China Investment Corporation:
Investment Performance in 2010 and Outlook

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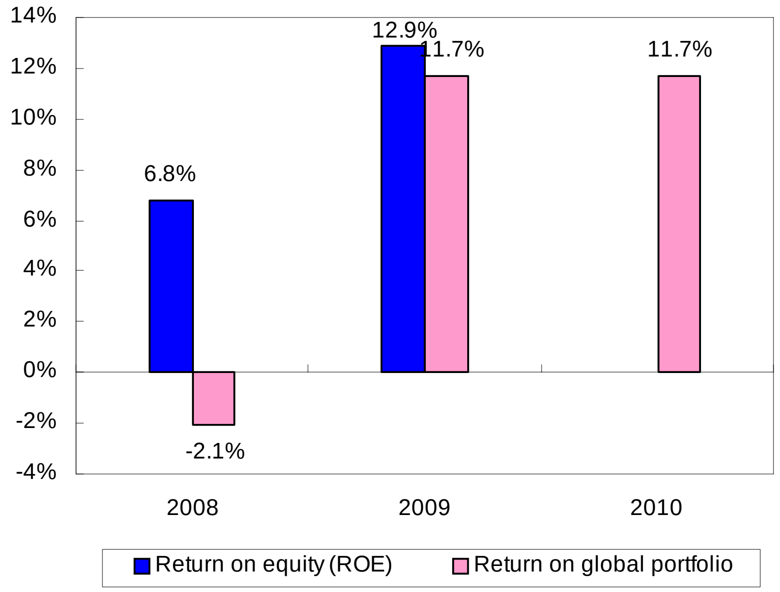
I. CIC's investment performance in 2010

1. Achieved same return in 2010 as in 2009

On 26 July 2011 China Investment Corporation (CIC) published its annual report for 2010. Established on 29 September 2007 independently of the People's Bank of China and with the aim of diversifying China's foreign exchange reserves and obtaining a long-term return, CIC is a sovereign wealth fund with $200 billion to invest both at home (stakes in domestic Chinese financial institutions) and abroad (global portfolio).

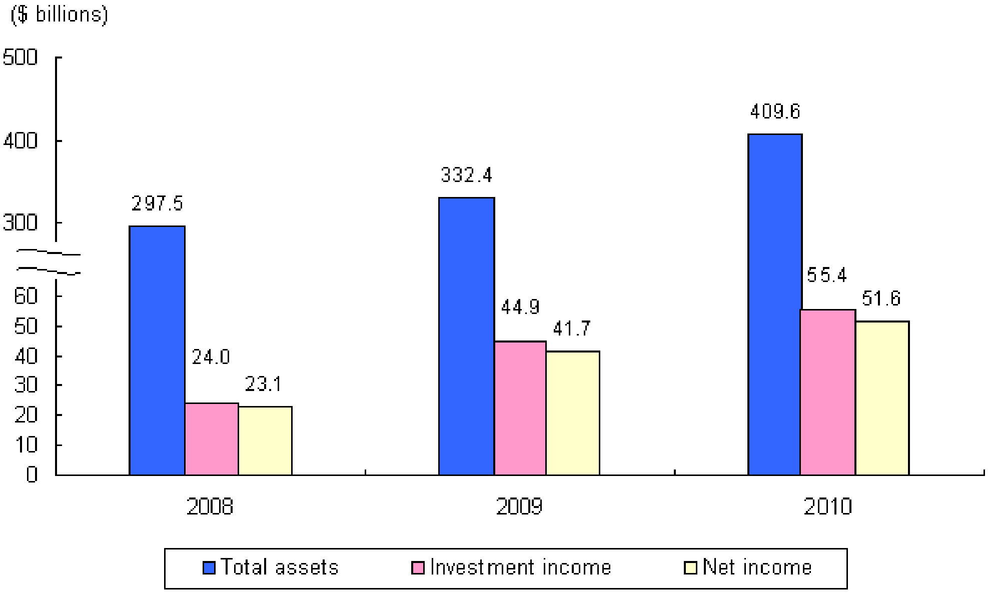
In 2010 it achieved a return of 11.7% on its global portfolio—the same as in 2009. However, it has not disclosed its overall return on its domestic and overseas investments combined (ROE) in 2010 (Figure 1). Moreover, its average annual return on its global portfolio since its establishment in September 2007 has been 6.4%.

Figure 1: CIC's investment performance



Source: Nomura Institute of Capital Markets Research, based on CIC's annual reports for the years concerned

Figure 2: CIC's key financial indicators



Source: Nomura Institute of Capital Markets Research, based on CIC's annual reports for the years concerned

As a result, CIC's total assets increased from $332.4 billion in 2009 to $409.6 billion in 2010, while its investment income increased from $44.9 billion to $55.4 billion, and its net income from $41.7 billion to $51.6 billion (Figure 2)[1].

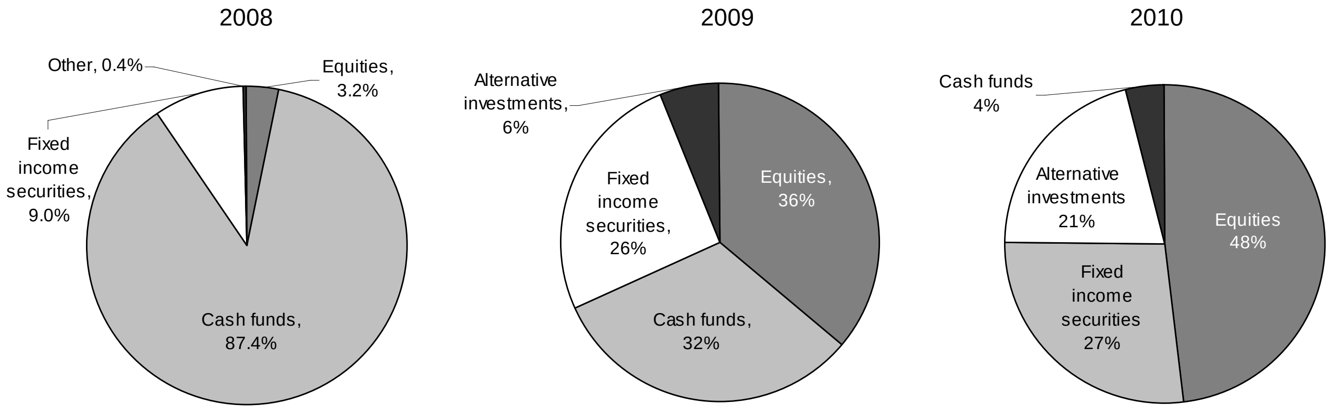
2. CIC's progress in reshuffling its portfolio in 2010

The most striking changes to CIC's portfolio in 2010 were a reduction in its cash position relative to other assets and new investments of $35.7 billion. These included alternative investments (e.g., in infrastructure and private equity) and direct investments.

As a result, the breakdown of CIC's global portfolio as of the end of 2010 ($135.1 billion) was as follows: equities (48%), fixed income securities (27%), alternative investments (21%), and cash funds (4%) (Figure 3), with equities and alternative investments accounting for a much larger share than before.

1 For more on CIC's performance and governance in 2009, see Sekine, Eiichi, "The Governance of China Investment Corporation on Its Way to Becoming a Sophisticated Institutional Investor," Nomura Journal of Capital Markets, Winter 2011, Vol.2, No.3.

Figure 3: Breakdown of CIC's global portfolio



Source: Nomura Institute of Capital Markets Research, based on CIC's annual reports for the years concerned

II. A closer look at CIC's global portfolio in 2010

1. Equity investments

As of the end of 2010, 76% of CIC's global portfolio ($102.7 billion) consisted of diversified investments while 24% ($32.4 billion) consisted of concentrated investments.

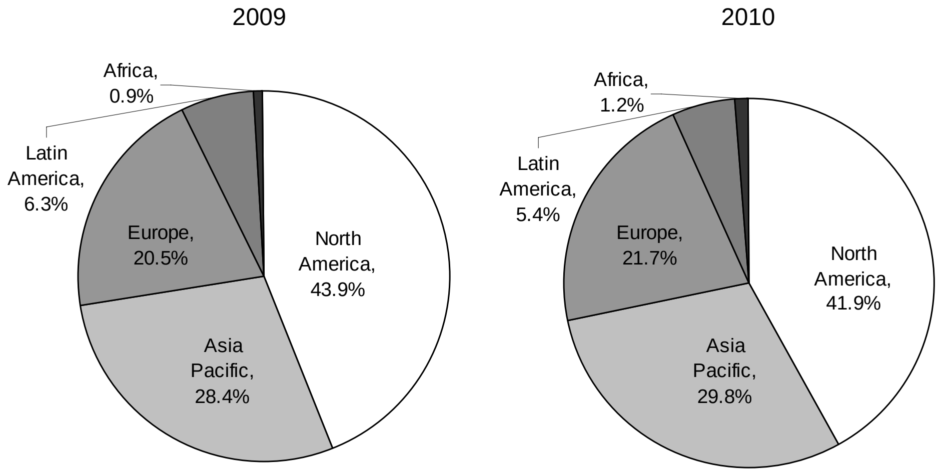
The geographical breakdown of the global portfolio's diversified equity investments as of the end of 2010 was as follows: North America (41.9%), Asia-Pacific region (29.8%), Europe (21.7%), Latin America (5.4%), and Africa (1.2%) (Figure 4). This was largely unchanged from the end of 2009.

By sector, the breakdown was as follows (in descending order): financials (17%), energy (13%), and materials (12%) (Figure 5). The publication of its annual report for 2010 was the first occasion for CIC to publish a sector breakdown of its equity holdings.

2. Fixed income investments

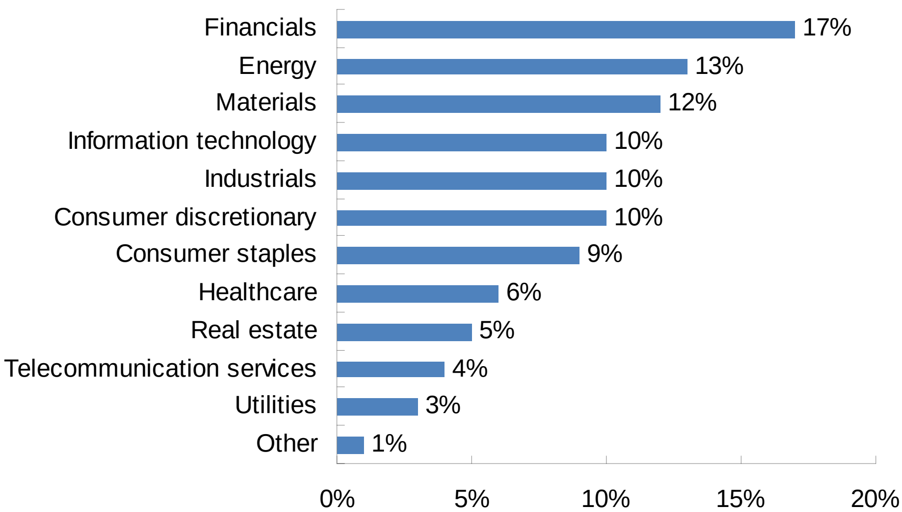
The breakdown of the diversified fixed income investments in CIC's global portfolio as of the end of 2010 was as follows: government bonds (38%), corporate bonds (32%), asset-backed securities (12%), agency bonds (9%), and other types of fixed income investments (9%). The most striking change since the end of 2009 was an increase in the percentage of corporate bond holdings and a decrease in that of agency bond holdings (Figure 6).

Figure 4: Breakdown of CIC's global portfolio (diversified equities) by region



Source: Nomura Institute of Capital Markets Research, based on CIC's annual reports for the years concerned

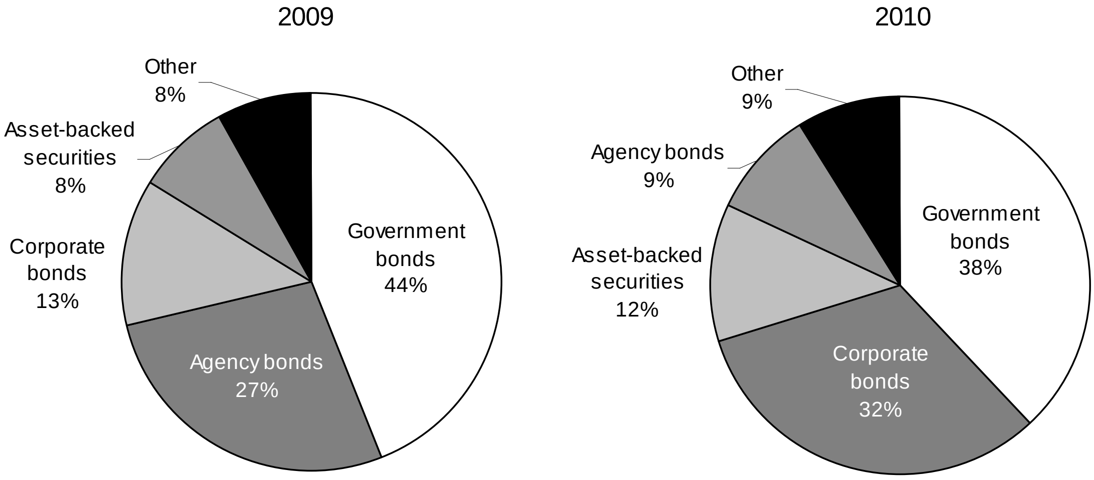
Figure 5: Breakdown of CIC's global portfolio (diversified equities) by business sector



Source: Nomura Institute of Capital Markets Research, based on CIC's annual reports for the years concerned

The increase in CIC's corporate bond holdings is connected with its new investments in public market investment vehicles in 2010. According to its annual report for 2010, CIC added to its global portfolio in that year US dollar bonds and euro covered bonds (interest products) as well as emerging market local currency debt, Asian emerging market sovereign bonds, and convertible bonds from around the

Figure 6: Breakdown of CIC's global portfolio (diversified fixed income securities)



Source: Nomura Institute of Capital Markets Research, based on CIC's annual reports for the years concerned

Figure 7: Selected public market investment vehicles added in 2010

Business area	Investment vehicles
Interest products	US dollar bonds, euro covered bonds
Credit products	Emerging market local currency debt, Asia fixed income active, investment grade corporate bond index products
Developed country equities	US large-cap equities, global convertible bonds
Emerging country equities	Emerging Europe equity active, Latin America equity active, Asia ex Japan active, Korea equity active, metals and mining equity active
Commodities	Metals and energy index swaps, gold equity funds, active commodity indices
Futures and options	Stock index futures, bond futures, commodity futures, FX forward options

Source: Nomura Institute of Capital Markets Research, based on CIC's annual report for 2010

world (credit products) (Figure 7) in a reshuffle of its fixed income portfolio. 59% of CIC's global portfolio ($79.7 billion) is managed externally, and 41% ($55.4 billion) in house. In 2010 it implemented a straight-through processing system[2] for the management of its proprietary trading and has used it to add a portfolio of index products such as the S&P 500 Index, the DJ Euro Stoxx 50 Index, and the Enhanced FTSE Xinhua Index to its existing fixed income portfolio.

2 Straight-through processing (STP) allows all the data needed to settle a trade (ranging from the consideration to collation, clearing and settlement) to be processed automatically as a seamless stream of electronic data by transmitting it in a standardized format between interoperable systems without the need for manual intervention. This enables an organization to operate more efficiently and reduce its operational risk and costs.

Figure 8: Highlights of selected direct investments in 2010

Company	Contract month	Amount of investment (US$ million)	Type of investment	Sector	Approximate initial ownership (%)
AES	March	1,581	Common stock	Power & utility	15%
Penn West	June	416	Equity	Oil & gas	5%
Peace River Oil Partnership	June	329	Joint venture	Oil & gas	45%
Chesapeake Energy	June	200	Convertible preferred stock	Oil & gas	N/A
BTG Pactual	December	300	Consortium	Finance	3%
BUMA	December	73	Equity	Mining services	8%

Source: Nomura Institute of Capital Markets Research, based on CIC's annual report for 2010

3. Direct investments

CIC's global portfolio also contains long-term direct investments as its largest and least diversified positions. CIC classifies these as concentrated investments. CIC's annual report for 2010 lists some examples of new direct investments (Figure 8). All are mainly active in the materials and energy sectors.

Another, more recent (April 2011) example is CIC's 11.6% stake ($250 million of convertible preferred stock) in the Chinese semiconductor manufacturer Semiconductor Manufacturing International Corporation ("SMIC")[3]. Although SMIC is listed in Hong Kong and CIC's stake therefore forms part of its global portfolio, the fact that it conducts its business in mainland China means that CIC's stake can be seen as a means of using China's forex reserves to foster the development of Chinese industry.

III. New developments at CIC in 2010 and the first half of 2011

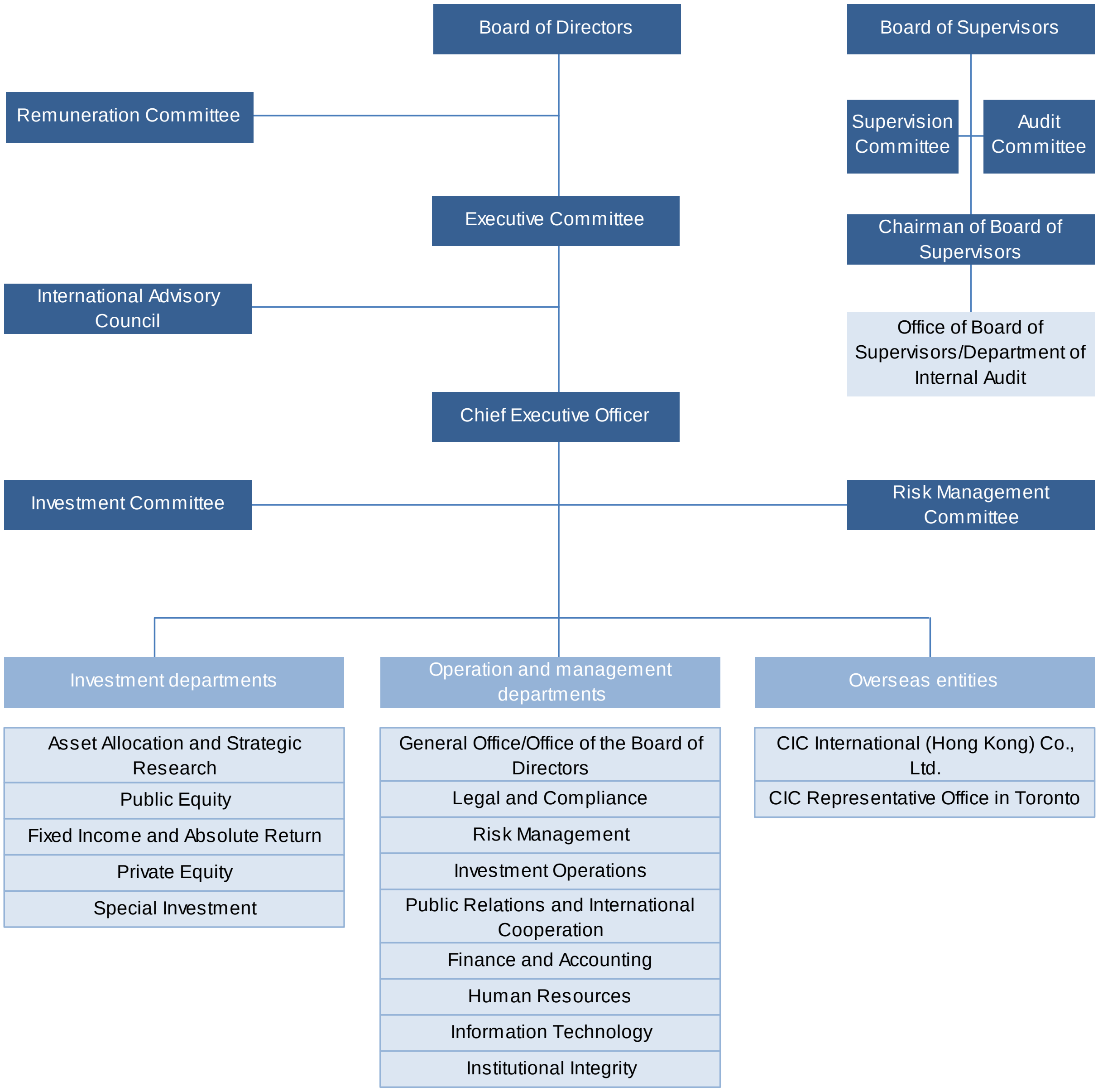
1. New definition of asset classes

When CIC was established in September 2007, it began to invest in traditional asset classes such as equities and fixed income but later began to invest in assets such as commodities, private equity, property, hedge funds as well as making direct investments as it gained experience as an asset manager. As such investments require a long horizon, CIC's Board of Directors decided in January 2011 to extend the horizon to 10 years and to assess these investments by their average annual return during this period. This resulted in adjustments to CIC's strategic asset allocation (SAA) plan, tactical asset allocation (TAA) plan, and risk management process.

Furthermore, CIC's benchmark portfolio, which until the end of 2010 consisted of four asset classes (cash funds, equities, fixed income securities and alternative investments) was recategorized into five classes (cash, diversified public equities, fixed income securities, absolute return investments, and long-term investments) from

[3] SMIC press release of 19 April 2011.

Figure 9: Organizational chart of CIC



Source: Nomura Institute of Capital Markets Research, based on CIC's annual report for 2010

the start of 2011. Absolute return investments include hedge funds. Similarly, long-term investments include direct investments, private equity, commodities, property and infrastructure.

2. Reorganization of investment departments and appointment of new CIO

Following the aforementioned recategorization, CIC reorganized its investment departments in May 2011. As a result, its Public Market Investment Department and its Tactical Investment Department became its Public Equity Investment Department and its Fixed Income and Absolute Return Investment Department, respectively (Figure 9). Similarly, its Private Equity Investment Department (formerly, its Private

Market Investment Department) and its Special Investment Department are now organized by sector to reflect the value chains of the sectors they invest in.

The functions and roles of the four investment departments following their reorganization are as follows.

1) Public Equity Investment Department

This department invests both directly and indirectly, via external fund managers, in public market equities.

2) Fixed Income and Absolute Return Investment Department

The Fixed Income and Absolute Return Investment Department manages all fixed income portfolios as well as credit derivative, hedge fund, multi-asset and commodity portfolios.

3) Private Equity Investment Department

The Private Equity Investment Department manages private equity investments through external managers as well as making and managing direct investments. It focuses on real estate, industry and technology, financial services, consumer goods and services, healthcare and biopharmaceuticals. In other words, it covers long-term investment in the secondary and tertiary sectors.

4) Special Investment Department

The Special Investment Department manages private equity investments through external managers as well as making and managing direct investments. It executes and manages investments in the energy, mining, precious metal, agriculture and infrastructure sectors. In other words, it covers long-term investment in the primary sector.

Following this reorganization, CIC's vice chairman and former vice chairman of the National Council of the Social Security Fund, Li Keping, was appointed as CIC's executive director, executive vice president, and chief investment officer at a meeting of its Board Of Directors on 12 July 2011, while CIC's vice president, Gao Xiqing, relinquished his role as chief investment officer. At the same time, Li Keping became a new member of CIC's Executive Board (Figure 10).

Figure 10: Members of CIC's Executive Committee

Executive Committee			
Title	Name	Born (age)	Education/career
Chairman & Chief Executive Officer	Lou Jiwei	1950 (61)	MA in economics, professor. PhD supervisor, Director General of the Macroeconomic Control Department of the State Commission for Restructuring the Economic Systems, Deputy Governor of Guizhou Province, Executive Deputy Minister of Finance, Deputy Secretary General (ministerial level) of the State Council.
Vice Chairman, President & Chief Investment Officer	Gao Xiqing	1953 (58)	LLD, professor, PhD supervisor. General Counsel and the Director General of the Public Offering Supervision Department, Deputy Chairman and Chief Executive Officer of the Bank of China International (Holdings) Limited, Deputy Chairman at the China Securities Regulatory Commission, Deputy Chairman of the National Council for the Social Security Fund.
Chairman of Board of Supervisors	Jin Liqun	1949 (62)	Graduate student of economics. Executive Deputy Director of China to the World Bank Group, Director General of the World Bank Department at the Ministry of Finance, Deputy Minister of Finance, member of the Monetary Policy Committee of the People's Bank of China, Vice President (Operations 1) of the Asian Development Bank (ADB).
Executive Director, Executive Vice President & Chief Investment Officer	Li Keping	1956 (55)	Master's degree in economics. Deputy Director General of the Macroeconomic Control Department of the State Commission for Restructuring the Economic Systems, Deputy Director General of the Macroeconomic Control Department of the State Council Office for Restructuring the Economic Systems, Head of the Investment Department, Secretary General & Deputy Chairman of the National Council for the Social Security Fund.
Executive Vice President	Peng Chun	1962 (49)	PhD in economics. Branch president of the Bank of Communications in Urumqi, Nanning and Guangzhou, Assistant to the President, Executive Vice President, and Executive Director of the Bank of Communications, currently Director and President of Central Huijin.
Executive Vice President & Chief Operating Officer	Fan Yifei	1964 (47)	PhD in economics. General Manager of the Finance and Accounting Department, General Manager of the Planning and Finance Department, Assistant to the President, and Executive Vice President of China Construction Bank.
Executive Vice President & Deputy Chief Investment Officer	Xie Ping	1955 (56)	PhD in economics, professor, PhD supervisor. Deputy Director General of the Policy Research Office, Director General of the Non-Banking Supervision Department, President of the Hunan branch, Director General of the Research Bureau, and Director General of the Financial Stability Department of the People's Bank of China, Chairman of Shenyin & Wanguo Securities Co. Ltd., President of Central Huijin.
Executive Vice President & Chief Risk Officer	Wang Jianxi	1951 (60)	PhD in accounting, PhD supervisor. Chief Accountant and Director General of the International Department at the China Securities Regulatory Commission (CSRC), Chief Financial Officer and Executive Vice President of the Bank of China International, President of the Bank of China International (UK), Assistant Chairman of CSRC, Deputy Chairman of Central Huijin, Chairman of China International Capital Corporation.
Counselor & Member of the Executive Committee	Liang Xiang	1955 (56)	BEng. Deputy Director of Planning Institution of Chemical Industry, Deputy Director of Planning Department at the Ministry of Chemical Industry, General Manager of the Second Credit Department, the Buyer Credit Department, the Export Credit Department, Assistant President, and Secretary of the Discipline Inspecting Commission in the Export-Import Bank of China.

Source: Nomura Institute of Capital Markets Research, based on CIC data

Figure 11: CIC staff backgrounds

As at end-June 2011

	Total	Advanced degrees	Overseas work experience	Overseas education	Overseas citizenship
Number	378	313	154	217	43
%	100%	83%	41%	57%	11%

(Compare: end 2009)

	Total	Advanced degrees	Overseas work experience	Overseas education	Overseas citizenship
Number	246	199	115	132	31
%	100%	81%	47%	54%	13%

Source: Nomura Institute of Capital Markets Research, based on CIC's annual reports for 2009 and 2010

3. Improving staff appointments and staff development

CIC appointed 105 staff in 2010. As a result, it had 378 staff at the end of 2011 (Figure 11, 497 if we include those working in its domestic investment department). Roughly half have worked or studied overseas.

As in 2009, CIC continued to provide professional development for its staff in 2010. Each employee is required to undergo 80 hours of formal training each year. In 2010 it offered courses in risk management, internal controls, business valuation models, international economics/politics, US financial regulatory reform, IT security, anticorruption policies and practice, training for managers, and training for new staff. In addition, in 2010 it ran self-study Internet courses.

Its external training courses in 2010 included five units of 2.5 hours each for senior managers run in conjunction with Beijing University. This external training was intended to give senior managers a broader perspective and improve their management and decision-making skills.

4. Overseas entities

Another noteworthy development in 2010 and the first half of 2011 was CIC's establishment of overseas entities.

First, in November 2010 it established a subsidiary in Hong Kong (CIC International (Hong Kong) Co., Ltd) with the former vice chancellor of the Chinese University of Hong Kong and a member of CIC's International Advisory Council, Lawrence Lau, as its first chairman. The aim was to capitalize on Hong Kong's position as a leading international financial center as well as its reputation for cross-border investment, trade and finance in order to improve CIC's international fund management capability.

Then, in January 2011, CIC established its first overseas office outside mainland China—in Toronto. CIC considers its Toronto representative office an important platform for developing not only its ties with its Canadian partners but also its overseas business in general. CIC had already made direct investments in resource and energy projects in Canada and probably needed an office from which to manage them. In addition, head office probably wanted its Toronto office to be involved from the start in developing new investments as well as its existing ones (e.g., by raising new capital).

5. Strengthening global ties

As well as expanding its international fund management operations, CIC has sought to strengthen its ties with the global financial industry. In March 2010 CIC hosted an international forum for leading institutional investors and fund management companies in Sanya in Hainan. In April 2011 it formally joined the Washington-based Institute of International Finance, an association founded in 1983 for leading international financial institutions.

Then, on 11–13 May 2011 CIC hosted the third meeting of the International Forum of Sovereign Wealth Funds (IFSWF) in Beijing, at which China's vice premier, Li Keqiang, gave a speech. The Beijing Declaration, adopted by the Forum on 12 May, provided for the establishment of a permanent secretariat for the forum within the International Monetary Fund. At the same time, Jin Liqun, Chairman of CIC's Board of Supervisors (see Figure 10), was elected chairman of the Forum (for two years).

IV. Conclusion

We have seen that in 2010 CIC continued to review the investment decision-making process and risk management structure and reforms it instituted in 2009. As CIC has used up all of its original capital ($200bn), it needs to raise more capital in order to be able to make new investments[4]. We think that, following the appointment of its new chief investment officer, CIC is likely to attract even greater attention as an international investor when it raises more capital.

We also think that Standard & Poor's decision on 5 August 2011 to downgrade US sovereign debt a notch from AAA to AA+ will make CIC's job of managing its US dollar investments that much more difficult. On 3 August 2011, the day after the US Senate passed the Budget Control Act of 2011, Zhou Xiaochuan, president of the People's Bank of China, which regulates the State Administration of Foreign Exchange (SAFE), the organization responsible for managing China's foreign exchange reserves proper, commented that China was still seeking to diversify its

4 For further details of the issue of increasing CIC's capital, see Sekine, Eiichi, "Chuugoku no Gaika Junbiun'you no Kyouka ni Muketa Ugoki" (Moves towards Improving China's Management of its Foreign Exchange Reserves), Kikan Chuugoku Shihon Shijou Kenkyuu, 2011 Summer edition, Tokyo Club Foundation for Global Studies (in Japanese).

foreign exchange reserve investments, improve its risk management, and minimize the negative impact of the volatility on international financial markets[5]. Judging by a 4 August 2011 report on a meeting of SAFE branch managers, CIC continued to optimize its medium- to long-term currency and asset allocation and improve its risk management in the first half of 2011 in accordance with its goal of diversifying its foreign exchange reserve assets, and will continue to do so in the second half of 2011[6].

Shortly afterwards, on 10 August 2011, CIC announced that it had signed a memorandum of understanding with the French energy company GDF Suez to cooperate in the areas of natural gas, electricity, water supply, waste management, and energy conservation mainly in the Asia-Pacific region[7]. As a first step, CIC will acquire a 30% stake (worth $3.15 billion) in a subsidiary of GDP Suez that explores for and produces oil and natural gas. CIC will also acquire an $850 million stake in the Atlantic LNG liquefaction plant in Trinidad & Tobago. In addition to these direct investments in natural resources and energy, it will be interesting to see what CIC's next move will be towards diversifying its investments, including those in yen assets.

5 http: //www. pbc. gov. cn/publish/goutongjiaoliu/524/2011/20110803005042423947288/20110803005042423947288_.html

6 http: //www. safe. gov. cn/model_safe/news/new_detail. jsp? ID=90000000000000000, 921&id=2

7 http: //www. china-inv. cn/resources/news_20110810_956728. html