China Investment Corporation: Investment Performance in 2013 and Outlook

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I. CIC's investment performance in 2013

1. CIC's global portfolio yielded return of 9.33% in 2013

The China Investment Corporation (CIC) published its annual report for 2013 on 8 August 2014. The CIC was established on 29 September 2007 as wholly state-owned company independent from the People's Bank of China for the purpose of diversifying the investment of China's foreign exchange reserves and maximizing returns over the longer term. The CIC is a sovereign wealth fund with $200 billion in capital to invest in overseas assets (the global portfolio) and domestic assets (Chinese financial institutions).

According to its 2013 annual report, the CIC posted a 9.33% investment return on its global portfolio in 2013, a 1.27ppt decline from the 10.60% return achieved in 2012 (Figure 1)[1]. Since its establishment in September 2007 until the end of 2013, the CIC has averaged an annual return of 5.70% on its global portfolio, bettering the 5.02% average annual return through the end of 2012.

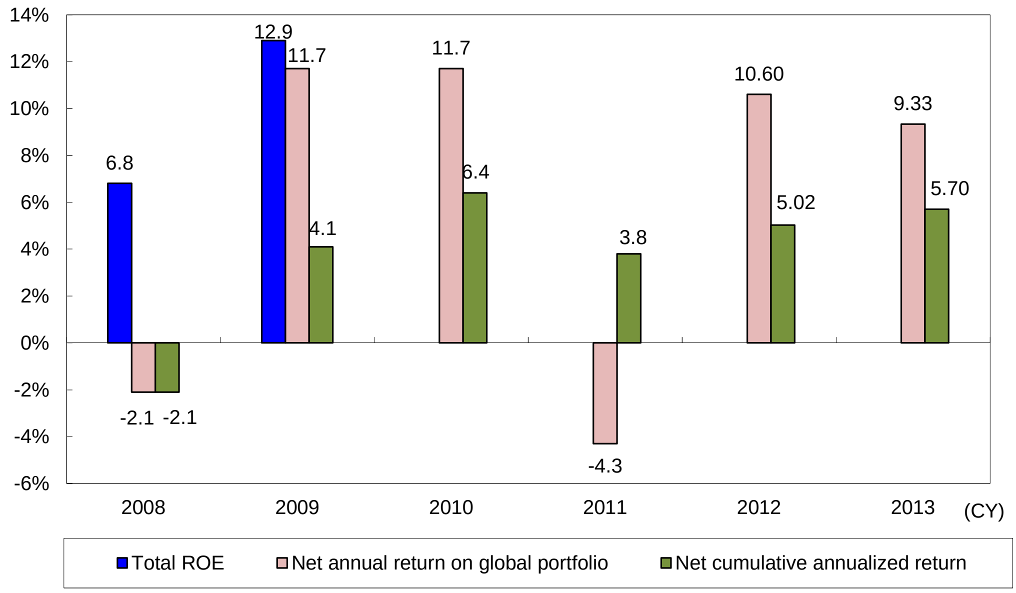
Also, the CIC's total assets increased from $575.5 billion at end-2012 to $652.7 billion as of end-2013. It also increased its investment income from $83.5 billion to $92.5 billion and net income from $77.7 billion to $86.9 billion (Figure 2).

2. Global portfolio's investment policy and strategies are unchanged

Before discussing the content of CIC's global portfolio in 2013, it might be useful to review the portfolio's investment policy and strategies to date. The 2013 annual report does not mention any changes in the global portfolio. We therefore think it appropriate to assume the CIC is adhering to the policy and strategies implemented to date.

[1] For a review of the CIC's investment performance in 2012, see Sekine, Eichi, "China's CIC: 2012 Investment Performance and Future Outlook" in the 2013 autumn edition of *Chinese Capital Markets Research*.

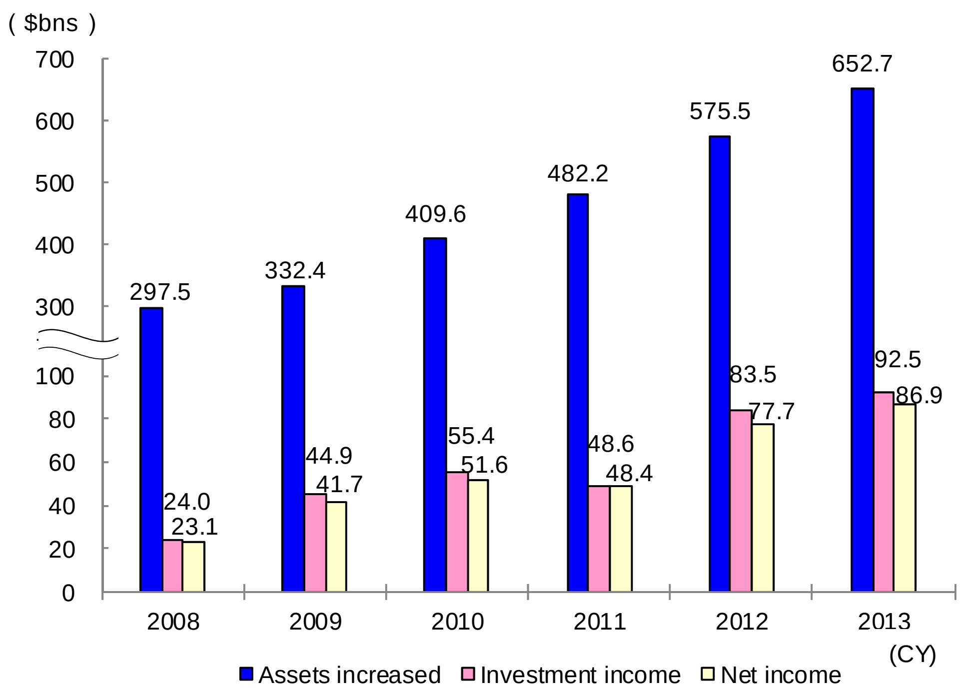
Figure 1: CIC's investment performance



Note: 1. The CIC has not disclosed the "Total ROE" on domestic and overseas investments since 2010.
2. Returns shown to one-decimal point from 2012

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

Figure 2: CIC's key financial indicators



Note: Consolidated basis

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

1) 10-year investment evaluation period

At the time of its establishment in September 2007, the CIC launched its global portfolio by investing in the two most traditional asset classes, stocks and bonds. As the CIC staff accumulated investment management know-how and capabilities, the global portfolio's asset allocation has been expanded to include commodities, private equity, real estate, hedge funds, and direct investments. In line with its mission of investing for the long term, the CIC Board of Directors in January 2011 established 10 years as its appropriate investment evaluation period and decided to focus on the average annual return achieved over this period of time.

2) Asset allocation based on the Endowment Model

In its 2012 annual report, the CIC said it had decided to maintain the Endowment Model as the basis for its asset allocation. The Endowment Model, often also called the Yale Model, is a long-term investment style that aggressively invests in non-traditional assets other than listed stocks and bonds[2]. In addition, the CIC has established a Policy Portfolio targeted at achieving greater flexibility and stability in portfolio management while boosting investment returns.

As a result of its adoption of the Endowment Model and the establishment of the Policy Portfolio, the CIC now has a three-layer asset allocation framework comprising a Strategic Asset Allocation (SAA), the Policy Portfolio, and a Tactical Asset Allocation (TAA).

The SAA defines asset classes and investment ranges in line with CIC's return target and risk tolerance, acting as long-term investment guidance. The Policy Portfolio is an asset allocation plan based on medium-term (1–3 years) economic projections and asset valuation analysis. Its three-year investment horizon and periodic rebalancing enables portfolio optimization within the established risk tolerance parameters. The TAA relies on in-depth analysis and understanding of economic events, asset valuation and risk factors to earn risk premiums generated by market volatility.

3) Strategic asset allocation philosophy

Based on the aforementioned asset allocation policy and the CIC's risk management principles, the CIC's SAA comprises five asset classes: (1) cash, (2) publicly listed equities, (3) fixed-income securities, (4) absolute-return investments, and (5) long-term investments. The absolute-return investment asset class includes hedge funds while long-term investments include direct investments, private equities, and investments in energy/mining projects, real estate, and infrastructure.

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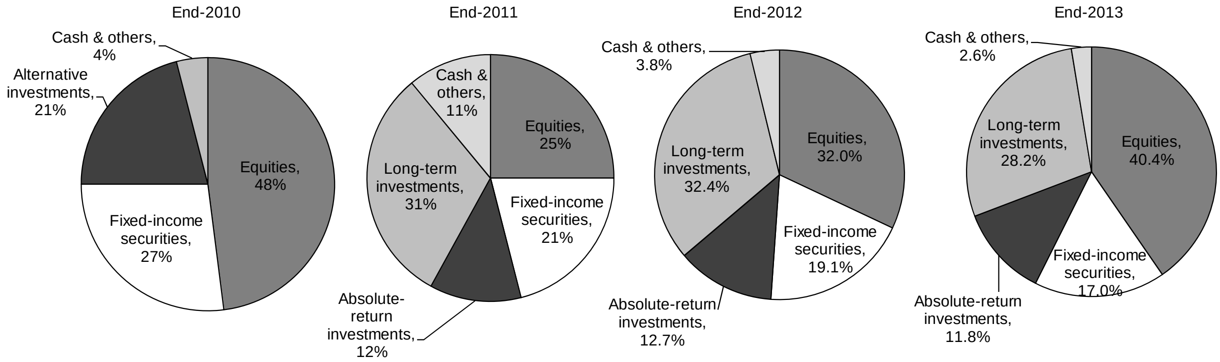
2 University endowment funds in the United States, including the Yale University endowment fund, rank with financial institutions and pension funds as major institutional investors. Focused on long-term investments, these funds tend to allocate over 50% of assets to alternative investments with relatively low liquidity, including private equity, real estate, and natural resources

Figure 3: CIC's global portfolio asset allocation



Note: 1. Asset class definitions changed from 2011.
2. Composition shares shown to one-decimal point from 2012.

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

3. Changes in CIC's global portfolio in 2013

The composition of the CIC's global portfolio at the end-2013 is as follows, with each asset classes' 2012 share shown in parentheses: (1) cash and others 2.6% (3.8%), (2) equities 40.4% (32.0%), (3) fixed-income securities 17.0% (19.1%), (4) absolute-return investments 11.8% (12.7%), and (5) long-term investments 28.2% (32.4%) (Figure 3).

According to the CIC's 2013 annual report, the changes in the global portfolio's allocation reflect (1) fine tuning of portfolio allocation resulting in a slight increase in equities and a decrease in fixed-income securities, (2) adjustments to holdings of publicly traded equities, (3) the strengthening of post-investment management, which resulted in timely exits from some projects that ensured solid returns.

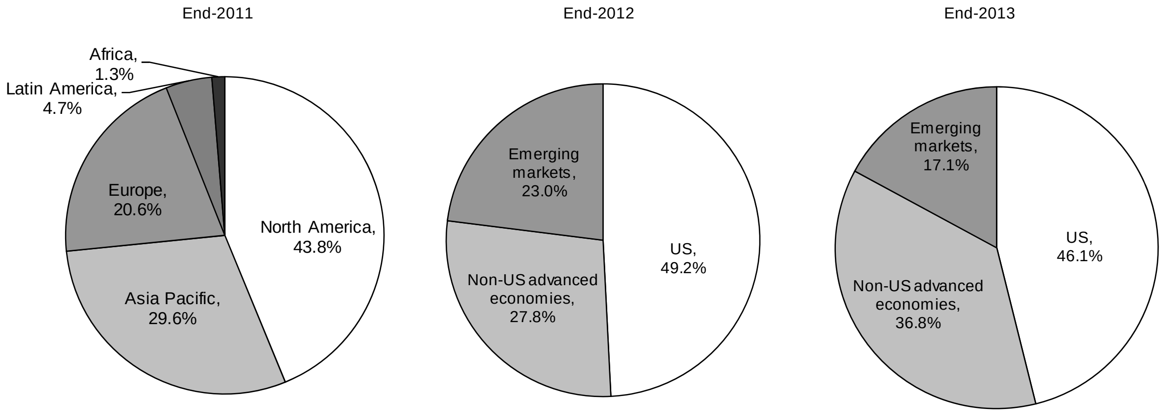
II. A closer look inside CIC's global portfolio in 2013

1. Equity investments

Up through its 2011 annual report, the CIC disclosed the details of its global portfolio on the basis of diversified investments versus consolidated investments (explained later). In this report, we examine trends in CIC's global portfolio during 2013 on the assumption this breakdown remains valid.

The geographical market breakdown of the global portfolio's diversified equity investments at end-2013 was as follows, with each regional market's 2012 share shown in parentheses: United States 46.1% (49.2%), advanced countries other than the United States 36.8% (27.8%), emerging countries 17.1% (23.0%) (Figure 4).

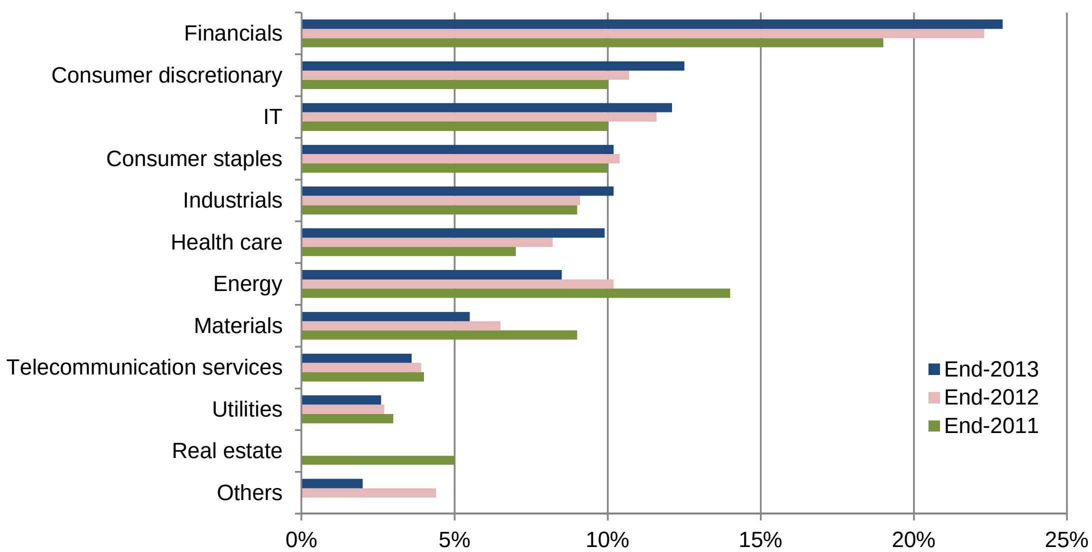
Figure 4: Diversified equity investment in CIC's global portfolio (geographical allocations)



Note: CIC changed its regional breakdown from 2012.
Source: Nomura Institute of Capital Markets Research, based on CIC annual reports

Meanwhile, the distribution by industrial sector shows that allocation weightings increased for financials 22.9% (22.3%), consumer discretionary 12.5% (10.7%), information technology 12.1% (11.6%), industrials 10.2% (9.1%), and health care 9.9% (8.2%). The energy and materials sectors, on the other hand, both saw significant declines in allocation for the third straight year, with energy falling to 8.5% (10.2%) and materials to 5.5% (6.5%) (Figure 5).

Figure 5: Diversified equity investment in CIC's global portfolio (industrial sector allocations)

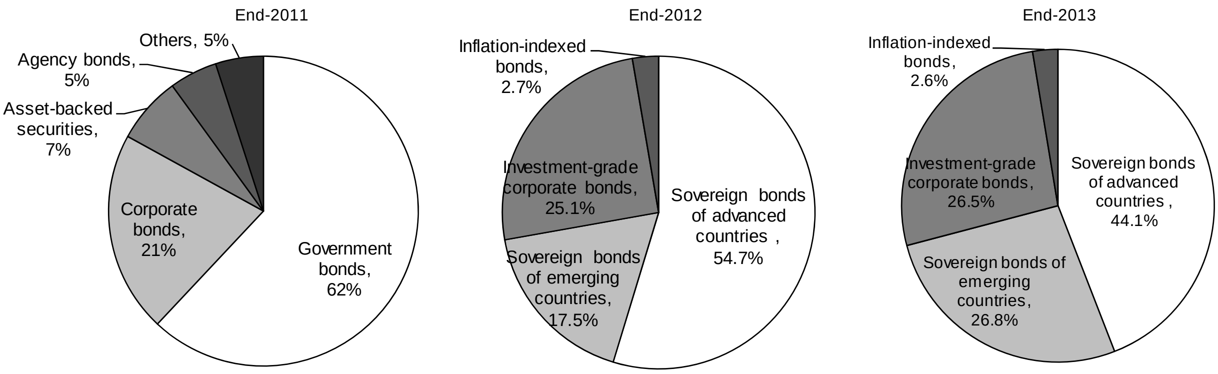


Source: Nomura Institute of Capital Markets Research, based on CIC annual reports

2. Fixed-income securities

The trend in the allocation of the global portfolio's diversified investments in fixed-income securities is shown in Figure 6. The breakdown as of end-2013 is as follows, with end-2012 ratios again presented in parentheses: sovereign bonds of advanced countries 44.1% (54.7%), sovereign bonds of emerging countries 26.8% (17.5%), investment-grade corporate bonds 26.5% (25.1%), and inflation-indexed bonds 2.6% (2.7%). The combined allocation for sovereign bonds of advanced nations and emerging countries fell from 72.2% as of end-2012 to 70.9% as of end-2013.

Figure 6: Diversified fixed-income investment in CIC's global portfolio



Note: 1. CIC changed its fixed-income breakdown from 2012
2. Returns shown to one-decimal point from 2012.
Source: Nomura Institute of Capital Markets Research, based on CIC annual reports

3. Direct investment

The CIC's global portfolio also includes direct investments that tend to be large, long-term investments in highly concentrated positions. As a result, these direct investments are categorized as "concentrated investments". The CIC introduced representative direct investments in its annual reports up through the 2012 report, however it did not include any such information in its 2013 report. We also could not find any press releases about new direct investments.

The 2013 report also does not include any information on joint funds. Joint funds established in 2012, such as the China-Belgium Mirror Fund and the Russia-China Investment Fund most likely moved into the investment stage in 2013.

4. Future investment policies

The CIC's future investment policies should be based on the CIC International 2012–2016 Strategic Plan of Development, which was approved by the Board of Directors in February 2013. However, the plan's contents have not been disclosed. We therefore must base our estimates on reports from local media. In its 13 February 2014 issue, the China Business News (CBN) reported the following comments by CIC Chairman Ding Xuedong[3]:

"First, regarding investment targets, the CIC will seek to be a major or controlling shareholder in domestic companies but could also conduct joint investments as a financial investor with a minority shareholder position.

Second, regarding investment areas, we will promote cooperation with domestic companies by focusing investments over the foreseeable future in the agricultural, high-tech, infrastructure and real estate sectors.

Third, from a global perspective, we anticipate huge demand for investment in infrastructure in the coming years given the need for infrastructure development in emerging countries and infrastructural renewal in advanced nations. In addition, we expect economic recoveries in advanced nations will present favorable opportunities to invest in real estate, especially commercial properties."

The above future investment strategies of the CIC, although not mentioned in its 2013 annual report, should be useful reference information for overseas financial institutions proposing investment opportunities to the CIC.

III. CIC governance

The CIC's organization chart, including its overseas offices (CIC International [Hong Kong] Co., Ltd., and the CIC Representative Office in Toronto, Canada) is unchanged from 2012. Meanwhile, the following corporate governance developments have been seen since 2013.

1. Changes in executive personnel

The CIC's current Executive Committee is shown in Figure 7 below. The main changes in the team during 2013 and 2014 are summarized below.

The biggest change was the departure of Lou Jiwei, CIC Chairman since its founding in September 2007, upon his appointment as Minister of Finance at the National People's Congress (NPC) in March 2013. Ding Xuedong, like Lou a former finance ministry official and deputy secretary-general of the State Council, was named CIC chairman by the State Council (of the People's Republic of China) on 3 July 2013.

The next major change was the appointment of Li Xiaopeng as Chairman of the Board of Supervisors on 17 May 2013, succeeding Jin Liqun, who had served in the post since September 2008.

3 http://money.21cbh.com/2014/2-13/zNMDA2NzZfMTA2MzYzNA.html

Figure 7: Current members of CIC's Executive Committee

CIC Executive Committee Members			
Title	Name	Birth Year	Education/career
Chairman & Chief Executive Officer (CEO)	Ding Xuedong	1960	PhD in economics, professor and supervisor of PhD students. Previously served in the State-owned Asset Administration Bureau as Director General of the Department of Human Resources & Head of the General Office, and as Director General of the Department of Property Rights. Has also held several positions in the Ministry of Finance, including Vice Minister, Assistant Minister, Director General of the Department of Education, Science and Culture, Director General of the Department of Agriculture, and Director General of the Department of State-owned Capital Administration. Mr. Ding has also served as Deputy Secretary General of the State Council.
Vice-Chairman, President & Chief Investment Officer	Li Keping	1956	BA in economics. Previously served as 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; Deputy Chairman, Secretary General, and Head of the Investment Department of the National Council for the Social Security Fund; and Executive Director, Executive Vice President and Chief Investment Officer of CIC.
Chairman of Board of Supervisors	Li Xiaopeng	1959	PhD in economics. Previously served as Deputy Head of the Henan branch of the Industrial and Commercial Bank of China (ICBC), General Manager of the Banking Department at ICBC's head office, Head of ICBC's Sichuan branch, Vice President of the China Huarong Asset Management Corporation, Assistant to the ICBC president and Head of the ICBC Beijing branch, and most recently as Senior Executive Vice President and Executive Director of ICBC.
Executive Vice-President	Fan Yifei	1964	PhD in economics. Previously served the China Construction Bank (CCB) as General Manager of the Finance and Accounting Department, General Manager of the Planning and Finance Department, Assistant to the CCB President, and most recently as Executive Vice President of CCB.
Executive Vice-President	Xie Ping	1955	PhD in economics, professor and supervisor of PhD students. Previously held a number of senior positions at the People's Bank of China (PBOC), including Deputy Director General of the Policy Research Office, Director General of the Non-Banking Supervision Department, Director General of the Financial Stability Department, Director General of the Research Bureau, and President of the Hunan branch. Has also served as Chairman of Shenyin & Wanguo Securities Co., Ltd., and President of Central Huijin.
Executive Vice-President, Secretary of Discipline Inspecting Commission	Liang Xiang	1955	Master's degree in Business Administration. Previously held a number of positions at the Export-Import Bank of China, including Secretary of the Discipline Inspecting Commission, Assistant to the President, and General Manager of the Second Credit Department, the Buyer Credit Department and the Export Credit Department. Also previously served as Deputy Director of the Planning Institution of the Chemical Industry and Deputy Director of the Planning Department at the Ministry of Chemical Industry.
Executive Vice-President	Xie Zhichun	1958	PhD in economics, senior economist. Previously served as Deputy Head of Dalian Branch of Everbright Bank, Director of China Everbright Financial Holding Corporation, Deputy Managing Director of China Everbright Group in Singapore Headquarter and Chief Executive Officer of China Everbright Pacific Ltd., President of Everbright Securities Co., Ltd., Executive Vice President of China Everbright Bank, Executive Director and Vice President of China Everbright Group, and Chairman of Sun Life Everbright Life Insurance Co., Ltd.
Executive Vice-President	Li Guiping	1966	PhD in economics, senior economist. Recipient of the State Council Expert Special Allowance. Previously served with the Agriculture Bank of China (ABC) as Deputy Head of the Shenzhen branch, Deputy Head and Head of the Fujian branch, Head of Shanghai branch, and the head of Retail Banking Department/Retail Product Department in ABC's head office.
Chief Strategy Officer	Zhou Yuan	1956	Master's degree in literature. Previously served as head of research at State Street Bank, director and top regional executive officer for UBS China, the top executive for finance, treasury, risk and clearing at the Hong Kong Futures Exchange, President of Zeta Institute of Finance and Risk Management, head of Asia business development at Chicago Mercantile Exchange, Executive Vice Chairman of Hong Kong Mercantile Exchange, head of CIC's Alternative Investment Department, Special Investments Department, and Asset Allocation and Strategic Research Department. Currently also serving as head of CIC's Finance and Accounting Department.
Chief Risk Officer	Guo Xiangjun	1966	Master's degree in economics. Previously served as Deputy Director General of the Macroeconomic Control Department at the State Council Office for Restructuring the Economic Systems, Deputy Director General of the Department of Fiscal and Financial Affairs at the National Development and Reform Commission (NDRC), and Deputy Managing Director and Managing Director of CIC's Risk Management Department. Currently also serving as Head of CIC's Risk Management Department.
Chief Information Technology Officer	Hua Hua	1957	PhD in management. Previously served as Assistant Professor at New Jersey Institute of Technology, Senior Engineer at Unisys Co., Senior Architect at Reed Technology Inc., Principal Consultant of Core Solutions, and President of Beijing Wuxianhao Technology Co., Ltd. Also served as Vice President of Great Wall Software International Ltd. and Head of CIC's Information Technology Department. Currently also serving as Head of CIC's Investment Operations Department.
Member of the Executive Committee	Zhao Haiying	1965	PhD in economics. Previously served as Commissioner of the Strategy and Development Commission at the China Securities Regulatory Commission (CSRC), Deputy Director of CSRC's Department of Securities Issuance Supervision, Director of the Board of the Industrial and Commercial Bank of China (ICBC) representing Central Huijin while serving concurrently as Director General of the Research and Legal Affairs Department of Central Huijin, head of the Asset Allocation and Strategic Research Department of CIC while serving concurrently as Executive Vice President and Director General of the Non-Banking Financial Institutions Department of Central Huijin. Currently also serves as Executive Vice President of Central Huijin.

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

Figure 8: CIC's global investment staff profile

As of end-June 2014

	Total	Advanced degrees	Overseas work Experience	Overseas education	Overseas citizenship
Number	467	381	177	271	41
%	100%	82%	38%	58%	9%

As of end-June 2013

	Total	Advanced degrees	Overseas work Experience	Overseas education	Overseas citizenship
Number	443	363	174	250	41
%	100%	82%	39%	56%	9%

Source: Nomura Institute of Capital Markets Research, based on CIC's 2012 and 2013 annual reports

The third major change was the promotion on 14 February 2014 of Li Keping from vice president to president upon the retirement of Gao Xiqing, who reached mandatory retirement age.

The fourth big change is the retirements of executive vice presidents Wang Jianxi and Peng Chun in 2013. The remaining members of executive committee include newly appointed Xie Zhichun and Liu Guiping and returning members Zhou Yuan, Guo Xiangjun, Hua Hua, Zhao Haiying. Each executive committee member has been assigned a new responsibility.

These changes in CIC executive personnel came on the heels of the Communist Party of China's 18th National Congress in November 2012 and the once-a-decade change in China's leadership at the National People's Congress in March 2013.

2. Staff numbers and composition

According to CIC's 2013 annual report, its global investment staff totaled 467 as of end-June 2014, up from 443 a year earlier (Figure 8). The report also notes that more than 60% of these staff members were either educated abroad or have work experience overseas. Including domestic investment staff, CIC's overall staff strength stood at 606 as of end-June, up from 583 a year earlier.

3. Compliance

China's National Audit Office (NAO), the equivalent of Japan's Board of Audit, conducted an audit of the state-owned CIC's fiscal 2012 financial statements from May to September 2013 and announced the results on 18 June 2014[4]. Through its audit, the NAO

4 http://www.audit.gov.cn/n1992130/n1992150/n1992379/3597433.html

determined that the CIC overall was fulfilling its expected role while maintaining proper compliance. However, the NAO pointed out the following areas for improvement.

First, regarding the CIC's overseas investments, insufficient management led to losses on six investments and unrealized losses on four others during the 2008–2013 period. Another two investments presented potential risks.

Second, the NAO pointed out that some of the seven subsidiaries of its domestic investment operating company, Central Huijin Investment Ltd., had conducted illegal operations, such as investments in non-core businesses.

Third, the NAO pointed out six financial management–related compliance violations by the CIC, Central Huijin Investment and its subsidiaries.

Responding to the issues raised by the NAO, the CIC announced that it had revised or established anew some 36 items to improve internal controls and operational flows and had also punished the staff responsible for the violations. Regarding matters with lingering suspicions, it has reported on those matters to the responsible government agencies and continues to investigate the matters. The NAO's audit of CIC was part of a simultaneous broad-sweeping audit of all state-owned enterprises. Although this marked the first such audit of the CIC since its establishment, going forward the CIC will be subject to these regular audits without exception.

IV. Investment in Japanese securities

CIC's annual reports do not disclose information about actual investments or policies toward investment in individual countries, including Japan. In addition to CIC, the key Chinese institutions investing in Japanese securities include the State Administration of Foreign Exchange (SAFE), which manages China's foreign reserves, and numerous qualified domestic institutional investors (QDIIs).

However, annual statistics released by the Bank of Japan (BoJ) enable us to understand China's total outstanding investment in Japan, including investments by these institutions, and gauge the trend in China's investment in Japan-based assets. BoJ statistics on other nations' total outstanding investment in Japanese equities as of the end of 2013 show that the United States ranked first, followed by the United Kingdom, and Luxembourg. China, which had ranked third for three straight years from end-2010 to end-2012, fell to ninth in this ranking of the top 10 nations in terms of holdings of Japanese equities (Figure 9). As of end-2013, Chinese institutions held ¥3,202.8 billion worth of Japanese equities, ¥945.8 billion or 22.8% less than the ¥4,148.6 billion held at end-2012. China's investment in Japanese fixed-income securities as of end-2013 totaled ¥14,337.0 billion, maintaining China's position as the largest holder of Japanese fixed-income securities for the fourth consecutive year, or since end-2010. Nonetheless, China's holdings of Japanese fixed-income securities also declined sharply during 2013, falling ¥6,156.9 billion or 30.04% from ¥20,493.9 billion at end-2012.

Figure 9: Foreign nations' holdings of Japanese equities (end-2013)

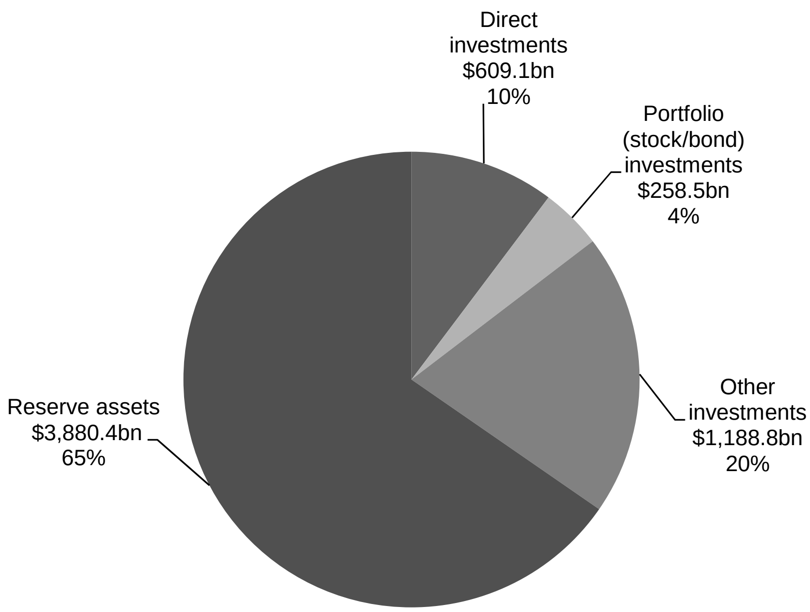
(￥bns)

Rank	Country	Value of equity holdings	Share	YoY chg		(Reference) end-2012	(Reference) end-2011	(Reference) end-2010
				(absolute)	(%)			
1	United States	68997.4	45.71%	31945.9	86.22%	37051.5	30282.6	37511.3
2	United Kingdom	27089.2	17.95%	12772.0	89.21%	14317.2	12436.9	14454.4
3	Luxembourg	7030.8	4.66%	3277.8	87.34%	3753.0	3057.3	3687.9
4	Belgium	5453.5	3.61%	2759.9	102.46%	2693.6	2156.5	2378.6
5	France	5185.3	3.44%	1995.4	62.55%	3189.9	777.7	2041.8
6	Canada	5075.1	3.36%	1636.1	47.57%	3439.0	1988.6	2207.6
7	Switzerland	4171.3	2.76%	1719.0	70.10%	2452.3	1578.4	2071.9
8	Saudi Arabia	3486.3	2.31%	1768.9	103.00%	1717.4	1592.7	2292.6
9	People's Republic of China	3202.8	2.12%	-945.8	-22.80%	4148.6	3569.5	3350.8
10	Hong Kong	2657.4	1.76%	1488.9	127.42%	1168.5	909.1	1099.8
	Total	150947.1	100.00%	67391.4	80.65%	83555.7	65841.4	80537.0

Note: Ranking of the top 10 nations/geographical entities in terms of total holdings of Japanese equities as of end-2013.
Source: Nomura Institute of Capital Markets Research, based on BoJ data

China's holdings of overseas assets as of end-2013 totaled $5,936.8 billion. Reserve assets, including foreign currency reserves, accounted for 65%, or $3,880.4 billion, of this total (Figure 10). This data, which does not include CIC investments, indicates some change in the investment of China's foreign reserves by SAFE may have affected the change in China's outstanding investment in Japanese securities from end-2012 to end-2013.

Figure 10: Breakdown of China's overseas asset holdings (end-2013)



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

China's investment of its foreign reserves is guided by the three principles of safety, liquidity, and price appreciation (profitability). Asset allocation is highly diversified, with asset classes including sovereign bonds, agency bonds, bonds issued by international financial institutions, corporate bonds, and investment funds. In addition, China is diversifying its investments to include assets denominated in the currencies of emerging nations as well as the traditional major currencies, such as USD, EUR and JPY. China aims to create a diversified portfolio of foreign currency assets based on (1) external payments related to its international trade and (2) the scale of various financial markets around the world. Accordingly, USD assets continue to account for the lion's share of its foreign currency assets. As shown by the BoJ statistics mentioned earlier, China's investment in Japanese assets is highly concentrated on fixed-income securities (JGBs).

Meanwhile, according to SAFE's 2013 annual report, released on 5 May 2014, China's foreign reserves are invested in assets of 70 nations/regions, assets denominated in more than 30 national currencies, more than 50 different asset classes, and over 6,000 companies around the world. Given such diversified investment and the scale of foreign-currency reserves managed by SAFE, even if it did reduce its holdings of Japanese equities and fixed-income securities, it is hard to imagine that it would suddenly adjust its existing asset allocations to an extent that would have an impact on the markets and the prices of other asset holdings.

One possible explanation is changes in custodians. The BoJ statistics on overseas nations/regions outstanding holdings of Japanese equities as of end-2013 (Figure 9) shows that holdings by the UK, Luxembourg, Belgium and Hong Kong all expanded sharply from the end of the previous year. These increases may also reflect some changes in the custodians for foreign-currency reserves managed by SAFE. The same factor may explain the large increase in Luxembourg's holdings of Japanese bonds[5]. However, because SAFE's actions cannot be fully understood from the outside, the only way to confirm such actions is to monitor policy discussions between the authorities responsible for investing China and Japan's foreign-currency reserves.

As institutional investors with the power to impact Japan's equity market, the CIC, which was established using foreign reserves as capital, and SAFE, which is responsible for the management and investment of China's foreign reserves, are likely to continue attracting the attention of market participants.

5 Luxembourg's holdings of Japanese bonds as of end-2013 totaled ¥11,959.8 billion, up 46.9%, or ¥3,818.2 billion, from ¥8,141.6 billion as of end-2012, boosting Luxembourg in the rankings of nations with the largest holdings of Japanese bonds from fourth at end-2012 to second at end-2013.