Sovereign Wealth Fund Investment Behavior

ANALYSIS OF SOVEREIGN WEALTH FUND TRANSACTIONS DURING Q2 2009

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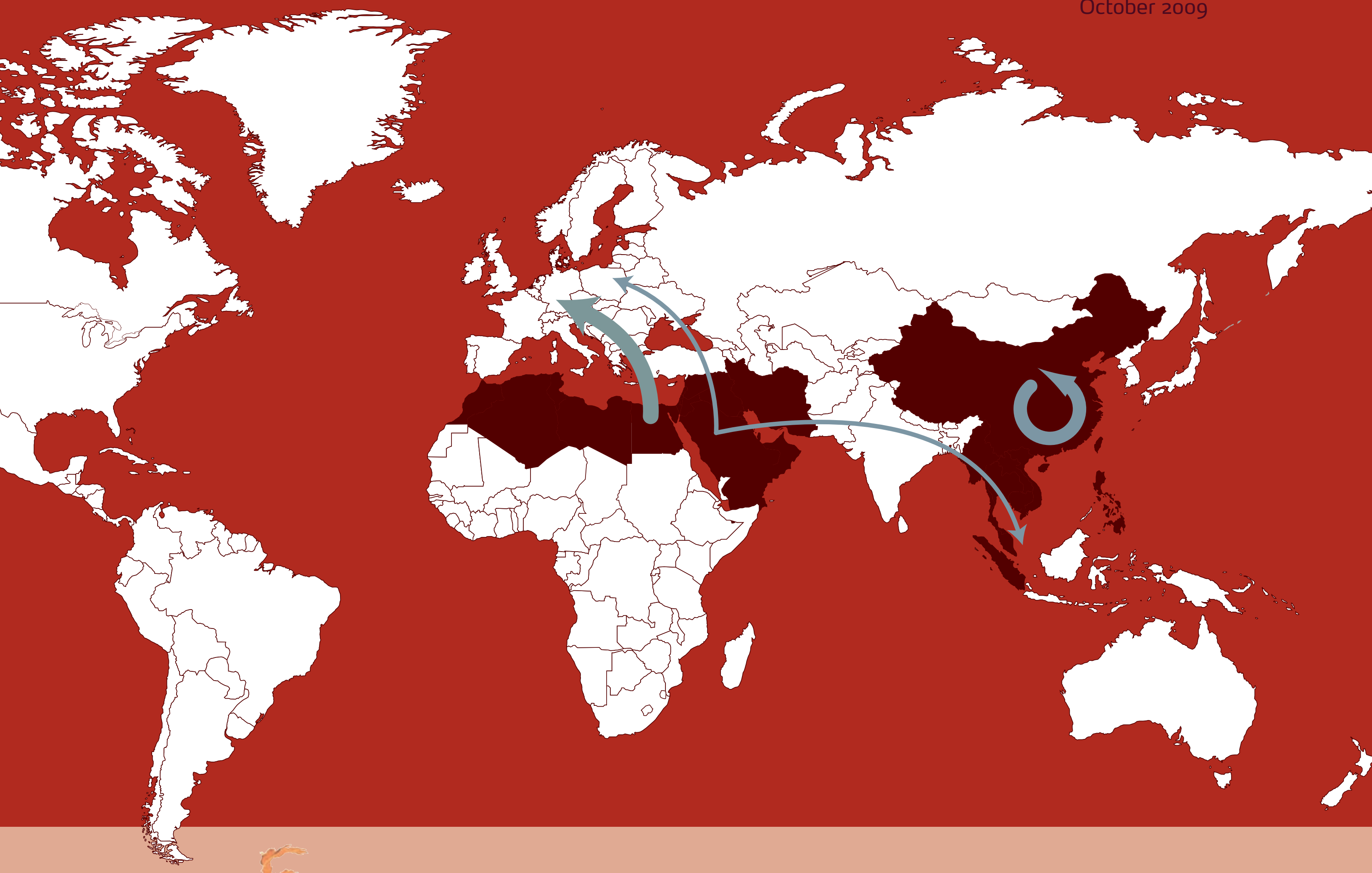

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SOVEREIGN WEALTH FUNDS INVESTED ACROSS
THE GLOBE IN THE SECOND QUARTER OF 2009

Overview

During the second quarter of 2009, sovereign wealth funds (SWFs) made 11 investments with a total value of $3.5 billion—the lowest expenditure of any quarter since the last of 2004.

Transaction data for the quarter appear to suggest that SWFs are exercising continuing caution in their investments. The funds completed only 11 transactions in Q2, while another 19 were either announced or pending completion, suggesting an upswing in activity that may be confirmed later. The Q2 investment data thus appears to be a consequence of a period of near hibernation at the end of 2008 and beginning of 2009 rather than a continuing retreat from global markets.

The geographical and sectoral spreads of SWFs' completed Q2 investments also suggest that, as we proposed in the Q1 2009 update, SWFs are cautiously returning to the market with a long-term approach to their investments, putting their losses behind them and resuming the business of investing abroad. The funds made only two investments in domestic markets in Q2, and over half were in the OECD. The investments also had a wide sectoral spread; the funds notably returned to investing in real estate after they had steered well clear over the previous two quarters.

Q2 2009 also witnessed other trends, not visible in their transaction histories. First, this was a time of reflection for SWFs, as global markets began to calm after the turbulence of the previous quarters. For many funds, which had sustained heavy mark-to-market losses in the financial tsunami of 2008, it was time to ask difficult questions about how best to take advantage of the new economic environment. This has resulted in some funds looking at restructuring their organizational architecture to take better advantage of the new conditions and improve performance of assets already in the portfolio. They are also rebalancing existing portfolios to maximize their performance, through divestments, establishing lower risk profiles, and investing in alternative assets, such as commodities.

There has also been an ongoing trend for SWFs to work in concert to make joint strategic investments. This will enable funds to make the most of local knowledge, leverage capital, spread investment risks and maximize returns. Such collaborations may have the effect of creating more transparency by highlighting the commercial aspects of their investments and quelling the concerns among some constituencies about potential political motivation.

REVISIONS TO OUR DATA

We constantly strive to ensure that the Monitor-FEEM SWF Transaction Database is as accurate as possible and have an ongoing revision process to ensure that the data reflects accurately the publicly reported investments made by the funds.

We have recently worked with a SWF reported on our database to revise and verify the data we held for them, and have reached out to other funds to invite them to help us verify the accuracy of the data. The historical data presented in this update reflects this ongoing process of revision..

Highlights

1. In Q2 2009, SWFs completed 11 investments, valued at $3.5 billion, their lowest quarterly expenditure since Q4 2004. This continues the trend of declining levels of publicly reported SWF transaction activity. Transactions completed in this quarter represented only two-fifths of the deals as Q1 and just over the half of the value.

2. Publicly reported SWF investment activity in the first half of 2009 was down 60 percent on the same period in 2008; these investments only represented 13 percent of the value of those made in the first half of 2008.

3. There was a continuing trend for funds to invest abroad – SWFs made only two publicly reported domestic investments in Q2 2009. Foreign investments accounted for all but $11 million of the reported quarterly transaction value.

4. Although SWFs completed only 11 publicly reported transactions in Q2, another 19 were announced or pending, suggesting an upswing in SWF activity during the second quarter, which would be realized at a later date

SAFETY IN NUMBERS: SOVEREIGN WEALTH IS LEARNING TO SHARE

An ongoing trend emerging in SWFs' investments in 2009, that we first commented on in Q3 2008,[1] is a tendency for SWFs to hedge or spread risk by joining together to make investments. In the first half of 2009, a number of funds, particularly those from Asia, have joined together in partnerships or consortia to invest in riskier assets that have a potentially favorable upside.

At the beginning of June, Lee Kwan Yew, the Chairman of the Government of Singapore Investment Corporation (GIC), announced that the fund would be cautious in the coming months. This has seen an apparent change in the fund's strategy: it has increasingly looked to collaborate with other SWFs to invest in financial services. In February, GIC purchased a share of private equity firm Apax Partners with Australia's Future Fund. It was also a member of a SWF consortium (with the China Investment Corporation (CIC) and the Kuwait Investment Authority (KIA)) that contributed a combined $2.8 billion to BlackRock's accepted $6.6 billion bid for Barclays Global Investors (BGI), the bank's fund management unit, in June. This was the first time that SWFs had actively bonded together to support an investment, rather than making individual deals with the same company on such a large scale. With the support of other SWFs, each fund could participate in transactions while sharing the risk.

GIC is not the only SWF working in this manner. In June, the Korean Investment Corporation (KIC) signed cooperation agreements with two foreign public funds—Malaysia's Khazanah and Australia's QIC (formerly the Queensland Investment Corporation)—to "expand cooperation", and later signed a deal with KIA "to seek increased mutual investment."

1 See "Joint Ventures, Consortia and Partnerships" in William Miracky, Davis Dyer, Drosten Fisher, Edward Chin, Victoria Barbary, *Sovereign Wealth Fund Investment Behavior: Analysis of Sovereign Wealth Fund Transactions During Q3 2008*, (Monitor Group, Cambridge M.A.: December 2008), pp. 4-5.

Although this is a more pronounced trend for Asian funds, Middle Eastern SWFs have also looked to follow this trend. KIA is a member of both the BlackRock SWF consortium and the cooperative agreement with KIC. The Mubadala Development Company has proposed a joint venture in Malaysia, which will see it cooperate with the regional Terengganu Investment Authority, which will be restructured into a SWF called 1Malaysia Development Bhd.

Collaboration appears to be a way for SWFs to continue their exposure to a diversity of sectors without shouldering all the risk in less-familiar sectors or riskier investments. As such, these collaborations represent a reaction to a volatile and uncertain investment environment of recent times. Having suffered such large losses in 2008, SWFs appear be maturing as investors and looking at more sophisticated approaches to managing their risk profiles in a way that not only produces good returns, but also lowers the risk of losses.

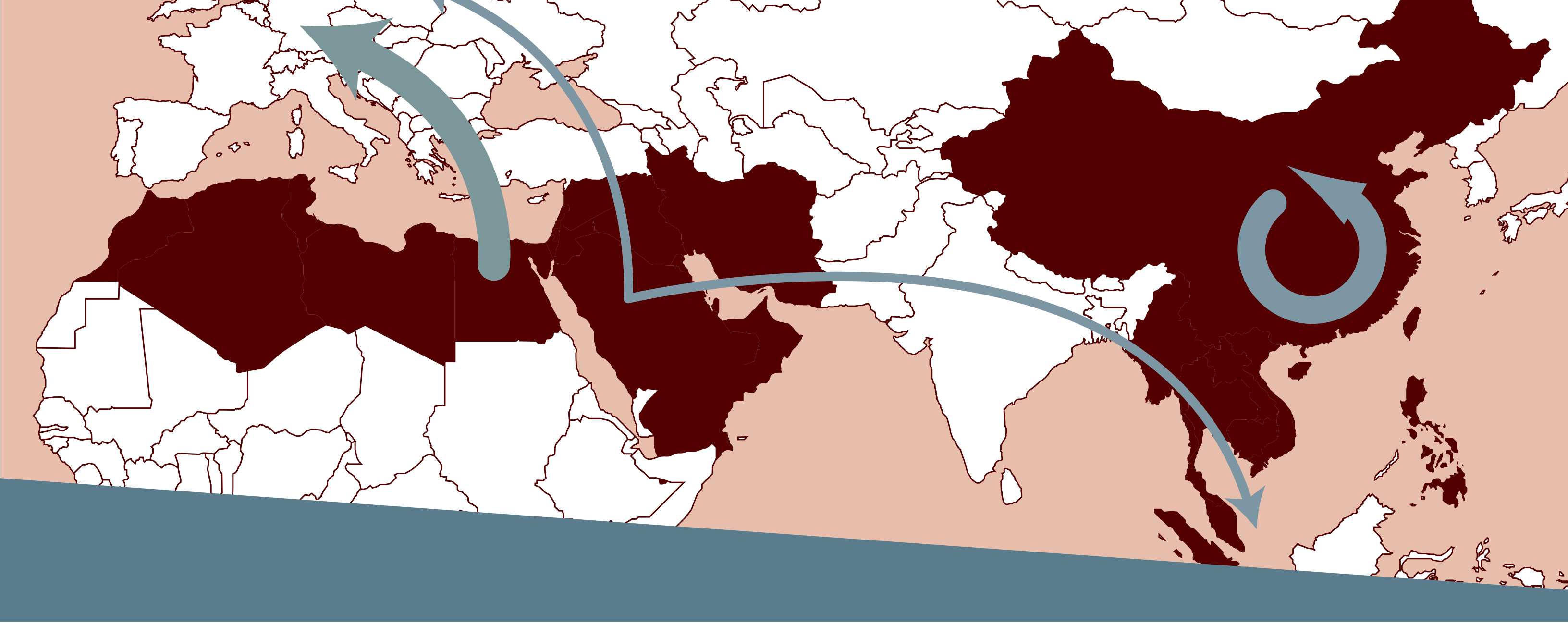
Methodology

Our research methodology focuses on two main objectives: comprehensiveness of research and accuracy of information. To ensure comprehensiveness, we survey multiple sources, primarily relying on established business and financial databases as well as other reliable news sources and funds' websites.

We follow a strict process for capturing deal information, establishing a clear prioritized order for the reliability of sources.

1. Financial transaction databases: Thomson One Banker (and SDC Platinum), Bloomberg, and Zephyr
2. Fund websites (where available)
3. News sources: *Financial Times, New York Times* (DealBook), *Wall Street Journal* (DealJournal), *GulfNews*, Zawya.com
4. Information aggregators: LexisNexis
5. News wires: Associated Press, Reuters

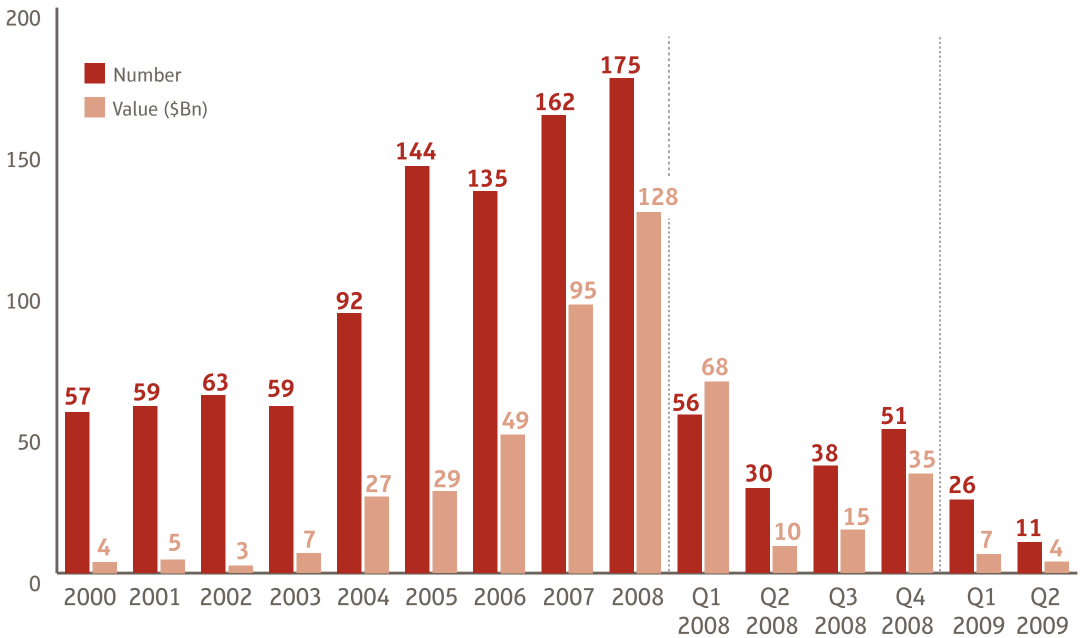
Most of the deals are amassed and consolidated from the business databases, with the other sources used for corroboration where necessary. To ensure accuracy, at least one high-quality source is captured for each data point, and where possible, two or more sources are established. Articles from information aggregators such as LexisNexis are carefully examined to ascertain the reliability of the original source. Moreover, news wires such as the Associated Press and Reuters are not used as a sole source of deal information because data quality tends to vary considerably.



Aggregate Data

According to our data, in Q2 2009, SWFs made 11 investments with a total reported value of $3.5 billion. This is half of the reported expenditure and only two-fifths of the deals made during the previous quarter, representing the lowest publicly reported quarterly expenditure on the part of SWFs since the last quarter of 2004.

Figure 1: SWF Equity Transactions by Number and Volume since 2000



Note: Publicly available data for SWF equity & real estate deals, joint ventures and capital injections
Source: Monitor-FEEM SWF Transaction Database

For the first half of 2009, publicly reported SWF investment activity was down 60 percent on the first half of 2008, with a value representing only 13 percent of SWFs' publicly reported expenditure in the first six months of 2008.

Of the 32 funds tracked on the Monitor-FEEM SWF Transaction Database, only five completed investments in Q2: the Abu Dhabi Investment Authority (ADIA), Government of Singapore Investment Corporation (GIC), Khazanah Nasional Bhd, Mubadala Development Company, and Temasek Holdings. These have historically been some of the most active funds on our database. Additionally, we have included the Oman Investment Fund (OIF) for the first time in our analysis. Although founded in 2006, the OIF has recently become more active, making a number of equity, and real estate investments globally. A more detailed study of its activity and management suggests that it meets our criteria of a sovereign wealth fund.[1]

1 *Weathering the Storm Sovereign Wealth Funds in the Global Economic Crisis of 2008*, ed. William Miracky, Bernardo Bortolotti (Monitor Group, Cambridge M.A.: 2009).

REORGANIZATION AND REALIGNMENT

Although the first half of 2009 was quiet in terms of completed SWF transactions, the funds have not been idle: this has been a period of reflection, reorganization and realignment. In 2009, the economic environment is fundamentally different from 2007 or 2008, and, for investors, underlying assumptions about risk have had to be reconsidered. In this respect, SWFs are no different from other institutional investors; they have not been immune from the ravages of the recession and, consequently, have needed to rethink their approach to risk, whether by restructuring their organizational architecture, by changing their investment focus, asset allocation or rebalancing their portfolio.

The China Investment Corporation (CIC) has undertaken the highest-profile reorganization amongst SWFs. At the end of February, the fund started recruiting professionals in commodities and natural resources, real estate, private equity and fixed income assets. This suggested to analysts that CIC was pooling talent and paving the way for a new phase of investment, targeting assets backed by the real economy. The rationale for its new hires was revealed in April, when CIC unveiled a restructure into four divisions along investment motives, rather than asset class: Public Markets Investments; Tactical Investments; Private Markets Investments; and Special Investments.

The fund's investments in the first part of the year suggest that this period of holding back until the global economy stabilized, self reflection and revamping the strategy and organizational structure, is enabling CIC to diversify its portfolio. CIC is now looking at alternative investments such as direct investments into companies that produce/supply commodities and natural resources, as well as hedge funds. It also appeared to be an opportunity for CIC to maximize returns by taking advantage of the opportunity to purchase undervalued or distressed assets and debt, which it could sell at a profit in the future—a position it is well-placed to take given its long-term investment horizon.

CIC is not the only SWF that has rethought the way it invests and its reasons for doing so. SWFs around the world—Norway, GIC, Temasek—have also seen reorganization. Most notably, there has been a major restructuring of the UAE's sovereign wealth, largely due to the impact of the financial crisis on Dubai. Much of the emirate's wealth was based on the growth of its financial services sector and real estate market, which were badly hit by the drying up of the credit markets and capital flight, leaving the emirate with a national debt of $80 billion. During the first quarter of the year Dubai restructured its sovereign wealth investment vehicles, bringing them under closer government scrutiny through the Advisory Council of the Government of Dubai, and looking to reallocate the debt burden across the "Dubai Inc" network. Consequently, Dubai funds have not made a publicly reported investment since the beginning of October 2008.

Abu Dhabi has also rethought how it invests its sovereign wealth. ADIA has been eclipsed by funds like Mubadala and the International Petroleum Investment Company (IPIC), that have a more developmental approach to investing, making acquisitions and partaking in joint ventures in sectors from which Abu Dhabi can benefit from knowledge and technology transfer. There has also been a shake up in the Abu Dhabi Investment Council, which has formally orientated itself towards investing in Abu Dhabi's economy. Its subsidiary, the Abu Dhabi Investment Company has also rebranded itself "Invest AD", focusing on the domestic and regional markets, particularly in financial services and facilitating investments, rather than making proprietary investments on behalf of the government.

In addition to restructuring their organizational architecture, SWFs have also rebalanced their portfolios through divesting stock that did not fit into their new investment strategy. The most eye-catching of these were the sales of shares in British bank Barclays by the Qatar Investment Authority, IPIC and Temasek, with varying degrees of success. Qatar trimmed its stake in the bank to 5.8 percent from 6.4 percent as part of a "volatility-driven portfolio management strategy, which it applies to a small part of its aggregate holding". In June, both IPIC and Temasek announced sales of Barclays' stock. IPIC made $2.5 billion on its investment, which it sold to "reflect the focus of IPIC's long-term investment strategy on hydrocarbon-related opportunities." Temasek, however, was reported to have made a loss of about £500 million ($814 million) when it sold its stock in January.

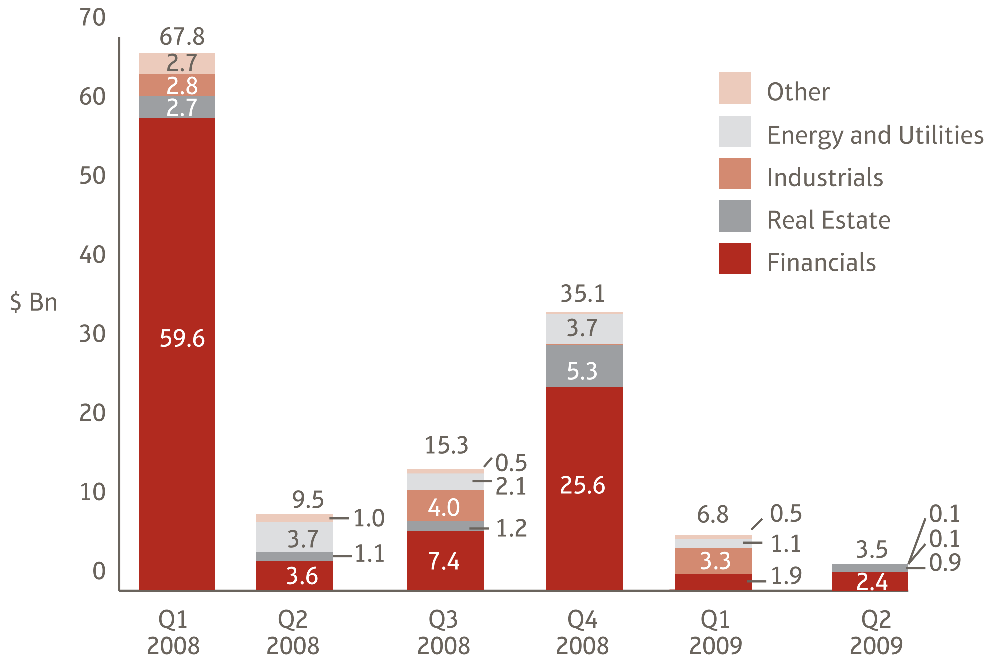
BISHOPS SQUARE, SPITALFIELDS, LONDON
The Oman Investment Fund spent $735 million
on a 75 percent share of this Richard Rogers designed building

Sectoral Analysis

During Q2 2009, SWFs invested in a wide range of sectors. Although financial services remained the most popular target, SWFs also invested in industrials, healthcare, aerospace, and for the first time in 2009, real estate.

In Q2 2009, SWFs made two publicly reported investments in financial services, worth $2.4 billion or 69 percent of the total reported expenditure for the quarter. The value of these deals was half a billion dollars more than it had been in Q1, primarily due to Temasek, the Singaporean fund, investing $2.34 billion in the China Construction Bank. The other acquisition in the sector—Temasek's acquisition of a 0.3 percent share of Standard Chartered Bank, in which it is already a shareholder—resulted from the fund receiving a stock dividend from the British lender in May.

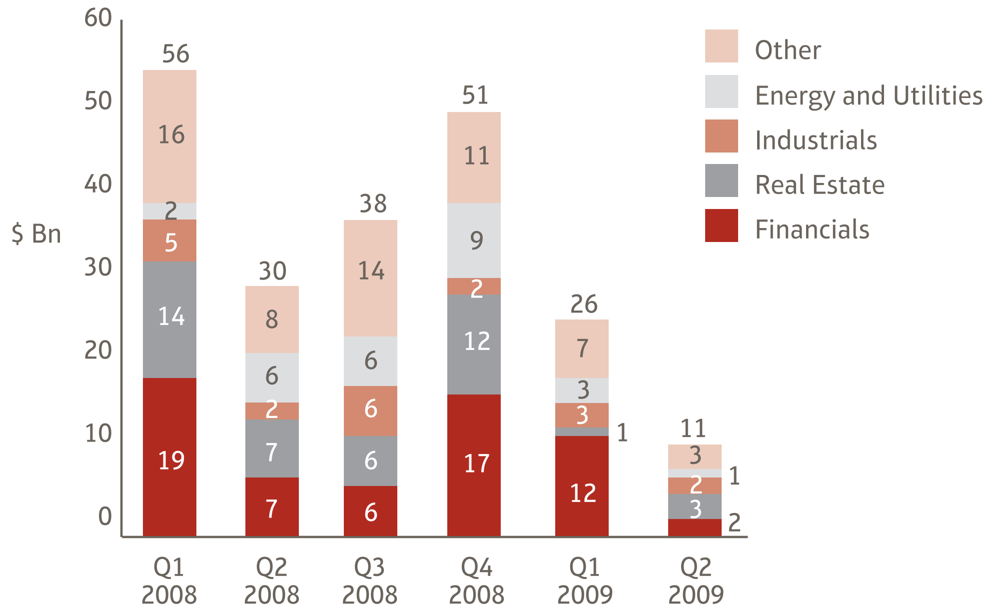
Figure 2: Value of SWF Investments by Target Sector Q1 2008-Q2 2009



Note: Publicly available data for SWF equity & real estate deals, joint ventures and capital injections
Source: Monitor-FEEM SWF Transaction Database

There was also an upturn in SWFs' interest in real estate, which had been hit hard by the collapse of global real estate values at the end of 2008. There were three reported SWF investments in property. GIC has been acquiring real estate from American industrial REIT, ProLogis, since the beginning of the year; in Q2 it completed the sale of an industrial park in China for an undisclosed sum and ProLogis Park Misato II, in Japan, a 637,000-square-foot facility, for $140 million. The Oman Investment Fund has also been interested in real estate, adding to its London property portfolio through the acquisition of a 75 percent share of Bishops Square, an office development on the east edge of the City of London, from Hammerson plc for $735 million.

Figure 3: Number of SWF Investments by Target Sector Q1 2008-Q2 2009



Note: Publicly available data for SWF equity & real estate deals, joint ventures and capital injections
Source: Monitor-FEEM SWF Transaction Database

The remaining deals were in a diverse range of sectors primarily with a developmental feel. For example, Mubadala acquired an additional 30 percent share of Swiss aerospace firm SR Technics from the Dubai SWF Istithmar World, taking its total shareholding up to 70 percent, as part of its remit to establish Abu Dhabi as an aerospace maintenance, repair and overhaul centre. Khazanah Nasional, the Malaysian fund, purchased a $25 million share in American specialized orthopedics company, Smallbone, which secured Kuala Lumpur as the location for its Asia Pacific hub, where it will undertake biomaterial research, product development, surgeon education and distribution in the region.

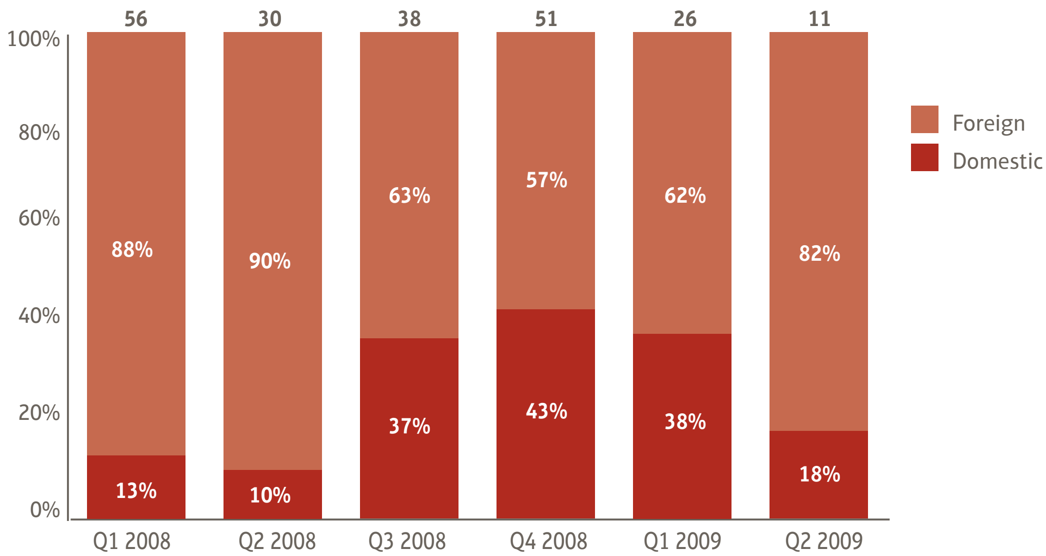
NIGHT VIEW OF SEOUL, SOUTH KOREA

Geographical Analysis

SWFs have continued the trend that we observed last quarter: that of investing abroad. SWFs made only two publicly reported domestic investments in Q2 2009, with foreign investments accounting for all but $11 million of the reported transaction value.

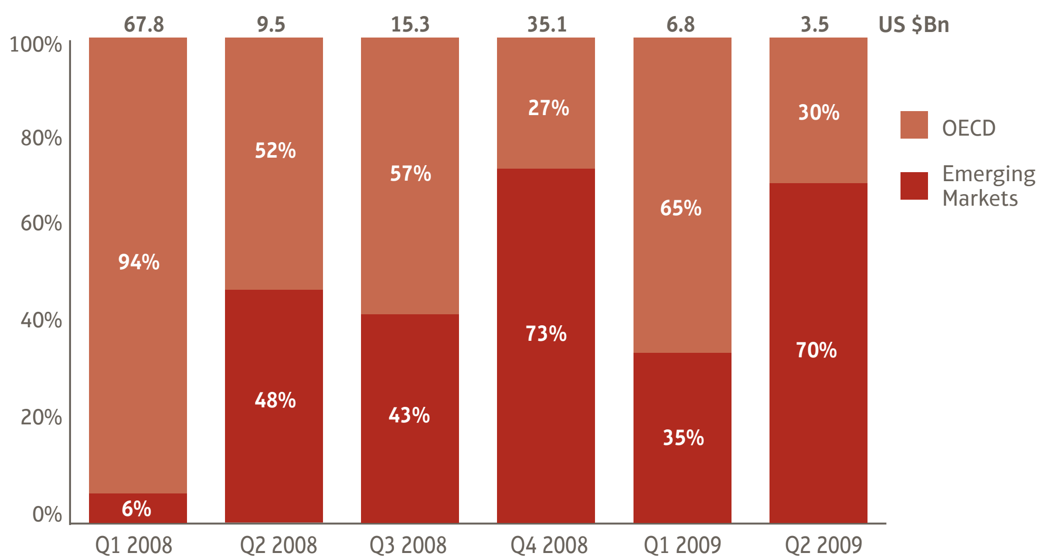
Over half the deals (six) had OECD targets (companies headquartered in Japan, South Korea, Switzerland, the United States and United Kingdom), but the funds were cautious with their expenditure here, as these acquisitions only had a reported total value of $1 billion. Emerging markets, therefore, accounted for the majority of SWF expenditure during Q2 2009; however, this is unbalanced by Temasek's injection of $2.34 billion into the China Construction Bank, which by itself accounts for two thirds of the total reported transactions.

Figure 4: Number of SWF Deals by Location of Target: Domestic vs. Foreign



Note: Publicly available data for SWF equity & real estate deals, joint ventures and capital injections
Source: Monitor-FEEM SWF Transaction Database

Figure 5: Value of SWF Deals ($bn) by Location of Target: OECD vs. Emerging Markets



Note: Publicly available data for SWF equity & real estate deals, joint ventures and capital injections
Source: Monitor-FEEM SWF Transaction Database

FUTURE INVESTMENTS: SWFs BEGINNING TO WAKE UP

Although Q2 was quiet in terms of completed deals, investments that were announced and/or awaiting confirmation in Q2 outnumbered those completed by almost two to one and with a total reported value of $10.9 billion. Moreover, while only six SWFs completed acquisitions in Q2, nine had announced investments in this quarter, or had investments agreed subject to approval in this quarter. This suggests that SWFs believe that the investment climate is now stable enough to return to the market in earnest.

The most active fund was Mubadala, which has awakened from a period of uncharacteristic austerity to table three new joint ventures in the financial services, aerospace and energy sectors. A fourth joint venture in Malaysia will invest in the energy, real estate and hospitality sectors and will see the regional Terengganu Investment Authority restructured into a SWF called 1Malaysia Development Bhd, wholly-owned by the Malaysian Ministry of Finance, reporting directly to the Prime Minister.

CIC was also busy queuing up alternative asset investments during Q2. The Chinese fund showed a particular interest in financial services, particularly asset management. In June, the fund announced that it would be allocating $500 million to Blackstone Group's "fund of funds" unit, and would allocate $1.2 billion to be overseen by Morgan Stanley's asset-management unit. This underlined its sharpened focus on hedge funds and alternative asset management brought by CIC's new structure, with a new "private markets investment" division. Such investments may also help soften occasional criticism that CIC has been investing politically; investing in hedge funds will give CIC no direct influence on company policy, making these unarguably passive, commercial investments. Additionally, by investing with top-tier hedge funds, fund-of-funds and other alternative asset investment groups, CIC can expand its investment footprint more rapidly while hiring and building its own internal capability, while taking advantage of the unique investment climate that exists today.

This upsurge in activity, particularly in the financial sector and property market, suggest that SWFs believe the investment climate to be stabilizing and that it is now the time to make investments. However, it appears that funds are still being cautious. Only Mubadala's commitment to two of its proposed joint ventures, and CIC's Morgan Stanley investment top the billion-dollar mark—a stark contrast to a year ago where investments in the billions were commonplace. So, while we're seeing SWFs dipping their toes back in the water after being caught in the financial tsunami of 2008, we see no evidence that there will be an immediate return to the big-spending ways of 2007 and 2008. The proposed deals from Q2 suggest that funds are investing smaller amounts in a wider range of assets as a way of diversifying their portfolio and hedging risk.

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