

Sovereign Wealth Funds: A differentiation of investment strategies

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Abstract

“Sovereign Wealth Funds (SWFs) are defined as special purpose investment funds or arrangements owned by the general government. (...) SWFs hold, manage, or administer assets to achieve financial objectives, and employ a set of investment strategies that include investing in foreign financial assets (...).” (Willson, 2008) The focus of the thesis is on an in-depth exploration of characteristics of investment strategies of SWFs. By applying a cluster analysis the thesis aims to provide a precise description of SWFs as an investor group. Afterwards it establishes a link between corporate governance structures of the SWFs and the analyzed investment strategies.

1. Introduction to the research field

Sovereign Wealth Funds (SWFs) has become a frequently used term in the business media. While some of the SWFs have existed since the 1950ies they never attracted so much attention from economists, politicians and the public worldwide until recently. Numerous headlines e.g. in The Wallstreet Journal (e.g. Davis, 20.03.2008), the Financial Times (e.g. Burton, J., 22.08.2008), The Economist (e.g. Economist Intelligence Unit ViewsWire, 28.2.2008), or the Journal of Applied Corporate Finance (e.g. Butt et al., 2007) serve as examples for the growing interest in the investor type that appears on the scene internationally. Furthermore, recent activities of the IMF (IMF Survey, 04.03.2008), publications by the OECD (Gow, 21.08.2008) and the European Central Bank (Beck and Fidora, July 2008) as well as regulatory initiatives by governments e.g. of Germany (Blundell-Wignall, 01.01.2008) and the US (Levin, Carl, 23.02.2006) illustrate the relevance of the issue.

Current alertness of these institutions is mainly traced back to huge direct equity investments in Western financial institutions since 2007 by highly secretive investors grouped under the SWF umbrella term. For example, Abu Dhabi purchased a 4.90% stake in Citigroup (Citigroup Inc., 26.11.2007), Qatar a 6.4% stake in Barclays (SECinfo, 2008), China a 10% stake in Morgan Stanley (Ministry of Commerce of the People's Republic of China, 06.03.2008) and Singapore an 11% stake in UBS (Butt et al., 2007).

A definition of the term SWF is compiled by the International Monetary Fund (Willson, 2008): "SWFs are defined as special purpose investment funds or arrangements owned by the general government. Created by the general government for macroeconomic purposes, SWFs hold, manage, or administer assets to achieve financial objectives, and employ a set of investment strategies that include investing in foreign financial assets. The SWFs are commonly established out of balance of payments surpluses, official foreign currency operations, the proceeds of privatizations, fiscal surpluses, and/or receipts from commodity exports."

2. Aim of the study

The focus of the thesis is on an in-depth exploration of the characteristics of investment strategies of SWFs. Both equity investments and portfolio compositions of SWFs are considered. Than the explored investment strategies are linked to the corporate governance

structures of the SWFs. Therewith the thesis aims to provide a much more precise description of SWFs as an investor group which takes the unique characteristics of each entity into account. In this way results are of strong interest for researchers but also practitioners.

3. Characteristics used to describe strategies of investor groups

Equity investments are explored with regard to a number of characteristics. These characteristics are selected based on two dimensions. Either they were used to describe SWFs' investment strategies in research or they were used to describe investment strategies of other investor groups such as private equity investors, hedge funds or pension funds. Using variables out of these fields has the advantage of using already tested and applied variables. Second, data availability about SWF investments allows exploring the variable. This restriction is necessary due to the missing transparency of SWFs - especially SWFs from the GCC countries and East Asia - with regard to their asset allocation.

4. Methodology

In order to find natural groupings of SWFs a cluster analysis is applied. The underlying assumption is that if SWFs are a homogeneous group of investors, a cluster analysis should result in a one cluster solution. If this is not the case it should be possible to empirically distinguish two or more clusters.

All variables selected based on the criteria explained in section 3 are applied as attributes.

After standardizing of the variables a hierarchical algorithm (Ward method) is used. Then a non-hierarchical algorithm (k-means) is employed. How to link the findings about investment strategies of SWFs to the corporate governance structures of the SWFs is methodically not yet specified.

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