

Temasek Holdings Investment Performance and Transparency

On 8 June, I wrote in the Straits Times, a newspaper in Singapore that Temasek Holdings should not shy away from risk despite recent losses. Here is the article:

“Temasek’s track record has come under fire of late for a couple of false steps, notably its investments in Merrill and Barclays. These false steps are unfortunate, but so too is a general criticism of Temasek.

Temasek should not shy away from taking risk, particularly now. The last 30 years have seen steady growth in economies and wealth. The democratization of risk through the rise of derivatives, the growth of capital employed in active management across markets, in arbitrage and relative value as well as traditional investing, the widening and deepening of markets, have all contributed to a gradual reduction in continuous risk. Unfortunately this has also stored up gap risk. In the period of calm preceding 2008, however, the risk reward characteristics of investment in general were deteriorating as more capital chased fewer opportunities manifesting in higher correlation between seemingly unrelated investments, the need for more leverage to eke out decreasing levels of return, lower volatility across almost all markets. Risk levels became higher as risk perception became lower. Risk is highest in calm waters. Once the iceberg is sighted and collided with, risk is apparent and is converted from risk to damage.

The Fall of 2008 was such an iceberg. Markets are no longer as risky; they are damaged. For arbitrage and relative value investments, there is no better environment than damaged markets. Investors will be well compensated for policing of spreads, for bringing efficiency and price discovery back to markets. Equities may be cheap or expensive, but given the systemic de-risking of 2008, there are clearly relative value opportunities. Mergers and acquisitions have been more active than expected as companies seek strategic acquisitions, fire sales,

consolidations. Bond markets have seen a recovery in issuance and take up has been healthy. Equity recapitalizations have been strong in emerging markets. All these are signs of a global economy healing itself.

The timing of the disposals of Barclays and BoA may have been unfortunate, but in the new world order, financial institutions are likely to be regulated as utilities with lower returns on equity.

The financial crisis represents a step change in the world order where the profligacy of the developed world is exposed and paid for over a period of decades, while the value creation and maturity of emerging markets raise productivity, economic growth and standards of living. Emerging markets are the source of demand and the source of supply of natural resources, whereas service economies in the developed world appear to be sidelined in the value chain. Perhaps there is some method behind Temasek's new choice of CIO after all."

The response to the article, from what I guess was mostly be a Singaporean audience, was mostly negative. Most Singaporeans are suspicious of Temasek's track record and apparent lack of transparency. In many ways, Temasek's main problem is a public relations one rather than a material one. While I neither defend nor criticize Temasek, I thought I would take a closer look at the objections to address my own questions about the organization.

While Temasek is known for its apparent lack of transparency regarding financial results and the precise details of its investments, the Temasek website provides some information. It provides quite a lot of information actually. But first, Temasek is 100% owned by the Ministry of Finance and is required to report only to its shareholders. One can of course argue that such responsibility should pass through to the citizens of Singapore as well, but that is another discussion.

In 2005, however , Temasek issued Yankee bonds which are a USD public bond issue regulated under the US Securities Act of 1933. Under the Act, these bonds are subject to certain standards and conditions including creditworthiness and reporting standards. Temasek received a AAA rating from Standard and Poor's and Moody's in

December 2008. Temasek's group financials are now available on their website dating back to 2004 in some detail.

I cannot comment about the management quality of Temasek. The website provides some investment performance information indicating a circa 18% annualized return on equity since inception. In the absence of volatility or other risk measures, it is difficult to comment on the quality of those returns.

The period of poor performance which is most in the public eye is 2008 where Temasek reported that for the period March to November 2008, the value of its portfolio declined by some 31% from 185 billion SGD to 127 billion SGD. This is a large loss, but the MSCI World equity index fell some 38% in the same period.

Using a rough and ready calculation, Temasek's NAV increased by roughly 54% from Mar 2004 to Nov 2008. The absence of precisely comparable data means that I am using book value for the March 2004 valuation and market value for the November 2008 valuation. This is conservative I believe given the economic cycle. In contrast, in the same period, the HFRI Hedge Fund Index gained 15%, emerging market bonds (EMBI) gained 15%, global bonds (the old Lehman Agg) gained 19% and the MSCI World Equity Index made a total return of -4.22% with dividends reinvested. Note that the Temasek portfolio is slightly levered at between 0.9 to 1.4 X equity.

It is not a bad performance for an effectively long only private equity, strategic investment mandate.