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Singapore looks to move away from Harvard model

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The doughty Government Investment Corporation of Singapore is not often a hotbed of heretical thought. Recently, however, a debate has been bubbling at the GIC that has fascinating implications for investors around the world.

The issue at stake revolves around the so-called Harvard or Yale investment model. During most of its recent history, the GIC - like many other sovereign wealth funds around the world - has looked at these huge university endowment funds with envy and admiration. For the Harvard or Yale model seemed to offer an exciting vision for any long-term investment group that wanted to do more than act like a stodgy, old-fashioned pension fund. After all, for 20 years, groups such as Yale earned solid returns, by pioneering a distinctive investment style. This essentially championed the idea of diversifying into illiquid and alternative asset classes, such as private equity, alongside mainstream securities.

But these days, the names of Harvard and Yale - like so many American financial brands - are looking somewhat tarnished in places such as Asia. Or as Tony Tam, deputy chairman of the GIC, explains: "The whole idea of the endowment model has been very influential [before]. But any reasonable investor would [now] want to take another look at this." Or, more specifically, about whether to copy it.

That is partly down to the numbers. In the year to June 2009, the value of the assets held in the Harvard and Yale endowment funds fell by over 25 per cent. Meanwhile, across all US colleges, the average loss was 23 per cent (a pattern similar to the GIC, which saw losses of 20 per cent in the year to March 2009).

Supporters of the Harvard approach insist that these declines are likely to be partly reversed in the coming years. Moreover, precisely because the losses were so widespread, some investment managers are apt to shrug them off, as a force of nature.

But the fact is that not everybody suffered quite the same way; at the Oxford University endowment fund, for example, losses in the year to June 2009 were "only" 10 per cent. And that, according to Sandra Robertson, head of this fund, is because Oxford deliberately decided a few years ago that it would *not* try to emulate Harvard.

But the sense of tarnish - or unease - goes beyond the losses. After recently scrutinising their performance data, some GIC executives are starting to conclude that their own in-house managers have performed as well, if not better, than external managers in recent years. That leaves them asking a question that used to seem heretical: namely why does anyone ever bother to pay such hefty fees to, say, hedge funds or private equity?

More important still is the issue of liquidity risk. Until 2007, the GIC tended to assume that it would never need to engage in asset firesales or unseemly investment exits. After all, the whole point of a sovereign wealth fund (or endowment fund) is that it is supposed to take a long-term perspective, which should enable it to ride out any temporary storms.

However, in the past two years, sovereign funds discovered that the long-term mantra provides far less protection than previously thought. For by investing in private equity and hedge funds, the GIC (and others) ended up being exposed to the vagaries of their co-investors - and some of *those* had short-term horizons, or mark-to-market triggers. Thus what hurt groups such as the GIC was not just the issue of asset correlation, but a contagion of investor style as well.

That raises some big questions about how the GIC (and others) should conduct themselves. Should they only co-invest with similar investors in the future? Could they now demand detailed lists of their co-investors (even if they hate providing such data themselves)? Could they ask to be paid for assuming illiquidity risk? Or should they dump external managers altogether, and bring that activity "in-house"?

Frankly, it is still unclear where this debate will end since, at groups such as the GIC, it is still at an early stage. Moreover, as Mr Tam admits, there has been little intellectual work done on this liquidity issue before, and most Asian funds have limited experience in trying to forge radical new ground. Instead, they have generally spent recent decades trying to follow a US model, to some degree (not least because many Asian investment officials have degrees from . . . er . . . Harvard or Yale).

But in a world where more wealth is moving to the emerging markets - and away from America - the question of where the future intellectual leadership for the investment business will be found is becoming ever more fascinating. Investors should keep watching what the GIC does next, not to mention its other - less vocal - brethren in places such as China.

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