An Appraisal of the Nigeria Sovereign Investment Authority

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Abstract
This study seek to critically appraise the operations of the Nigeria Sovereign Investment Authority (NSIA) since its establishment by the Nigeria Sovereign Investment Authority Act (2011), trying to x-ray its performance in terms of its operational outlook and target outlay. Due to paucity of data, this study employed the descriptive analytical technique. The NSIA was structured into three windows to include; the Stabilization Fund, The Future Generation Fund and the Nigeria infrastructure Fund, each of these funds has its specific investment and development objectives. NSIA's asset allocation is based on long-term risk and return objectives, diversified across various asset classes. These classes are segmented into growth drivers, inflation hedges and deflation hedges.
Keywords: Nigeria Sovereign Investment Authority, Stabilization Fund, The Future Generation Fund and the Nigeria infrastructure Fund.

Introduction

The Nigeria Sovereign Investment Authority is a Nigerian establishment which manages the *Nigeria sovereign wealth fund*, into which the surplus income produced from Nigeria's excess oil reserves is deposited. This sovereign wealth fund was founded for the purpose of managing and investing these funds on behalf of the government of Nigeria. The wealth fund commenced operations in October 2012 with JP Morgan appointed as the custodian of the funds and was set up by the Nigeria Sovereign Investment Authority Act, which was signed into law in May 2011. It is intended to invest the savings gained on the difference between the budgeted and actual market prices for oil to earn returns that would benefit future generations of Nigerians. The fund was allocated an initial $1 billion USD in seed capital.

Nigeria is the most populous country on the African continent with an estimated 170,123,740 million people. It is also one of the largest producers of oil, on which the majority of its economy relies. Petroleum exports account for approximately 90 percent of its foreign revenue and 80 percent of government revenue. Given Nigeria's dependence on oil, its economy is susceptible to shifts in oil prices. Excess oil reserves were previously allocated to the Excess Crude Account (ECA), which was set up in 2004 as a stabilization fund to meet the country's yearly budget deficits and to contribute to the development of local infrastructure. The constitutionality of the ECA has been brought into question.

Nigeria's SWF was brought into law in 2011 via the Nigeria Sovereign Investment Authority Act to replace the ECA. The act authorized the establishment of the Nigeria Sovereign Investment Authority, giving it jurisdiction over the country's excess petroleum reserves. The fund is intended as security against future economic instability, to contribute towards the development of the country's infrastructure and as a savings mechanism for future generations, using the country's excess oil revenues. It is also expected that managing these reserve funds will help to protect Nigeria's economy from external shocks. With an initial financing of $1bn USD from the Nigerian government, Nigeria's fund is the third largest in Sub-Saharan Africa, after Botswana and Angola. .

The NSIA has formed partnerships with key players in the business sector in order to realize its objectives. The NSIA has been invited to request observer status at the International Forum of Sovereign Wealth Funds (IFSWF), with the intention of eventual membership. The NSIA presented its credentials at an October 2013 meeting in Oslo, Norway.

Objective of the Study

The main objective of this study is to critically appraise the operations of the Nigeria Sovereign Investment Authority (NSIA) performance in terms of its operational outlook and target outlay for measuring its performance.

Literature review

NSIA's Threefold Mandate

Nigeria's Sovereign Investment Authority is composed of three distinct funds or windows, each with specific investment and development objectives. Of the initial $1bn, 85 percent of the funds will be distributed among the three windows with an initial 15 percent or $150 million remaining unallocated, to be assigned to any of the three funds as needed in the future. The funds will be invested in various securities. The Stabilization Fund was

allocated an initial 20 percent; while 32.5 percent each went to the Future Generation and the Nigeria Infrastructure funds.

Stabilization Fund
The Stabilization Fund (SF) serves as a secondary source of funding to support the national economy in periods of budget revenue shortfalls. The SF accounts for 20% of Assets under Management. The Stabilization Fund is intended to safeguard against budgetary deficits. It would be a last resort from which government may withdraw annually to meet shortfalls in the budget brought about by falls in oil prices or other budgetary constraints. Given that liquidity and capital preservation are the main objectives of the SF, assets have been allocated with a mix of 75% growth assets and 25% hedge assets.

The purpose of the SF is to act as a buffer against short-term macro-economic instability associated with considerable government revenues derived from hydrocarbon exports. The SF has a short time horizon and a low returns target. The Asset Allocation is split between Hedge Assets and Growth Assets. Investments are made conservatively with a focus on liquidity given the unpredictable nature of the Fund cash calls. Given these considerations, the Asset Allocation below was set.

Growth Assets
Investment Grade Corporate Bonds This segment exposes the Fund to investment grade debt from corporate issuers with a maturity of less than three years. Adopting a 'Buy & Hold' strategy in this segment, the Fund takes on a degree of credit risk. However, with the securities held at cost, volatility is negated. For this strategy, maturity of such securities can be extended out to a maximum of five years. Of the two buckets in the Asset Allocation this segment is a more active approach. As such, diversification across managers is important, whilst considering cost restrictions given the lower returns profile associated with this strategy. This segment received a higher weighting of the portfolio than the Hedge portion, as it will yield a greater return without significantly more risk given the quality of the managers available.

Hedge Assets
US Treasury Bills & US Treasury Bonds: This asset class provides exposure to less risky and lowers yielding instruments. The maturity on US Treasury Bonds is limited to three years. This component will help to ensure the capital preservation goal of the Stabilization Fund. Given the simplicity and standardized nature of this mandate, diversification across managers is not necessary; rather cost considerations are at the fore.

Future Generations Fund
The Future Generation Fund is a savings fund that will seek investment in long-term investments and assets to provide savings for future generations of Nigerians. For the Future Generations Fund, the Investment Policy Statements, Investment Guidelines and Strategic Asset Allocation were approved by the Board in July 2013. The initial selection of managers was concluded in December 2013. Given the investment objectives of the FGF, we have set an investment horizon of about 20 years. Our near term view is positive for the market in 2014 and our asset allocation reflects this positive view, with 80% of the asset allocation in growth assets, 15% in inflation hedge assets and 5% in deflation hedge assets. Within the growth asset category, we have allocated 25% to equities, split 15% to emerging markets and 10% to developed markets. We have also allocated 25% to absolute return funds, another 25% to private equity funds and 5% to other diversifiers. Within the inflation protection assets, we have allocated 10% to real assets and 5% to commodities. And finally we have retained 5% in cash as deflation protection for the portfolio. Managers were selected for the Absolute Returns asset class and Long-Only Equity asset class; and a couple of private equity

Nigeria Infrastructure fund
The Nigeria Infrastructure Fund (NIF) is a domestic infrastructure fund focused on investing in critical infrastructure that would attract and support FDI, economic diversification and growth. The NIF accounts for 40% of Assets under Management. The Nigeria Infrastructure Fund is expected to secure investments in the infrastructural development of the country in areas such as agriculture and other government directed projects. NIF at the start-up phase focuses on five investible sectors in Nigeria infrastructure, in order to balance financial return and developmental needs of Nigerians. These sectors are Healthcare, Agriculture, Motorways, Housing/Real Estate and Power.
The choice of the current focus sectors is guided by the following principles:

- ✓ Sectors that align with national priority;
- ✓ Projects with attractive commercial and social returns;
- ✓ Potential for attractive commercial and social returns;
- ✓ Sectors where the regulatory environment is conducive.

Focus Sectors

Agriculture

Agriculture is a sector of strategic importance and an area where lies opportunities for economic impact and financial returns through direct investments in critical agriculture infrastructure, strategic trading platforms and indirectly via agriculture-focused funds. In December 2013, the Board approved a US$10 million commitment to the Fund for Agricultural Finance in Nigeria (FAFIN), as one of the three Fund sponsors, alongside the Nigerian Federal Ministry of Agriculture and Rural Development (FMARD) and KfW, the German Government-owned development bank. FAFIN is a US$100 million target agriculture-focused investment fund that provides tailored capital and technical assistance solutions to commercially-viable small and medium-sized enterprises (SMEs) and intermediaries across the agricultural sector in Nigeria.

Healthcare

NSIA is interested in “high-impact, high-value” opportunities across the entire healthcare value chain that will facilitate the delivery of high quality, affordable and accessible healthcare services to Nigerians. Consequently, NSIA has entered into strategic partnership agreements with the Federal Ministry of Health and leading global healthcare sector participants to identify and invest in healthcare infrastructure projects. We will leverage the investment and technical expertise of our strategic partners to deploy capital within the sector on a commercial basis.

Real Estate

The affordable and mass housing real-estate segment is a critical target segment predicated upon Nigeria’s large housing deficit and the growing middle class demography in the country. With a population of over 160 million people, rapid urbanization and inadequate housing stock, there is a need to provide housing at all levels, particularly in the low and middle income segments. Pursuant to NSIA’s real-estate strategy of unlocking demand in the real-estate sector, NSIA, through NIF, invested in the Nigeria Mortgage Refinance Company (NMRC) in December 2013, to increase liquidity within the mortgage market, increase mortgage tenors, lower the cost of mortgages, and improve access to mortgage credit for the Nigerian population.

Motorways

NSIA is actively pursuing investments in road infrastructure delivery and maintenance to improve the general state of Nigeria’s roads, reduce the funding burden on the Federation Account and introduce private sector efficiencies to the procurement, delivery and management of road infrastructure. Consequently NSIA, in partnership with Julius Berger, is developing a project to finance, construct, operate and maintain the Second Niger Bridge, in order to improve the connection between the South-South and South-East zones of Nigeria.

Power

Given the pivotal role of power generation and distribution in our economy, particularly in light of the nation’s strategic focus on developing its industrial base, NSIA has targeted the power sector as a key focus sector. NSIA is investing alongside private investors in attractive projects across the power sector value chain. With the ongoing transformation of Nigeria’s power sector through privatization, there are numerous attractive opportunities to participate in Establishment of Sector-focused Subsidiaries. Hence NSIA had approved the establishment of a number of corporate subsidiaries, to operate as legal entities under which the NIF would invest in specific target sectors. These corporate subsidiaries include:

- NSIA Motorways Investment Company
- NSIA Property Investment Company
- NSIA Healthcare Development and Investment Company and;
- NSIA Power Investment Company Strategic Partnerships

Developed Markets Equities

United States

It is expected that the Fed will eventually withdraw liquidity, if the economic growth environment remains supportive. This is likely to put pressure on prices of both risk assets and of bonds. Within equities it is expected that, ceteris paribus, yield oriented assets (including dividend focused strategies, master limited partnerships, Real-Estate Investment Trusts (REITs), and minimum volatility equity strategies with hefty utility sector exposure) will face some of the greatest headwinds in an environment of tapering and eventual tightening. This is because prices will need to adjust for yields to remain competitive with bonds and cash. Within credit and bonds, the high-quality, long-duration bonds should face significant headwinds, but lower-quality credits could also face pressure, as investors that were forced to reach for yield no longer face that need.

Europe
The first quarter rally in European equities year-to-date has run ahead of improvement in underlying earnings, though valuations going into 2013 were undemanding. Although growth has also disappointed, however, recent data looks more promising and structural imbalances are being addressed. Looking ahead in 2014, valuations closer to historical averages suggest companies only need to deliver on fairly muted earnings expectations. The macro picture also needs to continue showing improvement, although again the picture outside the Eurozone looks more robust, and the troubled peripherals are a fairly small percentage of overall market capitalizations. European equities remain attractive relative to US equities given relative valuations and the earnings cycle.

Japan
Prime Minister Abe's economic reform programme is finally taking hold in the economy as businesses are borrowing again. This was achieved by initiating an aggressive fiscal and monetary stimulus programme with the Nikkei 225 stock index gaining 57% in 2013. The financial environment remains supportive and equity prices should continue to do well in 2014, which are mostly supported by a depreciating currency and a strong corporate profitability. It is unlikely that the Bank of Japan will change its low interest rates policy and is expected to continue with its asset purchases with the goal to keep interest rates near zero.

Emerging Market Equities
Emerging market equities may be poised for a burst of outperformance after lagging so much in 2013. This is based on a belief that over the long-term, valuations should normalize and EM equities do not deserve a discount quite as large as at present. However, this undervaluation is concentrated in the sectors with the strongest headwinds, whilst the consumer theme seems fully priced. Indeed, financial and energy/ materials stocks seemingly hold the key to broad EM index outperformance. Furthermore, it is likely that cheap China-sensitive sectors and markets would likely drive such a rally, especially if U.S. and European demand picks up, and Chinese growth surprises to the upside, or investors take a more constructive view on Chinese banks. EM equities performed phenomenally well over the previous cycle. As such the return differential over 2003–07 was astounding as EM equities returned 391% versus "only" 119% for the MSCI World Index. Much of this outperformance, however, was due to extremely depressed absolute and relative valuations for EM equities in 2001–02, with emerging markets trading at 50% discount to developed market equities, and nearly every sector and country was underpriced. Today's valuations are not as extreme and undervaluation not so widespread (including EM currencies).

Therefore outperformance going forward should not be as strong. Furthermore, much of the previous run-up was tied to China's integration into the global economy following its ascension to the WTO in 2001, which helped shape today's global supply chains and triggered the commodity boom. The strong performance in this period also drove widespread adoption of EM equity allocations within institutional portfolios.

Discussion
In light of the ongoing, the FGF has a long investment time horizon of greater than 20 years, effectively spanning multiple economic and market cycles. This, coupled with the Fund's payout requirements, allows Management to gain exposure to certain asset classes that are less liquid and can therefore attain greater risk-adjusted returns. Though this is not a required mandate, such investments should also dampen near-term volatility in relative terms. To implement the investment objectives of the FGF, NSIA set the Fund's first Strategic Asset Allocation as detailed below:

The Asset Allocation is based on long-term risk and return objectives, giving consideration to volatility and correlation levels across the Fund. The allocation is diversified across various asset classes ensuring that underperformance in a single class is mitigated to an extent at the portfolio level. The classes are segmented into *Growth Drivers, Inflation Hedges and Deflation Hedges*. At this stage of NSIA's life cycle the vast majority of exposure to these asset classes will be sought through the hiring of external managers.

Growth Drivers
Long Only Equity
The Long Only Equity portion of the Asset Allocation comprises 25% of the FGF, and is broken down into developed market and emerging & frontier market components. Given the time horizon of the Fund, the decision has been taken that the emerging & frontier market portion should receive a larger weighting than that of developed market. This is due to the view that over a long time horizon there is greater growth potential in emerging and frontier markets than developed markets.

Absolute Return
This component received a 25% weighting of the FGF. Managers in this asset class have the discretion to invest

across growth strategies and geographies. Absolute Return strategies, such as credit, long/short, or global macro, aim to earn a positive return irrespective of market direction.
As such, this asset class should provide a source of growth in times of stress in equity markets.

Private Equity
The Private Equity component also received a 25% weighting of the FGF. Again given the long-term nature of the investment horizon of the FGF, the inherent lack of liquidity in this asset class is negated. Therefore the Fund can gain exposure to an asset class that can obtain considerable outperformance to other benchmarks within the Asset Allocation. The selection of Private Equity managers will take longer than managers in any of the other asset classes.

Others
This component is a small contributor to the Asset Allocation at 5%, serving as a diversifying strategy to the other asset classes within the growth section of the allocation. This component will allow the Fund the latitude to seek exposure to asset classes such as direct lending, and shall seek out uncorrelated returns to the rest of the portfolio.

Inflation Hedges: Hard Assets & Commodities
In order to counter the impact of inflation on the rest of the portfolio, an allocation of 5% to commodities and 10% to hard assets has been made. Given the bulk of capital accruing to the Fund comes from revenues derived from oil exports, this component has been underweighted somewhat as the Fund has a natural inflation hedge built in.

Deflation Hedge: Cash
The threat of deflation is remote, as such the allocation received a small weighting of 5% to cash or cash-like instruments.

Risk Management
Risk Management Approach NSIA's risk universe is categorized broadly under Investment, Operational, Political and Strategic risks to facilitate effective risk management and reporting. Our strategy for managing risk is to identify and understand risks inherent in the operations of the Authority and to control them. Accordingly, our highly experienced Risk Management team has developed a comprehensive risk management process through which we monitor, evaluate and manage the risks in conducting our activities (both internal and external).

Conclusion
Looking ahead to 2014, several key themes should emerge. On the macro side, it is worth monitoring the evolution of global monetary policy, and the impact that tightening in markets like the United States will have on various global assets. Whilst concern that tapering and higher rates in the US may further impact a variety of assets, like sovereign bonds and emerging market (EM) currencies, one needs to understand how other central banks will react. Further easing by the European Central Bank or Bank of Japan, for example, could help blunt the potential impact of U.S. Federal Reserve actions.

Another macro theme would be how the aforementioned variables will influence earnings growth across markets and asset classes. On the equity side, it is worth noting the relative attractiveness of European and EM equities. In Europe, faster growth should allow earnings to rebound from a low base, given the valuation discount. However, one still needs to be aware of a number of risks such as a hard landing in China, overvaluation in consumer-focused sectors, and headwinds from balance of payments adjustments in some countries.

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