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Sovereign funds stop coming to the rescue

INVESTMENT STRATEGY

State-backed vehicles retreat from investing money directly

ATTRACTA MOONEY

Sovereign wealth funds are investing less money directly than at any time in the past five years. This marks the end of a safety net whereby state-backed vehicles mopped up assets in times of market stress, according to research.

During the financial crisis, sovereign wealth funds were often credited with keeping markets functioning by buying assets as other investors retreated.

But a study has found that sovereign wealth funds are investing much less than before. The fear is that this could have a destabilising effect on markets, especially if there is another financial crisis.

Bernardo Bortolotti, the author of the report from Bocconi University in Milan, and an associate professor in economics at the University of Turin, said: "Since the most recent financial crises, western markets have come to rely on an SWF safety net, knowing that a large class of investors was on the prowl for cheap assets.

"That safety net has now been removed."

The Bocconi report found that state funds invested €48bn directly last year, down 57 per cent from €112bn in 2008.

The fall in investments comes as some countries have been forced to contribute smaller sums of money to state funds or withdraw money on the back of the fall in oil and commodity prices.

The fall in oil and commodity prices has affected sovereign funds negatively — Dreamstime

> 'We can dismiss the prospects of SWFs coming to the rescue, should another crisis scenario materialise'

Sven Behrendt, managing director of GeoEconomica, a consultancy, said: "Given the low oil-price environment and lower revenues for oil producers, [state funds] no longer have the cash positions to get into the markets once they correct.

"We can dismiss the prospects of SWFs coming to the rescue — a popular headline in 2008 — should another crisis scenario materialise."

Martin Skancke, who used to run Norway's oil fund, the world's largest sovereign wealth fund, added: "SWFs will not be supporting asset prices to the same degree [in the future, compared with previous years], but I would still expect them to retain their countercyclical nature through rebalancing."

A state fund specialist at a large asset manager, who did not want to be named, rejected the idea that sovereign funds act as a safety net, pointing out that they are a far smaller investor group in terms of assets than pension funds.

The report, which was produced by the Bocconi University's Sovereign Investment Lab, a department focused on state-backed vehicles, found that as well as investing less, sovereign funds are investing more in western markets and in so-called safe assets.

More than 57 per cent of state funds' direct investments went into safe assets such as utilities, hotels and property last year, compared with 15.5 per cent in 2008.

57%
Decline in direct investment by state funds, to €48bn, from €112bn in 2008

The Bocconi figures include money placed directly into companies, infrastructure projects, property and other investments, rather than money invested via asset managers.

Investments via asset managers have also been falling, according to figures from eVestment, the data provider. It found that sovereign wealth funds pulled at least $46.5bn from investment houses last year.

Prof Bortolotti said state funds are becoming more discerning investors. "Funds will be much more selective [from now on]. It will be more difficult [for companies and projects] to tap sovereign funds for investments. Everything is pointing to better diversification."