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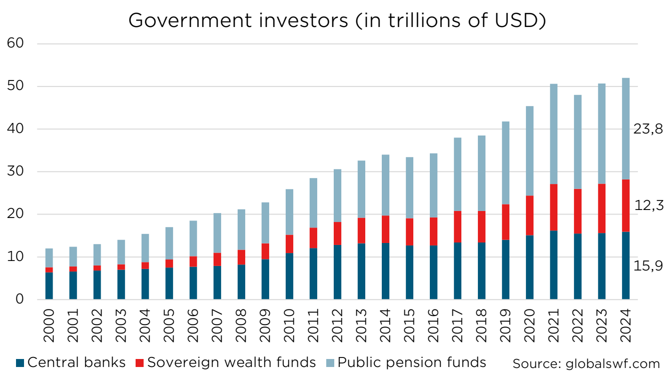
Sovereign wealth funds: underestimated players on the capital markets

Sovereign wealth funds are among the biggest players on the global financial markets. Their approaches and objectives differ depending on the origin of the capital under management, but they have one thing in common: they manage enormous assets. How big is their influence on the capital markets and what are these funds used for?

The assets under management of sovereign wealth funds are growing

In contrast to pension funds, the state has full control over the capital invested in sovereign wealth funds and is not tied to specific purposes. A good example of this is the Irish sovereign wealth fund, whose funds were used to rescue banks during the financial crisis instead of being used for pension payments as originally planned.



Sovereign wealth funds are a relatively new phenomenon on the financial markets and differ significantly from traditional financial players such as banks, insurance companies or investment funds. In 2000, sovereign wealth funds managed around 1.2 trillion US dollars worldwide. By 2024, this amount had risen to an impressive USD 12.3 trillion. A basic distinction is made between commodity-based and non-commodity-based sovereign wealth funds. They are often used to cushion fluctuations in government revenue and reduce the negative effects of economic cycles on government finances and the economy.

The Norwegian sovereign wealth fund

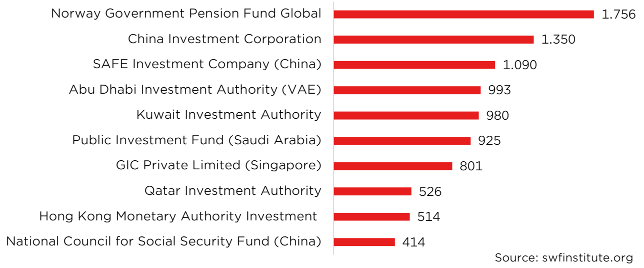
Norway is a prime example of the benefits of a sovereign wealth fund. After the discovery of oil in the 1960s, the question arose as to how the entire population could benefit from this wealth. The oil price fluctuations in the 1970s and the decline in demand made it clear that a long-term strategy was needed to secure Norway's prosperity, regardless of developments on the commodity markets. The Norwegian Oil Fund was founded in the 1990s with a starting capital of two billion Norwegian kroner (approx. 200 million euros). Since then, the income from the oil and gas business has been successfully invested on the international financial markets. The government is allowed to use a maximum of three percent of the fund volume for the state budget each year, while the rest of the capital remains protected.

Today, the Norwegian sovereign wealth fund is the largest shareholder in the world with over 18,500 billion kroner (over 1,500 billion euros). In purely mathematical terms, every one of Norway's 5.5 million inhabitants is a millionaire - measured in kroner. In euros, this corresponds to assets of almost 300,000 euros per capita. The fund is managed by Norges Bank Investment Management (NBIM), a unit of the Norwegian central bank, while the parliament sets the strategic direction. In the first half of this year alone, the fund made a profit of 125 billion euros.

Most sovereign wealth funds profit from commodities

The Norwegian model has led to more and more resource-rich countries setting up similar sovereign wealth funds in recent years. One of the most recent examples is Mozambique, which set up a sovereign wealth fund following the discovery of large natural gas deposits. Countries in the Middle East are also using their sovereign wealth funds to protect themselves in the event that revenues from fossil fuels decline. Four of the ten largest sovereign wealth funds in the world are from the Gulf states alone: Qatar, Kuwait, Saudi Arabia and the United Arab Emirates.

Largest sovereign wealth funds worldwide by assets under management
in billions of US dollars; as of September 2024



Source: swfinstitute.org

Not all sovereign wealth funds are based on commodities. The list of the largest funds also includes four Chinese funds and one fund from Singapore, which are fed by foreign exchange reserves, export surpluses and high tax revenues and are used to hedge against economic fluctuations.

How strongly are the markets influenced?

Due to their enormous investment volumes, sovereign wealth funds have the opportunity to exert considerable influence on companies and sectors through their investment decisions - for example with regard to sustainability. The Norwegian fund holds an average of 1.5 percent of shares in all listed companies worldwide and actively uses its voting rights to influence company policy. Voting behavior is based on transparent voting guidelines that are publicly available. Most sovereign wealth funds invest broadly and therefore have limited influence on financial market prices.

This transparency is crucial, as critics often warn that large sovereign wealth funds could be misused for political purposes. Mixing politics and business could lead to misallocations. The Norwegian fund is often cited as a role model here, as decisions are made by a government-independent administration according to strict guidelines in order to minimize political influence.

The focus on sustainability is increasing

Many sovereign wealth funds not only pay attention to economic criteria, but also consider environmental, social and ethical factors in their investments. According to a survey by OMFIF, around two thirds of sovereign wealth funds are currently guided by ESG criteria. This is often not just about moral considerations: Sovereign wealth funds want to avoid investing in so-called stranded assets - assets that could lose a lot of value as a result of the shift towards a more sustainable economy. The Norwegian sovereign wealth fund is seen as a role model for a global investor that is guided by environmental and social goals as well as good corporate governance. Since 2015, companies with more than 30 percent of their turnover coming from coal energy have had to be removed from the portfolio. Tobacco companies, manufacturers of weapons of mass destruction and companies that violate human rights are also consistently excluded. These guidelines are continuously being developed and must be approved by parliament.

A sovereign wealth fund for Germany?

According to a survey conducted in 2021, 58% of Germans are in favor of introducing a state equity fund for old-age provision. However, unlike countries rich in raw materials, Germany does not have any significant income from raw material deposits that could be used to finance such a fund. In 2019, the ifo Institute developed a proposal to take advantage of Germany's good credit rating and role as a stable financial anchor in the eurozone during the low-interest phase. The idea was to borrow at favorable conditions and invest the capital raised in a state fund.

These considerations are now reflected in the idea of “generational capital”, which was agreed by the coalition government this summer as part of Pension Package II. In addition to contributions and state subsidies, the statutory pension insurance scheme is to be supported in future by a new funding pillar managed by an independent foundation under public law. The operational structures of the already established KENFO, which manages the fund for financing nuclear waste disposal, will initially be used for this purpose. For 2024, the federal government plans to initially provide twelve billion euros to set up the equity pension, with a gradual increase in funding until 2028. To finance this, the federal government will take on new debt that does not fall under the debt brake. In addition, a further 15 billion euros are to be made available from the assets of the federal government, e.g. from company shareholdings, by 2028.

By 2035, a capital stock of at least 200 billion euros is to generate returns through investments on the financial markets. The returns should then flow into the pension insurance scheme and thus dampen the increase in the contribution rate.

However, the low-interest phase is now over and German public debt has deteriorated somewhat and is slightly above the Maastricht reference value of 60 percent of GDP. It must therefore be taken into account that the expected return on generational capital will be lower than for a sovereign wealth fund that draws its state revenue from commodity profits. This is because money must be borrowed on the capital market to finance the generation fund, for which interest must be paid. Even if the government's interest rates on bonds are significantly lower than the expected returns on generation capital, the relief provided by this form of equity pension is likely to remain manageable. Consideration should therefore be given to feeding part of the pension contributions directly into a state fund in future. For example, scientists are considering the idea of pension contributors who do not have children (and thus indirectly undermine the pay-as-you-go pension system) paying an additional contribution into such a fund in order to finance part of their pension a few decades later. However, the question arises as to whether there would be the political courage and will to do so.

Jan Mooren

Market data

Stock marktes	As of 27.09.2024 09:41	Change versus 20.09.2024 -1 week	26.08.2024 -1 month	26.06.2024 -3 months	26.09.2023 -1 year	29.12.2023 YTD
Dow Jones	42175	0,3%	2,3%	7,8%	25,5%	11,9%
S&P 500	5797	1,7%	3,2%	5,8%	35,6%	21,5%
Nasdaq	18190	1,3%	2,6%	2,2%	39,2%	21,2%
DAX	19271	2,9%	3,5%	6,1%	26,3%	15,0%
MDAX	26997	4,5%	7,2%	6,6%	5,1%	-0,5%
TecDAX	3401	4,2%	2,3%	2,2%	14,6%	1,9%
EuroStoxx 50	5037	3,4%	2,9%	2,5%	22,0%	11,4%
Stoxx 50	4485	2,2%	-0,1%	-0,7%	14,9%	9,6%
SMI (Swiss Market Index)	12205	2,3%	-1,2%	1,6%	11,4%	9,6%
Nikkei 225	39830	5,6%	4,5%	0,4%	23,3%	19,0%
Brasilien BOVESPA	133010	1,5%	-2,8%	8,5%	16,5%	-0,9%
Indien BSE 30	85600	1,2%	4,8%	8,8%	29,8%	18,5%
China CSI 300	3704	15,7%	11,4%	6,4%	0,3%	7,9%
MSCI Welt	3721	1,2%	2,2%	5,7%	30,8%	17,4%
MSCI Emerging Markets	1163	5,1%	5,4%	7,1%	22,8%	13,6%
Bond markets						
Bund-Future	134,49	56	17	247	560	-273
Bobl-Future	120,08	74	228	353	432	80
Schatz-Future	107,17	34	92	145	222	63
3 Monats Euribor	3,35	-6	-31	-31	-59	-53
3M Euribor Future, Dec 2024	2,90	-13	-10	-38	-49	60
3 Monats $ Libor	4,90	-5	-44	-69	-74	-69
Fed Funds Future, Dec 2024	4,29	0	-24	-70	-47	46
10 year US Treasuries	3,77	4	-5	-55	-78	-10
10 year Bunds	2,11	-4	-8	-32	-66	11
10 year JGB	0,86	-2	-3	-16	12	23
10 year Swiss Government	0,39	-11	-5	-21	-68	-31
US Treas 10Y Performance	622,64	-0,4%	0,6%	5,3%	10,5%	3,6%
Bund 10Y Performance	570,77	0,5%	0,9%	3,2%	8,1%	1,0%
REX Performance Index	455,42	0,3%	1,0%	2,6%	6,3%	1,7%
IBOXX AA, €	3,00	-7	-16	-45	-95	-7
IBOXX BBB, €	3,50	-7	-16	-51	-126	-25
ML US High Yield	7,29	3	-18	-76	-167	-51
Commodities						
MG Base Metal Index	441,22	4,1%	5,8%	3,3%	16,4%	12,9%
Crude oil Brent	71,49	-4,4%	-9,4%	-16,5%	-24,0%	-8,0%
Gold	2663,34	1,9%	5,9%	15,7%	39,9%	28,9%
Silver	32,22	3,0%	8,0%	11,6%	38,2%	32,9%
Aluminium	2598,02	5,5%	2,4%	5,3%	17,9%	10,8%
Copper	9944,84	6,4%	8,4%	5,8%	23,8%	17,5%
Iron ore	92,54	0,7%	-5,9%	-13,2%	-23,5%	-32,1%
Freight rates Baltic Dry Index	2091	5,8%	18,7%	6,5%	23,4%	-0,1%
Currencies						
EUR/ USD	1,1130	-0,3%	-0,3%	4,1%	5,0%	0,7%
EUR/ GBP	0,8328	-0,7%	-1,6%	-1,6%	-4,2%	-3,9%
EUR/ JPY	159,37	-1,1%	-1,0%	-7,0%	1,0%	1,9%
EUR/ CHF	0,9412	-0,8%	-0,5%	-1,8%	-2,7%	1,6%
USD/ CNY	7,0134	-0,6%	-1,5%	-3,5%	-4,1%	-1,3%
USD/ JPY	144,81	0,6%	0,2%	-10,0%	-2,9%	2,7%
USD/ GBP	0,75	-0,6%	-1,2%	-5,5%	-8,9%	-4,6%

Source: Refinitiv Datastream

Carsten Klude
+49 40 3282-2572
cklude@mmwarburg.com

Dr. Rebekka Haller
+49 40 3282-2452
rhaller@mmwarburg.com

Martin Hasse
+49 40 3282-2411
mhasse@mmwarburg.com

Dr. Christian Jasperneite
+49 40 3282-2439
cjasperneite@mmwarburg.com

Simon Landt
+49 40 3282-2401
mlandt@mmwarburg.com

Jan Mooren
+49 40 3282-2992
jmooren@mmwarburg.com