Sovereign Wealth Fund Investment Behavior

SEMI-ANNUAL REPORT: JANUARY–JUNE 2010

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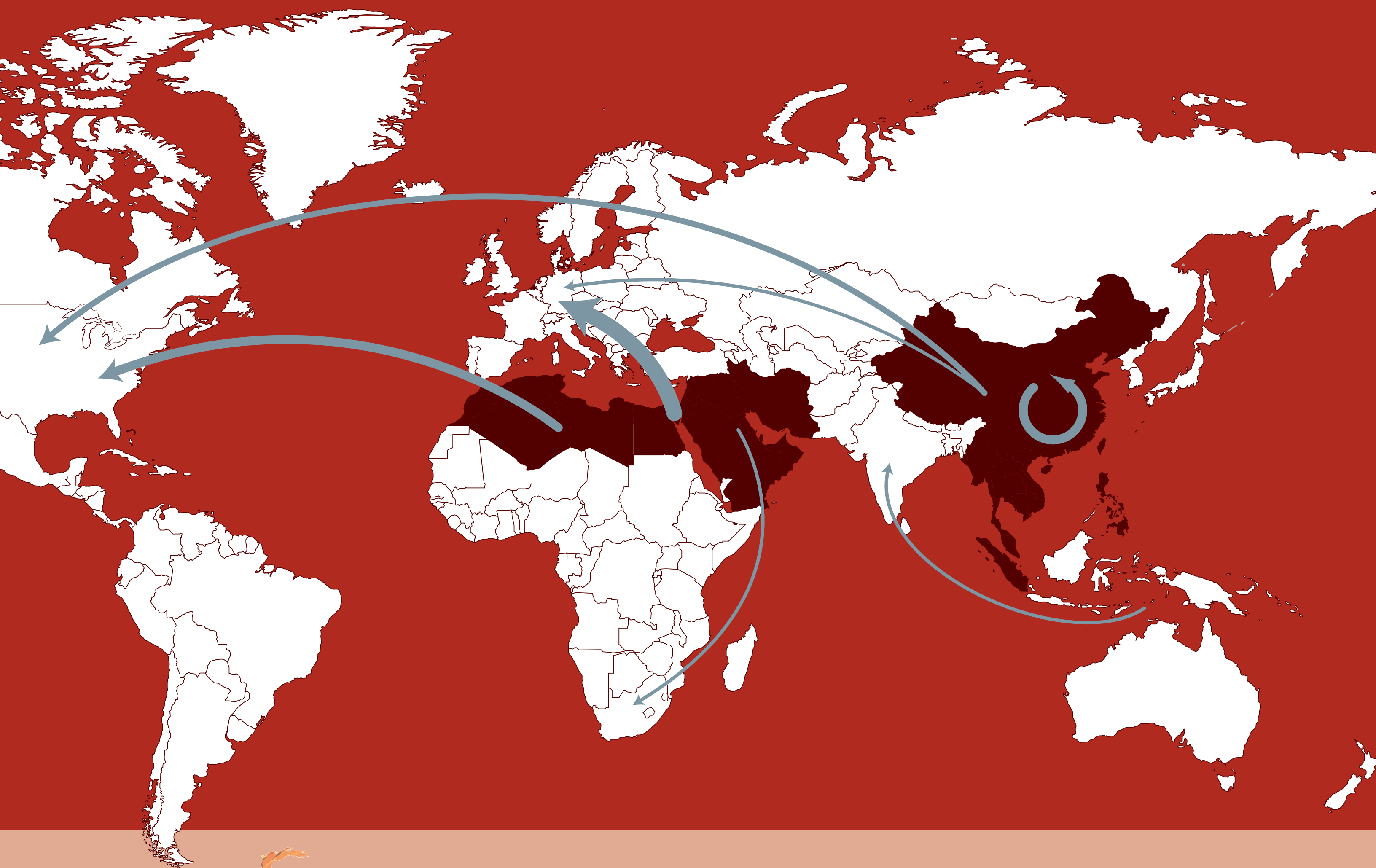

Fondazione Eni Enrico Mattei

MONITOR GROUP

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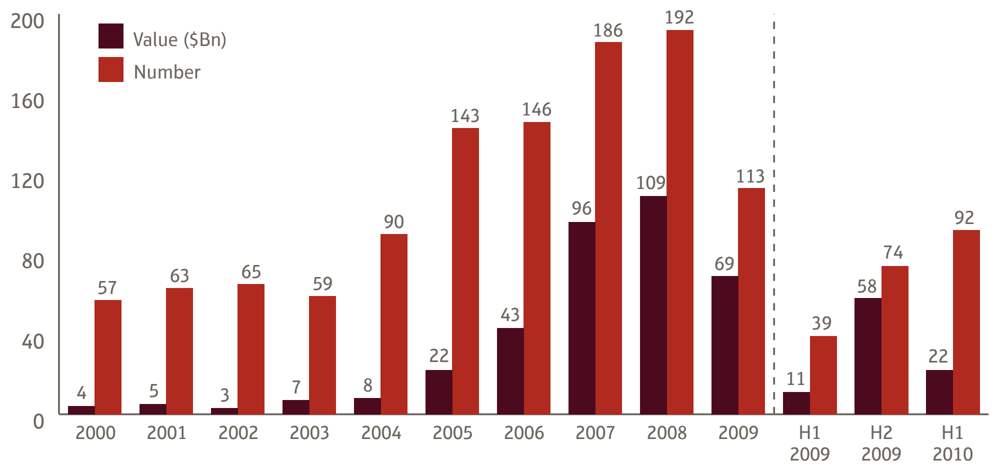
IN THE FIRST HALF OF 2010,
SWF INVESTMENT CONTINUED ITS UPWARD TREND.

Overview

The global economic environment of the first half of 2010 was far better than that of the same period a year earlier. After withdrawing from the market during the first half of 2009, SWF investment activity picked up. At the beginning of 2010, this trend continued. During H1 2010, 16 of the 33 SWFs on the Monitor-FEEM SWF Transaction Database undertook 92 publicly reported investments with a value of $22.2 billion—double the number and value of the same period in 2009. Compared to H2 2009, the previous half year, the number of deals increased by 20 percent in H1 2010, but the value of these represented only 40 percent of the previous total. It thus appears that SWFs continued a trend we identified at the end of last year—that of making more, but smaller individual investments and (generally) taking smaller shareholdings. Additionally, the value of SWFs' investment was depressed in comparison to H2 2009 as during H1 2010 they did not make any large domestic investments or recapitalizations such as those that inflated total expenditures in the earlier period.

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

However, this pattern may also signal that SWFs are being more cautious than they were six months ago, as they respond to concerns about sluggish economic growth and the possibility of a double-dip recession. For example, during the first half of 2010 we recorded only 18 announced or pending SWF investments—the same amount announced in the third *quarter* of 2009. This suggests that while SWFs remain active in M&A markets, they are unwilling to commit too far in advance or to announce investments before the fact.

In 2009, we noted a trend of SWFs retreating from financial services investments. During the first half of 2010 we saw a move back to this sector, with SWFs making 19 investments with a total value of $7.4 billion. However, the investment pattern was different from that in 2008, when SWFs took large equity stakes in OECD financial institutions. In 2010, SWF purchases were not, on the whole, equity stakes in banks, but rather indicate a trend towards more diverse exposure to this sector.

For example, SWFs invested in private equity and investment funds focused on emerging markets or infrastructure development.

SWFs also partook in a global and accelerating M&A boomlet in energy, suggesting that their continuing interest in natural resources is part of a wider trend in the global economy. According to Thompson Reuters the value of global investments in energy and power are up 64 percent on 2009 to $292 billion and accounted for 22 percent of all global deals in the first half of 2010. The SWFs in our database contributed 15 deals valued at $6.9 billion to these sectors during the first half of the year. A related sector in which SWFs also showed interest was mining and solid minerals. In the first six months of 2010, SWFs invested over $1.6 billion in mining companies; although most of these were listed in OECD countries (Canada, the United States and Britain) their businesses are centered on mining in emerging markets.

Among SWFs, China Investment Corporation (CIC) and Qatar Investment Agency (QIA) once again proved the most willing to make large investments. CIC made 14 publicly reported investments valued at $7.3 billion, primarily in natural resources (energy and mining) and private equity. QIA also made 14 publicly reported investments with a value of $5.5 billion, the most notable being the Raffles Hotel in Singapore and Harrods, the luxury London department store.

Highlights

1. During H1 2010, 16 of the 33 funds on the Monitor-FEEM SWF Transaction Database executed 92 investments valued at $22.2 billion: a 20 percent increase in deal volume, but less than 40 percent of the value of SWF investments in H2 2009. Compared to H1 2009, SWFs doubled the number and investment value of deals in H1 2010.

2. In H1 2010, SWFs' publicly reported deals remained spread across diverse sectors, continuing the trend we identified in 2009. However, three sectors stood out in their investment patterns: financial services (19 deals, $7.4 billion); natural resources (16 deals, $4.3 billion); and utilities (6 deals, $4.3 billion).

3. Again, Europe was the largest market for SWF investment in terms of recorded value, accounting for almost 40 percent of the total. North American assets were also proportionately more attractive to SWFs, accounting for a third of the value of investments we recorded. OECD markets accounted for nearly three quarters of the total deal value.

4. Once more, Asia-Pacific accounted for the largest number of deals (28) in the period. North America was the second most popular region (22 deals). SWFs also continued to demonstrate interest in Latin America, non-Pacific Asia and sub-Saharan Africa, executing 14 deals with a value of $1.5 billion in these markets.

5. The most active funds were Temasek Holdings (20 deals), the China Investment Corporation and the Qatar Investment Authority (both 14 deals). CIC and QIA were the largest spenders accounting for a third and a quarter of the total SWF investment value, respectively, and eight of the ten largest investments for the period.

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 but also employing press-releases, published news, fund annual reports and many other data sources.

To ensure accuracy, we follow a strict process for capturing deal information and we establish a clear hierarchy of sources, based on our estimate of reliability:

1. Financial transaction databases: Bloomberg, SDC Platinum, Zephyr
2. A financial database for target firm information: DataStream
3. Fund disclosures, including annual reports, press releases and other information from their websites
4. Target company and partner organization press releases and other information from their websites

5. Information aggregators: LexisNexis and Factiva. These include news reports by newswires (Dow Jones, Reuters, Business Wire, Associated Press, etc.) and numerous respected publications, including: *The Wall Street Journal*; *Financial Times*; *Newsweek*; *Forbes*; *Fortune*; *Time*; *The Economist*; *The New York Times*; *The Washington Post*.
6. Other websites, including Zawya.com, Sovereign Wealth Fund Institute, Google Finance, Yahoo! Finance and others.

Most of the deals are amassed and consolidated from the financial transaction databases, while the other sources are mostly used for corroboration where necessary. At least one high-quality source is captured for each data point, and, where possible, multiple sources are identified. News items from information aggregators such as LexisNexis are carefully examined to ascertain the reliability of the original source.

Where possible, we contact the management of the funds to obtain feedback regarding the accuracy of our data. Whenever available, we incorporate such feedback into our database.

THE ALTERNATIVE ENERGY SECTOR WAS A POPULAR INVESTMENT FOR SWFs WITH CIC AND MUBADALA INVESTING IN SOLAR AND WIND ENERGY GENERATION

Sectoral Analysis

In the first half of 2010, SWFs invested in a wide range of sectors, as they continued to diversify their portfolios. However, their publicly reported investment activity suggests that three sectors—financial services, natural resources[1] and utilities—were particularly attractive. These accounted for nearly three-quarters of SWFs' publicly reported expenditure during this half of the year ($16.1 billion), and just under half of the deals (42).

Away from these sectors, investments have been varied. Some funds invested in manufacturing and engineering-based industries (transportation, automobiles, aviation and construction), while others were interested in technology companies with strong IP (communications, healthcare and biotechnology). For some funds, hotels and real estate were notable sectors.

1 "Natural resources" refers to the coal, petroleum and natural gas and mining sectors.

Financial Services

Following SWFs' frenzied investments in failing American and European financial institutions during the winter of 2007-08 and a bailout of domestic banking sectors in early 2009, SWFs generally shied away from the financial sector. At the beginning of 2010, however, SWFs seemed to regain their appetite for investments in financial services, making 19 investments (20 percent of the total) valued at $7.4 billion (a third of the total) in this sector during H1 2010.

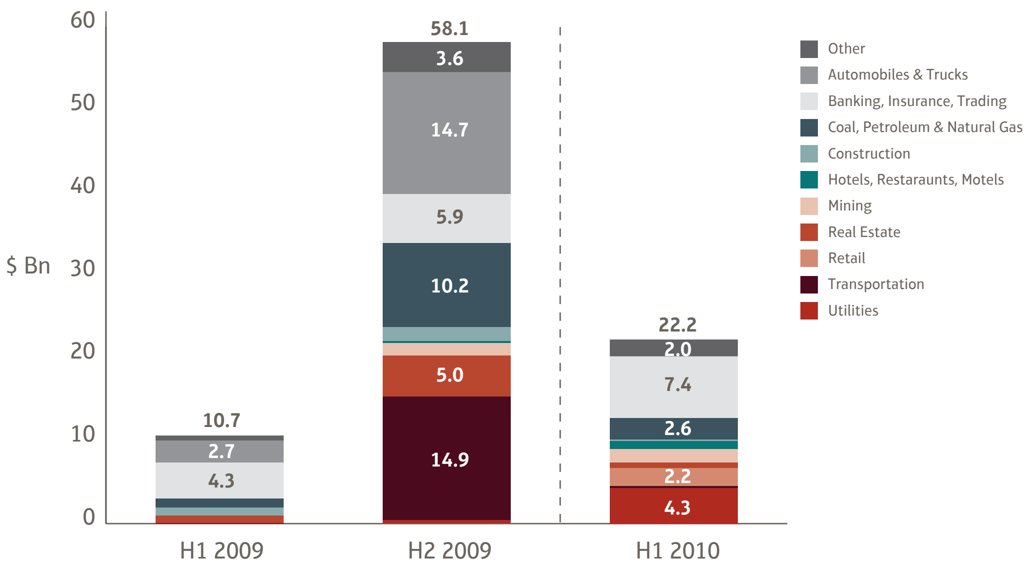
The character of these investments differs from that of earlier years, with SWFs diversifying their financial services investments. There were only three direct equity investments in banks. Two were to assist domestic banks: Ireland's NPRF invested €630 million in the Bank of Ireland to maintain its 36 percent stake after a new rights issue, and QIA invested $221.7 million in the Commercial Bank of Qatar. The third was the purchase of a 4.99 percent stake in Italian Bank Unicredit, by Abu Dhabi's International Petroleum Investment Company's (IPIC) subsidiary, Aabar Investments, which aligns with the stated aim of diversifying its portfolio away from petroleum and natural gas assets.

On the whole, however, rather than taking direct equity stakes in banks or recapitalizing their balance sheets, SWFs invested in alternative assets. CIC and the Government of Singapore Investment Corporation (GIC) invested in private equity. The former gave both Goldman Sachs and Lexington Partners $500 million mandates to manage ring-fenced portfolios for the private equity secondary market, and purchased a stake in Apax Partners, while GIC purchased a three percent stake in British private equity company 3i Group.

Another notable target for SWF deals was investment funds for frontier markets. The Korea Investment Corporation (KIC) and State Oil Fund of the Republic of Azerbaijan (SOFAZ) both invested around $150 million in the International

Finance Corporation's new African, Latin American, and Caribbean Fund, which has a mandate to find commercially viable opportunities to finance growth and jobs in the developing world. QIA followed a similar path by establishing PT Qatar Holding Indonesia, a $1 billion Indonesian fund to invest in infrastructure and natural resources in South-east Asia's biggest economy.

Figure 2: Value of SWF Investments by Target Sector H1 2009–H1 2010

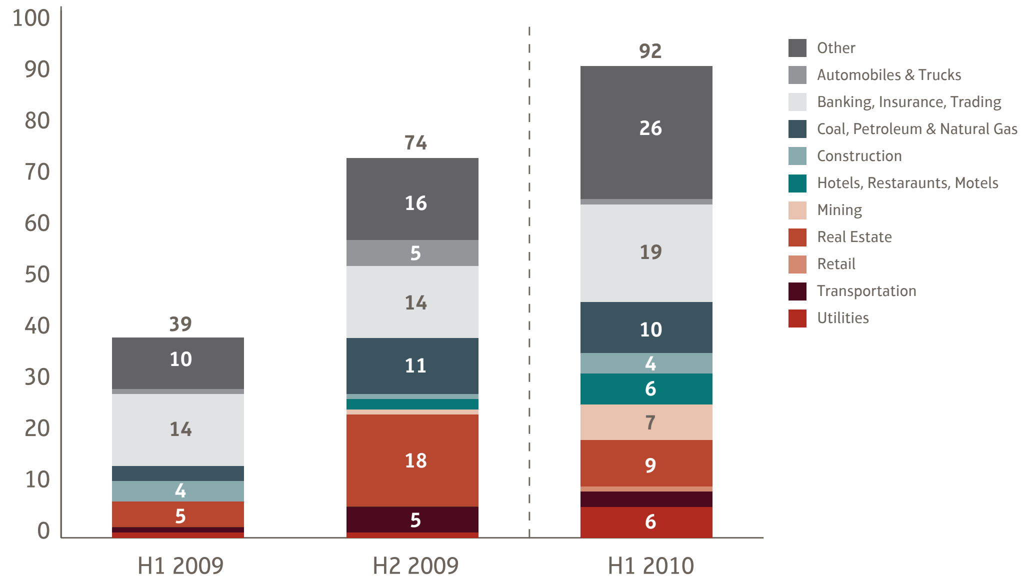


Other: Consumer Goods; Healthcare, Medical Equipment, Pharmaceutical Products; Recreation; Personal and Business Services; Printing & Publishing; Fabricated Products and Machinery; Communication; Aircraft, ships, and railroad equipment; Chemicals; Food Products; Beer and Liquor; Business equipment; Business Supplies and Shipping Container; and Wholesale.

Publicly available data for SWF equity & real estate deals, joint ventures and capital injections

Source: Monitor-FEEM SWF Transaction Database

Figure 3: Number of SWF Investments by Target Sector H1 2009-H1 2010



Other: Consumer Goods; Healthcare, Medical Equipment, Pharmaceutical Products; Recreation; Personal and Business Services; Printing & Publishing; Fabricated Products and Machinery; Communication; Aircraft, ships, and railroad equipment; Chemicals; Food Products; Beer and Liquor; Business equipment; Business Supplies and Shipping Container; and Wholesale.

Publicly available data for SWF equity & real estate deals, joint ventures and capital injections

Source: Monitor-FEEM SWF Transaction Database

Natural Resources

At the end of 2009 we noted SWFs' growing appetite for investments in energy assets and mining companies. In 2010, SWFs on our database remained active in this sector, undertaking 16 publicly reported investments with a value of $4.3 billion. This is part of wider trend of investments in natural resources evident this year, driven largely by the emergence of China and "its insatiable need for resources." This has been mirrored in publicly reported SWF investments: CIC was responsible for six deals worth nearly $2.4 billion—over half of total SWF investment in this sector.

Investing in companies that produce energy assets have been at the heart of this trend. For example, the Chesapeake Energy Corporation, an American natural gas producer, received more than $1 billion from KIC, CIC, and Singapore's Temasek Holdings in H1 2010. SWFs also displayed significant interest in solid mineral exploration with a focus on metals such as platinum, copper and zinc. The seven mining investments made in the first six months of 2010 were valued at $1.7 billion. The Singaporean funds led the way, showing a new interest in this sector.

Utilities and Infrastructure

The power-generation sector, from both alternative and hydrocarbon energy sources, was the major recipient of utilities investments by SWFs in the first six months of 2010. The sector accounted for six deals with a total value of $4.3 billion. The alternative energy sector was the most prominent, with CIC and the Mubadala Development Company investing in solar and wind energy. Temasek also sought to take advantage of opportunities in previously under-exploited markets by investing $200 million in India's GMR Energy, a subsidiary of diversified infrastructure major GMR Infrastructure Ltd. GMR will use the funds to enhance its installed power generation capacity in India from 808MW to over 6,500MW over the next three to four years.

SWFs found attractive opportunities in the infrastructure sector during H1 2010. Such investments appeal to long-term investors like SWFs by helping to diversify their portfolios and providing a hedge against inflation and wealth-source changes. SWFs sought exposure to this sector in diverse ways. The Abu Dhabi Investment Authority (ADIA) purchased a direct share of London's Gatwick Airport and increased its share in Australian infrastructure management company, Intoll Group, to just below 10 percent, from 8.6 percent. The Asian funds Temasek and Khazanah Nasional, in contrast, invested in the construction of new cities in China, Singapore and Malaysia.

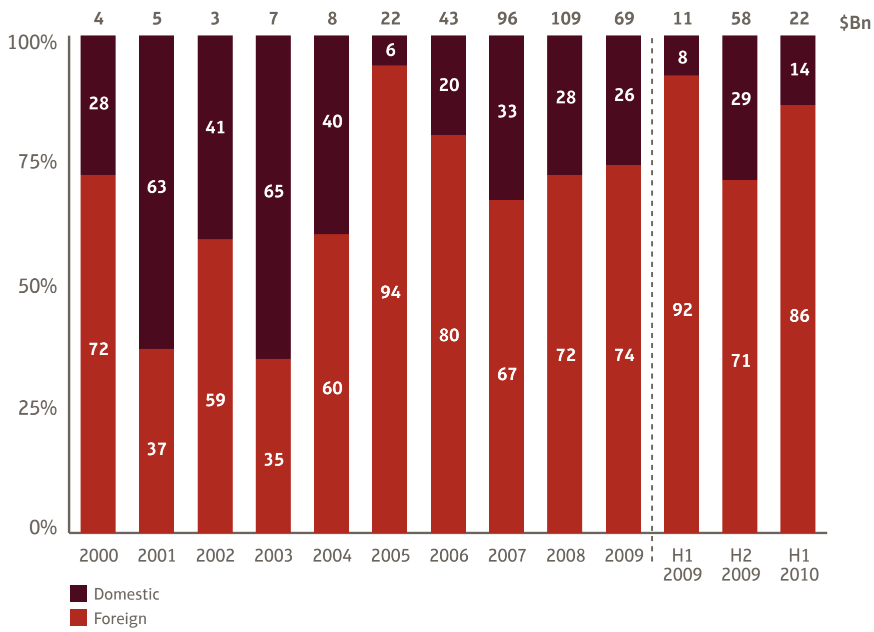
AGAIN, EUROPE WAS THE LARGEST MARKET FOR SWF INVESTMENT IN TERMS OF RECORDED VALUE. INVESTMENTS INCLUDED QIA'S PURCHASE OF HARRODS IN LONDON

Geographical Analysis

Following the trend evidenced at the end of last year, SWFs remained active abroad, with a particular focus on developed markets. Only 12 publicly reported deals valued at $3 billion were made in funds' home economies. By contrast, over three quarters of SWFs' publicly reported expenditure ($16.3 billion) and nearly half of the deals (47 percent, 43 deals) occurred in the OECD.

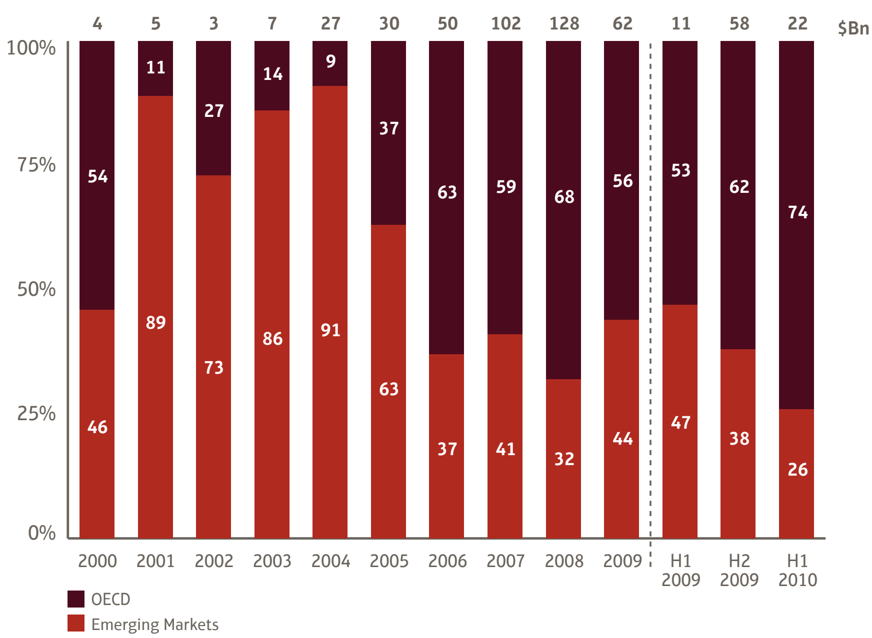
Europe was once more the largest market for SWF investment in terms of recorded value, accounting for almost 40 percent of the total expenditure ($8.2 billion) and half of the ten largest deals in the period. Most of the investment came in the second quarter with QIA's purchase of Harrods, and IPIC's investment in Unicredit. Otherwise, SWFs largely stayed away from European financial services, preferring to invest in a wide range of sectors from infrastructure and real estate to retail and consumer goods.

Figure 4: Value 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 by Location of Target: OECD vs. Emerging Markets

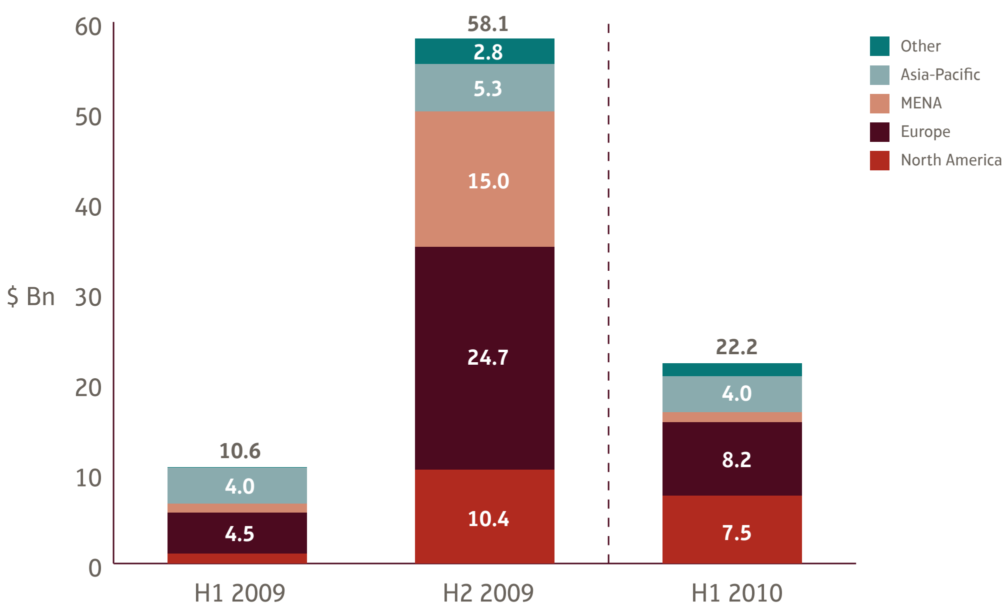


Note: Publicly available data for SWF equity & real estate deals, joint ventures and capital injections
Source: Monitor-FEEM SWF Transaction Database

Having shied away from investments in North America during most of 2009, SWFs displayed a cautious return to these markets during H1 2010: North American investments accounted for a third of the value of SWFs investments we recorded ($7.5 billion). However, this could be misleading: few of these investments appear to represent a vote of confidence in the American economy. Only three investments were made in companies with substantial operations in the United States and none exceeded $50 million. Half the value of SWFs' investments in North America during H1 2010 involved asset management and investment funds ($1.4 billion), many of which focused on emerging markets, and energy ($2.4 billion).

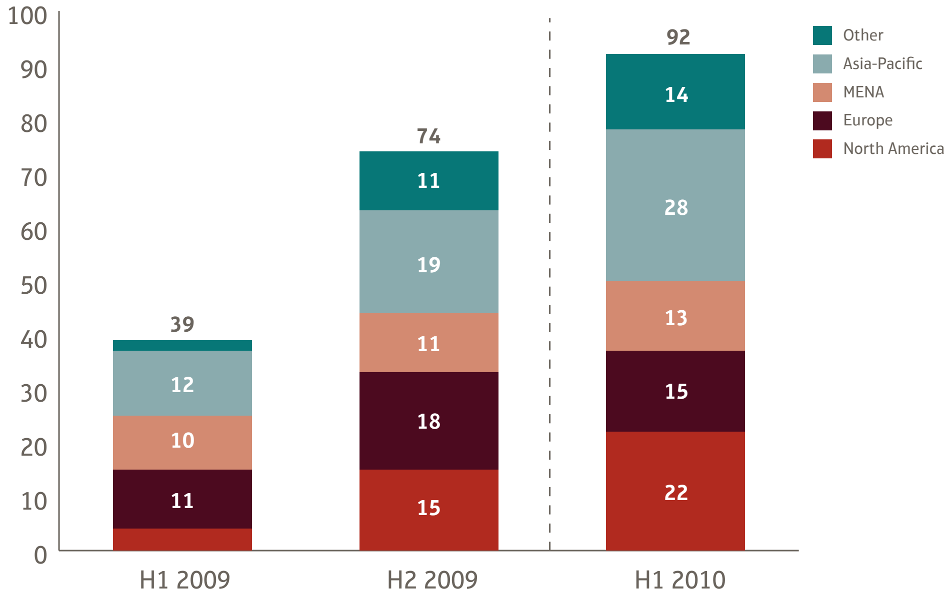
SWFs once more made the greatest number of investments by geography in Asia Pacific. Target companies based in the region accounted for 30 percent of all deals made by SWFs, but this represented less than 20 percent of the value. This suggests that while SWFs, particularly those from the region, find attractive investment opportunities in Asia Pacific, they remain cautious about committing too much capital to a single company: half of the publicly reported SWF investments in Asia Pacific were valued at less than $100 million. SWF investments in the Middle East followed a similar pattern; while funds made 13 investments in the region, these were valued at only $1.1 billion.

Figure 6: Value of SWF Investments by Target Region H1 2009-H1 2010



Other: Latin America, Sub-Saharan Africa, and Asia (Non-Pacific).
Publicly available data for SWF equity & real estate deals, joint ventures and capital injections
Source: Monitor-FEEM SWF Transaction Database

Figure 7: Number of SWF Investments by Target Region H1 2009-H1 2010



Other: Latin America, Sub-Saharan Africa, and Asia (Non-Pacific).
Publicly available data for SWF equity & real estate deals, joint ventures and capital injections
Source: Monitor-FEEM SWF Transaction Database

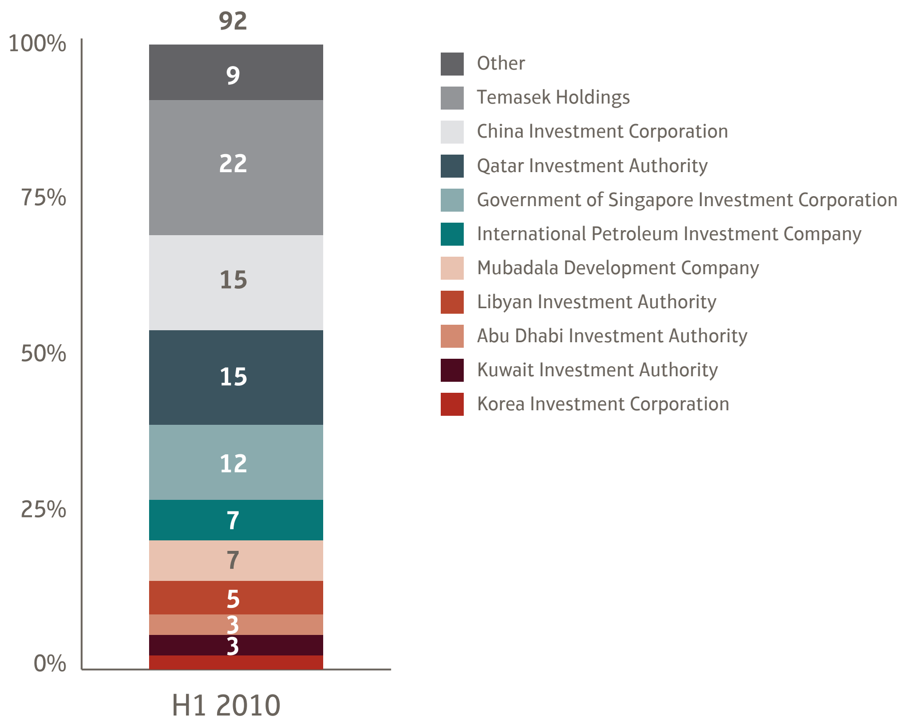
In the first half of 2010, SWFs continued their drive to look further afield for investment opportunities. Whereas the funds invested as usual in OECD, East Asian or South-East Asian markets, as well as the Middle East and North Africa, a growing number of SWF investments occurred in countries such as India, Russia and those sub-Saharan Africa. While the total value of these investments remains comparatively small—around $1.5 billion—it represents an ongoing trend of the geographic diversification of SWF portfolios.

TEMASEK HOLDINGS WAS THE MOST ACTIVE SWF IN H1 2010

Funds

The most active funds during the first half of 2010 were Temasek, CIC and QIA, which together accounted for over half the investments made by SWFs during this period. Temasek made 20 investments valued at $2.5 billion, continuing its strategy of investing in natural resources and technology companies with strong IP. On the whole, these were small investments concentrated on emerging markets, with the fund investing in countries such as India, Chile, and South Africa, along with its usual Asia-Pacific geographies. Temasek made only three investments valued at $225 million in Singapore.

Figure 8: Number of Deals for 10 Most Active SWFs, H1 2010



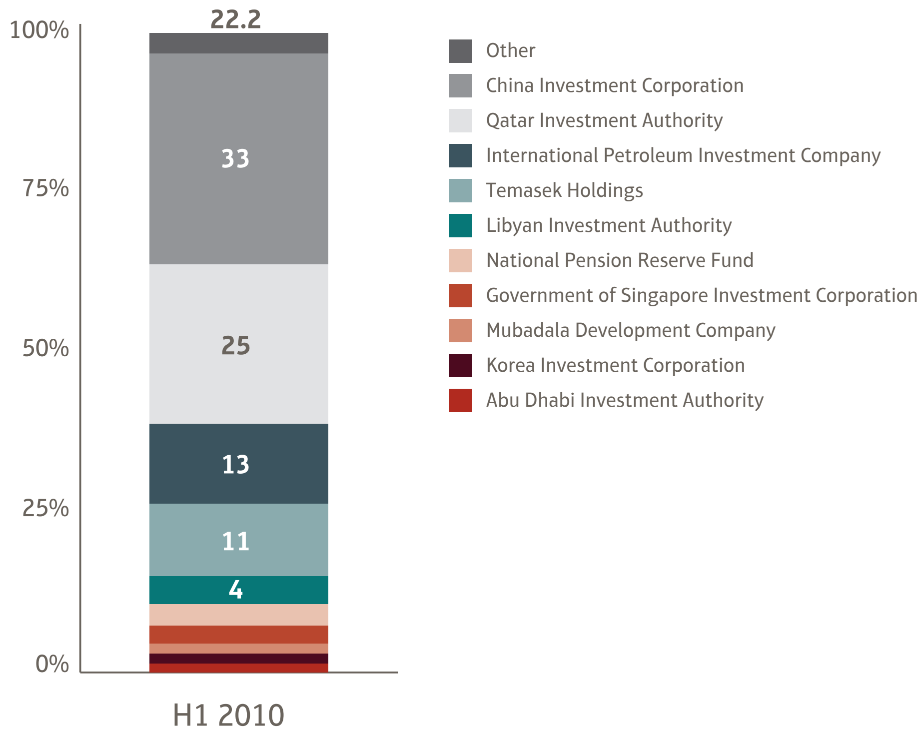
Other: Abu Dhabi Investment Council, Khazanah Nasional Bhd, Korea Investment Corporation, National Pension Reserve Fund, New Zealand Superannuation Fund, Oman Investment Fund, and State Oil Fund of the Republic of Azerbaijan.

Note: Publicly available data for SWF equity & real estate deals, joint ventures and capital injections

Source: Monitor-FEEM SWF Transaction Database

CIC continued the strategy that we saw emerging last year, concentrating on natural resource and power investments to satisfy the need for energy and metals for China's economic growth. It also invested in power generation and construction companies, most notably its investment in AES. Although their joint venture was abandoned, the investment in AES is an important landmark, perhaps signaling a desire to move away from hydrocarbon energy sources.

Figure 9: Value of Deals ($bn) for 10 Highest-Spending SWFs, H1 2010



Other: New Zealand Superannuation Fund, State Oil Fund of the Republic of Azerbaijan, Mubadala Development Company, Abu Dhabi Investment Council, Khazanah Nasional Bhd, Oman Investment Fund, and Kuwait Investment Authority.

Note: Publicly available data for SWF equity & real estate deals, joint ventures and capital injections

Source: Monitor-FEEM SWF Transaction Database

QIA remains one of the most intriguing SWFs. In 2009, it took a break from investing for the first six months of the year. Since then, it has been rapidly deploying capital around the globe, investing $32.5 billion during H2 2009. At the beginning of 2010 this breakneck speed continued. Particularly notable was the fund's tendency to act as an asset accumulator, purchasing "trophy" assets, such as the Raffles Hotel and Harrods. While this behavior was fairly common for SWFs prior to the global financial crisis, QIA is the only fund on our database that still acts like this. These high-status assets sit atop what, from the outside, appears to be a diversified portfolio. This year, QIA has invested in a range of sectors and geographies, from French utility company Veolia Environnement, to creating a $1 billion fund to invest in Indonesian assets. However, our data suggests that QIA is active in making small, open-market purchases, which are more difficult to track, thus leaving its asset accumulator reputation intact.

Figure 10: The 10 Largest SWF Investments in H1 2010

PARENT ENTITY NAME	NATIONAL AFFILIATION	TARGET	COUNTRY OF TARGET HQ	COMPLETED DATE	SIZE OF DEAL (USD MM)	SIZE OF STAKE
International Petroleum Investment Company	UAE	Unicredit SpA	Italy	16/06/2010	$2,300.00	4.99%
Qatar Investment Authority	Qatar	Harrods	UK	07/05/2010	$2,227.05	100.00%
China Investment Corporation	China	AES Corp	US	15/03/2010	$1,580.51	15.82%
Qatar Investment Authority	Qatar	PT Qatar Holding Indonesia	Indonesia	11/05/2010	$1,000.00	—
China Investment Corporation	China	Apax Partners	UK	04/05/2010	$956.00	2.20%
Qatar Investment Authority	Qatar	Veolia Environnement	France	16/04/2010	$868.00	5.00%
Qatar Investment Authority	Qatar	Fairmont Raffles Holdings International	Canada	07/04/2010	$847.00	40.00%
China Investment Corporation	China	JV - CIC & Penn West Energy Trust	Canada	01/06/2010	$817.00	45.00%
National Pension Reserve Fund	Ireland	Bank of Ireland	Ireland	08/06/2010	$756.13	—
China Investment Corporation	China	GCL Poly Energy Holdings Limited	China	01/01/2010	$709.69	20.00%

SWFs AND PRIVATE CAPITAL

A certain type of SWF is exhibiting a new form of behavior that could ultimately change its character. Those funds with portfolios with a substantial proportion of real assets—stakes in government-linked companies (GLCs), joint ventures or fully-owned corporate entities, and real estate holdings—have recently started seeking finance from the private sector in a trend that appears to have become more pronounced since the end of 2009. This has raised the question that if a SWF is financed by something other than sovereign wealth, should we still think of it as a *sovereign* wealth fund?

Although Singapore's Temasek Holdings has been issuing bonds since 2005, it accelerated its bond program from Q3 2009. Between October 2009 and February 2010, it raised $4 billion through debt issues, and announced that it was doubling its global medium-term note program to $10 billion; it also issued its first sterling-denominated bond in July. Other funds have followed Temasek's lead. In April 2009, the Mubadala Development Company offered $1.25 billion in five-year bonds and $500 million in ten-year bonds to international investors. In June 2010, the Bahrain Mumtalakat

SWFs and their Subsidiaries Raising Capital from the Private Sector

FUND	SUBSIDIARY	PRIVATE CAPITAL RAISING	DATE
Temasek Holdings		Bond Issuance	2005–present
Temasek Holdings	Mapletree Investments	Initial Public Offering of 2 REITs (first, $910 million)	2010
Mubadala Development Company		Bond Issuance ($1.75 billion)	2009
Bahrain Mumtalakat Holding Company		Bond Issuance ($750 million)	2010
Khazanah Nasional		Sukuk Issuance ($1.1 billion)	2010
Qatar Investment Authority	Qatari Diar	Bond Issuance ($3.5 billion)	Forthcoming 2011
China Investment Corporation	Central Huijin Investments Ltd	Bond Issuance ($22 billion)	Ongoing 2010
Government of Singapore Investment Corporation	Global Logistic Properties	Initial Public Offering	2010

Holding Company issued $750 million of five-year senior unsecured bonds, attracting an order book of about $3 billion. Khazanah Nasional, the Malaysian SWF, recently underlined its move away from domestic holdings by selling $1.1 billion in Singapore-dollar denominated *sukuk* (Sharià-compliant bonds) on the Singapore market, making it the city-state's biggest *sukuk* sale.

Other SWFs have raised private financing through bond issuance on particular subsidiaries underpinned by real assets. Qatari Diar, the real-estate arm of the Qatar Investment Authority, is currently planning to sell $3.5 billion in bonds next year. Also getting in on the act is the China Investment Corporation's domestic investment arm, Central Huijin Investment—whose portfolio is dominated by large stakes in many SOEs, most notably domestic banks—recently raised $7.94 billion via the domestic interbank market in its maiden bond offering and is planning to issue at least $22 billion in Yuan-denominated bonds in Q3 2010.

Another trend has been for SWFs formed from sovereign holdings in GLCs to offer units for IPO. For funds like Temasek, Mumtalakat, Khazanah, Vietnam's State Capital Investment Corporation, and Kazakhstan's Samruk-Kaznya, this reflects their purpose. They were formed to invest in nationalized companies and prepare them for privatization. Temasek, for example, has listed many of its portfolio companies in the past and its Mapletree Investments unit is planning to float two real estate investment trusts later this year. Mumtalakat has also announced the sale of part of its Bahrain Family Leisure unit, as the government seeks to get illiquid and commercial assets off the balance sheet. However, a fund that was not formed for this purpose is the Government of Singapore Investment Corporation (GIC), which is taking a similar course by listing part of its Global Logistic Properties business on the Singapore stock exchange in an IPO that may raise as much as $3 billion. GIC is exhibiting a new strategy for an "endowment fund," that of bringing private investors on board.

This trend raises a number of questions: why are they raising money in this manner? How does this affect the fund's investment strategy? And to what extent can they still be considered "sovereign investors?"

WHY?

An obvious reason for SWFs deciding to raise money from the private sector is the need for cash. The funds (or units of funds) taking this step are those with relatively illiquid capital bases, mostly bound up in real estate or other fixed assets, rather than equities or bonds which could be sold to rebalance or expand their portfolios. Additionally, in light of the economic conditions of the last two years, inflows from their government owners may have declined or stopped altogether. Consequently, they are taking advantage of the current low interest conditions to issue debt that will help them maintain their deal flow and investment strategy, as well as enabling them to take advantage of unforeseen investment opportunities. In the case of some funds like Mumtalakat, the issuance of bonds enabled the SWF to rebalance its debt repayments from short-term to long-term, easing demands on its cash flow. Raising capital from private investors thus relaxes the funds' current financial constraints.

Another potential reason for SWFs to seek private capital funding is an increased appetite for risk, or pressure for higher returns from their government owners. On the whole, bodies investing state wealth are obliged to take a low-risk approach to prevent them losing citizens' money. However, in the current economic environment, in which returns on equity and bond markets are relatively depressed, funds may be seeking to achieve higher returns by investing in riskier assets. Rather than "gamble" with state cash, the funds can justify investments in higher-risk assets to increase returns by citing the use of private (as opposed to government) money. While this might be attractive, it runs the risk of losing money on such investments, with the result that a fund may have to draw on state funds to pay private investors their coupon.

Drawing on private capital might also be a way for SWFs to cement their legitimacy by underlining their commercial credentials. There are still concerns that some funds invest in a politically motivated manner to the detriment of other states' economic or political interests. If the funds hold private, international capital, their critics have less room to take this line, as private investors are primarily concerned with financial, not political, return. Equally, funds might be seeking legitimacy from their domestic populations, particularly at a time when some SWFs faced criticism over their 2008 and 2009 losses. If private investors are willing to entrust their money to such a fund, this displays confidence in gaining acceptable returns. Bringing in private investors thus may bolster a fund's damaged domestic reputation.

Finally, SWFs might choose to raise capital from private investors for local macroeconomic reasons. It has been suggested that Central Huijin is issuing bonds to mop up the excess liquidity in the Chinese economy contributing to the formation of a property bubble. Moreover, in many emerging markets, bond markets are relatively small and illiquid. Deep, liquid bond markets are important for developing domestic economies as they enable businesses to raise money to grow, particularly when credit is scarce. By issuing bonds, SWFs (particularly those with a significant exposure to their home economies) can facilitate the development of the bond market to contribute to local economic growth. On a related note, SWFs with large domestic interests might also look to raise money from international markets to recapitalize or support those struggling firms in their portfolio—funneling international capital into parts of the local economy that otherwise it might not have reached.

IMPACT ON FUND ACTIVITY?

Raising capital from the private sector acts as a corporate commitment device, locking the fund and its private investors into a course of action that they might not otherwise choose, but also one that produces beneficial results. In this case, the SWF has to invest to satisfy investors' expectations, and pay their coupons. This has some effects that are beneficial for the fund; for example, it might act to increase fund managers' equity share of the fund and thus reinforce capital efficiency and long-term financial discipline by making them more sensitive to profits and thus improving returns.

On the other hand, it may also have detrimental effects by fundamentally altering the SWF's investment strategy. An important competitive advantage for SWFs is that they have no liabilities and can thus invest in illiquid and long-maturity assets that other institutional investors, such as pension funds, cannot. However, by taking on bondholders or shareholders, SWFs may lose this advantage. They alter their liability profile and must be attuned to the rights, needs, and requirements of private stakeholders as well as their government owners.

Having private bondholders or shareholders also forces a SWF to maintain or improve its level of transparency and reporting as well as corporate governance, which may bolster investor confidence in the fund. The practice also serves to improve a fund's reputation by demonstrating both the apolitical character of its investment strategy and the independence of its management. Some SWFs, however, may see increasing transparency as having an unacceptable downside. Based on the experience of the Norwegian Government Pension Fund—Global, it has been widely argued that the process of seeking legitimacy through transparency forced the fund to be more risk averse, because it had to earn the "buy-in" of the Norwegian people, and thus depressed potential returns.

Private capital acts as a commitment device on the side of the holders. By purchasing SWF bonds, investors are buying into the underlying aims, objectives, and aspirations of the fund. This has a substantial upside for the bond issuer. It enhances the fund's domestic legitimacy at a low price: while the bondholders are locked into the aims and objectives of the SWF, they do not have voting rights, and cannot, therefore, hold management to account. Moreover, in return for certainty of payment, they forgo the upside of the fund – if returns skyrocket, they do not see the benefit.

The relationship between the fund and its private stakeholders is different when the SWF invites them in as equity-holders through an IPO. The directors and officers of the fund are thus bound by fiduciary duties to act in the best interest of the shareholders. Equally, the SWF has to take into account shareholder rights to vote on matters such as elections to the board of directors, which remove its ability to appoint their chosen candidates unilaterally. Consequently, the government loses full control of the assets that the fund has accrued using government capital.

In the long term, these new responsibilities may change the behavior of SWFs as investors. Heretofore, the funds have been largely passive shareholders, rarely taking seats on boards or controlling stakes in companies outside their domestic economies. However, with the new obligations put upon them by private stakeholders, SWFs may need to become more involved in the management of the companies in which they invest and more activist as investors, bringing management to account. This might make them less attractive as investors for companies that want a capital injection but no interference. Equally, it might raise issues of sovereignty, particularly where a SWF holds a significant stake (five percent or more) in a foreign company. Such activity might, once more, raise political concerns about SWF investment abroad.

STILL SOVEREIGN INVESTORS?

SWFs are becoming increasingly diverse. However, the common feature of the funds is their liability profile, or rather their lack thereof: ostensibly, they have no liabilities beyond their government owner. If a SWF brings in private bondholders or shareholders then it is no longer solely accountable to its government, it must also to take new interests into account. This relationship eventually may alter the way in which we think about SWFs. Economic globalization has changed how we think about sovereignty, particularly as it pertains to excluding foreign actors, political authority, and the control of money flows across borders. States are increasingly sharing sovereignty with other players in the global economic system (other states, supranational organizations, for example). However, if a SWF is also responsible for investing private capital, then is it really a sovereign investor?

On the whole, for the moment at least, it is unnecessary to question the sovereignty of SWFs. Most funds that have brought private investors on board have limited their capital raising to about five percent of the fund's (or subsidiary's) AUM. Temasek, for example, have eight outstanding bonds, totaling just under $6 billion, on a portfolio worth $133 billion. Similarly, Mubadala's bond issue is valued at about seven percent of its total AUM. These comparatively small sums do not appear large enough to warrant subordinating the wishes of the sovereign government owner to those of private parties. Questions, however, might be asked if the value of private capital should rise above 15 percent in a fund's AUM. Until that time, it seems that the raising of private capital is unlikely fundamentally to alter the sovereign character of the SWF.

Appendix: Trends in SWF Asset Allocation

Since the signing of the Santiago Principles and the formation of the International Forum of SWFs to facilitate an understanding of the Principles and SWF activities,[2] several SWFs have improved transparency, with more publishing annual reports and others disclosing their assets under management. Thirteen of the SWFs on this list provide annual reports or detail portfolio allocation on their website, with six also publishing quarterly or semi-annual figures.[3] A further three publish accurate monthly or quarterly assets under management on their websites: a total of half the funds on our database, representing assets of over $1.8 trillion, 70 percent of the total assets.

2 See the International Forum of SWFs webpage for more details: http://www.ifswf.org/members-info.htm.

3 Global Pension Fund—Global (Norway); Abu Dhabi Investment Authority; China Investment Corporation, Government of Singapore Investment Corporation; Temasek Holdings (Singapore); Future Fund (Australia); Korea Investment Corporation; National Pension Reserve Fund (Republic of Ireland); Kazakhstan National Fund; Mubadala Development Company (Abu Dhabi); Bahrain Mumtalakat Holding Company; New Zealand Superannuation Fund; State Capital Investment Corporation (Vietnam).

Although not all funds report, and in some cases public disclosure is still not complete—ADIA and GIC, for example, publish annual reports with varying degrees of detail, but refuse to disclose their total AUM—there has been a significant trend toward transparency. This is reflected both in the growing number of SWFs producing annual reports, and the clarity and detail of reporting contained therein. For example, both Mubadala's 2010 half-year results and CIC's 2009 Annual Report are clearer and more detailed than previous reports. Additionally, senior officials from some funds that do not officially disclose the size of their AUM or asset allocation (such as IPIC and LIA) have been reported giving ballpark figures of their AUM. Even KIA's asset allocation has had more news coverage, despite it being illegal for any KIA current or former employee to disclose data or information about its invested assets.[4]

On the whole, MENA SWFs are the least inclined toward transparency. Most of the big players from the region (KIA, QIA, and LIA) do not disclose any information about their portfolios, while ADIA only publishes its benchmark asset allocation. Of the 15 MENA funds only two (Mubadala and Mumtalakat) publicly report their financials, presenting full accounts. The funds from the CIS (Russia, Kazakhstan and Azerbaijan) have adopted a different strategy. Rather than publishing a corporate annual report, they publish the accurate value of their assets on a month-by-month basis on their website. This may reflect the fact that their funds are primarily invested in liquid assets, such as cash reserves and government bonds, but, nevertheless, provides an alternative form of transparency.

Since our last report, *Back on Course*, was published in May 2010, most of the funds that disclose annual figures have published new reports with current asset allocation and AUM. SWFs are increasingly diverse in their mission, objectives investment activity and asset allocation; consequently, each fund has reacted differently to the

4 See table notes for details.

uncertain economic conditions of the past year, changing portfolios to take best advantage to the risks and opportunities they perceive. However, there are four overarching trends that have emerged from the changing of SWFs' asset allocations over the last year.

1. Of the funds for which we have revised AUM (or rates of return), nine grew—CIC, GIC, Temasek, Kazakhstan National Fund, KIC, Khazanah, SOFAZ, Timor Leste, State Capital Investment Corporation—while seven—GPFG, Future Fund, NPRF, Mubadala, Mumtalakat, NZ SuperFund, Istithmar—lost value.

2. With the exception of GPFG and GIC, the changes in asset allocation suggest that SWFs have an increased appetite for risk, allocating greater proportions of their portfolios to equities, commodities, real estate and infrastructure, as well as other alternatives such as private equity and hedge funds, possibly in a bid to achieve higher returns in a depressed market.

3. On the whole, SWFs have tended to increase the share of the portfolio invested in developed-market equities, primarily in Europe, rather than the United States. Notable exceptions to this trend are: Temasek, which increased its allocation to Asia, and slightly reduced its exposure to both developed and emerging non-Asian economies, and CIC, which published its geographical spread for the first time, and has nearly 44 percent of its global portfolio in American assets.

4. Those funds with asset bases in business operations (Mubadala, Temasek, Mumtalakat, Khazanah) on the whole have had a strong year, although both Mubadala and Mumtalakat lost value, the former due to a decrease in the value of its long-term equity portfolio.

Descriptive Data of the 33 SWFs in the Monitor-FEEM SWF Transaction Database

COUNTRY	FUND NAME	AUM $US BN	INCEP-TION YEAR	SOURCE OF FUNDS	ASSET CLASSES	GEOGRAPHIES
Norway	Government Pension Fund–Global[1]	430.6	1990	Commodity (Oil)	Equities and units (59.6%) Bonds and other fixed income instruments (40.4%)	Europe (54%); Americas & Africa (35%); Asia/Oceania (11%)
UAE/ Abu Dhabi	Abu Dhabi Investment Authority[2]	395	1976	Commodity (Oil)	Developed Equities (35-45%) Emerging Market Equities (10-20%) Small Cap Equities (1-5%) Government Bonds (10-20%) Credit (5-10%) Alternative Assets (5-10%) Real Estate (5-10%) Private Equity (2-8%) Infrastructure (1-5%) Cash (0-10%)	United States (35-50%); Europe (25-35%); Developed Asia (10-20%) Emerging Markets (15-25%)
China	China Investment Corporation[3]	332.4	2007	Trade Surplus	Cash and bank deposits (5.6%) Cash management products (6.2%) Equities (12.0%) Fixed income securities (7.6%) Alternative Investments (2.2%) Receivables & prepayments (0.9%) Held-to-maturity investments (4.3%) Long-term equity investments (60.6%) Deferred tax assets; (0.3%) Other assets (0.2%)	**Domestic (≥50%)** **Global (equity investments only (≤50%)** United States (43.9%) Asia Pacific (28.4%) Europe (20.5%) Latin America (6.3%) Africa (0.9%)
Kuwait	Kuwait Investment Authority[4]	295	1953	Commodity (Oil)	Equities (55-65%) Bonds (8-12%) Real Estate (8-12%) Alternative Investments (3-7%) Cash (3-7%)	United States & Europe (equal share) (76-86%) Asia and Japan (13-17%) Other Emerging Markets (4-6%)
Singapore	Government of Singapore Investment Corporation[5]	185	1981	Trade Surplus	Developed market public equity (41%) Developing markets public equity (10%) Nominal Bonds (17%) Inflation-Linked Bonds (3%) Real Estate (9%) Private Equity, VC & Infrastructure (10%) Absolute Return Strategies (3%) Natural Resources (3%) Cash (4%)	**Americas (43%)** United States (36%) Other North & South America (7%) **Europe (30%)** United Kingdom (8%) France (5%) Germany (4%) Italy (2%) Others(11%) **Asia (24%)** Japan (11%) China, Hong Kong, S. Korea & Taiwan (10%) Others(3%) **Australasia (3%)**

COUNTRY	FUND NAME	AUM $US BN	INCEPTION YEAR	SOURCE OF FUNDS	ASSET CLASSES	GEOGRAPHIES
Singapore	Temasek Holdings[6]	133.0	1974	Government-Linked Companies	**Liquidity** Unlisted Assets (23%) Listed Large bloc shares (≥20%) (43%) Liquid & sub-20% listed assets (34%) **Sector** Financial Services (37%) Telecoms, Media & Technology (24%) Transport & Industrials (18%) Life Sciences, Consumer & Real Estate (11%) Energy & Resources (6%) Others (4%)	Asia (excl. Singapore & Japan) (46%) Singapore (32%) OECD (20%) Others (2%)
China	National Social Security Fund[7]	130	2000	Trade Surplus	Domestic Stocks (30%) Domestic Bonds (63.3%) International Investments (6.7%)	China (93.3%) Other Markets (6.7%)
Russia	National Wealth Fund[8]	87.1	2008	Commodity (Oil)	No information disclosed	No information disclosed
Qatar	Qatar Investment Authority[9]	70	2005	Commodity (Oil & Gas)	No information disclosed	No information disclosed
Libya	Libyan Investment Authority[10]	64	2006	Commodity (Oil)	No information disclosed	No information disclosed
Australia	Future Fund[11]	57.1	2006	Commodity (Various)	Australian equities (11.1%) Developed markets equity (20.5%) Developing markets equity (2.9%) Private equity (2.8%) Property (4.6%) Infrastructure (4.3%) Debt securities (20.5%) Alternative assets (14.7%) Cash (12.3%) Telstra holding (6.3%)	No information disclosed
UAE/Abu Dhabi	International Petroleum Investment Company[12]	46	1984	Commodity (Oil)	No information disclosed	No information disclosed
Kazakhstan	Kazakhstan National Fund[13]	34.1	2000	Commodity (Oil & Gas)	No information disclosed	No information disclosed

COUNTRY	FUND NAME	AUM $US BN	INCEPTION YEAR	SOURCE OF FUNDS	ASSET CLASSES	GEOGRAPHIES
Republic of Korea	Korea Investment Corporation[14]	30.06	2005	Trade Surplus	Developed Market Equities (42.2%) Emerging Market Equities (2.04%) Government Bonds (22.3%) Agency Bonds (8.1%) Corporate Bonds (8.7%) Securitized Bonds (8.7%) Cash & Derivatives (1.02%) Private equity, hedge fund, strategic investment (4.8%) Real Estate & Commodities (2.0%)	No information disclosed
Brunei	Brunei Investment Agency	30	1983	Commodity (Oil)	No information disclosed	No information disclosed
Ireland	National Pension Reserve Fund[15]	29.6	2001	Non-Commodity	Large Cap Equity (30.7%) Small Cap Equity (3.5%) Emerging Markets Equity (7.1%) Private Equity (3.3%) Property (2.3%) Commodities (1.1%) Bonds (5.9%) Currency and Asset Allocation Funds (0.8%) Cash (16.9%) Assets Transferred from University Pension Funds (0.2%) Directed Investments (preference share investments in domestic banks) (28.2%)	Domestic (34%) Europe (excl. Ireland) (24.4%) North America (18%) Asia (incl. Japan) (6%) Other Emerging Markets (5.4%) Global Investments (7.2%) (excludes cash and currency fund investments)
Malaysia	Khazanah Nasional Berhard[16]	26.9	1993	Government-Linked Companies	Financial Services (23.0%) Media & Communications (21.6%) Infrastructure & Construction (19.4%) Utilities (16.0%) Property (6.3%) Transport & Logistics (4.7%) Others (4.7%) Healthcare (3.0%) Automotive (1.1%)	Malaysia (88.8%) Singapore (3.2%) India (2.4%) China (1.8%) Others (1.8%)

COUNTRY	FUND NAME	AUM $US BN	INCEP-TION YEAR	SOURCE OF FUNDS	ASSET CLASSES	GEOGRAPHIES
UAE/Abu Dhabi	Mubadala Development Company PJSC[17]	23.4	2002	Commodity (Oil)	Corporate/Acquisitions (27%) Oil & Gas (14%) Real Estate (13%); Aerospace (12%) ICT (10%) Infrastructure (9%) Renewable Energy (8%) Other Energy & Industry (4%) Service Ventures (2%) Healthcare (1%)	United Arab Emirates (33%) Qatar (41%) Others (26%)
UAE/ Dubai	Investment Corporation of Dubai[18]	19.6	2006	Government-Linked Companies	Transportation Sector Companies (~40%) Financial Sector Companies (~20%) Industrial Sector Companies (~20%) Real Estate Companies (~15%) Other Companies (~5%)	Dubai (100%)
Azerbaijan	State Oil Fund of Azerbaijan (SOFAZ)[19]	18.1	1999	Commodity (Oil)	No information disclosed	No information disclosed
Bahrain	Bahrain Mumtalakat Holding Company BSC[20]	12.9	2006	Government-Linked Companies	Insufficient information disclosed	No information disclosed
New Zealand	New Zealand Superannuation Fund[21]	11.3	2001	Non-Commodity	New Zealand Equity (5.8%) Private Equity (1.3%) International Fixed Income (7.6%) New Zealand Fixed Income (0.2%) Global Listed Property (4.5%) New Zealand Property (1.7%) Commodities (4.6%) Infrastructure (8.1%) Global equities (63.6%) Timber (7.5%) Other Private Markets (2.4%) Cash, Collateral, FX Hedges (-2.7%)	No information disclosed
UAE/ Dubai	Istithmar World	10.7	2003	Government-Linked Companies	Equity & Venture Capital (40%) Real Estate (60%)	Europe (20%) Middle East (25%) North America (40%) Asia Pacific (5%) Sub-Saharan Africa (5%) Latin America (5%)
Oman	State General Reserve Fund	8.2	1980	Commodity (Oil & Gas)	No information disclosed	No information disclosed

COUNTRY	FUND NAME	AUM $US BN	INCEPTION YEAR	SOURCE OF FUNDS	ASSET CLASSES	GEOGRAPHIES
East Timor	Timor-Leste Petroleum Fund[22]	6.3	2005	Commodity (Oil & Gas)	Cash and Cash Equivalents (0.1%) Fixed Interest Investments (98.6%) Accrued Interest (1.3%)	No information disclosed
UAE/ Ras Al Khaimah	Ras Al Khaimah (RAK) Investment Authority	1.2	2005	Commodity (Oil)	No information disclosed	No information disclosed
Vietnam	State Capital Investment Corporation[23]	0.6	2005	Government-Linked Companies	Manufacturing (39.7%) Consumer Goods (24.7%) Materials (13.1%) Financials (9.3%) IT (4.8%) Healthcare (4.4%) Telecoms (3.6%) Other (0.4%)	Vietnam (100%)
Kiribati	Revenue Equaliztion Reserve Fund[24]	0.391	1956	Commodity (Phosphates)	No information disclosed	No information disclosed
São Tomé & Principe	National Oil Account[25]	0.009	2004	Commodity (Oil)	Insufficient information disclosed	No information disclosed
Oman	Oman Investment Fund	N/A	2006	Commodity (Oil & Gas)	No information disclosed	No information disclosed
UAE/ Federal	Emirates Investment Authority	N/A	2007	Commodity (Oil)	No information disclosed	No information disclosed
UAE/ Dubai	DIFC Investments (Company) LLC	N/A	2006	Government-Linked Companies	No information disclosed	No information disclosed
UAE/ Abu Dhabi	Abu Dhabi Investment Council	N/A	2007	Commodity (Oil)	No information disclosed	No information disclosed
	TOTAL Oil & Gas	**$1,509.0**				
	TOTAL Other	**$979.56**				
	GRAND TOTAL	**$2488.56**				

Note: Where no reference is given AUM is from the Sovereign Wealth Fund Institute

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