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Tougher challenges for Temasek ahead

By ALVIN FOO

THE good news from the recent Temasek Review was that the Singapore investment firm's portfolio rose $5 billion to a fresh peak of $198 billion as of March 31 this year.

However, another closely watched number – its one-year total shareholder return – fell to 1.5 per cent from 4.6 per cent a year earlier. This is one measure of how hard the investment funds are working.

While this was far better than the minus 30 per cent one-year return seen in 2009 and the performance of some key regional stock indexes last year, the number was certainly nothing to write home about.

Even though it is not one of Temasek's benchmarks, critics have already lost no time in pointing out that this 1.5 per cent return does not beat inflation.

In contrast, the Government of Singapore Investment Corporation discloses real rates of return, adjusted for inflation.

Certainly, bettering inflation is not Temasek's goal. Rather, it is to deliver sustainable value over the long term. This is seen in its track record over 38 years since its inception in 1974 which stands at an annualised 17 per cent.

How do we judge Temasek's performance, then?

One factor to consider is that market conditions in the past year or so have been anything but favourable as a result of the European debt crisis and weak US growth. And the heightened market volatility that does not show signs of easing.

The past year has been more challenging for large investors worldwide, as "we're in uncharted territory. It's difficult for most fund managers", says Mr David Lee, managing director of Ferrell Asset Management. "Whatever strategy you're using, it will expire much faster than you think it'll last," he added.

Norway's Government Pension Fund Global endured a negative 2.5 per cent return last year, mainly due to world stock market declines. The fund's equity investments returned minus 8.8 per cent last year as stocks fell in Europe, where the fund had half its shareholdings at the end of the year. It did, however, deliver a 7.1 per cent return in the first three months of this year as markets rallied.

Neither was investment guru Warren Buffett spared. His company Berkshire Hathaway's book value per share rose just 4.6 per cent last year compared with 13 per cent a year before.

Moreover, Mr Buffett's proud record of averaging a better-than-20 per cent annual gain in Berkshire's book value per share ended in his 47th year. The average hit 19.8 per cent for the first time.

It was a tough year for the asset management industry as a whole, said Professor Melvyn Teo, director of the BNP Paribas Hedge Fund Centre at the Singapore Management University (SMU).

He added: "Traditional long-only investors were hurt by, among other things, the poor performance of global equity markets. Hedge funds were grappling with volatility, increased compliance and regulatory costs, investor redemptions, and costly financing."

Going forward, market experts point out that delivering decent returns will become progressively tougher, given the size of Temasek's growing portfolio.

"At its current size, generating returns over cost of capital is admittedly challenging," said Mr Mark Matthews, head of research for Asia at Julius Baer Bank.

SMU associate professor of finance Annie Koh added: "You cannot be playing stocks on a year-to-year basis. You have to pick long-term trends."

> **RIGHT SUCCESSOR**
>
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>
> **– CIMB analyst Song Seng Wun**

To significantly boost returns, Temasek must therefore rely on an ability to spot champions like the China banking sector, which has been one key positive over the last 12 months.

Temasek chairman S. Dhanabalan noted: "The banking sector in China remains a good proxy to the growing Chinese economy and expanding middle income population."

One raw diamond that it is betting on is the energy and resource sector. Temasek doubled its exposure in this area from 3 to 6 per cent of its portfolio.

The sector has strong fundamentals of growing demand and tight supply, said IG Markets Singapore market strategist Justin Harper, and should help generate higher returns going forward.

Another area is the use of private equity and special investment vehicles, tools which will enable Temasek to indirectly broaden its reach across wider geographies and asset classes.

Earlier this year, Temasek said it started Pavilion Capital, a new wholly owned unit to invest in North Asia, including China.

In 2010, Temasek set up a similar investment unit called Seatown Holdings with a committed capital of over $4 billion.

These investment vehicles allow Temasek to spread its investment reach while still remaining flexible and nimble.

But given the current volatility, investment companies may not want to be too aggressive and perhaps not pursue higher returns as a priority. A defensive stance might be more appropriate, some analysts caution.

"At this juncture, the ideal strategy should be more of capital preservation – being defensive and seeking safer returns rather than taking an aggressive stance," CIMB regional economist Song Seng Wun noted.

Management will also be key. That is why market watchers continue to look for concrete signs of a successor to current chief executive Ho Ching.

Many still remember 2009 when former BHP Billiton chief Charles Goodyear left Temasek just four months after being appointed CEO-designate on March 1, citing "unresolved strategic differences".

The past two years have indeed seen a deepening of bench strength among its top management, a step in the right direction to find a successor to Ms Ho.

A smooth succession plan would contribute towards generating healthy returns for the years to come.

Mr Song said: "This will ensure continuity and stability, providing a stable ship going forward. Any potential successor must be someone who clearly understands the mandate and can work well with everyone."

Temasek watchers have long made a habit of keeping a critical eye on its numbers. But today's investment climate may necessitate a more back-to-basics approach.

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