Sovereign Wealth Funds:
A New Global Investment Power
By Kevin Chambers

In recent years, there has been an explosion of new investment organizations called Sovereign Wealth Funds (SWF). These government-owned funds have grown to hold vast sums of money, some of which are large enough to affect global financial markets. Let's review a brief history of these types of funds, evaluate the largest funds in the world, and discuss how they are being invested.

Types of Sovereign Wealth Funds

A Sovereign Wealth Fund is a government owned investment fund that is established for a common good. There are 5 main types of SWFs.

- Stabilization Funds – Formed to offer stabilization for economies reliant on a particular industry, for example, oil.
- Savings Funds – Used to save for future generations during times of budget surplus.
- Pension Reserve Funds – Funds saved to support social welfare programs and public service pensions.
- Reserve Investment Funds – Formed to reduce the opportunity cost of holding excess foreign reserves.
- Strategic Development Sovereign Wealth Fund – Used to promote the national economic, development, or political goals of a government.

SWFs are formed and funded through various methods. The most common funding methods are from budget surpluses and commodity revenue. Depending on the goal, funding source, and size of the fund, SWFs have different abilities and desires to take risks in order to generate returns. The funds all have varying types of organizations and objectives that they attempt to reach; however, most are focused on the long-term and are fairly conservative.

History of SWFs

Many historians credit the Republic of Texas with the first SWF. In 1845, through the annexation of Texas by the United States, the Federal Government gave the new state $2 million to be set aside for the establishment of a fund to support public schools in Texas. This SWF, which became known as the Texas Permanent School Fund, now also gets some revenue from oil rights off the coast of Texas.

The first SWF started by a National Government was Kuwait in 1953. Funded by oil profits, it was founded to help the economy through times of down oil prices. A few other commodity-reliant countries followed suit, especially learning from the 70s and the Oil embargo: Kiribati (1956), Abu Dhabi (1976), Canada (1976), and Oman (1980). From 1953 - 1990, nine countries established SWFs. Since then there has been a rapid increase in the number of SWF globally. Currently, there are 78 SWF in about 65 countries.

After the formation of the Texas Permanent School Fund, now 9 US states have SWFs. The largest and most well-known is the Alaska Permanent Fund, which invests profits from oil drilling and sends out checks to every Alaska resident each year. All of the US SWFs are funded from mineral or oil extraction, but each has a different organization and objective. Texas actually has two SWFs with the formation of the Texas Permanent University Fund, which owns over 2 million acres of land in Texas and supports the state's public university system.

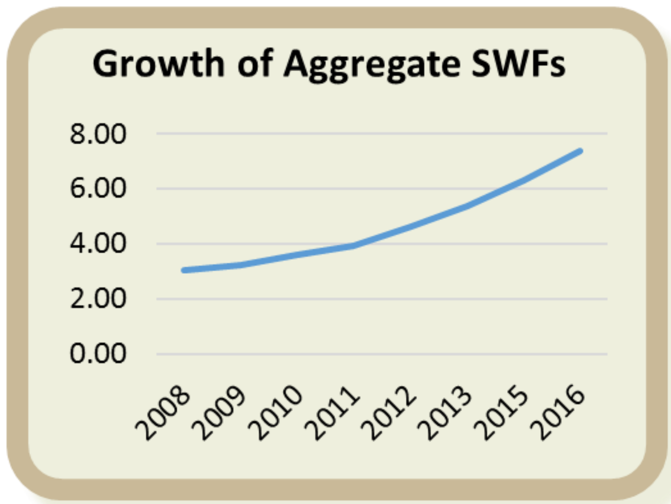
Texas Permanent School Fund

SWF Facts:

SWFs funding sources:
56% domestic oil and gas industry;
12% other commodities;
32% non-commodities funded.

SWFs are spread out around the globe with most SWFs in the Middle East and North Africa. SFWs in the Asian region have the most assets.

Most (31%) SWFs are in the $1 billion to $9 billion range.



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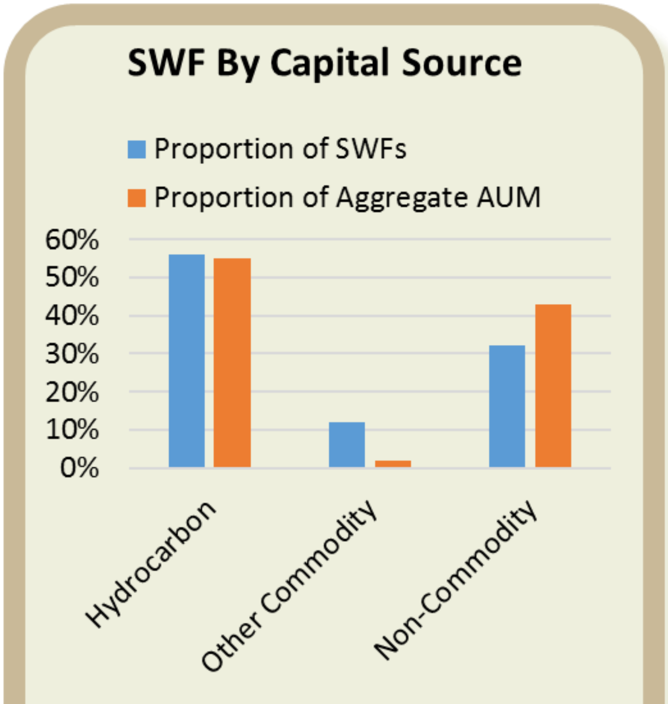
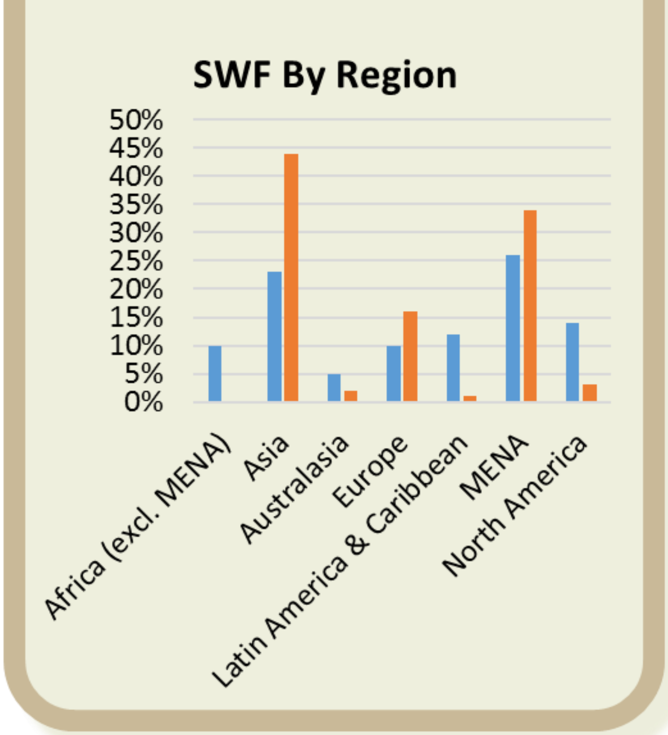
The Current State of SWFs

The boom in oil prices and the growth of many emerging markets has led to a ballooning of assets in SWFs around the globe. From 2008 to 2016, the amount of money managed in SWFs has more than doubled. Now $7.4 trillion is managed in SWFs. For comparison, all of the US university endowments added together is $467 billion and all of the US foundations added together is 715 billion. It is just a little under the total GDP of Japan and Germany combined.





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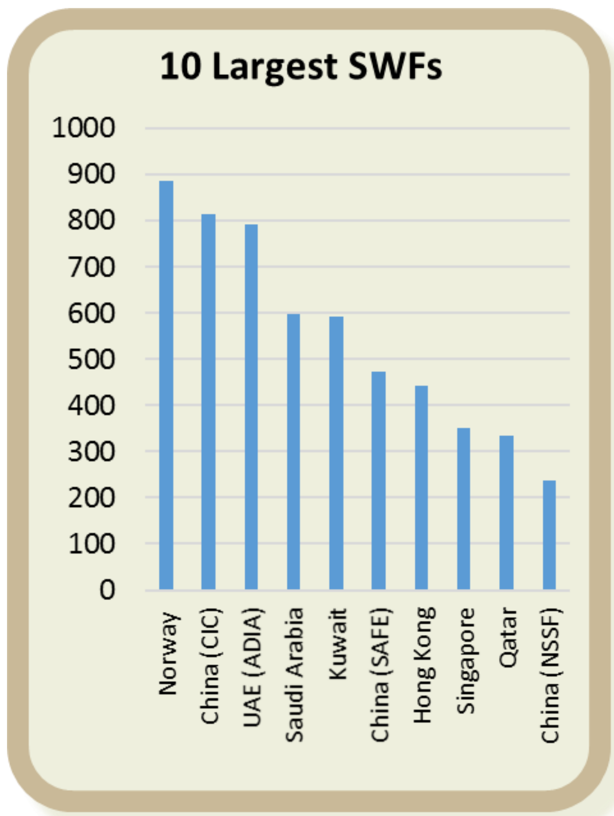
Norway has the largest SWF in the world. It was funded with oil and gas proceeds and is currently worth about $885 billion. It owns more than 2% of all listed stocks in Europe and 1% throughout the world. Estimates show that Norway has already extracted over 45% of their total oil supply. The fund is limited in spending at 4%, and since 2012 has made more in investment gains and income than inflows from oil profits.

Although Norway has the largest single fund, combined China and the UAE have more assets in SWFs. China (including Hong Kong) has a total of $1.97 trillion in 5 different funds. The UAE has 1.25 trillion in 7 separate funds. Apart from China, the top countries are dominated by oil-rich countries. Even some relatively poor countries: Kazakhstan, Libya, Algeria, Azerbaijan, have amassed billions of dollars in sovereign wealth funds.



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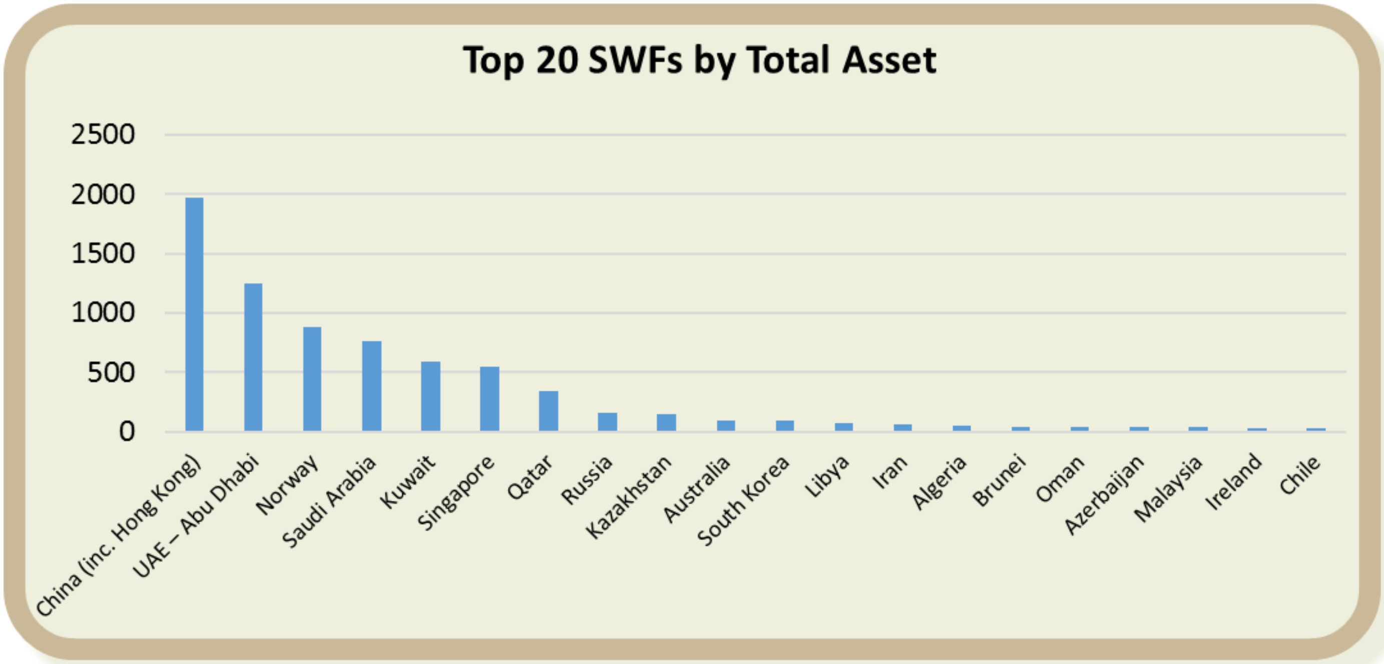

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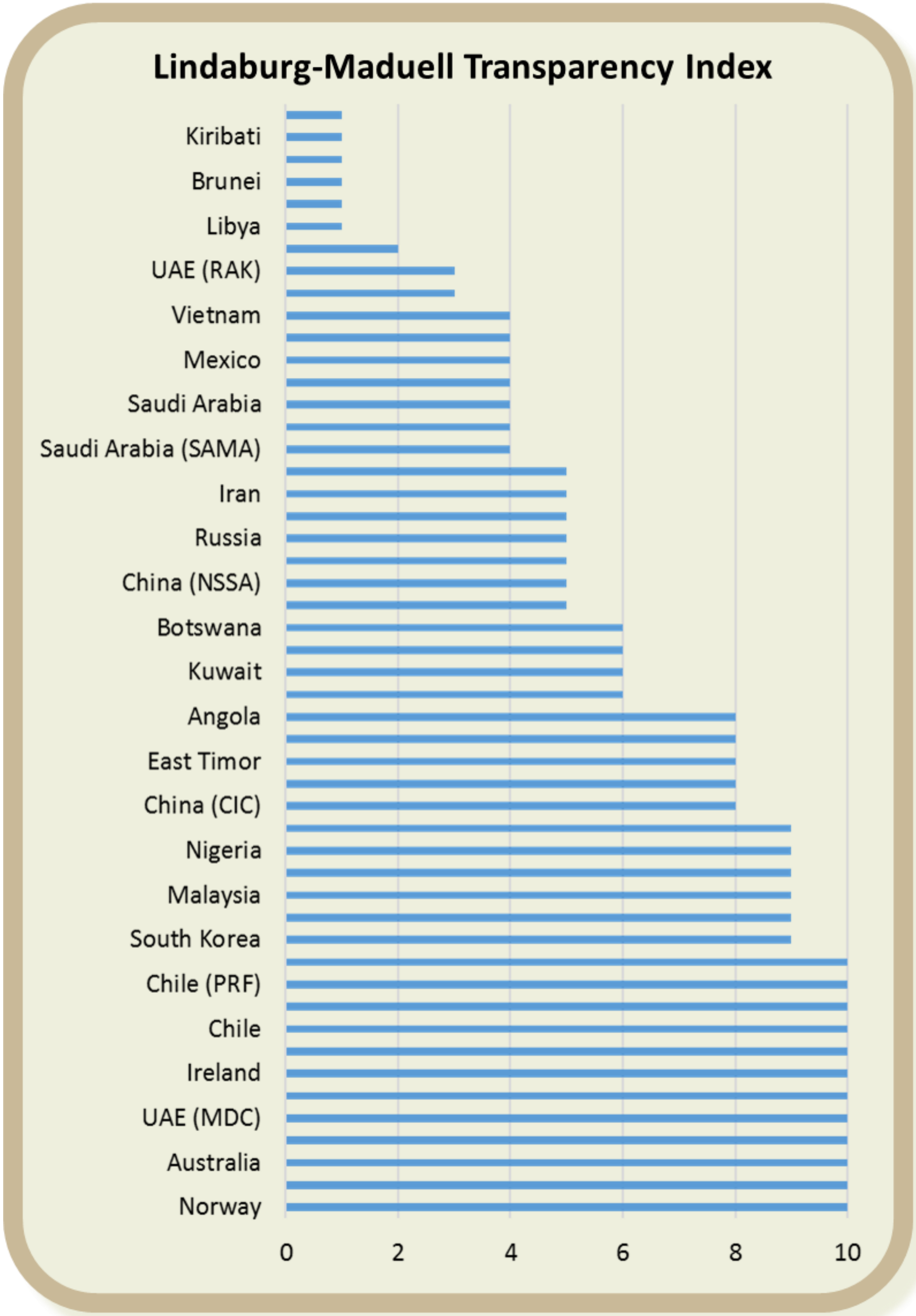
Problems with SWF

The Congressional Research Service lists two main problems with SWF for companies and citizens in the United States: transparency and political motivators. These factors arise from the objectives of the individual funds.

Transparency

Unlike privately held companies or non-profits, there are currently no laws that require SWF to report financial information. There is no overseeing body or organization that can require disclosure or provide oversight. Some funds are very transparent. The Norway Oil Fund reports up-to-date holdings, transactions, and income. It is considered the most transparent of all SWFs . The Sovereign Wealth Fund Institute (SWFI) developed the Lindaburg-Maduell Transparency Index, a method of rating transparency of the various funds created by Carl Lindaburg and Michael Maduell. It assigns a possible 10 points to funds, with 1 point for 10 different criteria. Of the 50 funds they have ranked, 10 of them get perfect scores and 6 more got 9 points.

Point	Principles of the Linaburg-Maduell Transparency Index
+1	Fund provides history including reason for creation, origins of wealth, and government ownership structure
+1	Fund provides up-to-date independently audited annual reports
+1	Fund provides ownership percentage of company holdings and geographic locations of holdings
+1	Fund provides total portfolio market value, returns, and management compensation
+1	Fund provides guidelines in reference to ethical standards, investment policies, and enforcer of guidelines
+1	Fund provides clear strategies and objectives
+1	If applicable, the fund clearly identifies subsidiaries and contact information
+1	If applicable, the fund identifies external managers
+1	Fund manages its own website
+1	Fund provides main office location address and contact information such as telephone and fax


Lindaburg-Maduell Transparency Index
Kiribati
Brunei
Libya
UAE (RAK)
Vietnam
Mexico
Saudi Arabia
Saudi Arabia (SAMA)
Iran
Russia
China (NSSA)
Botswana
Kuwait
Angola
East Timor
China (CIC)
Nigeria
Malaysia
South Korea
Chile (PRF)
Chile
Ireland
UAE (MDC)
Australia
Norway
0
2
4
6
8
10

Political Motivators

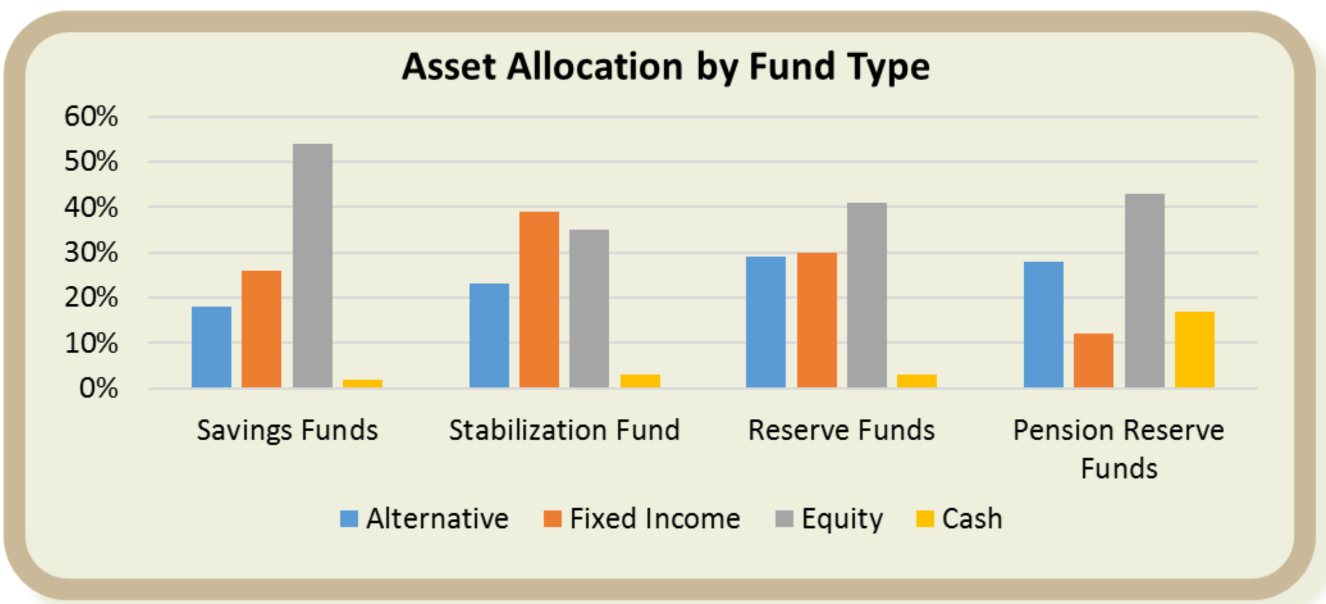
The other potential problem with SWFs stems from the government's motivations. There is not a lot of oversight on how these funds spend and invest their funds, which suggests they have the potential of being used for political means. The ostensible goal of funds is to increase their value to better meet their objectives. However, because SWFs are operated by governments, it is not inconceivable that they could be used as tools to project power or national interests abroad. Sometimes this interest is fairly reasonable. For example, the Norway fund avoids investing in tobacco and firearms and have blacklisted about 100 companies. However, it is the extension of this ability to pick and choose how funds are invested that worries some political analysts. For example, in 2006 one of Singapore's SWFs took a controlling interest in the Thai telecom company Shin Corporation. This may seem benign; however, Shin had exclusive rights to operate government satellites. Thus, the government of Singapore essentially took control of the satellites used by the Thai military. A far extension of this logic worries critics of SWF. They worry that a foreign government could use SWF to take controlling interests in American corporations and impact the US economy or hurt certain industries.

Asset Allocation

Asset allocation for SWFs is dependent on the type of fund. Stabilization funds are the least risk adverse, holding an average of 42% of assets in fixed income and cash. Reserve funds are slightly riskier with 33% in safer holdings. Savings and pension reserve funds are invested more aggressively with only about 29% in cash and fixed income.

Conclusion

SWFs are a newer phenomenon. As globalization has allowed products and companies to spread around the world, countries now have greater ability to spread money around the world. Pension funds, foundations, and endowments get a lot of oversight and speculation from outside observers. For the most part, SWFs do not have that type of intervention. Hopefully, the citizens of each county will continue to demand transparency, forcing more funds to emulate Norway and the other more open funds. However, it is a continuing worry that more funds will become arms of their government in political games despite pushback from the international community. One thing is certain, these are new powerful wealthy investment entities that are sure to be important factors in the global political and financial landscape.



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