

A change of strategy

Sovereign wealth funds find new ways to venture into the market. By *Sophia Grene*

SOVEREIGN WEALTH FUNDS (SWFs) are tentatively sticking their toes back in the water after experiencing a turbulent ride through the financial crisis.

Most SWFs exclude from the definition government pension funds and foreign currency reserve assets.

Many belong to oil-rich nations, aiming to invest and manage the proceeds of a country's natural resources for the long-term benefit of its citizens.

After a disastrous 2008 for investors around the world, 2009 started off quietly for SWFs. Having suffered mark-to-market losses of an estimated \$67bn (£45bn, €54bn) on investments in publicly listed companies to the end of the first quarter of 2009, SWFs unsurprisingly did little new business in the first half of the year.

A renewal of interest in the second half of the year brought transaction levels up again. But totals for the year – 113 deals worth an aggregate \$68.8bn – barely reached 60 per cent of the totals for 2008.

"We've seen it a little more towards the back end of last year, but it's gone quite quiet again now," says Victoria Barbary, an analyst at Monitor Group, which reports and analyses SWF activity.

As well as investing, SWFs also play an important role in providing acquisition finance.

A consortium of SWFs, including Government of Singapore Corporation, China Investment Corporation and Kuwait Investment Authority, stumped up a combined \$2.8bn to help BlackRock, the asset manager, in its \$6.6bn bid for Barclays Global Investors. Another consortium stood ready to act as cornerstone investor to the ill-fated deal between Prudential, the UK insurer, and the Asian arm of AIG.

Though the failure of that deal may not appear to augur well for such transactions in future, it might not have a significant impact on strategic decisions, Ms Barbary says: "It wasn't necessarily a bad judgment on the part of the funds, even though it didn't go ahead."

Whether to finance acquisitions or for other purposes, this seems to be a signifi-



There seems to be a significant new pattern in SWF investment: partnership or co-operation

cant new pattern in SWF investment: towards partnership or co-operation. It allows the funds to share the risk of the investment, while potentially doubling the due diligence on the investee company, and can help calm concerns in the host country about investment by a foreign sovereign body.

The impact of the financial crisis has been felt in more than one way among SWFs, says Ms Barbary. "One of the trends from last year is that SWFs were very busy looking at their investment strategy and building their personnel, their in-house capabilities."

CIC, for example, in February started recruiting professionals in commodities and natural resources, real estate, private equity and fixed income. In April, it announced it was restructuring along strategic lines instead of asset classes: public market investments, tactical investments, private market investments and special investments.

As a result of the general rethink, SWFs have diversified their investment focus significantly, adds Ms Barbary.

"There has been a more general trend to a more diverse pattern of purchasing," she says. "We used to end up being able to put transactions into these buckets: financial, real estate, energy and other, but now there's a lot more going on."

TECHNOLOGY-ORIENTATED companies with a high intellectual property component are popular, she says, as these are seen to be relatively resilient to further potential swings of the global economic climate.

Coinciding with this shift in sectoral focus is a change in geographical distribution.

While Europe is, by value, still the largest destination for SWF investment, Asia and emerging markets elsewhere now dominate in terms of transaction numbers, although these deals, ranging perhaps from \$25m to \$150m in size, are often for smaller companies.

For SWFs, investing in smaller deals in emerging markets has the added advantage that they can afford to be more active investors, taking board seat and actively voting their stock. In developed markets, traditionally there has been political wariness about accepting an SWF – seen at some level as the agent of a foreign government – as an active participant in the economic and financial life of a host country.

Recent research* found a pattern of SWFs taking a large stake in investee companies, then sitting back and leaving it untouched, which it attributed largely to a fear of causing political waves.

The study then found underperformance in those companies, which it linked precisely to the *laissez faire* attitude of the investors.

Other research has found the opposite, however, indicating that in many cases, SWFs are active investors, with significant benefit to their investee companies. The difference may lie partly in a more nuanced interpretation of those political sensitivities, since they are noticeably more active as investors in emerging markets.

The current relatively depressed global economic climate has also given SWFs more





freedom to act in their own best interests regardless of public attitudes, points out Ms Barbary.

"When everyone was so desperate for private capital, [political concerns] went away," she says. "While the climate's not great, it's not an issue, but when the economy starts to pick up, there'll be a lot more pressure on them to align with the Santiago Principles." The Santiago Principles are a voluntary set of conventions and practices agreed among SWFs, intended partly to promote confidence in them as a general structure.

The degree of transparency from SWFs, however, still varies, although it is increasing steadily as they find it to their own advantage to improve relations with investee companies and co-investors. The most transparent SWF is the Norwegian Government Pension Fund Global, which is committed to transparency both about its investment strategy and its evolving philosophy.

For the purposes of those seeking acquisition finance, the Norwegian fund is unlikely to be fertile ground, however, as it concentrates on public markets and has recently declared it sees little value in active management.

Filling up the jar: sovereign wealth funds invest in financial assets, and many of these funds invest and manage the proceeds of a country's natural resources

**Sovereign Wealth Fund Investment Patterns and Performance, by Bernardo Bortolotti, Veljko Fotak, William Megginson and William Miracky*

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An opaque fund moves towards transparency

Abu Dhabi sovereign wealth fund in the public eye, reports *Andrew England*

THE ABU DHABI INVESTMENT Authority (Adia), one of the world's largest sovereign wealth funds (SWFs), traditionally has sought to avoid the limelight. But in 2007, as the global economic crisis began to bite and US banks sought sources of capital, the fund made an investment that grabbed the headlines.

Adia pumped \$7.5bn (£5bn, €6.1bn) into Citigroup, the US bank, and became one of the first SWFs to come to the aid of a struggling western financial institution. The investment has turned out to be one of Adia's most controversial.

The fund's holding in Citigroup is in "equity units" that pay 11 per cent annual income. But the units began converting into common shares in March, a process that will go on until September 2011. Under the terms of the deal, Adia must buy the common shares at \$31.83 each. Citigroup's shares are trading at roughly \$4, highlighting the hits SWFs have taken through the downturn. However, it is understood Adia will make \$2.5bn-\$3bn on the interest payments.

The deal took a further twist in December, when Adia took the unusual decision to file an

arbitration claim against Citigroup, alleging it was the victim of "fraudulent misrepresentations." The bank has said the claims are without merit.

Adia rarely discusses its investments publicly, but in an interview with Germany's Handelsblatt newspaper in January, Sheikh Ahmed bin Zayed al-Nahyan, then Adia's managing director, said the fund "will always have holdings in banks and other financial institutions". He added: "The challenge lies in valuing the sector in a way that factors in the continued economic uncertainty and the possibility of lower returns in the future due to more conservative business models."

The sheikh died in a glider accident earlier this year and was replaced by his brother, Sheikh Mohamed bin Zayed. Experts expect little to change in Adia's investment strategy, which focuses on the long term.

Set up in 1976, Adia has traditionally revealed little information and it does not comment on the size of its assets, which are estimated to be roughly \$450bn. However, it has taken tentative steps to open up, and released its first annual review this year, which stated that its 20-year and 30-year annualised rates of return to the end of 2009 were 6.5 per cent and 8 per cent, respectively.