the separation took effect in early 2021.

Equity market performance in Asia Pacific countries varied during the quarter. Australia and South Korea posted gains while Japan ended the quarter with a negative return.

Graph 01 Major Equity Indices Movement (USD)



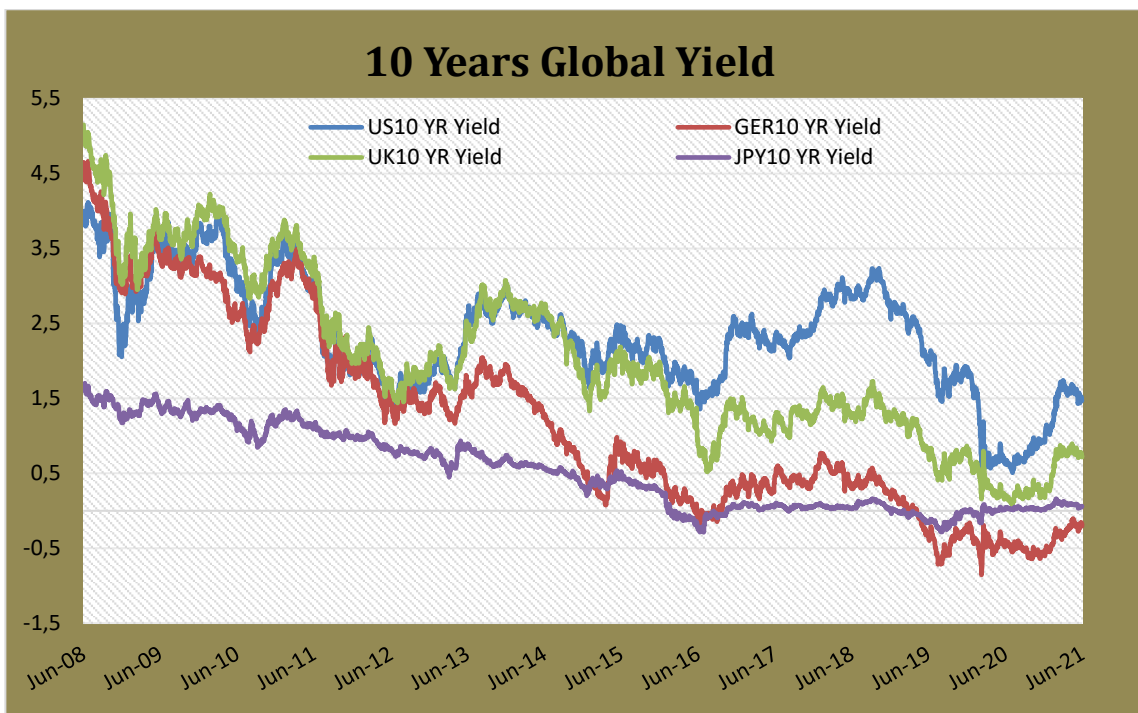
Global Treasury Bonds include U.S Treasuries

The yield of the global Treasuries moved in very different directions during the quarter as the long-term US Treasury yield declined while the yields of other developed markets increased.

After a significant increase in the previous quarter, the yield of U.S Treasury 10-year retracted in the second quarter, declining more than 0.20%. The move reflects the significant rebound in economic activities which triggers inflation to a level not seen in more than a decade. The prospect of raising inflation triggered the Fed to discuss rewinding its monetary policy support. The yield of U.S Treasury Notes, which are sensitive to the monetary policy, increased during the quarter.

Improvement of vaccination pace and the growing optimism in the region have pushed the rate of the 10-year treasury securities higher across Euro area countries during the quarter. While, the yield of the U.K's 10-year Gilt declined during the same period.

Graph 02. 10 Years Global Yield



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 4

Mandate	Management Style	Authorised Managers	Tracking Error	Outperformance Target	Commencement date
3 Month USD Treasury Bills/Cash	Passive	BCTL	n/a	Nil	14-Aug-18
BOA Merrill Lynch 3-5 Years US Treasury Bond Index	Passive	BCTL	0.25%	Nil	19-Jan-12
BOA Merrill Lynch 5-10 Years US Treasury Bond Index	Passive	BCTL	0.50%	Nil	29-May-20
Barclays Global Treasury Developed Market ex US, 30% Eurozone and 10% Country Capped Measured on a hedged basis	Enhanced Passive	Bank for International Settlements	0.50%	0.15%	30-Apr-20
MSCI World Index ex Australia Net Dividends Reinvested	Equity Factor	Schroders Equity Factor	3.00%	Nil	2-Aug-19
	Equity Factor	SSgA Equity Factor	3.00%	Nil	2-Aug-19
MSCI World Index ex Australia Net Dividends Reinvested	Passive	SSgA International Equity	0.35%	Nil	18-Jan-12
	Passive	BlackRock International Equity	0.35%	Nil	21-Feb-13
MSCI Australia	Passive	BCTL	0.50%	Nil	4-Jul-16
Private debt instrument for Petroleum Operations	Passive	BCTL	n/a	Nil	10-Apr-19

Operational Implementation

The actual allocation of the capital of the Fund to the various mandates as at the end of the quarter was as follows:

Table 5

Mandate	Managers	Target Benchmark	Tolerance	Actual	Lower Boundary	Upper Boundary
3 Month US Treasury Bills/Cash	BCTL	5.00%	± 2.5%	5.53%	2.50%	7.50%
BOA Merrill Lynch 3-5 Years Treasury Bond Index	BCTL	40.00%		37.05%		
BOA Merrill Lynch 5-10 Years Treasury Notes and Bond Index	BCTL	10.00%		9.08%		
Barclays Global Treasury Developed Market ex US, 30% Eurozone and 10% Country Capped measured on a hedged basis	Bank for International Settlements	10.00%		9.43%		
Total Fixed Income		65.00%		61.09%		
MSCI Index ex Australia Net Dividends Reinvested (Equity Factor)	Schroders Investment Management	8.75%		9.92%		
	SSgA Equity Factor					
MSCI Index ex Australia Net Dividends Reinvested (Passive)	SSgA International Equity	25.38%		27.61%		
	BlacRock					
MSCI Australia Index	BCTL	0.88%		1.39%		
Total Equities		35.00%	± 5%	38.91%	30.00%	40.00%
Total Financial Market Investments		100.00%		100.00%		
Total Private debt instrument for Petroleum Operations	BCTL			3.67%		

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 recognize 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 \$19.49 billion as follows:

Table 6

Capital Account	\$'000
Opening book value (01 April 2021)	18,978,757
Receipts during the period	73,743
Transfer to General State Budget	-150,000
Investment Return	589,758
Closing book value (30 June 2021)	19,492,257

The Fund was invested as follows:

Table 7

Assets	\$'000
Cash and Cash Equivalents	1,244,991
Other Receivables	44,774
Financial assets held at fair value through profit or loss	17,493,697
Financial assets held at amortised cost	716,060
Less:	
Payable for Securities Purchased	-4,772
Accounts Payable	-2,492
Total	19,492,257

The income for the quarter was as follows:

Table 8

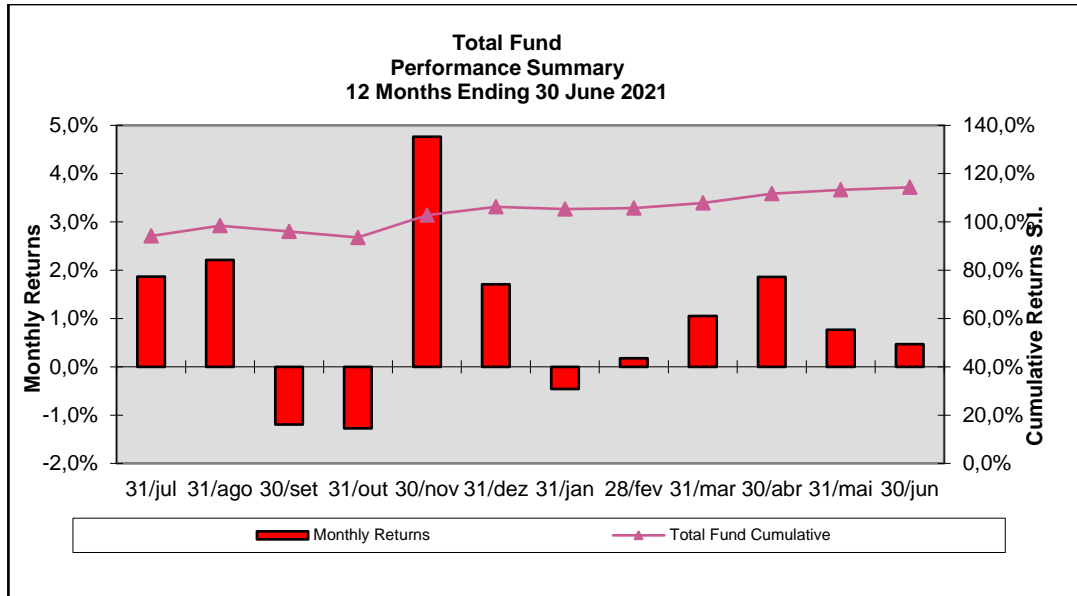
Income	\$'000
Interest income	36,455
Dividend income	39,257
Unit Trust distributions	1,398
Other Investment income	1
Net gains/(losses) on Financial Assets at fair value	523,886
Net foreign exchange gains/(losses)	-878
Less:	
External manager, custody fees	-3,684
Central Bank management expenses	-2,550
IAB Expenses	-33
Other expenses	-184
Withholding taxes	-3,909
Total Investment Income	589,758

The following notes are intended to assist in interpreting this information:

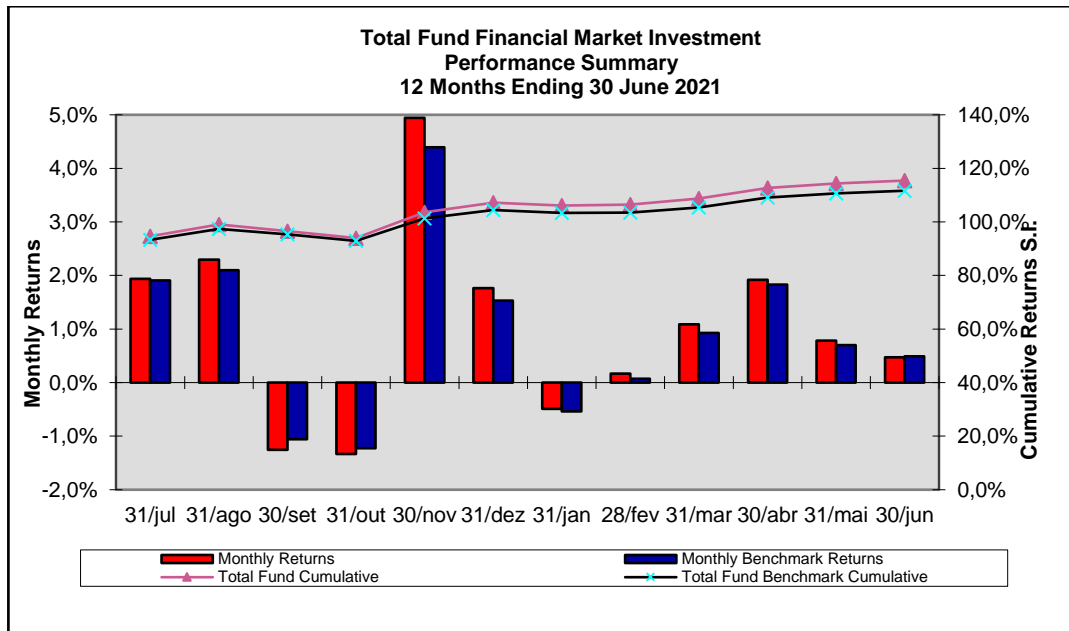
- Unit trust distribution is the income received from listed property investment entities.
- Other expenses relate to derivative trading costs which are deducted directly from the Fund.

The global Fund Performance of absolute and benchmark over the same period are shown in the following graph.

Graph 03 Total Fund Performance



Graph 04 Total Financial market Investments Performance



International 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 9

%	Qtr	FYTD	1 Year	3 Years	5 Years	Since Inc
International Fixed Interest	0.51	-1.36	-1.16	3.50	1.74	2.66
Benchmark	0.57	-1.38	-1.20	3.66	1.74	2.67
<i>Excess</i>	<i>-0.06</i>	<i>0.02</i>	<i>0.04</i>	<i>-0.16</i>	<i>0.00</i>	<i>-0.01</i>
BCTL Cash Management (TLCM)	0.00	0.00	0.00	1.18	n.a	1.20
Three Month US Treasury bills	0.00	0.02	0.09	1.40	n.a	1.49
<i>Excess</i>	<i>0.00</i>	<i>-0.02</i>	<i>-0.09</i>	<i>-0.23</i>	<i>n.a</i>	<i>-0.28</i>
BCTL 3-5 yr US Treasury Bond	0.29	-0.94	-0.83	4.05	2.03	1.91
BoA Merrill Lynch 3-5 Years US Treasury Passive	0.34	-0.94	-0.82	4.15	2.05	1.91
<i>Excess</i>	<i>-0.05</i>	<i>0.00</i>	<i>-0.02</i>	<i>-0.10</i>	<i>-0.01</i>	<i>0.00</i>
BCTL ML 5-10 Years US Treasury Notes & Bonds	1.82	-2.70	-3.20	n.a	n.a	-3.02
BoA Merrill Lynch 5-10 Years US Treasury Passive	1.95	-2.62	-3.07	n.a	n.a	-2.73
<i>Excess</i>	<i>-0.13</i>	<i>-0.08</i>	<i>-0.13</i>	<i>n.a</i>	<i>n.a</i>	<i>-0.29</i>
BIS FI - Global Treasury Developed Market - Hedged	0.44	-2.58	-1.47	n.a	n.a	-1.00
Benchmark6	0.39	-2.62	-1.60	n.a	n.a	-1.14
<i>Excess</i>	<i>0.05</i>	<i>0.04</i>	<i>0.14</i>	<i>n.a</i>	<i>n.a</i>	<i>0.14</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 10

	Qtr	FYTD	1 Year	3 Years	5 Years	Since Inc
International Equities	7.83	13.79	39.55	14.77	14.76	11.37
Benchmark	7.74	13.05	39.04	14.99	14.83	11.02
<i>Excess</i>	<i>0.08</i>	<i>0.75</i>	<i>0.50</i>	<i>-0.22</i>	<i>-0.07</i>	<i>0.35</i>
Schroders Investment Management*	8.56	17.40	41.50	n.a	n.a	20.57
MSCI World Index ex Net Australia dividends Reinvested	7.76	13.10	39.03	n.a	n.a	20.82
<i>Excess</i>	<i>0.80</i>	<i>4.30</i>	<i>2.47</i>	<i>n.a</i>	<i>n.a</i>	<i>-0.25</i>
SSgA Equity Factor**	7.52	14.47	38.46	n.a	n.a	17.55
MSCI World Index ex Net Australia dividends Reinvested	7.76	13.10	39.03	n.a	n.a	20.82
<i>Excess</i>	<i>-0.24</i>	<i>1.37</i>	<i>-0.57</i>	<i>n.a</i>	<i>n.a</i>	<i>-3.27</i>
SSgA International Equity	7.78	13.18	39.34	15.12	15.04	12.42
MSCI World index ex Australia Passive	7.76	13.10	39.03	15.12	14.92	12.17
<i>Excess</i>	<i>0.02</i>	<i>0.08</i>	<i>0.31</i>	<i>0.00</i>	<i>0.12</i>	<i>0.26</i>
BlackRock Investment Management	7.82	13.23	39.46	15.25	15.16	12.03
MSCI World index ex Australia Passive	7.76	13.10	39.03	15.12	14.92	11.76
<i>Excess</i>	<i>0.05</i>	<i>0.13</i>	<i>0.43</i>	<i>0.14</i>	<i>0.24</i>	<i>0.27</i>
BCTL Australia Equity	6.77	10.58	39.60	9.17	n.a	10.43
MXAU AU Index Passive	6.87	10.51	39.64	9.60	n.a	10.68
<i>Excess</i>	<i>-0.09</i>	<i>0.07</i>	<i>-0.03</i>	<i>-0.43</i>	<i>n.a</i>	<i>-0.25</i>

Private Debt Instrument for Petroleum Operations

The performance of the investment in Private debt instrument for Petroleum Operations for the quarter was as follows:

Table 11

	Qtr	FYTD	1 Year	3 Years	5 Years	Since Inc
Private debt instrument for Petroleum Operations	1.10	1.10	4.50	n.a	n.a	4.50
<i>Benchmark</i>	1.10	1.10	4.50	n.a	n.a	4.50
<i>Excess</i>	0.00	0.00	0.00	n.a	n.a	0.00

5. MANAGEMENT COSTS

A management fee of \$6.45 million for operational management costs was charged to the fund during the quarter. The fee covered the following services (in thousands \$):

Table 12

External Management and Custody expenses	3,684
Central Bank management expenses	2,550
IAB expenses	33
Other Expenses	184
Total Cost	6,451

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 \$150 million was transferred to the State Budget account during the quarter.

Table 13

In Thousand (\$)

Transfer April 2021	-150,000
Transfer May 2021	0
Transfer June 2021	0
Transfer for this Quarter	-150,000
Total transfers this fiscal year to June 2021	-350,000

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

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 2020.

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 14

BALANCE SHEET	June-21	June-20
In thousands of USD		
ASSETS		
Cash and Cash Equivalents	1,244,991	1,298,046
Receivables	44,774	28,917
Financial assets held at fair value through profit or loss	17,493,697	16,088,066
Financial assets held at Amortized Cost	716,060	686,400
TOTAL ASSETS	19,499,522	18,101,429
LIABILITIES		
Payables for securities purchased	-4,772	-23,850
Accounts payable	-2,492	-3,204
TOTAL LIABILITIES	-7,264	-27,054
NET ASSETS	19,492,257	18,074,376
CAPITAL		
Opening Balance (January)	18,990,614	17,691,816
PF Law Art. 6.1 (a) Revenue receipts	73,718	86,620
PF Law Art. 6.1 (b) DA receipts	53,287	152,613
PF Law Art. 6.1 (e) Other receipts	915	7,610
PF Law Art 7.1 Transfers to State Budget	-350,000	-250,000
Income for the period	723,724	385,716
CAPITAL	19,492,257	18,074,376

Table 15

STATEMENT OF PROFIT OR LOSS In thousands of USD	QUARTER		YEAR TO DATE	
	Jun-21	Jun-20	Jun-21	Jun-20
INVESTMENT INCOME				
Interest income	36,455	52,660	76,918	114,406
Dividend income	39,257	39,830	73,902	78,768
Trust income	1,398	1,536	2,380	3,029
Other investment income	1	481	23	481
Net gains/(losses) on Financial Assets at fair value	523,886	1,144,488	599,191	216,801
Net foreign exchange gains/(losses)	-878	810	-1,543	-12,412
Total Investment Income	600,119	1,239,805	750,872	401,073
EXPENSES				
External management, fees	3,684	3,696	4,297	4,560
Internal operational management fees	2,550	1,740	3,776	3,498
IAB Expenses	33	13	69	26
Other expenses	184	396	337	1,258
Total expenses	6,451	5,845	8,479	9,342
Profit before tax	593,668	1,233,960	742,393	391,731
Withholding taxes on investments	3,909	4,251	18,670	6,015
Profit/loss for the period	589,758	1,229,709	723,724	385,716
Other comprehensive income	0	0	0	0
Total comprehensive income for the period	589,758	1,229,709	723,724	385,716

Note: 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, 15 July 2021



Venancio Alves Maria
Deputy Governor



Abraão de Vasconcelos
Governor