

## CHALLENGES OF DIVERSIFYING THE INVESTMENT UNIVERSE



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- Current investment strategy
- Diversification
- A review of the current operational settings
- ☐ The challenges...
- Some final words...

#### The PFL provides specific investment strategy:

- Not less than 90% invest in USD cash and fixed interest, rated AA- or higher and average duration less than 6 years.
- Not more than 10% invest in other assets, provided that:
  - It is issued abroad;
  - Liquid and transparent.
  - o Traded in well-regulated financial markets

## Current allocation

#### Where are the Fund invested today?

US Government 0-5 years	90.4%
US Government 5-10 years	2.0%
Governments/Supranational USD AAA	2.6%
Governments/Supranational USD AA	1.4%
Australian Government	1.4%
Euro Governments	1.4%
United Kingdom Gilts	0.4%
Japan Government	0.4%

# Diversification





### Objectives when setting the strategic benchmark

- Reduce concentration risk to an asset class, a country or region, or another risk factor like duration, credit, etc.
- $\Box$  The need to sustain the real rate of return of 3%.
- ☐ To get the best expected long term return for a given level of risk.
- To ensure that there is necessary liquidity in the portfolio for withdrawals.

# Diwersification

## Minister of Finance decides what assets to invest in



#### Existing system in place



Exist system to select external manager



System in place for trade execution and settlement



Custody appointed



Fund accounting



Global performance reporting

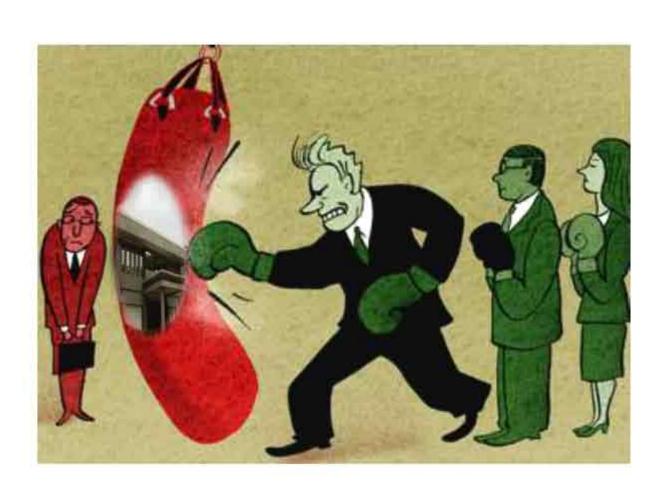


Global compliance monitoring

### The BPA has already been tested as the operational manager of the Petroleum Fund!

- BPA has successfully managed more than 90% of the portfolio since 2005 as a passive portfolio (0-5year treasury bonds).
- ☐ The BPA was able to manage the portfolio during the 2006 crisis.
- ☐ The BPA has successfully been trough a process of hiring BIS and has just completed the process for commercial equity and fixed interest managers.
  - This includes; designing RFP's, assessing and ranking all candidates, designing and negotiating the investment management contracts, setting up performance attribution systems, accounting and custodian operations.
- Towers Watson has reviewed the operational process in BPA for managing the passive portfolio (December 2009).
  - "... we were very impressed by the investment operations of the BPA and the management of the existing nominal US Government bond portfolio. The overall process appears to be of a high quality and the historically close to benchmark performance of the nominal portfolio reflects this".

## The operational manager need to be protected by law, good systems, skilled staff and a high degree of independence



# The challenges...

## The operational challenges for BPA In the next years

- The operational complexity will depend on the investment philosophy set by the Minister of Finance and the implementation of this in the form of a strategic benchmark
- □ Continuation scenario (a very simplistic investment philosophy);
  - The asset classes is restricted to just sovereign bonds and global developed marked stocks (as today) but more stocks in the portfolio and more passive enhanced external managers.
  - The BPA has already proved that it can manage this situation
- ☐ A semi-complex scenario (a more ambitious investment strategy)
  - Sovereign bonds, mortgages bonds, investment graded credit bonds, TIPS, Real estate and all equities included emerging markets
- A highly complex scenario (a highly complex investment strategy)
  - Bonds and stocks of all sorts. Private equity, infrastructure, commodities, real estate, hedge funds, equity style exposures, highly use of derivatives to gain exposures. Highly use of external managers

### The strategic investment ambitions and the operational capability should be in alignment

- The BPA sees the need to change articles 14 and 15 in the law to improve the expected return in the Fund.
- The BPA is comfortable with "the continuation scenario". But even this requires continue efforts by all stakeholders to improve internal processes and inform the public continually.
- Improve understanding on governance and communications mechanism among key stakeholders like parliament (include KKFP), government, ministry of finance, BPA, civil society, etc.

#### There are many investment challenges to Timor going forward!

### We need a prudent strategy as well as a waterproof management operation!

Watch the purchasing power of the fund

Watch the people that borrows our money





THE SORCERER'S STIMULUS