Bortolotti—of Milan research institution Fondazione Eni Enrico Mattei (FEEM)—and Miracky—a partner at Boston-based Monitor Consulting—have joined forces to shed light on sovereign wealth fund deal flows. Speaking to *ai5000* from their home towns, they waxed eloquent on why SWFs are important—and why they'll be here long after we're all gone.

William Miracky & Bernardo Bortolotti

“The objective is to improve knowledge, to increase transparency. It's useful to inform the debate about these funds that, until recently, were viewed as the new Barbarians at the Gate. If you turn the clock back, SWFs have been around since the '50s, but what happened in 2004, 2005, 2006 is that they began to grow, and that's when the world and media took notice. Everybody was extremely fearful of activity; the media created a very big fuss with limited knowledge. With our partnership, we have been able to define and track deals through public sources; we have been able to throw the stone in the lake, document what was going on, and hopefully quiet fears. We needed to create some facts. There are a couple of facts: First of all, it is true that these funds invest in equities, but they don't just invest in equities. Historically, they've been in bonds, especially U.S. bonds but, more recently, they've begun to diversify, like endowment funds. It's very tricky to talk about them as a generalizable group. They have different strategies, histories, and objectives. Because there was a big run-up in the middle of this decade, you had lots of young funds in big deals outside their economies. Why? There is an instinct to get deals done, yes, but there was also a need for their capital. After the Perfect Storm, many of these funds, whether younger or older, all suffered significant losses. They will now be more cautious about the quality of the enterprises they invest in; they have more experience, and will have better risk management. It must be said about these capital pools: They do have a buffer. Of all the various types of investors, these funds generally have the longest investment horizon. They have suffered lots of losses in taking all of Wall Street, but they can wait. One of the things we're seeing more of this year is more collaborative investing—not just joint ventures, but also putting more of their funds to work through third-party investors. It makes lots of sense because it allows them to put their money to work in a professional way—because these third parties can be more active in management, and it allows the SWFs to remain at arms length from activism—which is important politically. They have been white knights, but they have stayed out of shareholder activism, yes. That is important for them. From the standpoint of corporate entities looking to raise funds, they occupy a great place—passive and long term is what they are, and corporations like that. Bill's right: They will remain extremely relevant because of the type of capital they are, and because of their size. They're too big and too important to go away quickly. They once were worried about political backlash, and they saw some of it, but this crisis has made them more cautious, better risk managers, more likely to work with others—and more wanted.”

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LOOKING AHEAD

Asian Sovereign Wealth Funds and Economic Recovery

by Victoria Barbary, Monitor Group

During the financial crisis, the eyes of the world were on the sovereign wealth funds (SWFs) of the states of the oil-rich Middle East, particularly funds like the Abu Dhabi Investment Authority, which was rumored to have more than a trillion dollars of assets under management. The financial crisis hit SWFs as badly as any other international institutional investor and, with Asia appearing to be the first region to enter a recovery, the attention of the world now is shifting eastward. However, less has been written about the Asian funds, and here we seek to look a little deeper into their investment patterns over the last two years.

Monitor tracks 10 funds in the Asia-Pacific region, the majority of which are non-commodity funds, receiving their resources from government fiscal surpluses or holdings in government-linked companies. The funds range widely in age, from the venerable Temasek Holdings to the two-year-old China Investment Corporation (CIC), and in magnitude, from the minnow $425 million Vietnam State Capital Investment Corporation to the giant Government of Singapore Investment Corporation (GIC) with nearly $250 billion and the almost $300 billion CIC.

Asian SWFs historically have undertaken investments in a wide range of sectors. Taken as a group, SWFs have tended to concentrate their activity in energy, real estate, financial services, and industrials. Asian funds, however, have been more diverse, typically making 40% to 50% of their yearly deals in sectors such as information technology, telecommunications, health care, and consumer goods between 2000 and 2006.

Asian SWFs recently have become more prominent in world markets. In 2005, Asian SWFs made only a quarter of their publicly reported

COUNTRY	FUND NAME	ASSET (US$B)	FOUNDED
Australia	Future Fund	56.8	2006
Brunei	Brunei Investment Agency (BIA)	30	1983
China	China Investment Corporation (CIC)	297.5	2007
Kiribati	Revenue Equalization Reserve Fund (RERF)	.4	1956
Malaysia	Khazanah Nasional Berhad	20.25	1993
Republic of Korea	Korea Investment Corporation (KIC)	17.8	2006
Singapore	Government of Singapore Investment Corporation (GIC)	247.5	1981
Singapore	Temasek Holdings	95	1974
Timor-Leste	Petroleum Fund	3.2	2005
Vietnam	State Capital Investment Corporation	0.4	2006

deals, worth 49% of the total reported value, in the OECD. By 2008, this had risen to about a third of their publicly reported deals, and accounted for nearly 61% of the total recorded value.

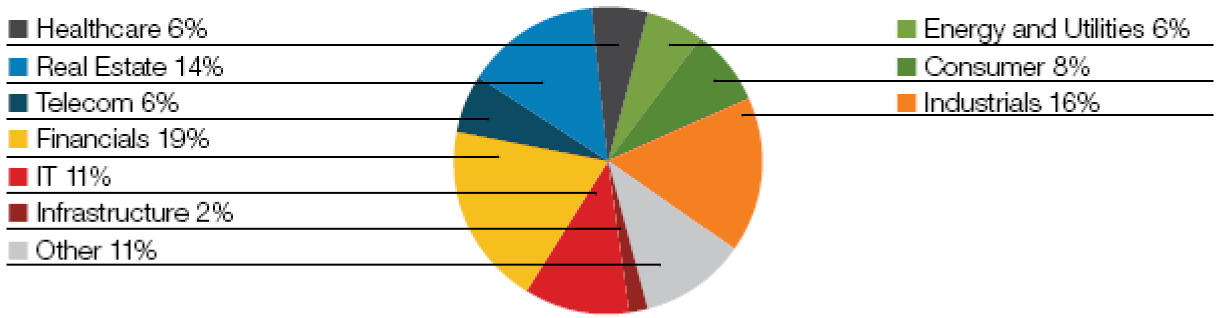
This increase in investment in the OECD has been driven primarily by investments in financial services. Until 2007, the majority of Asian SWF financial services investments were in non-domestic Asian markets, such as Indonesia and China. Temasek was particularly active in this area, being responsible for 72% of all Asian funds' investments in financial services from 2000 to 2006. At the end of 2007, the magnitude of Asian SWFs' reported investment in financial services increased from $4 billion in 2006 to $40 billion in 2007 and $55 billion in 2008. Moreover, rather than concentrating on regional markets as previously had been the pattern, companies in Europe and the United States became investment targets.

Capital injections from Asian SWFs, particularly those from Singapore, played a critical role in stabilizing the global economy in late 2007 and early 2008, by increasing U.S. and European banks' tier one capital. Between October 2007 and March 2008 Asian SWFs made 11 transactions with a combined value of $36 billion in OECD financial institutions. This was substantially greater than the eight investments worth $22 billion committed to these institutions from the Middle East.

During 2008, as the crisis worsened, Asian SWFs—like those based elsewhere—hastily retreated from public equity markets. Asian funds completed 37 publicly reported transactions valued at $35.3 billion in the first quarter of 2008. However, between April and December 2008, there were only 39 publicly reported investments by Asian SWFs (about half their volume of the same period in 2007), with a publicly reported value of only $26.8 billion, $19 billion of which is attributable to CIC's recapitalization of the Agricultural Bank of China in October, and $3.4 billion to Temasek's follow-up investment in Merrill Lynch in July.

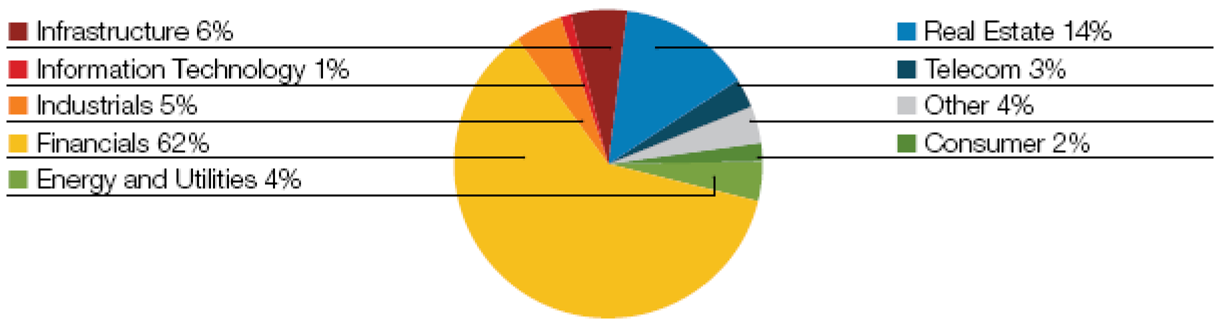
Even in retreat, Asian funds suffered significant portfolio losses. Temasek was hardest hit by the downturn, reporting losses of 31%, or about $39 billion, between March and November 2008 and was reported to have lost a further $27 billion in Q1 2009; Khazanah, the Malaysian SWF, was the second-worst hit fund, with realizable asset value dropping 20% between May and December 2008. GIC fared better, incurring apparent losses of 15%, while KIC's portfolio shrank by 14% in 2008. Despite initially reporting a modest

Number of Asian SWF Investments by Target Sector (2000-Q2 2009)



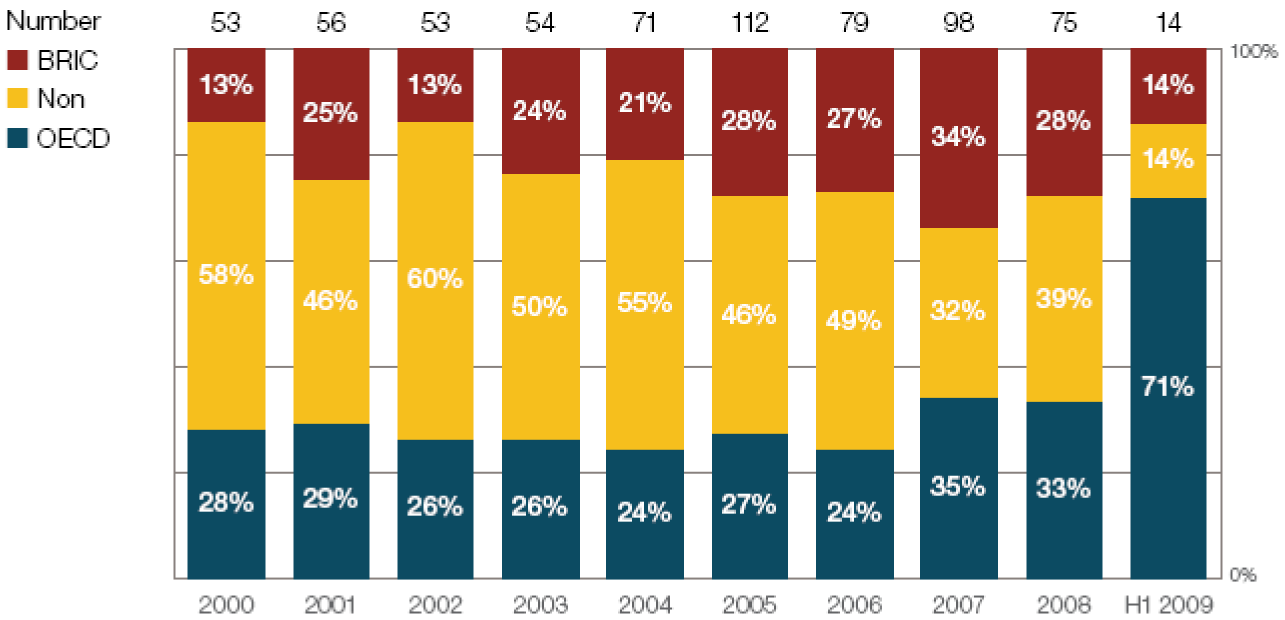
Note: Publicly available data for SWF equity & real estate deals, joint ventures, and capital injections.
Source: Monitor-FEEM SWF Transaction Database

Value of Asian SWF Investments in Financial Services 2000-2008



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

Number of Asian SWF Investments by Geography, 2000-Q2 2009



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

profit of 5% ($10 billion) in 2008, CIC reported a small loss (2.1%) on its global portfolio, only 3.2% of which was invested in equities.

Stung by these losses, Asian SWF activity in Q1 2009 suggested that they would continue to retreat from equities and concentrate on minimizing the impact of their losses: They only completed six deals valued at less than a billion dollars during this time.

In the second part of the year, however, Asian SWFs have reemerged into the marketplace having reassessed their strategies, taking account of the current economic environment. Both GIC and Temasek have signaled a shift in focus to Asia, where GIC's Deputy Chairman and Executive Director Tony Tan believes "there'll be more growth opportunities... compared to the developed world." Temasek, which traditionally has concentrated on local markets, divested its stakes in Barclays and Merrill Lynch Bank of America to focus once more on the regional markets in which it has had greater success. This approach has a double advantage for Singapore, as regional investments both have commercial returns and help rehabilitate local markets in the wake of the financial crisis, which will benefit the export-oriented Singaporean economy. Nevertheless, their transaction volume also has continued to remain low, suggesting greater caution and conservatism on the part of fund managers.

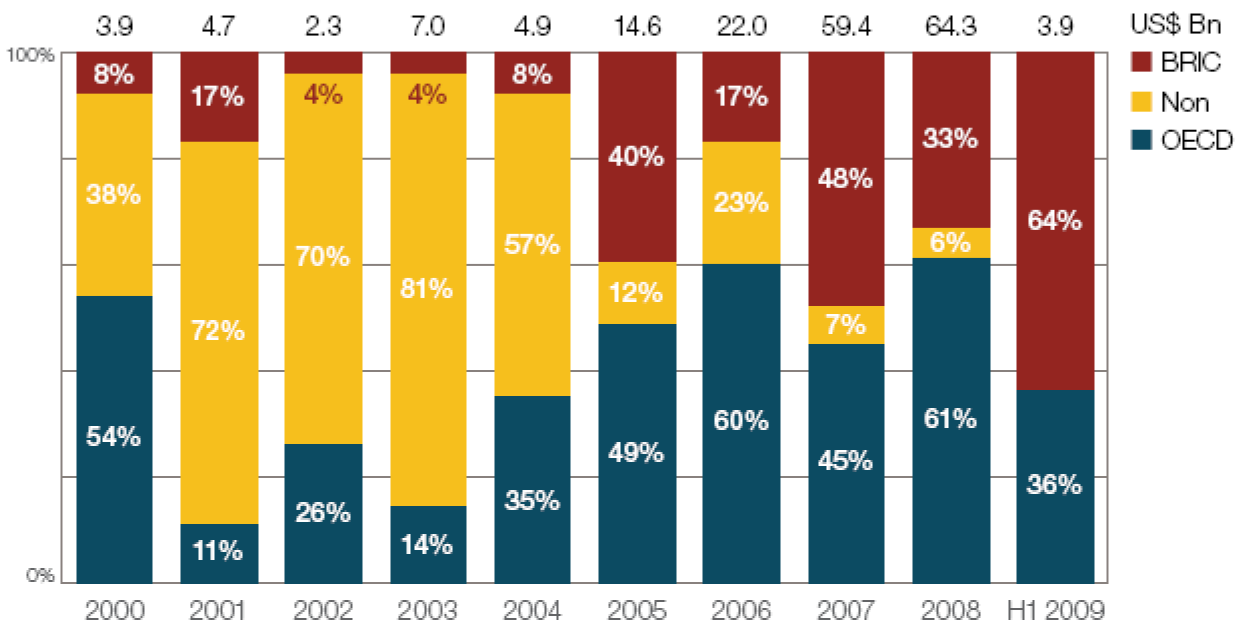
Where it has invested, GIC in particular has tended to collaborate with other sovereign and private investors. GIC purchased a share of private equity firm Apax Partners with the Australian Future Fund in February, as well as being a member of an SWF consortium with CIC and the Kuwait Investment Authority that contributed a combined $2.8 billion to BlackRock's accepted $6.6 billion bid for Barclays Global Investors, the bank's fund management unit, in June. More recently, it has entered another partnership with private equity firm Kohlberg Kravis Roberts and Chinese investment bank, China International Capital Corporation, to invest between $150 million and $200 million in International Far Eastern Leasing Company, a Chinese lender to SMEs.

GIC is not the only Asian fund working like this. In June, KIC signed cooperation agreements with two foreign public funds—Khazanah and Australia's QIC (formerly the Queensland Investment Corporation)—to "expand cooperation" and, a month later, signed a deal with KIA "to seek increased mutual investment." Temasek also is looking to release pressure by working with major players. July saw the fund talking to BOC International, the investment banking arm of Bank of China, to launch a $1 to $2 billion investment fund to focus on fast-growing infrastructure projects across China.

Despite Singapore's continued caution, in the second and third quarters, Asian funds have accelerated their investments, completing acquisitions valued at $2.8 billion in the second quarter and more than $5 billion in the third. This has been driven by an uptick in activity by the Australian Future Fund and CIC. Prior to 2009, the Australian Future Fund had not made any publicly reported direct investments. The fund started the year by taking a 7.7% stake in Apax Partners with GIC, and has invested in property, purchasing a 33% stake in the Birmingham Bullring shopping center in September, suggesting that it is seeking to take advantage of distressed assets to diversify its portfolio.

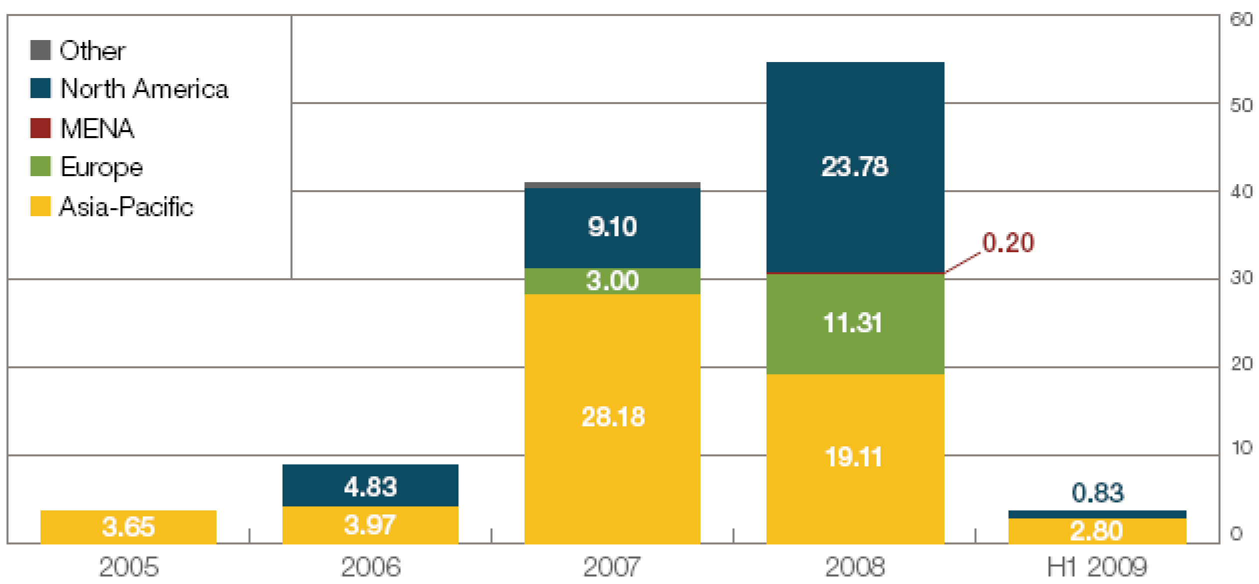
CIC, however, is driving Asian SWF activity: The fund's publicly reported investments in 2009

Value of Asian SWF Investments by Geography, 2000-Q2 2009



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

Value of Asian SWF Investments in Financial Services 2000-2008



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

currently are valued at more than $17.5 billion.

CIC started the year hesitantly, avoiding high-profile foreign purchases as a response to the intensification of the global financial crisis in September and October 2008, which hit the value of its portfolio, particularly holdings in U.S. financial companies. This retreat from the market represented a period of holding back until the global economy stabilized, and revamping its strategy and organizational structure.

Since April, the fund has looked to diversify its portfolio with alternative assets: companies that produce or supply commodities and natural resources, as well as hedge funds and real estate. It thus has taken the opportunity to maximize returns by purchasing 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.

This is highlighted by CIC's decision to invest $850 million for a 15% stake in commodities trader Noble Group and $1.9 billion in a debt-like instrument into PT Bumi Resources, the largest producer of thermal coal in Indonesia. The fund also took 17% of Canadian miner Teck Resources Ltd in early July for $1.5 billion, an 11% stake in Astana, Kazakhstan-based JSC KazMunaiGas Exploration Production for $939 million in September, and made a $700 million investment in Mongolia-focused Iron Mining International Ltd in October. In 2009, therefore, CIC has agreed to invest nearly $6 billion in resource deals, a sign of how energy, metals, and agricultural commodities are proving increasingly central to CIC's investment strategy.

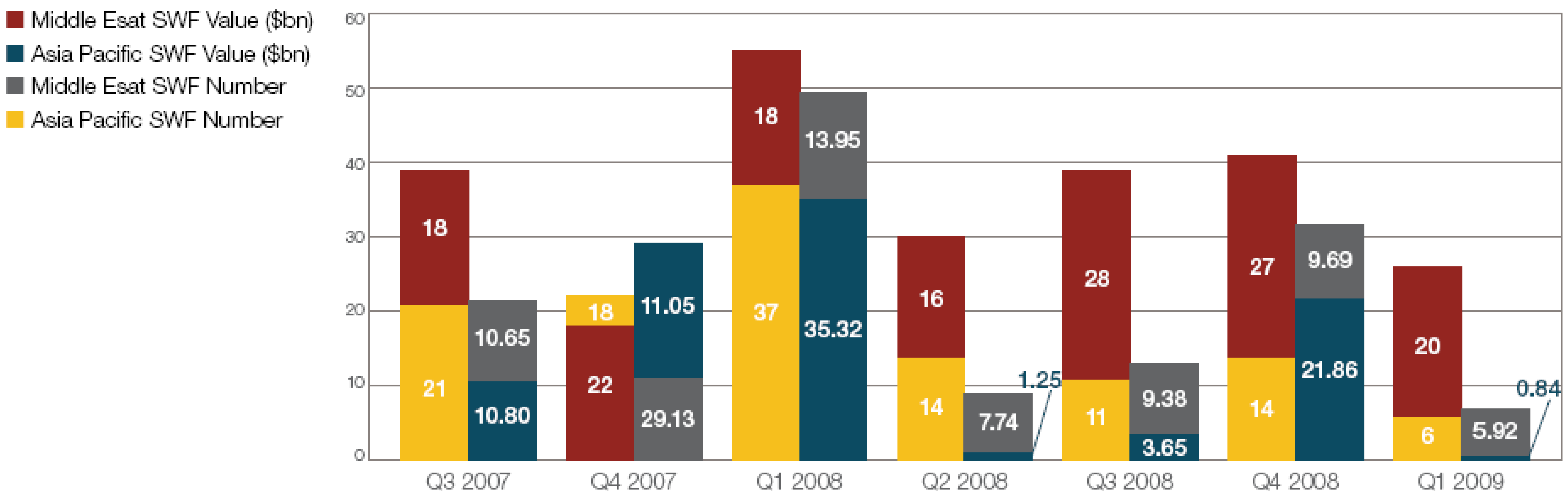
CIC also was busy queuing up alternative asset investment. The Chinese fund showed a particular interest in financial services, particularly asset management. In June, it announced that it would allocate $500 million to Blackstone Group's "fund-of-funds" unit, and $1.2 billion to Morgan Stanley's asset management unit. Additionally, CIC announced a $1 billion investment in the Oaktree Investment Corporation, another hedge fund investment group in September. This underlined its sharpened focus on hedge funds and alternative asset management brought by CIC's new structure, with a "private markets investment" division. Such investments also may 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, funds of funds, and other alternative asset investment groups, CIC can expand its investment footprint more rapidly while hiring and building its own internal capability, and taking advantage of the unique investment climate.

Real estate also has been a major sector for CIC in 2009. Its self-imposed period of thrift ended with an $800 million commitment to Morgan Stanley's new $6 billion Real Estate Fund VII Global on March 31. In June, CIC revisited the real estate theme, lending $200 million to Australian industrial property group Goodman and gave itself further exposure to real estate in July by purchasing a 40% stake in Hong Kong-based real estate fund manager CITIC Capital for $258 million. The fund also has been linked with large investments in the U.S.'s housing market through the Public-Private Investment Program and, in September, it teamed up with Morgan Stanley's real estate fund, the Qatar Investment Authority's Qatar Holding, and private investors to invest in Songbird Estates (a British real estate company that controls the owner of more than half of London's Canary Wharf financial district) in which CIC acquired a 19% stake.

CIC clearly sees these opportunities and has embarked on its own unique strategy. Chairman Lou Jiwei stated, in late August, that CIC was building a broad investment portfolio that includes products designed to generate both alpha and beta—to hedge against both inflation and deflation, and to provide guaranteed returns in the event of a new crisis. "We have to be in everything because you never know what's going to happen in this world."

There is thus a clear difference between CIC and the rest of the Asian funds that are continuing to be cautious in their investment approaches. GIC, Temasek, Khazanah, the Future Fund, and KIC are looking to partner to share risk, gain specialist expertise, get help with red tape, and effective due diligence. Nevertheless, both strategies represent a new trend in SWF investment—that of investing abroad to assist economic development at home—which is something we shall see more of in the coming months. ai

Number of Asian SWF Investments by Geography, 2000-Q2 2009



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