Ministry of Finance organized a series of information sessions on the update of Petroleum Fund investment strategy

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7 November 2014

Dili – Petroleum Fund Administration Unit of the Ministry of Finance recently organized a series of information sessions to key stakeholders informing them of the latest update of the Petroleum Fund investment strategy.

These sessions took place in the Ministry of Finance from Wednesday the 5th to Friday the 7th of November 2014 and were attended by key stakeholders including members of the Government, Investment Advisory Boards and civil societies.

Mr. Peter Ryan-Kane, from Towers Watson, an external advisor to the Ministry of Finance on the Petroleum Fund's investment, started the presentations mentioning that the Petroleum Fund investment strategy takes into account three core issues; sustainability, diversification and purchasing power of the Fund.

He recalled that when the Fund started, a simple investment strategy was adopted, mainly by investing in US dollar denominated high rated bonds. It was deemed necessary to avoid exposure to risk and volatility, while building capacity. However, he further elaborated that the then strategy was unsustainable, as every year a 3% of ESI was withdrawn, while the Fund's investment would return less than 2% real.

Therefore, he argued that the fundamental reason for changing the Petroleum Fund Law was to diversify the Fund's investment, by investing across and within different asset classes, to enable the alignment between the investment policy and fiscal policy. Diversification also helps the Fund to bolster capital preservation, by avoiding being concentrated in any one asset class.

The newly revised Petroleum Fund Law allowed for up to 50% allocation to public equities, not less than 50% in fixed income and not more than 5% in alternative instruments. It is expected that with the new investment strategy, 60% in bonds and 40% in equities, there would be a reasonable probability that in the long-term, the Fund would be able to achieve a real return of 3%, which is matched to the 3% Estimated Sustainable Income (ESI), the guidelines for annual transfers to the state budget.

The Government decided in 2012 to increase the public equity exposure by 0.83% a month over a period of two years to June 2014 as a prudent means of achieving a 40% equity exposure. Having a long-term investment horizon, the Fund is ready to assume the higher risk in order to pursue the expected increase in long-term average return. The Government also decided in 2013 to further diversify the Fund's fixed income portfolio by reducing its concentration in US Treasuries. An initial exposure of 10% of the Fund was allocated to non-US developed market sovereigns, with 30% Eurozone and 10% country capped.

As of September 2014, the Fund invested 60% in US Treasuries, 10% in non-US sovereign bonds, and 40% in developed market equities. The Fund's assets are being managed by BCTL (40%), BIS (10%), Interim Manager (5%), AllianceBernstein (5%), SSgA (18%), Blackrock (17%), and Schroders (5%). The Fund's assets were invested across more than 2,579 securities, with more than 70% of them located in the US, and the remaining spread across Europe, Japan, the UK, Canada, Australia and other developed countries.

The Fund earned a net investment return of 4.4% or an accumulated $2.4 billion, since its inception in 2005. The 2013 was an outstanding year for equity markets in developed economies, while bond markets performed badly. The Fund's equity investment performed exceptionally well in 2013, returned 27% for the year. The one year equity return, however, should be considered more of an exception than the rule, as it may be difficult for equity markets to post a similar result in 2014.

The divergent performance between equities and bonds illustrated the virtue of diversification. By investing in several asset classes that seldom move in tandem, the total Fund is shielded from the full impact of temporary negative returns from any one of these.

The Government is currently contemplating making further incremental improvements to the bond and equity portfolios by investing in a wider range of sub-asset classes to improve the risk and return characteristics of the Fund.