

Where Next For National Wealth Management?

From Theory to Practice

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Introduction

This chapter looks at national wealth management in a broad sense. We aim to explain how global trends in national wealth management have changed and how these changes have impacted, and will impact the investment activity of the institutions that fall under this umbrella description. We will draw conclusions concerning the impact of these changes on asset allocation, the global capital markets and on how institutional asset managers might approach the entities that fall within the definition of national wealth.

Our favoured classification of national wealth is one that embraces a broad range of institutional vehicles. This begins with Central Bank foreign exchange reserve managers and moves on to stabilisation funds, to sovereign wealth funds, as well as national pension funds (especially when that fund is a “future generation fund”).

This chapter is largely based on our own observations and unsurprisingly, our primary focus will be on those nations which have seen the most rapid change in their aggregate national wealth in the last decade, ie the commodity producers and Asian exporters.

We will look at the dynamics of how a changing quantity of wealth is managed, and examine why assets under management (AUM) growth has been a primary driver of asset diversification in the past. Importantly, we will also examine why the simple fact of whether a fund is growing or shrinking is a principal force driving national wealth managers’ objectives.

We assume that the key driver of changes in management patterns is the evolution of AUM at the national level, rather than via individual institutions. This approach of aggregating the national wealth story and choosing not to be bound by institutional frameworks that differ from nation to nation may appear unusual, but it enables us to get to the heart of the matter: that is to say, the sum of what is happening to all national wealth pots. Developments at this aggregate national level appear to have been critical throughout the difficult period of 2008 and 2009.

For many nations, 1997 was a year when national wealth ambitions were born and new institutional frameworks established. The difficult period of 2007-2009 was when these new institutions reached adolescence, and began to change.





Politics and rising/falling AUM

Analysis of the world of national wealth has been challenged in the last twelve months by a few key issues. Firstly, the role of the government, or political agent, behind the fund has been underestimated. Much analysis within this field has typically focussed on the fears and consequences of investments in host, or recipient countries, something that we will leave to others. Secondly, the financial and economic crisis has led to a re-ordering of objectives for many national wealth managers. Thirdly, in the world of national wealth management the liability profile for the fund is usually layered, vague and subject to shifting prioritisation over time.

Governments will always have the final say

There are many differences between the various national wealth managers around the world, such as size, age, structure, source of funding, objective, risk/return profile¹. However, the one commonality is that they are all politically accountable. This simple fact helps explain why the activity of many funds is tricky to forecast: politicians are ultimately in charge of the fund, and the priorities of the politician may change quickly when national interest dictates. The last two years have made it clear that it is impossible to establish a framework for the analysis of a wealth fund without appreciating that they operate in a very sensitive and changeable domestic political environment.

Domestic political forces ultimately determine many aspects crucial to the life of a fund, including the asset allocation. Although national wealth managers invest for the long-term, today's long-term plan may not be the same as tomorrow's. The government of the day can change the rules of the game and may well have very good reasons for doing so during a challenging period. The example of Ireland makes the point. In the wake of the Lehman collapse, the Irish government directed the National Pension Reserve Fund (NPRF) to invest Euro7 billion to recapitalise two Irish banks. Despite the view of the commission monitoring the fund that investing 35% of its assets in the two banks breached its remit; the Finance Minister drove through new legislation enabling the government to compel the investment. The rules were changed! In effect the NPRF state pension fund was forced to become a stabilisation fund for the Irish banking system. Most stabilisation funds are "budget" stabilisation funds, but more of that later. Other countries which have explicitly used national wealth pots to help support the domestic banking system include Russia² and Qatar³.

¹ Ref Rozanov 2008, Central Banking Journal Volume 18, no3. Rozanov was talking specifically about SWF, and his list also included investment horizons, eligible asset classes, levels of transparency and accessibility. To this list we would add the demographic profile of the home nation.

² Russian state banks VEB and Sberbank will get funds from the state National Wealth Fund on deposits until 2020 as part of the state plan to rescue the country's financial sector. Sberbank will receive a subordinated 500 billion rouble (\$19.11 billion) loan at an annual interest of 8 percent and will issue bonds to guarantee it. VEB will get the money from the National Wealth Fund at a rate of 7 percent a year and will provide loans to state bank VTB and other banks and companies at 8 percent a year.

³ The Qatari government bought stakes in local banks, purchased their portfolios of local equities and offered to buy parts of banks' real estate portfolios in order to shore up the local banks.



National wealth managers are long-term investors, and we are mindful of the description used by the European Central Bank in 2007⁴, when they surmised that SWF are likely to have a long-term horizon for their investments. However, it would be dangerous to assume that these managers are homogenous, or passive buy-and-hold investors. The investment in Barclays in November 2008 by International Petroleum Investment Company is testament to the fact that they are not. After doubling in value in less than eight months, the position was sold, illustrating that long-termism will not be subordinate to commercial opportunity. And why should it?⁵

⁴ ECB Financial Stability Review December 2007.

⁵ Let's not overlook the fact that one of the demands of the West has been that SWF operate as commercial (rather than political) investors.



Rising and Falling levels of AUM; An Asymmetric Relationship

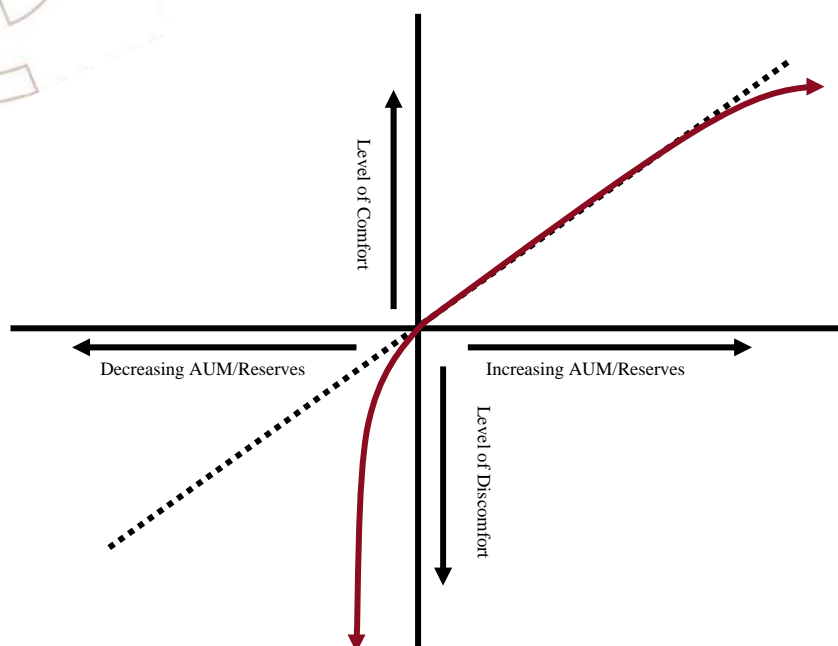


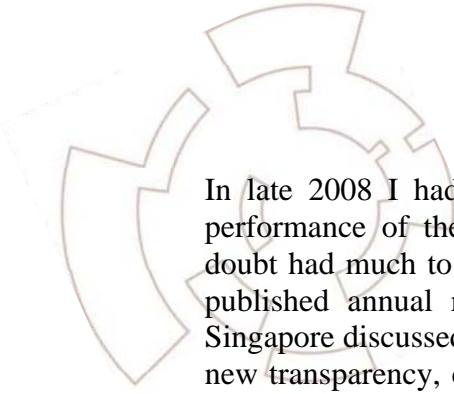
Chart 1

Crisis and transparency, a time to rethink

As stated in the introduction, the principal influence on strategy for national wealth managers is AUM. This is even more evident when AUM are shrinking. The sensitivity to rising/falling AUM is far from symmetrical and can be illustrated by the model in chart 1. We believe that the rapid rise in national wealth – either via commodity wealth or, in particular, by the rise in foreign exchange reserves in the first seven years of this century – may have masked sensitivity to declining AUM: rising reserves assuaged the painful memory of their previous decline. Secondly, as the rapid increase in national wealth has occurred, wealth managers, especially via newly created sovereign wealth funds (SWF), have invested more in equities and alternatives, by implication diversifying away from fixed income. This led both to increased exposure to more volatile asset classes and, sometimes to greater headline risk, especially when the equity investment was a Western bank. This heady mix has been exacerbated by a trend towards greater transparency, which has enabled inhabitants of the home country to monitor “their” fund’s performance. It is ironic that the Santiago principles for SWF best-practice⁶, which originally seemed to be motivated by Western nations’ desire to exert some control over in-coming investment by promoting transparency, have had the important consequence of also increasing transparency in the funds’ home nations. This has led to a greater degree of hostile scrutiny of funds from domestic critics.

⁶ In September 2008, at a summit in Chile, the International Working Group of Sovereign Wealth Funds – consisting of the world’s main SWF – agreed to a voluntary code of conduct first drafted by IMF. The agreement constitutes 28 Generally Agreed Principles and Practices (GAPP) which the funds would work towards adhering to. Although the GAPP are comprehensive in their breadth, the primary driver of the initiative was a desire to encourage SWF to act in a more transparent manner, as a response to widespread political commentary on the intentions of these overseas investors.





In late 2008 I had the pleasure of hearing a Singapore taxi driver's thoughts on the performance of the Government of Singapore Investment Corporation (GIC). This no doubt had much to do with the fact that my visit coincided with the fund's first publicly published annual report in September 2008. I rather doubt that the taxi drivers of Singapore discussed the GIC very often in the first 29 years of its existence. However, this new transparency, coupled with poor performance, is an interesting cocktail contributing to a lower risk appetite which, of course, may have implications for asset allocation.

❦ Complex and often opaque liability profile, with ever-changing priorities

The more complex the situation, the simpler the requisite model. Our model (chart 2) aims to capture what is happening to national wealth at the macro level across all institutions that are charged with managing national wealth within a given nation. In the model, a left-to-right journey reflects how the process of national wealth management might evolve. The process is driven by AUM, or total wealth, rather than by the passing of time. Unsurprisingly, the left-hand side of the chart is densely populated by the nations of the world, and the right-hand side is considerably less well-populated. In some countries, the task of managing national wealth is shared between multiple organisations (the Central Bank and a SWF, for example). The institutional division of responsibilities does not alter the way in which the national wealth story evolves at an aggregate level. Instead, it is the change in accumulated wealth which leads the government to give the fund, or funds, new jobs, or liabilities. These liabilities, as they are layered upon each other, drive the asset allocation process. The model is not intended as a prescription for development, but is based on our own observations. It aims to capture the link between aggregate wealth, changing liability priorities and consequent asset allocation.



How National Wealth Management might evolve; with AUM driving the liability profile.

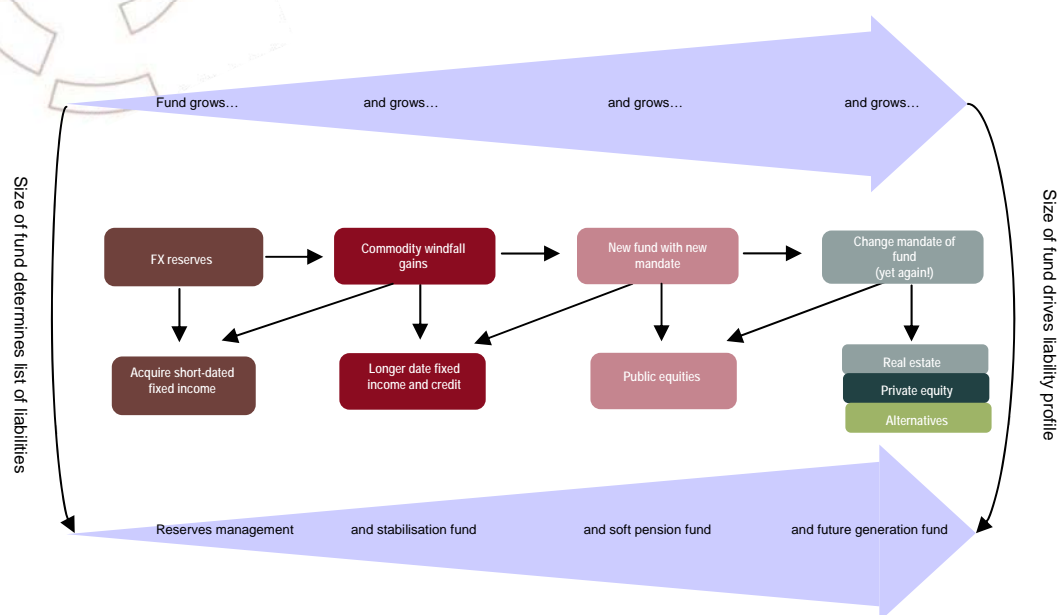


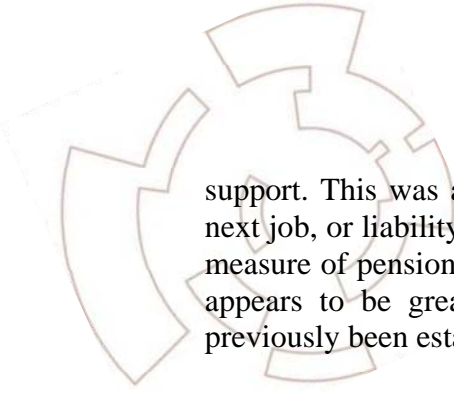
Chart 2

From reserves management to a stabilisation fund

The institutional management of national wealth begins in most countries in a very similar way, as illustrated on the left-hand side of the model. Foreign exchange reserves are accumulated to manage the domestic currency's external value. This process is managed by the Central Bank and money market and short-dated fixed income securities are deemed the most appropriate investment, usually denominated in US dollars, more of which later. Moving to the right, the model captures a sudden increase in the value of stored wealth within a nation, either through a rapid increase in foreign exchange reserves, or, as illustrated, by a commodity revenues surge. At this point, as AUM grow very quickly, the government may give the wealth manager an additional job, that of providing a stabilisation fund umbrella for the nation. This is particularly true of nations blessed with commodity wealth, when the increase in AUM can be very sudden and may also be transitory. A budget stabilisation fund sounds like a prudent and sensible vehicle when wealth growth is rapid and the source, ie the commodity, is exhaustible. The creation of such a "rainy day fund" is an additional challenge for the national wealth managers and is a longer dated liability, implying an exposure to longer dated assets. This usually leads to a change in asset allocation, which we have described as an extension into longer dated fixed income. The new assets are still very liquid, but reflect the fact that the preferred risk/reward relationship is not the same as for a pure foreign exchange reserves manager.

But how big does this slice of the national wealth have to be? The answer clearly varies and depends on myriad factors that differ in each nation. The bigger the fund and the faster it grows, the more attention it gets in the media and the more attractive it is for politicians to throw jobs at the fund. However, it is clearly possible for the national wealth pot to grow to such an extent that governments can eventually feel comfortable with giving the national wealth managers a further challenge, especially during a period when the stabilisation fund only appears to grow and is rarely called upon to actually provide budget





support. This was a feature of the 2000-2008 period. Following a stabilisation fund, the next job, or liability, given to the national wealth managers might well be to provide some measure of pension fund provision for the nation. The desire to establish such a provision appears to be greater in nations where a traditional social security network has not previously been established.

This pension fund commitment can take many forms and can be designed to fit very different segments of the population in any given country. However, the pension fund commitment is unlikely to be a defined promise; it is usually a commitment to create a pot of money to be used at an undefined future date to pay off a pension liability on the nation's balance sheet. The man in the street may know that he has a share of the pot, but is unlikely to know much more. He certainly will not be able to identify his own slice of the pension fund and will not be able to monitor the precise value of his slice. Thus, it is typically a very soft pension promise, which is important for the next stage of the story. Nevertheless it is a pension commitment, and, as such, implies a need to purchase equities in line with a further extension of the liability profile and is consistent with the behaviour of the vast majority of corporate pension funds around the world. Thus, the institution, or institutions that administer the nation's wealth have a new liability layer to deal with.

Moving to the next generation

Beyond a pension fund commitment, it might well be that growth in the overall national wealth reaches a point where not only the existing generation is catered for, but where provision for successive generations becomes an additional target - although few nations are at this level. Lengthening the commitment horizon should eventually lead to further changes to the desired asset allocation mix; again this would be for the new additional layer of liability. As before, it would suggest the need for an additional tranche of assets, as illustrated in the model, reflecting the longer dated appetite for assets and the commensurate demand for a higher return profile.

Our model has been criticised as simply being a reflection of developments in Norway, and certainly the Norwegian example does map on to the early stages of the model quite well. But the model's greatest value is that it enables us to make sense of the collapse in risk appetite that has occurred in the field of national wealth management in the recent past: this not least in nations where AUM have shrunk, resulting in asset allocation changes, in effect by default, for many national wealth managers. The model captures this aspect of the story very well. In Norway, risk appetite remains relatively unchanged and crucially, portfolio rebalancing between equity and fixed income appears to be continuing.⁷ But the Norwegian example of sticking to a pre-advertised plan to rebalance into equity markets, as equity markets fell in 2008 and early 2009 is very much the exception among national wealth managers. The Norwegian fund has not only actively rebalanced, but has now reached an increased equity weighting of 60% after a two year transition period. This action underlines its uniqueness.⁸

⁷ Although the value of the Norwegian fund fell by around 23% in 2008, the fund itself was topped up by on-going inflows from oil related tax inflows and, of course, it is aggregate AUM that we believe drive the model, not just portfolio performance.

⁸ Ref Government Pension Fund Global 2009.





Where does the turning point lie?

We judge the addition of the soft pension fund liability to the earlier liability tranches to be the inflection point in the story for the many countries which have not followed the Norwegian example. As AUM fell, so too did the risk appetite of national wealth managers, and significant changes in asset allocation ensued in consequence. Many nations which had reached the pension fund stage of the model (and so were buying equities) became averse to this asset class in 2008 and 2009. In a shrinking AUM environment some funds were involuntarily driven back to the left of the model on the waves of market turbulence. Shrinking AUM forced them to lower their soft pension fund commitment. This shift may only be temporary. A move to the left in our model highlights the reality that in 2008 many nations were reminded of the need for wealth managers to provide a stabilisation fund. For many managers, this particular liability had not previously been called upon during what, for many funds, was a period of ever rising AUM. The model suggests that if the government of the day decides that the new top priority is the stabilisation fund objective, then the soft pension fund objective becomes subordinate, and a shift in asset allocation towards fixed income and away from equities might actually make sense.⁹

The global trends in national wealth in 2008 and into 2009 demonstrate that there was a widespread failure to rebalance between fixed income and equities, as global equity markets collapsed. In short, by doing nothing at all, wealth fund managers presided over an enormous asset allocation shift. This shift reflected an underlying change, a reprioritisation of national liabilities. The goal posts were moved.

An asset versus liabilities framework in an environment of constantly shifting priorities and volatile AUM is very difficult to achieve. Liabilities were always ill defined, and so changed easily. This redefining of goals was almost inevitable where liabilities were never clearly fixed. This is why any analysis of national wealth that tries to impose the discipline applied to the analysis of corporate pension funds is doomed to failure, even when the description of the national wealth vehicle includes the word “pension”. As Monk 2008¹⁰ highlighted when discussing SWF specifically, “liabilities, if they have any, are part of the broader national balance sheet”. This description can be extended to encompass all the institutions that fall within our analysis of national wealth.

⁹ The case of Ireland and certain others, where the shift leftwards in the model actually results in the buying of equity in the local banking sector, are exceptions that actually prove the rule. The change in strategy in favour of domestic banking stocks was imposed by absolute necessity and should not be viewed as an asset allocation choice in favour of equities versus another asset class. The fund, its guardians, and perhaps the nation, had no choice.

¹⁰ Ref: Monk 2008: Recasting the Sovereign Wealth Fund Debate; Trust, Legitimacy, and Governance.





The bankruptcy of the excess foreign exchange reserves argument?

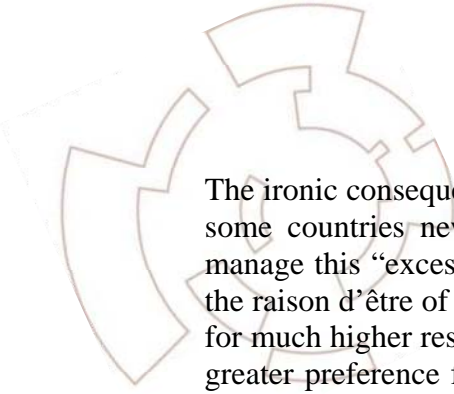
During the period of rapidly rising global foreign exchange (FX) reserves from 2000 to 2007 we heard more and more about the “problem” of having excess foreign exchange reserves. This concern was essentially one of negative carry, ie the home country interest rate exceeded the interest rate on dollar assets. This appeared to matter because nations that built FX reserves quickly were typically sterilising the effects of their FX reserves by issuing local market debt. Thus the costs of negative carry would rise hand-in-hand with increases in the size of the reserves. By 2007 this had led to widespread calls for nations to do something about this supposed problem.

A second cost of large scale FX intervention is that it implies FX losses on the value of the dollar assets that have been purchased when the domestic currency is eventually allowed to strengthen versus the dollar (assuming the intervention was designed to keep the currency cheap in the first place). The popular diagnosis was that nations should earn a higher return on that part of their reserves deemed “excess”, thus lowering the overall cost-of-carry. This led to the call for many nations to establish SWF that might invest in assets expected to deliver a higher return, ie equities with the portion of reserves deemed excess. It is clear now that this plan did not work as well as many nations had hoped it would. This was due to the twin problems of unexpected equity market volatility and what can only be described as a miscalculation of what actually constituted a measure of excess reserves. We will leave the study of equity market valuation to others and concentrate on the problem of defining excess reserves.

The argument that nations could reach a point of having excess FX reserves was based on an analysis of adequacy that tended to be backward looking, and not comprehensive enough to deal with modern capital market pressures. The analysis also ignored the possibility that perceptions of reserves adequacy could change very quickly. The concept of “cost-of-carry” was at the heart of this type of analysis, which ignored the possibility that the negative cost argument could be overwhelmed in a time of crisis. Judging the value of the in-flight entertainment is all very well, but having confidence in whether the plane is airworthy is perhaps more important during inclement weather. Circumstances had changed, and nations thought to have ample reserves in September 2008 were viewed as having something considerably less by the following month, as reserves were drawn down at a previously unimaginable pace.

In the wake of the Lehman collapse, FX reserves in many emerging nations moved sharply lower. As a consequence, the precautionary demand for FX reserves is likely to be higher, possibly much higher, in the future. We do not know what the best measure of adequate and excess reserves is, but we do know that those numbers are considerably greater than previously thought. Hoarding has surely been encouraged by the chilling pace at which reserves dropped in 2008, witness the experience of Russia and Korea in late 2008, two countries which in early 2008 were judged to have excess reserves. In simple terms, if the old definition of “excess” is the new definition of “adequate”, this will only serve to encourage future hoarding. Nations are likely to build reserves sufficient to fight the next, rather than last, FX crisis – and to do so as a matter of urgent priority.





The ironic consequence of the re-evaluation of the concept of excess FX reserves is that in some countries new institutions were created, often called sovereign wealth funds, to manage this “excess”. If the definition of excess is going to be reassessed as we suggest, the *raison d’être* of some of these institutions might need to be changed. After all, the need for much higher reserves arising from the need for a larger precautionary buffer suggests a greater preference for fixed income assets at any given level of reserves. Politicians will deal with the inconvenience of the new institutions they have created to invest in assets that are probably now out of favour, at least for a given level of reserves, by changing the rules. This is not meant as a criticism, but is simply recognition of the realities of the situation. As Clark (2009)¹¹ points out, “more often than not, institutions once created, claim new responsibilities carrying with them the compromises and conditions at the time of establishment - amplified or dampened by experience”.

So more similarities than differences?

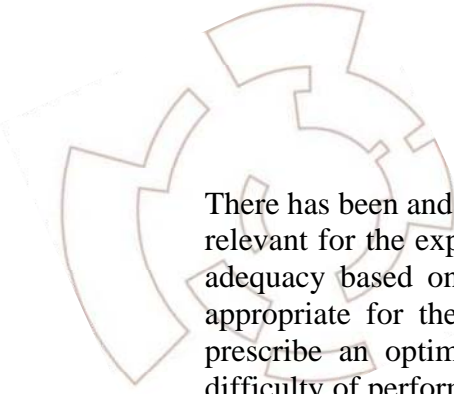
There are numerous similarities in how national wealth is managed at the macro level around the world. The key issues, such as the size, rate of change, and direction of AUM, appear to be of importance everywhere. Throw in vaguely defined liabilities and the primary role of the domestic political agent, then there are more similarities than differences in the key influences of how national wealth is managed, whether it be in Russia, Abu Dhabi, South Korea or Brazil. And the tendency to emulation reinforces the similarities. This tendency stems directly from the vagueness of these liabilities compared to the liabilities of a corporate pension fund. This pressure to copy a neighbouring country is not only a function of the vague liability profile, but also of the more intense scrutiny of developments at an institutional level. In the early part of this decade this emulation pressure may have helped to explain the launch of many new SWF, a fashionable and successful trend.¹² However, this pressure to copy may also work when times are tough: and those wealth managers credited with having had a relatively strong performance during the crisis because of their existing asset allocation, such as the Saudi Arabian Monetary Authority¹³, may find that their asset allocation preferences become more popular with peers, and in turn perhaps emulated.

¹¹ Ref: GL Clark 2009 - Temptation and the virtues of long-term commitment: the governance of sovereign wealth fund investment.

¹² Ref: Ormerod 1997 Butterfly Economics Chapter 1

¹³ Ref Setser ; CFR Dec 14th 2008. Sovereign loss funds, and others.





There has been and will be in the future, a greater desire to hoard wealth. This is especially relevant for the expected future path of FX reserves. It is clear that previous estimates of adequacy based on calculations involving import cover, and short term debt were not appropriate for the crisis that developed in 2008¹⁴. We do not pretend to be able to prescribe an optimum level of reserves for any country, but we do believe that the difficulty of performing such a task will ensure that the precautionary demand for reserves is much higher than it used to be. The experience of the Asian crisis in 1997/98 drove the precautionary demand for reserves to previously unforecasted levels. That these levels in some cases were perceived as inadequate during the 2008 global crisis will further increase the appetite for precautionary reserves.

The story of the last five years can be summarised as follows: Western countries decided that they would welcome investment in their equity markets, if the managers of national wealth (usually in emerging countries) followed Western rules of play. The 2007-2009 equity market turmoil has left many funds damaged. The dilemma is that at current equity market levels the value of these overseas investment flows has never been higher, and Western countries are hoping for more equity inflows from funds that have not only suffered, but who also appear to have altered their risk appetite for international assets, who might have changed their senior management, and might also have an increased focus on investment in their own nation.

Western equity markets are now very much open to national wealth managers of all origins. Necessity trumps previous political sensitivities, and investors who might have long-term horizons are greatly valued. However, these managers of national wealth have themselves changed, and the West needs to be sensitive to these changes.

¹⁴ Ref Greenspan and Guidotti 1999. The Guidotti-Greenspan rule states that reserves should equal short-term external debt (one-year or less maturity), implying a ratio of reserves-to-short term debt of 1. The rationale is that countries should have enough reserves to resist a massive withdrawal of short term foreign capital.






Conclusions

That risk appetite has collapsed is undeniable. As measured by the 2007 asset allocation between equity and fixed income, it will be very slow to reappear. The failure to rebalance from fixed income into equities during the 2008/2009 equity market turmoil may signal a permanent shift in favour of fixed income. We are dubious of the mean reversion argument that suggests that risk preference will shift back to 2007 levels when equities recover, if indeed they do! Our Chart 1 reminds us that pain and pleasure are asymmetrically related and the pain of presiding over shrinking AUM far outweighs the pleasure of presiding over an increase, for any given incremental change. A permanent increase in the appetite for fixed income may well have occurred. Even for nations that had not travelled from left to right in our model, the implications are similar: they have a greater desire for precautionary reserves, to have them available for intervention at short notice and the same greater resistance to falling AUM. All suggest a permanent shift towards an increased appetite for fixed income. Of course for nations at the far left of the model who have not diversified their asset allocation, the implication is simple. Diversification will come later than it would have five years ago, when reserves are higher.

The asset diversification that many national wealth managers embarked on in recent years was not well suited to the rapid re-ordering of priorities that occurred when wealth started to shrink. This shrinkage has led to a reaffirmation that the primary policy objectives for holding national wealth clearly begin at the left-hand side of our AUM driven model. Furthermore, a new journey from left to right in future years may well be at a slower pace than last time for any incremental increase in the stock of what we have chosen to describe as the national wealth pots. Returning to Chart 1 for one last time, it might also be worth noting that the assets that have caused most pain in the new, more highly transparent world were publicly quoted equities. This pain has been accentuated by new levels of transparency. When risk appetite increases in the future this fact may help to boost the argument for private equity, and other alternatives, for any incremental increase in AUM. The fact that the value of such investments might not be as easy to monitor on a daily basis could also increase their appeal to wealth managers who are fatigued by high levels of transparency and consequent domestic monitoring and criticism.

It seems clear to us that the primacy of the dollar has been enhanced by events since the summer of 2007. Attempts to argue for an increased pace of diversification out of dollar assets in favour of the euro, or even the SDR, are unpersuasive in view of what happened in late 2008. No nation ran short of euros, pounds, or yen. It was the dollar swap lines offered to friends of the US¹⁵ that brought the currency crisis of 2008 to a close. In a time of crisis, there was only one currency that a national wealth manager needed and that was the US dollar. The low yield argument and negative carry cost just do not stack up against the national embarrassment of not having enough during a time of crisis. It will be many years indeed before a rival reserve currency can supplant the dollar, despite the rhetoric of various officials in the BRIC (Brazil, Russia, India, China) nations. The simplest reason for this is that emerging economies, especially China, still link the value of their currency to the US dollar, making them a forced buyer of dollars at times of dollar weakness. Most recent data shows that the FX reserves of the BRIC nations grew by over \$60bn in May





2009, the largest monthly increase since the summer of 2008. Moreover Fed data showed that holdings of US Treasuries by overseas Central Banks rose by \$68.8bn, the third biggest monthly increase on record. As Mark Twain is reported to have said, history may not repeat itself, but it can certainly rhyme. The role of the managers of national wealth will likely continue to grow and to have a large and increasing influence on global capital markets.

For external managers the implications are clear, if we are correct in our assumption that the desire for precautionary reserves and national wealth in a wider context continues to grow. The institutions which constitute our definition of national wealth managers will continue to grow in importance in both absolute terms, and probably relative to other major capital market players, such as hedge funds and pension funds. Most importantly, within this larger pie, the fixed income slice is going to be bigger than we imagined only a couple of years ago and it will stay bigger for longer (within an evolving asset allocation process)¹⁶. The mainstream equity slice will be commensurately smaller. National wealth managers will still look to diversify into equities as AUM grow, but this will probably occur at a higher level of aggregate wealth than previously, and later. External managers will not only need to offer traditional help such as knowledge transfer, but will also have to provide more in-depth and bespoke asset allocation advice. In future this advice may need to fit the country specifics of national wealth managers, with reference to the national balance sheet (including the possible involvement at some future date of the government agent behind the fund). All of these new aspects will, of course, need to be “sold” to stakeholders such as the domestic population – a process that will need to be undertaken before, rather than after, a roller-coaster in performance numbers. The heightened sensitivity to shrinking AUM may also suggest a move away from benchmarked products and a shift towards total, or absolute return. There may also be more interest in downside protection. The dollar remains the primary currency focus, and the crises of 2008 may slow the decade-long trend of diversification away from the dollar.

¹⁵ Fed swap lines. On the 29 October 2008 the US Fed agreed to provide USD30bn swap lines to the Central Banks of Brazil, Mexico, South Korea and Singapore to boost the availability of dollars in these key economies, and close friends of the US.

¹⁶ The allocation preference within fixed income is another story and will be driven by many things including previous exposures to non-government bonds. A favourable experience with credit bonds may heighten the demand for credit bonds, a painful experience with mortgage backed securities may cause a longer term aversion to that asset class, etc. Inflation linked bonds do, however, seem to be enjoying a higher level of interest from national wealth managers of all kinds from all geographies.



Biography



Gary Smith joined the BNP Paribas Group in 2004, and worked for four years within Fixed Income Sales, where he was responsible for a team covering institutional clients including Central Banks. He joined BNP Paribas Investment Partners in 2008 as Head of Central Banks, Supranationals and Sovereign Wealth Funds. He has global responsibility for relationships between these key customers and the various members of the BNP Paribas Investment Partners group.

Before joining BNP Paribas he spent nine years with Morgan Stanley, and six years with Merrill Lynch, working in the fixed income field. He began his career in the economics department of Greenwell Montagu in 1986.

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