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KUWAIT AND SAUDI ARABIA: FACING LIMITS ON US EQUITY PURCHASES

Kuwait and Saudi Arabia are facing limits on the amounts they can invest in US equities under current investment practices. US trust managers are finding it difficult to maintain desired portfolio profiles for the two countries while conforming to the constraints placed on equity purchases. In reaction to the problem, Kuwait will begin to expand sharply the number of companies in which it invests, and the Saudis may soon be forced to take a similar tack.

Investment Practices

Kuwait and Saudi Arabia purchase US equities through trust accounts managed by US financial institutions. The trust managers make investment decisions based on a loose set of guidelines designed to avoid public disclosure and to prevent investment in politically sensitive industries or those industries which the countries would consider religiously or culturally objectionable. Public disclosure is avoided by each country limiting investment in any one firm to less than 5 percent of its outstanding stock. The SEC requires disclosure of ownership if holdings equal or exceed 5 percent.

Magnitude of Investments

US equity investments by Saudi Arabia and Kuwait are not large compared with the overall US equity market. At yearend 1976, the Kuwaitis and Saudis had invested $2.2 billion and $1.5 billion, respectively. The rate of their purchases last year was about $50 million per month—less than one percent of the volume of purchases on the major US stock exchanges. The size of their holdings totaled less than one percent of the value of outstanding stock of the 750 firms on ***Fortune's*** list of the largest industrial, banking, life insurance, retailing, and transportation firms.

Growing Headroom Problems

Despite the immense size of the US equity market relative to Saudi and Kuwaiti purchases and holdings, trust managers for the two countries are already having difficulties placing new funds. The problems stem from a combination of (a) the limited number of stocks an individual trust manager recommends at any one time, (b) the 5 percent limit, and (c) the portfolio profile trust managers seek to maintain. Trust managers usually build portfolios with less than 100 companies. Most financial institutions will not be recommending more than that number of firms at any one time because of limitations on analysis, overall market size, and desired breakdown among major industries.

We examined some existing equity portfolios built for pension and mutual funds to see if the quantity of Saudi and Kuwaiti funds in individual trust accounts could be invested in a similar manner without violating the guidelines. In the cases of the larger trust accounts owned by Kuwait and Saudi Arabia, an investment pattern similar to those in the sampled pension and mutual funds would have violated the 5 percent ownership limit. Using one mutual fund portfolio as an example, the total amount of funds which could be invested if 5 percent of each company in the portfolio were purchased would be $8 billion. By applying the profile used by the fund, however, only $1.1 billion could be purchased before violating the 5 percent limit for at least one company. This indicates that, at a minimum, trust managers already deviate from desired profit maximizing portfolios to invest Saudi and Kuwaiti funds under the guidelines.

Reacting to the Problem

The Kuwaitis and Saudis have a number of options available. They could:

- limit new investments in US equities;
- exceed the 5 percent limit on some stock purchases; or
- invest in a far greater number of US companies.

Neither country currently shows any interest in slowing equity purchases in the US, and Kuwait recently made a decision to put a larger proportion of its new US funds into equities. Neither country currently wants the publicity accompanying exposure of stock purchases in specific firms that would result if they broke the 5 percent limit.

Kuwait is now coming to grips with the problem by opening up a "market-weighted" investment account. The account will contain several hundred stocks in a profile resembling a market indicator such as the Standard and Poor's stock average. Companies in "sensitive" industries will not be specifically exempted from this portfolio. Using this approach, Kuwait presumably will forgo some profits to stay within the 5 percent investment guideline.

Saudi Arabia has not yet had to deal with the headroom problem. The Saudis have less funds than the Kuwaitis in the US market and disperse their funds through a larger number of trust accounts. At the current rate of investment, however, the Saudis may have to face up to the problem within the next year or two. Saudi Arabia is as sensitive about financial publicity as Kuwait. For this reason, they too may opt for a market-weighted account. [redacted]

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