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Often in my letters I expound on the continually changing landscape of emerging & frontier market investment, highlighting their dynamic nature as one of the reasons I and readers of this publication are drawn to them. “May you live in interesting times” always seemed like a fitting quote, and even more so as the roots of this universally recognized line may be from a Chinese curse. In light of the past six months, I offer an alternate version: “May we live in slightly less interesting times.”

Over the course of 2014 we’ve seen the emergence of a new, highly organized and well funded terrorist threat in the form of ISIS, panic from a potential global pandemic, massive out/inflows of capital from a superpower still in trouble, a hedge fund taking on a sovereign nation, and we’ve still got two months left. What does this mean for developing markets? I say these are the Herculean tasks that will demonstrate how far emerging markets have come. Looking at the Ebola outbreak, here in the US there is still internal debate over quarantine protocols, treatment of aid workers and so on. Nigeria, a country of over 174 million people, has been declared Ebola free by the World Health Organization. An emerging market country is serving as a model for the rest of the world in dealing with a problem that requires a high level of organization, management and efficient use of available infrastructure – an extremely important development in the trajectory of these markets.

The self-sufficiency demonstrated by Nigeria is an important step in closing the spread between the perception and actuality of risks as emerging market nations continue on their path toward greater transparency, political & economic efficiency, and ability to deal with unforeseeable domestic issues. We’ll be here eagerly keeping you updated as to their progress.

Saludos,



Nate Suppaiah
Managing Editor
editor@aeinvestor.com
202-905-0378

ALTERNATIVE EmergingInvestor

Managing Editor	Nate Suppaiah
Public Relations Director	Tiffany Joy Swenson
Head Writer	Melodie Michel
Copy Editor	Sean O’Brien
Contributors	Stephen Kaczor
	Jonathan Rivas
	Yao Yang
	Ana Palacio
	Jorge Mariscal
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	Cynthia Howson

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Editorial Partners	Debtwire LatAm
	ClearPath Analysis
Design	Arman Srna
Artist	Matias Otamendi
Consultants:	Adam Berkowitz
	Tyler Ulrich
	Jennifer Peck

Contact: info@aeinvestor.com | (202) 905-0378

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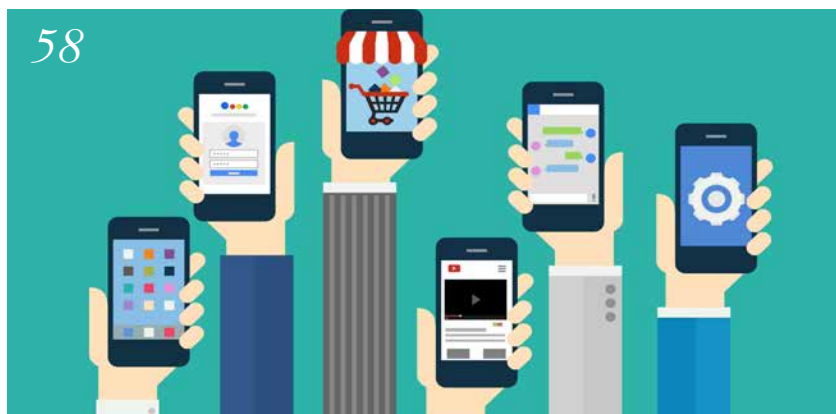
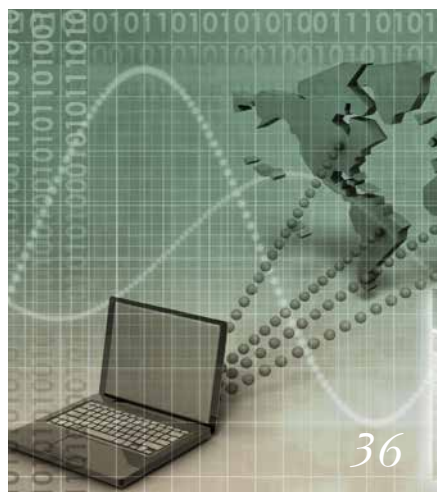
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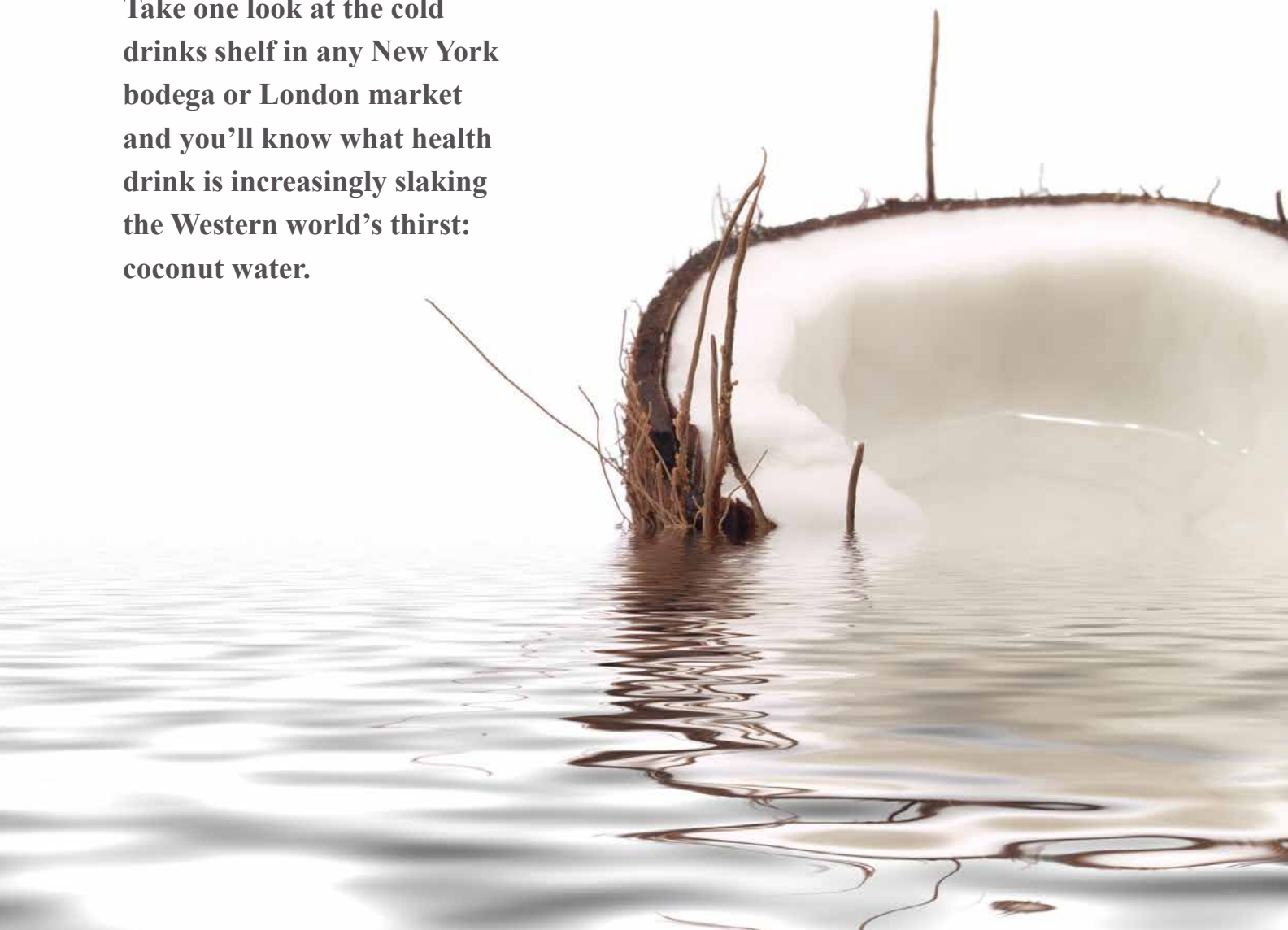
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Investing in Brazilian Coconuts

Take one look at the cold drinks shelf in any New York bodega or London market and you'll know what health drink is increasingly slaking the Western world's thirst: coconut water.



Indeed, watching those shelves over the last five years has been like watching a young coconut tree come to fruition. In the U.S. alone, sales have gone from essentially non-existent a decade ago to over \$400 million in 2013, and they show no signs of slowing. In the U.K., the industry promises to reach 100 million pounds this year, according to some analysts. Sales for the three leading global brands—Vita Coco, Coca-Cola’s Zico and PepsiCo’s O.N.E.—have grown nearly 3,000% since 2007. Over 250 brands color U.S. shelves with their distinctive boxes and cans.

And while growth has been most precipitous in the U.S. and U.K., coconut water is starting to catch on in continental Europe, as well. Even in Brazil, where drinking coconut water has long been a cultural staple, sales continue to rise by 20% per year.

The demand is driven by a shift in upper and middle-class tastes worldwide toward naturally healthy food and beverage products, bolstered by high-profile celebrity endorsements as well as a sustained marketing blitz emphasizing coconut water’s nutritional virtues.

■ Seeing Through the Water

But the water isn’t the whole story—not even close. The coconut fruit can be parsed into a wide array of utilizable components, including the meat, oil, milk, husk, and shell. Each of these parts yields elements essential to products in diverse industries, from biofuels to healthcare, cosmetics to construction, and discoveries continue to be made regarding its many possible uses.

Coconut oil, for example, has gained market share as a healthy alternative to cooking oils, as a skin care product, and even as a biofuel. In one grandiose endorsement, Richard Branson commissioned an experi-

mental Virgin Airlines flight from London to Amsterdam in part fueled by coconut oil.

Coconut milk, meanwhile, continues to be popular as a milk alternative in cooking, having entered Western markets via a growing love of East Asian cuisine. Fiber extracted from coconut husks is used

“The strategic shift in global demographics from West to East and the associated adjustments to food consumption patterns will play to Brazil’s strengths for years to come.”

*Anthony J. Archer,
Chief Executive, Liquid
Investments*

for rope and brushes worldwide, and Ford Motors is currently investigating the fiber as a potential alternative to plastics.

Additionally, coconut husks and shells are ideal biomass for generating activated carbon, a key tool for air and water purification. And in a lesser known but highly important development, researchers are currently attempting to clinically corrobo-

rate evidence that coconuts can help treat Alzheimer’s disease and other degenerative ailments in humans.

■ Short Supply

Thus a variety of industries and demographics have caught on to the fruit’s benefits, with demand rising across sectors worldwide—10% per year, according to The Food and Agriculture Organization of the United Nations, which expects comparable rates of growth through 2017.

But even as the explosion in popularity of coconut products in the West has driven demand for the fruit to record heights, the Asian countries that provide the bulk of the world’s supply face a crisis. In the Philippines, Indonesia, and India, massive amounts of coconut trees are approaching or have reached their productivity age limit of, on average, 60 to 80 years.

Consequently, these countries simply can’t meet the growing global demand for coconuts. Indeed, while demand for coconuts is growing by 10% per year, supply is growing by only 2% worldwide.

“While coconuts trees are very long-lived, Asian crops have reached their limits,” says James Duckworth, Chief Research Officer at Liquid Investments, a London and Brazil-based firm that owns and operates a number of coconut plantations.

It’s unclear to global investors that Asian producers will be able to expand or rejuvenate their crops adequately, he says. “Investment is needed.”

■ Enter Brazil

His firm, Liquid Investments, founded by Anthony J. Archer and Andrew Goodman in 2006, is part of a small wave of investors who, in recent years, have looked to



Brazil as the ideal locale for producing coconuts to meet global demand.

“Though it’s still a distant fourth in terms as a producer, Brazil is the only country where coconut yields are actually increasing,” Mr. Duckworth says. “And the industry is growing quite well.”

With offices in London and Fortaleza, Liquid Investments is currently expanding its coconut plantations in the North-eastern state of Ceará. The firm provides direct investment opportunities to global investors, who buy plots of land within Liquid’s coconut plantations. Liquid runs these plantations in partnership with its local Brazilian partner, Cohibra, the country’s largest coconut plantation manage-

ment company, who bring substantial crop optimization expertise to the table.

Brazilian soil has proved fertile for their partnership. According to Liquid Investments’ numbers, the five-year-old trees on its plantations already yield upward of 100 nuts annually, and upward of 200 nuts by year six—a rate the tree will maintain during its 60 year productive lifespan. These numbers are significantly higher than the annual yields of 35 to 80 nuts per year of many trees in India, Mr. Duckworth says.

This fertility of the Brazilian crop, bolstered by the strength of a Brazilian economy that recently became the sixth largest in the world, offers investors an appealing

investment alternative precisely at the moment when demand for coconuts is reaching record heights.

■ Commodity-Level Diversification

Yet it isn’t a one-dimensional supply-and-demand story. Indeed, as Mr. Duckworth explains, what first attracted Liquid Investments to coconuts was the impressive diversity of uses to which the coconut is put. This versatility gives investors diversification on the commodity level, as income will be a function of demand in multiple industries—food and beverages, cosmetics and skin care, clean energy, healthcare—all of which have strong demographics going forward.



“Don’t let anyone tell you investing in Brazil is easy...yet the country is an emerging market par excellence, with substantial investment returns on offer to those who show commitment, patience and the application of hard work and expertise in equal measures.”

Andrew Goodman, Co-Founder and Resident Partner, Brazil.

“Our investors’ crops are sold to major water suppliers, including Zico and O.N.E., but also to pharmaceutical companies, animal feed suppliers and energy companies, to name a few. This gives our investors multiple options for revenue streams,” he says.

■ Asset Class Diversification

Investors in Liquid Investments’ plantations get ownership of their land and its yields in perpetuity. Their income comes from capital appreciation on the land investment—which Mr. Duckworth puts at about 20% year-on-year—and the annual yield on the crop, with dividends of high double digits. While it takes up to four

years for coconut seedlings to grow into fruit-bearing trees, investors get immediate capital appreciation on the land. And, in any case, Liquid’s investors tend to be in for the longer term.

“Our investors tend to be investing retirement funds or on behalf of their families, and they’re looking for an asset that could be theirs years down the road. They’re attracted to alternative asset classes in general, because we’re seeing more and more evidence that net growth will come from alternatives going forward. And that’s what this investment gives them. It’s both a commodities and a real estate play, with diversification built in.”

■ Real Sustainability

Perhaps most importantly, these investors are also attracted to a product that inherently promotes human and ecological health and does so profitably—a value they share with Liquid Investments.

“Sustainability is essential to Anthony [Archer, the firm’s founder] and everything we do,” Mr. Duckworth says. “It’s something we really believe in, and not just as a marketing tactic but as a way of doing profitable business.” Indeed, another of the firm’s major investment projects is in neem, a plant endemic to South Asia that Liquid Investments recently began cultivating on its Brazilian plantations.





The firm first encountered neem when investigating organic insecticide alternatives for their coconut plants. Though little known in the West, neem is highly valued for its insecticidal properties on the Indian Subcontinent. It also has several other important uses relevant to diverse industries, including construction, food, and health and wellness.

Neem thus fit the criteria of the firm's portfolio perfectly: an off-the-radar investment that provides diversification on multiple levels and yields healthy, sustainable products that promise to grow in popularity in years to come.

■ Local Partners

While Brazilian coconuts offer investors multi-level diversification within the con-

text of a mature economy, Mr. Duckworth explains that there are risks to investing in the sector.

"Emerging markets are, almost by definition, markets where it's difficult to do business," he explains. "There are huge opportunities, and you have to be willing to roll up your sleeves to seize them."

For Liquid Investments, the most important means of mitigating risks and ensuring success was partnering with a local, seasoned coconut plantation manager. They found just that in Cohibra, he says.

"When you go into an emerging market like Brazil, you need to make sure you choose the right partner—and we've chosen without a doubt the best partner."

Cohibra's founder has 35 years' experience researching coconut cultivation, with much of that research sponsored by a Brazilian government that has prioritized agricultural R&D in recent decades.

"They are effectively subcontracted by the government to do business and research. So we don't say we're local experts, but we're partners with people who really are."

While the partnership with Cohibra mitigates operational risk, other risks remain, Mr. Duckworth says.

"The greatest of these is also the reason for the significant eventual likely outperformance of our investments – precisely

because it is located in a higher return emerging market. Investors such as ourselves pay for this through more frustrating bureaucracy, higher market volatility and in the specific case of Brazil, wage inflation higher than we would like. Yet we have adjusted to this environment because it will be worth it for our clients." On the other hand, Brazil has taken massive strides in macroeconomic and political stability, as well as infrastructure, he says.

"Brazil has been investing in infrastructure across the board, and Ceará is perhaps lucky in that respect, because it has fantastic beaches and is a big tourist destination, especially for Brazilians from Rio and Sao Paulo. So, in addition to the port and airport in Fortaleza, there are good roads and they're building more of them. There's also well-established agricultural infrastructure, including the industrial factories where we send our fruit to be processed into various products."

This infrastructural development, along with continual innovations in crop optimization, is helping the agricultural sector grow.

"Twenty years ago, Brazil was importing food," Mr. Duckworth explains. "Now it's one of the world's largest exporters. Our investors are essentially buying farmland in the country that will be the world's leading agricultural exporter by 2020. And with the coconut, they're getting a highly valued product for which new supply is sorely needed worldwide."

Download a complimentary copy of 'Investing in Coconuts' Guide 2014 from Liquid Investments here:

CLICK HERE



Opportunities in Nigerian Private Equity

The last seven years have seen remarkable and sustained growth in Nigeria's economy and marked improvement in its investment climate, turning it into a top destination for global investors increasingly open to frontier market plays.

Nigeria's growth has been a function not only of highly propitious demographics (the largest population in Africa, with a young and swelling consumer middle class) and global natural resource economics, but government-led reforms that have brought stability to financial markets and injected private sector funds and expertise into economic development.

Nigeria's seven-year spell of growth has coincided with—and been funded in part by—the country's burgeoning private equity industry, including major foreign investment firms and, more recently, bou-

tique domestic firms founded by a new generation of seasoned African investment professionals.

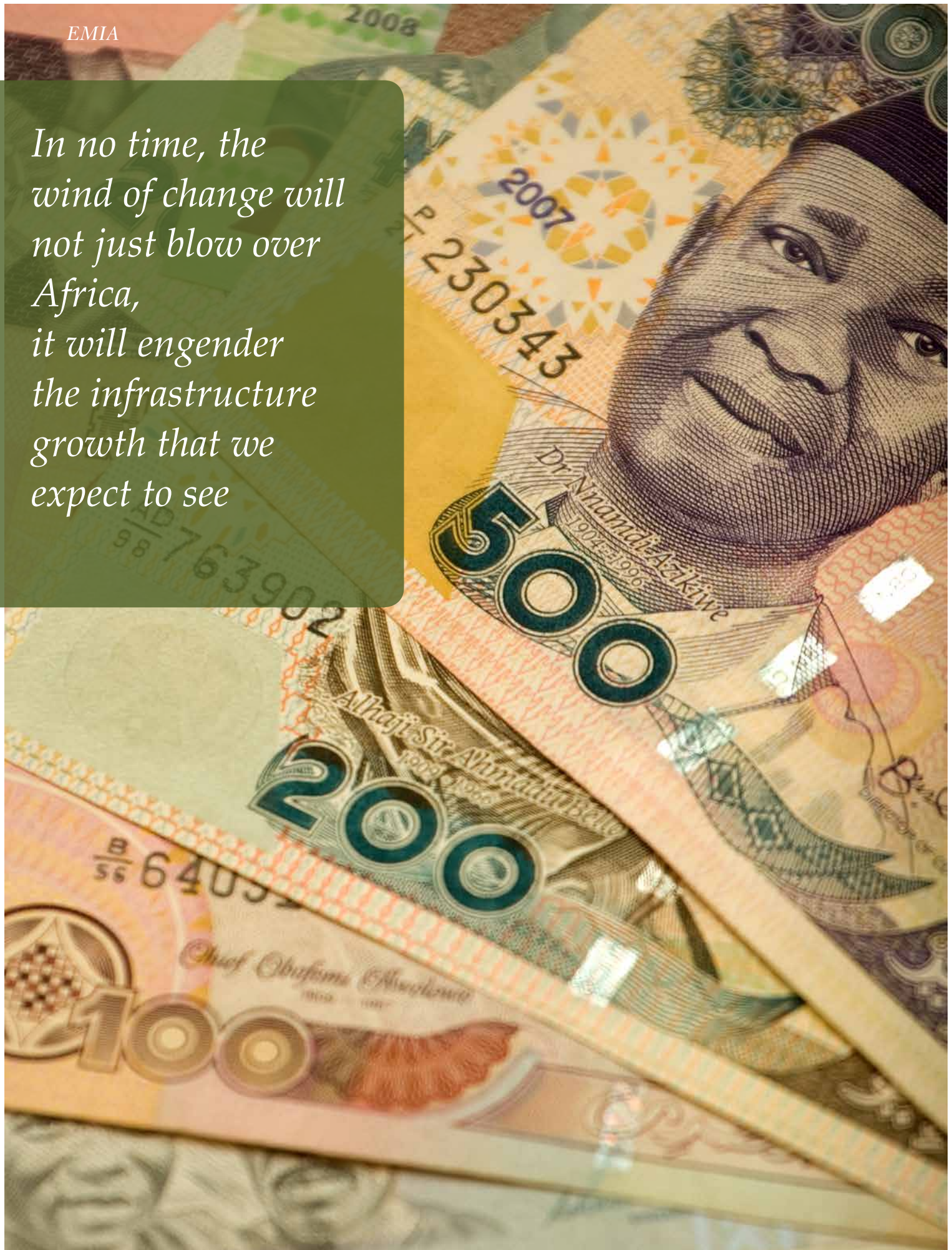
"Private equity funds, both foreign and domestic, see a huge potential in Nigeria," says Olutoyin Oyelade, Managing Partner at InVcap, an investment manager that provides accredited investors access to investment opportunities in Nigeria and other countries in West Africa. "The main draw is certainly in how the middle class and the consumer story has unfolded over the past few years. This middle class itself is rapidly growing, with new appetite, new attitude, and a need for quality products."

Before the late 1990s, a private equity industry hardly existed in Nigeria, save for a handful of large foreign investment banks that had taken stakes in domestic Nigerian banks and carried out some transactions. Gradually, global private equity firms, including Helios, Actis, Emerging Capital Partners and others, started entering the market. Then, in the late 1990s, two indigenous private equity firms, African Capital Alliance and ARM, opened shop, signaling the beginning of a domestic private equity industry that would come to comprise over 10 boutique firms by 2013.

■ Next Generation Private Equity

InVcap is part of this new generation of firms that were created by Nigerian and West African managers who plied their trade in banks and first-generation private equity firms over the last decade. The firm was founded in 2012 by a group of partners with decades of experience in invest-

*In no time, the
wind of change will
not just blow over
Africa,
it will engender
the infrastructure
growth that we
expect to see*



ment banking in West Africa and special expertise in construction development in particular. They saw huge opportunities in Nigerian and West African real estate, Ms. Oyelade says, as well as other sectors affected by the consumer class boom, and decided to bring their expertise to the table, serving both domestic and global investors.

InVcap now has investment and administrative teams in Toronto, Nigeria and Mauritius. Its first fund—InVcap Private Equity Fund I (IPEF I)—will invest US\$100 million in West Africa over a 5-year period, focusing on commercial real estate, hospitality, tourism, and support infrastructure (renewable energy, road, transport) for these projects.

Ms. Oyelade says that her firm's sector focus is in line with their strategy to provide infrastructure development capital to the commercial real estate and hospitality sectors in West Africa. Some partners of InVcap were part of Casa Consult, a Nigerian/Canadian construction development group that has delivered more than 30 commercial real estate and tourism sector projects under build, operate, and transfer (BOT); joint ventures (JV); and public private partnership (PPP) structures, including the only warm springs resort re-development in the country. After 22 years of operations under Casa, and with investment management skills garnered in West Africa over a cumulative 100-year period, it seems logical that the partners will naturally progress, as a fund manager-InVcap, towards funding the deal types that they successfully executed before now.

The consumer sector, telecom, power sector (focusing on downstream power providers) and sectors that leverage the rising middle class are of interest to most domestic PEs. Foreign investors, meanwhile, are generally investing in large infrastructure

projects, the aviation sector, telecom, financial services, and the entire energy supply chain—leveraging their size and access to capital and resources.

“They are aggressively investing in these sectors because they not only have a first mover advantage, they have the dollar power they bring with them,” Ms. Oyelade says.

*The Economist
remarked earlier
this year that
frontier markets
have gone from
being a fringe bet
for risky mavericks
to constituting an
asset class in their
own right.*

Ms. Oyelade also points to foreign investors entering Nigeria's food and retail sectors, including South African firms investing in large chain stores and restaurants across Nigeria's densely populated areas.

■ Seeking Foreign Investors

Still, even as Nigeria's private equity industry has grown, both fueled by and fueling the country's economic growth, the overall activity and impact of small, indigenous firms has been relatively limited, particularly in comparison to its wealthier foreign counterparts, Ms. Oyelade says.

She attributes the lack of accelerated growth in the industry, in part, to the size of investments that Nigerian pension funds can make, while foreign managers with access to foreign pension funds—as well as foreign development finance institutions—have been able to land larger, more impactful deals.

“If you look at offshore managers, they are most often funded by pension funds—as well as family offices and other institutional investors, but mainly pension funds. They contribute more than a third of the capital invested by the major PE players here. But in Nigeria this was not so. Up until 2013, the pension commission (PENCOM), which has over 3.2 trillion naira in pension assets (about US\$16 billion), was only allowed to invest about 5% of its assets in private equity; the capital and money markets were the main beneficiaries. Even the 5% isn't fully invested, because there were stringent criteria for investments and this has impeded the growth and impact of funds. However, a new Pension Reform Act signed in 2014 favors up to 50% of PENCOM's asset classes in variable income instruments including private equity (PE). This act should change the PE landscape in Nigeria such that more developmental impact is seen.”

She explains that for its first fund, InVcap is looking especially for pension funds (local and foreign) and family offices to make investments of between US\$1 million and US\$10 million.

“Other institutions are welcome, but the time needed for due diligence will be a major consideration for us, and that's a big reason why we're focusing on family offices and pension funds.”

The fund's appeal to foreign investors should lie in its on-the-ground credentials and its close access to high-growth

sectors within booming economies, she says.

“With our local presence, we intend to latch onto the good wind that has been brought about in Africa. This is a fund founded by Africans and based in Africa, and we know that we can manage the assets given our track record in the real estate industry and diverse sectors over the years of cumulative experience.”

■ In Line with the Times

These qualities are indeed appealing to global investors, who are turning to fron-

tier markets for high returns and diversification. Increasingly frontier markets constitute an essential component of the portfolios of wealthy family offices and large institutional investors. Indeed, as an essay in the Economist remarked earlier this year, frontier markets have gone from being a fringe bet for risky mavericks to constituting an asset class in their own right.

And several of the most attractive frontier markets are in Africa, and West Africa in particular. As Ms. Oyelade notes, by some accounts 23 of the 25 fastest-growing economies in the world are in

frontier markets, and the majority of these are in Africa. Countries such as South Africa, Nigeria, Angola, and Ghana lead the 16 reforming countries on the continent, which account for 76% of its total GDP.

With an annual growth rate around 7% in recent years, Nigeria ranks near the top of frontier markets with large populations. Earlier this year, after the federal government decided to rebase the country's economy, Nigeria's GDP surpassed South Africa's as the largest on the continent. Nigeria also has Africa's largest population, with a growing middle class.



NIGERIA

Unity and Faith, Peace and Progress

179 million Population

7th most populous country on earth

38 Provinces

Capital : Abuja

Currency : Naira (NGN)

Languages : English, Hausa, Igbo, Fulah

AFRICA



And, of course, it continues to be rich in natural resources, notably oil and mineral resources. Trade with the U.S., China and other countries has grown considerably in the last decade.

But Ms. Oyelade stresses that Nigeria's is not simply a demographics and natural resources story. The sustained economic growth has much to do with government policies instituted beginning about nine years ago.

"The transformational agenda of the federal government of Nigeria itself, which was set-up in 2005, has yielded some of these positive outcomes in several important sectors that have been privatized—including energy, telecoms, and IT sectors, where there have been some success stories (MTN of South Africa, Etisalat) due to these reforms. The country's economic progress emanates partly from the government's deregulation exercises and other policy moves, such as the rebasing of the economy."

■ Closing the Perception-Reality Gap

African countries, including Nigeria, have also benefitted from an improved image among investors and global mass media, which are more and more attuned to the improving investment climate among the continent's reforming countries and the returns reaped by alternative investments in high-growth African economies.

Ms. Oyelade notes, however, that the continent's image still suffers due to localized tragedies that, all too often, dominate headlines and give a false impression of region-wide or countrywide chaos. A case in point is the current Ebola outbreak in West Africa that has riveted and frightened the world. She emphasizes that the Nige-

rian government has been more effective at managing this crisis than others in recent times, earning praise from the United Nations and even from the government's staunchest critics.

"People are confident that the government is really on its toes in managing the situation. Even though the Minister of Health has confirmed that the country isn't closing its borders, because we can't afford to, they're being very aggressive in screening inbound and outbound travelers, having committed US\$15 million to its treatment. And I think these measures have instilled confidence in investors, rather than eroded it."

In general, Ms. Oyelade believes that global investors are beginning to pierce through the prejudice that has long obscured the reality of Africa as investment destination.

"Africa in general was a 'dark continent' to investors for too long," she says. "The tendency was to ignore it completely or deal with it at arm's length. But the story is changing, and it's allowing investors to begin to explore the real opportunities that exist. In no time, the wind of change will not just blow over Africa, it will engender the infrastructure growth that we expect to see."

About the Author

InVcap is an investment manager that provides accredited investors access to investment opportunities in the frontier markets of Africa. Its investment focus is driven by the high growth opportunities in the frontier markets, representing a total of 17 of the 20 fastest growing economies in the world. InVcap is licensed and regulated by the Financial Services Commission (FSC) with investment teams in Toronto and Nigeria. Its InVcap Private Equity Fund (IPEF I) is registered, domiciled and administered from Mauritius and is FSC regulated.

InVcap participates in the developmental processes of the businesses we support. It partners with these companies by making equity investments, availing the capital required, and providing professional advisory services to function effectively.

InVcap invests in companies that operate in emerging markets with a focus on West Africa. It is active in business environments that are characterized by limited competition—where Africa has a comparative advantage. This is a strategy that ensures diversification within the InVcap investment portfolio and provides investors with above average, risk-adjusted returns.

PROFILE

The Granularity Advantage

Investors and analysts often speak of capital flows to and from emerging market regions. But while this view of the capital tide gives a sense of investor appetite for certain emerging market assets, it lacks granularity. Investors and investment professionals need to know about flows to – and holdings in – specific sectors and securities.

Now Copley Fund Research, an independent research company specializing in the analysis of emerging market mutual fund holdings, is addressing this need. It analyzes data on the constituent holdings of the world's top global emerging market mutual funds, generating a unique picture of the EM landscape from an investor's perspective.

"We're offering the most granular peer group analysis of emerging market funds

available on the street," says Steven Holden, Copley's founder. "It's a unique product, the first that gives investors information on aggregate stock level positions from prominent EM investors."

Copley analyzes one hundred emerging market mutual funds with a total of US\$290 billion in AUM invested in over 2000 securities. It then ranks stock positions and performance according to various criteria. The firm's reports help investment professionals survey the playing field

of top funds, while telling prospective investors what securities top managers find most and least convincing.

■ Increasing granularity

Formerly a Director of Emerging Market Equity Derivatives at Citi, Mr. Holden founded Copley in early 2014. The idea for the fund research method, he says, came from his time serving clients at Citi.

"I would hear about strong inflows, but I never knew what to do with that data. I was frustrated by the lack of granularity. People talk as if you buy a country, but that's not how it works. I was always more interested in what specific securities people were actually buying and holding. So I started looking at what people were holding, and building a picture of where the ownership was. The more we knew, the more we could serve our clients."

Compiling data was complex and time-consuming, he says, and the original picture was simplistic, focusing only on sector and country level weightings.

"But then we got into the single stock level," he says, "and that's where things got interesting. I started getting way more questions from emerging market PMs on EM stock holdings than I did on day-to-day derivative issues. There was a real interest among portfolio managers for staying abreast of trends within their peer groups, what others were owning and not owning. When I saw this positive feedback about my approach, I decided to leave Citi and develop the method more."

■ Building the picture

Key to Copley's analysis is their selection of funds to monitor and analyze, Mr. Holden says.



“There are thousands of EM funds out there, and knowing which ones to look at is quite important. For instance, many don’t update regularly so it is key to screen for funds that update filings at the very least on a quarterly basis – anything longer and the data becomes meaningless.”

To further winnow the selection, Mr. Holden examined the investment profiles of each fund, selecting only those that were global emerging market funds as opposed to focusing on certain regions, sectors, or niches. He also preferred long-only equity investors, whose positions tend to be high-conviction and reflect long-term investment horizons. Then Mr. Holden looked at fund concentration.

“I didn’t want the number of stocks held to be too high,” he explains. “The average number of stocks held amongst our portfolios is 143, that’s compared to 834 in the MSCI Emerging Market Index. The higher the concentration, the higher the conviction of each stock in the portfolio.”

Finally, Mr. Holden looked at funds’ AUM. “Once the screening process was complete, funds were chosen on the basis of AUM, the larger funds favored to give a better feel for gross positioning, which forms part of our analysis.” He explains, “though I’d stress that the initial screening process is more important than the size of the fund, I’m more interested in picking the right fund than the largest.”

Much of his analysis gives equal weight to all funds regardless of size, so that the stock holdings of the larger funds don’t skew the overall picture.

The conviction and depth of research reflected in funds’ long-term holdings are at the heart of his method’s value, Mr. Holden says.

“The funds we’re looking at are making long-term investment decisions, and when you look at their investment process you see the huge amount of analysis that goes into each stock. It goes way beyond just examining a set of company financials;

*Our reports allow
you to see how
your positions
compare with your
peers’ and your
peers’ versus the
index. This helps
you differentiate
yourself or see if
you’re missing
something that
these funds are
seeing.”*

factors such as population demographics, country politics, the impact of future technology are all researched in detail. A stock’s inclusion and subsequent weighting in a portfolio is a direct product of that research and expertise.”

■ Country and sector analysis

With its selection of 100 funds, Copley’s flagship Emerging Market Investor Trends report breaks down the combined holdings by country and by sector. Each country or

sector receives a five-page dossier detailing current and historical analysis on a number of metrics, notably stock, sector and country weightings both in absolute terms and versus the MSCI Emerging Markets Index. “The report can be used by Global EM professionals but also by regional, country and sector specialists,” Mr. Holden advises. “The way the reports are structured allows for direct comparison of stocks within a specific country or sector.”

■ Position and momentum

In addition to the country and sector level information, Copley produces stock rankings based on predefined position and momentum characteristics. “We look at the stocks in the EM universe and rank them based on a number of factors, for example how many funds are holding a stock, how many are overweight versus the MSCI EM benchmark, what is the average size of the holding. We then look at the investment pattern over time to determine positive or negative momentum characteristics.”

A September blog post on the Copley website explains these position and momentum calculations, and gives a list of the Top 25 stocks according to combined position and momentum scores – with the Power Grid Corporation of India at the top. An earlier post gave a list of stocks in which none of the hundred funds that Copley monitors held a position.

Seeing where prominent mutual funds are overweight and underweight is valuable to portfolio managers and individual investors, Mr. Holden says.

“It’s not an absolute game, it’s a relative game. People are competing with each other. Our reports allow you to see how

Emerging Market Stock Screening, Top 25

Ticker	Name	Position Score	Momentum Score	Combined Score	Combined AUM, \$	No. Funds Held	No. Funds O/W	12m Local ccy Return (inc div)
532898-IN	Power Grid Corporation of India Limited	88	72	80	495 271 997	19	18	42,3%
532454-IN	Bharti Airtel Limited	92	66	79	657 266 849	17	17	35,9%
030530-KR	WONIK IPS Co., Ltd.	76	75	76	53 481 154	7	7	96,3%
MOEX-RU	Moscow Exchange MICEX-RTS OJSC	73	77	75	166 231 955	12	12	6,0%
QNBK-QA	Qatar National Bank SAQ	88	61	75	299 895 848	17	16	35,1%
ASII-ID	PT Astra International Tbk	97	53	75	2 129 936 839	44	36	41,7%
JMT-PT	Jeronimo Martins, SGPS S.A.	87	62	74	342 378 420	13	13	-30,6%
532296-IN	Glenmark Pharmaceuticals Limited	77	70	74	86 148 955	11	11	50,9%
EREGL-TR	Eregli Demir ve celik Fabrikalari T.A.S.	66	81	73	99 360 214	16	14	115,6%
QIWI-US	Qivi Plc Sponsored ADR Class B	73	74	73	88 896 041	11	11	34,4%
BAP-US	Credicorp Ltd.	94	51	73	790 337 671	56	49	27,3%
WHL-ZA	Woolworths Holdings Limited	84	58	71	418 301 521	22	22	21,4%
FIVE-GB	X5 Retail Group N.V. Sponsored GDR RegS	86	56	71	289 336 626	14	14	23,9%
ARCLK-TR	Arcelik A.S.	78	64	71	128 585 249	14	14	36,4%
GTE-US	Gran Tierra Energy Inc.	68	73	71	53 030 579	9	9	-4,7%
000660-KR	SK Hynix Inc.	71	69	70	1 032 327 308	51	44	53,5%
017670-KR	SK Telecom Co., Ltd.	97	42	70	784 268 540	44	43	35,4%
958-HK	Huaneng Renewables Corp. Ltd. Class H	73	66	69	52 099 906	6	6	21,0%
1928-HK	Sands China Ltd.	96	42	69	799 243 834	33	33	9,5%
TAVHL-TR	TAV Havalimanlari Holding A.S.	76	63	69	99 021 710	16	16	55,5%
ALRS-RU	AC ALROSA OJSC	78	60	69	459 808 771	14	13	29,2%
BBSE3-BR	BB Seguridade Participacoes SA	94	43	69	916 376 556	35	33	85,7%
2338-HK	Weichai Power Co., Ltd. Class H	84	53	69	218 283 545	16	15	1,7%
512070-IN	UPL Limited	77	61	69	116 030 277	15	15	182,8%
500257-IN	Lupin Limited	89	47	68	274 857 710	26	26	56,4%
BVT-ZA	Bidvest Group Limited	92	44	68	775 188 529	30	23	17,0%
LPPF-ID	PT Matahari Department Store Tbk Class A	70	66	68	134 166 529	17	17	44,8%
BITA-US	Bitauto Holdings Ltd. Sponsored ADR	80	56	68	206 925 548	8	8	496,6%
GLTR-GB	Globaltrans Investment Plc Sponsored GDR RegS	81	54	68	96 232 279	16	16	-25,1%
500180-IN	HDFC Bank Limited	98	38	68	1 519 796 713	39	37	40,6%

your positions compare with your peers' and your peers' versus the index. This helps you differentiate yourself or see if you're missing something that these funds are seeing."

It's especially helpful to smaller-scale PMs who don't have an army of analysts across every country and sector. "Our research is a valuable addition to the investment process for these funds, from

helping stay abreast of emerging themes right through to justifying or rejecting a position." Mr. Holden cites the example of Celltrion, the Korean Biotech stock that has lost faith among EM investors over the last year. "Despite being mid-weighted in the MSCI EM Index, not one of the one hundred funds we analyze holds a single share. If you are a holder it might encourage you to re-examine the investment case at the very least."

Overweight in India

Based on recent analysis, Mr. Holden says, emerging market mutual funds are more bullish on India than any other country.

"India is a real outlier now, in the positive sense. It is the most bullishy positioned country on pretty much every metric. Of the funds we track, 84 are overweight Indian stocks versus the MSCI EM Index,



with an average 10.1% allocation in India, versus 6.7% for the Index. Only 2 years ago investors were on average in line with the index at 7%, and only 45 funds were overweight. Investors are looking to tap into India's renewed hopes of reform after Modi's election win, hoping that it can replicate what China has done in terms of productivity gains."

On the topic of China, he sees the recent Alibaba IPO as a harbinger of investor enthusiasm for EM technology stocks.

"Over the past 12 months, more investors have added new positions in semiconductor, internet and electronic equipment stocks than any of the other sub-sectors. Names such as MediaTek and SK Hynix have seen their breadth of ownership increase in conjunction with large scale inflows, and with Baidu and Tencent being the third and seventh largest holdings amongst our EM funds, we expect Alibaba to be a major player in EM portfolios in the coming months."

PROFILE

COPLEY FUND RESEARCH

About the Author

Copley Fund Research is an independent research company specializing in the analysis of emerging market mutual fund holdings. Through our reports and commentary we are able to identify the key investment trends of some of the world's most sophisticated and well-informed emerging market equity investors.

Our reports are used by experienced emerging market investment professionals for unrivaled peer group analysis, by EM Corporates for insight into industry and competitor perception and by investors new to emerging markets keen to enhance their knowledge and understanding of the EM investable universe.

Our analysis of one hundred prominent emerging market mutual funds comprises over US\$290bn in equity assets spread over 2000 securities. By analyzing each portfolio from the bottom up we are able to build a concise picture of the emerging market landscape on a country, sector and stock level.

For more information on subscription terms, contact steven.holden@copleyfundresearch.com

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GUADUA BAMBOO

Guadua angustifolia has been called green steel and is considered one of the most versatile forestry species on Earth. It is native to South America and is being grown throughout the Americas. It is used for construction of everything from homes to bridges to cathedrals. Guadua is processed into panels, laminates, and flooring. It is used in the bio-energy industry. Guadua is excellent for columns, girders, and planks and can be compacted into solid beams. It is also used to make furniture, musical instruments, and arts & crafts.

■ Stephen Kaczor

Guadua is the most important bamboo in the Americas because it grows rapidly, with consistent diameter, and is more productive per hectare than trees. “No other natural resource possesses more: versatility, lightness, flexibility, endurance, hardness, strength, climatic adaptability, seismic-resistance, rapid growth, easy handling and visual warmth.” It easily meets the International Building Code. (Guadua Bamboo, Costa Rica, 2014)

A Guadua forest can be established in five years, at which time one-third of each culm can be harvested annually for the 80-year useful life of the culm, making it an extremely attractive investment at US\$1-2 per start for Guadua stock purchased in Colombia or Panama. Yields provide a multiple over other forestry products ranging from three to five times the yield of slower growing hardwood forests. Its diameter is constant for the first 15 meters. Civil engineers, architects, and interior designers are creating a renaissance for this ancient building material. (Nakasone, Sara. “Bamboo: An Alternative Movement”. *Illumin: A Review of Engineering in Everyday Life*. University of Southern California, 2013)

Córdoba, Colombia is home to the National Bamboo and Guadua Investigation Center (Spanish: Centro Nacional para el Estudio Bambú-Guadua). Open to the public, the center shows the potential uses of guadua as a material for construction, furniture and decoration. It undertakes research on the cultivation of new varieties of guadua.

The Bamboo and Guadua Festival (Spanish: Fiesta del Bambú y la Guadua) is held in Córdoba every June.

Recent studies conducted by the European Union indicate that bamboo has relatively low water requirements and that its root system is excellent for protecting watersheds from erosion. German fire authorities tested Guadua and, guided by the European Building Code, approved bamboo as a building material for the Guadua Pavilion at Expo 2000 in Hanover.

An environmentally sustainable preservation technique using non-toxic smoke can prevent bamboo’s deterioration for several decades. Other chemical preservative treatments prevail, but are not necessary. Bamboo construction is earthquake-resistant; recent earthquakes in Colombia’s coffee zone demonstrated this when many houses built in the 1930s survived, while modern houses collapsed.

Bamboo contributes significantly to economic development in producing countries in the tropics and sub-tropics. China’s bamboo sector is worth US\$19.5 billion per year and provides employment to 7.75 million people. In 2012, the domestic market for bamboo and rattan products in major producing countries was estimated at US\$34.2 billion, with this figure also being supplemented by US\$2.5 billion of annual international trade. A report focusing on the international market for bamboo and rattan products “provides a snapshot of international trade, production and consumption, with detailed analysis of the global market of bamboo and rattan.” It can be downloaded from the International Network of Bamboo & Rattan (INBAR) at: www.inbar.int/publications, along with technical reports.



About the Author

Stephen Kaczor is Executive Director of the Big River Foundation, a non-profit focused on river and watershed ecology conservation initiatives throughout the Americas. He is an organic farmer, eco-entrepreneur, consultant, and a writer with a documentary film in production in Central America. As a Panama-based consultant, Mr. Kaczor’s focus is sustainable organizational development, research & management. www.BigRiverFoundation.org

The Puerto Rico Electric Power Authority (PREPA) reached a forbearance agreement with 60% of its bondholders and with two banks yesterday (14 August) extending lines of credit to 31 March 2015 and freeing up some cash in ways not previously authorized.

Puerto Rico Electric Power Authority Forbearance Wrap:

8 things you should know



Reid Tomlin, director of municipal research at Wasmer, Schroeder & Company, said the forbearance agreement was “a positive” in that it ensured that PREPA is not “going to fall apart all at once.”

And not a moment too soon...without the line of credit extension, PREPA could have been left in a cash crunch that would have left the electric authority unable to continue operating and paying its bills.

Here are eight items you need to know about the new forbearance agreement:

1. Violations of bond covenants will not be pursued.

To make a 1 June 2014 payment, PREPA drew USD 41.6m from a reserve account, according to prior reports. Bondholders cannot sue PREPA for this under the forbearance agreement. The utility didn't make payments to the bond service redemption and sinking fund reserve account, which has a balance of USD 411.7m, and took money out of the capital improvement fund, which has a balance of USD 279.0m, for purposes other than construction.

2. The commonwealth can use existing funds for ongoing expenses.

The construction fund will be allowed to make operational expenditures for payroll.

“What they’re basically going to do is run the construction fund out of money,” said Daniel Hanson, an analyst at Height Analytics, a research and advisory firm in DC.

The funds are hoping that PREPA, in the time this buys, will organize a capital improvement plan and union negotiations.

3. Parties are snubbing the Recovery Act.

Puerto Rico and bondholders have agreed to more or less a standstill on the so-called Recovery Act, passed by the legislature in June, which sets up a bankruptcy-like process under which the commonwealth's public corporations can restructure.

According to the agreement, the forbearance agreement will no longer be in effect if PREPA seeks to reorganize under the Recovery Act. PREPA can also terminate the agreement if bondholders – other than those that are currently challenging the act – sue over the law.

Preventing lawsuits or a filing under the Recovery Act helps ensure that the negotiating power doesn't shift to one side or the other as talks progress, said Timothy F. Nixon, a bankruptcy attorney with Godfrey & Kahn.

"Right now, both sides have analyzed the risk of an adverse decision and have factored that into the deal terms," said Nixon. "Once the court finds the act is legal or not, one side or the other's bargaining power significantly improves and they will want a lot more from the other -- this deal would go away."

Reid Tomlin, director of municipal research at Wasmer, Schroeder & Company, also noted that there has been "some movement" in a proposal by Puerto Rico Resident Commissioner Pedro Pierluisi to change federal bankruptcy law to allow Puerto Rico's public corporations to file under Chapter 9.

Franklin Funds and Oppenheimer Rochester Funds are likely going to try to push any sort of default back until the US federal court can rule on their lawsuit over the constitutionality of the Recovery Act. The

US District Court for the District of Puerto Rico will hear the arguments in October, according to prior reports.

4. The agreement introduces more uncertainty in the event of a restructuring.

There is an agreement from a supermajority of bondholders that the bank lines

Bondholders are also trying to get PREPA to do something it has long failed to: crack down on non-payment. Moody's Investors Service noted PREPA's "high rates of nonpayment" in a 26 June note downgrading the bonds.

of credit are a senior lien included in the forbearance agreement. The impact of this in a potential restructuring depends on if the commonwealth is granted access to Chapter 9, as advocated by Resident Commissioner Pedro Pierluisi, said Hanson. Chapter 9 would give these holders seniority, while under the Recovery Act the older

contracts, which give bondholders seniority in a restructuring, would stand.

"In the event that they enter a Recovery Act restructuring scenario it's my understanding that the bank interest would become junior to the bond payments, but if they entered a Chapter 9 process the debt would probably be senior," Hanson said.

The funds, Oppenheimer and Franklin, were prone to agreeing to the forbearance since they have a large number of retail clients with Puerto Rico exposure. They're essentially taking a risk on credit lines to preserve client portfolios, Hanson said.

5. Conflicting deadlines give PREPA until 2 March, or 1 January, to have a restructuring plan.

The forbearance agreement gives PREPA a 2 March deadline for a restructuring agreement. This is after the next principal and interest payment, 1 January.

"Whether or not they're going to be able to make the 1 January payment depends on what they pay for oil over the next few months," Hanson said. PREPA will need to sign a contract in mid-September to prevent the utility from running out of fuel.

The commonwealth leadership has a powerful incentive to move on a restructuring agreement as soon as possible, Hanson said. Elections are in November 2016, with Governor Alejandro Garcia Padilla coming up for election along with many other members of the Popular Democratic Party. The sooner they can do something like layoffs the sooner they can start rebuilding good will.

There's also a benefit for bondholders, the sooner there's a restructuring agreement the more cash there is.



6. PREPA will be looking into municipalities' electric deals.

PREPA has a number of increased reporting requirements to bondholders under the agreement, including reporting monthly cash flows and bank statements and weekly updates to its 13-week cash flow statement. It will also have to record revenue from municipalities and contributions in lieu of taxes on a gross basis.

PREPA's electrical charges to municipalities have proven controversial. One lawsuit alleges that PREPA has engaged in racketeering by deliberately overbilling customers, in part by instituting a fuel adjustment charge to recoup the payment in lieu of taxes to municipalities, but subsequently failed to transfer that money to local governments. PREPA denies that charge.

PREPA is required to pay municipalities a payment in lieu of taxes and charge them for their electricity. But rather than doing so directly, PREPA offsets the amount that it can charge municipalities for electricity with the amount it is obligated to pay them in lieu of taxes, said Sergio Marxuach, policy director at the Center for the New Economy.

The forbearance bondholders appear to want to see a breakdown of each of the it impact the calculation of net revenue to debt service, said Marxuach.

7. Paying bondholder forbearance fees.

PREPA doesn't get the forbearance agreement for free. Bondholders will be paid a USD 1m a month amendment fee and a USD 1.4m monthly forbearance fee, according to the EMMA disclosure. Such fees are standard, said Nixon, and while USD 2.4m a month is "big in the abstract," it is a "very small percentage" of the USD 8.8bn PREPA has outstanding.

"It does not strike me as inappropriate on a debt of that size," Nixon said.

8. Cracking down on non-payment.

Bondholders are also trying to get PREPA to do something it has long failed to: crack down on non-payment. Moody's Investors Service noted PREPA's "high rates of non-payment" in a 26 June note downgrading the bonds. Under the agreement PREPA "shall use commercially reasonable efforts to pursue overdue accounts."

As of 8 August PREPA had about USD 86.9m in its general fund, USD 279m in its capital improvement fund and USD 15.9m in its maintenance reserve fund.

A USD 150m tranche of Series 2013A power revenue bonds which mature in 2033 last traded in round lots on 31 July at 48.6 yielding 15.43%, according to Electronic Municipal Market Access. The bonds were last rated CC by Fitch Ratings on 26 June, CCC by Standard & Poor's on 31 July and Caa2 by Moody's Investors Service on 1 July.



DEBTWIRE

About the Author

Debtwire Latin America provides actionable intelligence on event-driven special situations in the distressed and high-yield markets. With an on-the-ground team of journalists based in Sao Paulo, Buenos Aires, Bogota and Mexico City, Debtwire LatAm closely tracks special situations throughout the LatAm market, providing real-time coverage of primary equity issuance, and alerting subscribers early-on to restructuring events and key credit situations. Please visit www.debtwire.com for more information.

Understanding Emerging Market Corporate Credit

Among global investors entering emerging markets, there's a common perception that equities and mutual funds are the safest bets for long-term gains. On the fixed income side, the tendency is to seek the familiar ground of EM sovereign bonds. Meanwhile, corporate credit, though well established as an asset class in developed markets, remains largely overshadowed by sovereign and local debt in popular accounts of EM opportunities.



Yet corporate credit is, in fact, the fastest-growing asset class in EMs, with a market capitalization of about 72% of the US\$2.4 trillion EM debt market. And this growth comes largely from sophisticated institutional investors who are increasingly allocating into corporate credit because of its higher yield, lower volatility and better risk-return profile.

“The world is built around equity,” says Wilbur Matthews, founder, CEO, and CIO of Vaquero Global Investment, a

San Antonio-based investment manager focused on EMs and specializing in EM corporate credit. “But in EMs particularly, the risk-return profile is so far superior in fixed income that unless you’re a true specialist in market timing and are able to have the discipline to get into equities when multiples are low and get out when they’re high, fixed income is a much more dependable asset class in the long term.”

Institutional investors have gradually come to agree with this position over the

last decade. While the asset class was occupied mostly by hedge funds in its early days, mutual funds and insurance companies began to enter last decade, followed by pension funds more recently.

In 2006, EM corporate debt overtook EM sovereign debt in terms of market capitalization, and Mr. Matthews founded Vaquero a year later. The firm launched its Vaquero EM Credit Fund in 2008, just as global investors began turning toward EMs at unprecedented levels.



The most basic rationale for investing in emerging markets is that they’re large: 38% of global GDP, 73% of the land on earth, 86% of the labor; one would expect the capital to converge.

“The most basic rationale for investing in EMs,” Mr. Matthews says, “is that they’re large: 38% of global GDP, 73% of the land on earth, 86% of the labor. One would expect the capital to converge. People see that trend. It’s been a dominant theme for the last decade, and I see it going on for the next.”

But even as they invest increasingly in EMs, investors still make the mistake, all too often, of courting volatility, he says.

“Most investors, when they go into the debt market, tend to go toward sovereign debt; and when they go into EMs, they go into equities. It’s surprising and unfortunate, and it tarnishes the credibility of the asset class, because the volatility of EM equities is profound, and negative experience with EM volatility undermines the rationale of investing in emerging markets across the board.” Selecting the most volatile element of the asset class as your entry to the market often gives investors a negative first taste when they should instead seek out the least volatile part of the market as they begin to gain greater comfort with an EM allocation.

The debt market has a more normalized return profile, he says. “It’s basically an upward line punctuated by some draw-downs, which are a reality in EMs – it’s basically an asset class punctuated by bouts of volatility. But that volatility is so much more significant with equities, and that’s something people need to wrap their heads around with EMs. Fixed income has a much better return profile and doesn’t suffer draw-downs anywhere near the scale of equities.”

As large institutional investors have been attracted by lower volatility, the resulting influx of money has stabilized the market in turn, Mr. Matthews explains.

“While you still have hedge funds and hot money elements in EMs, what you’re seeing more of is this constant ingress of new money that’s trying to move allocations from 5% to 10%, or 2% to 6%. We believe that this is a big shift that will influence how the market will behave going forward and likely result in reduced volatility and greater differentiation among EMs and the credits within them.”

Corporate credit is the fastest growing segment of the emerging markets fixed income asset class, with a market capitalization of about 72% of the US\$2.4 trillion EM debt market.

■ Focus on high-yield bonds

Although it invests in all kinds of EM debt, Vaquero specializes in high-yield bonds, an aspect of the asset class that remains largely overlooked.

“There are still very few investors going down the credit spectrum and looking at B and BB corporate credit, the real meaty, high-yield part of the corporate credit sector,” Mr. Matthews says. “For that you need highly experienced analysts, and there’s only about 40 of us globally who are doing it.”

Most of that expertise is found in developed markets, where investment managers have plied their trade since well before EM corporate credit caught on.

“One of the surprising things about our space is that local markets haven’t really produced analysts that can do what we’re doing,” he says. “In Mexico, for instance, there aren’t a lot of people doing hardcore corporate credit analysis. There’s a line of people outside Pemex’s door trying to figure out how to lend them another billion dollars, but if you’re a single-B telecom in Mexico, you don’t have a lot of options. So, contrary to what a lot of people would naturally believe, there’s really not a pool of skilled credit analysts rising from local markets.”

■ Deep analysis

Vaquero’s fundamental strategy is value-driven, Mr. Matthews says.

“We pick apart companies and look for ones that are trading below where they should be, getting high yields for high-quality companies.”

Corporates trade at a spread relative to the sovereign, he explains. Ratings agencies determine the ratings of each, with the sovereign’s rating typically marking a “ceiling” or the highest possible rating in a given country. He considers rating agencies just one perspective among many.

“I certainly don’t rely on their analysis to make my investments. We spend a lot of



time cracking numbers to figure out where we think the real ratings of a business are and determining if we think a company is underrated or overrated, and underpriced or overpriced – that’s the essence of our business. If we’re paying attention to our numbers, I tend to think we’re ahead of the curve.”

Analysis of many companies in a specific country gives Vaquero both a well-rounded understanding of the sovereign bond value and the value of individual company bonds, he explains. They look for attractive spreads between specific corporate bonds and sovereign bonds, while also comparing similar companies in different countries.

“That’s the general allure of our asset class: You can find attractive spreads both with corporates versus sovereigns and when comparing like for like – for instance, a BB credit in Mexico versus a BB credit in the US. With that example, more often than not you’ll see that the Mexican company is bigger than its US counterpart, has better credit metrics, and better experience riding out volatile markets. And to really judge a company, it’s not just about building a model and looking at credit metrics. It’s about knowing how they behaved in times of crisis.”

■ Playing off events

Event-driven dynamics are an important factor in EM credit investing, Mr. Matthews says, particularly political and economic developments that affect the corporate sector. Often crises create opportunities to find good but undervalued assets.

“In EMs, when you see a big sovereign blow up, you try to get in on the corporate side and find the babies that have been thrown out with the bathwater: things that are undervalued because of a general fear. For instance, in Russia, when things cool down and money is ready to look there again, there will probably be opportunities to buy cheap bonds in very high-quality companies.

He explains that the constant shift in country performance provides a wealth of opportunities for discerning investors.

“One of the interesting things about the market is that, if you’re looking at 40 countries, there’s always one on top and one on bottom, but no country is ever at the same level. For example, there’s going to be an opportunity in Venezuela soon. There’s a lot of debt that’s been issued not only by the sovereign but by

PDVSA, and I would argue that there’s a lot of hidden debt out there. And when people start to do the counting, the numbers are going to be a lot higher than many people think.”

Elsewhere in the region, he sees Mexico rising as Brazil stumbles.

“One of the most interesting opportunities in the last year has been to short Brazil versus Mexico. Brazil has the highest weighting in many of the indexes, but what you’ve seen there is a sort of serial dilution of the quality of management at every level. What were once highly professionalized ministries are now infiltrated by political hacks, and the reform process just kind of died – whereas reform needs to be a living, breathing thing. I also think there’s a lot of pent-up inflation that will come out through the currency. Mexico, on the other hand, has this great forward momentum with its reform, and it’s going to attract a lot of foreign investment. There are a lot of opportunities there.”

CLICK HERE

A Guide to Dairy Investment in Latin America

With an average growth rate of 5% a year, South American dairy production appears to be a strong market for investment, despite a certain degree of price and political instability.



According to a Food and Agriculture Organization (FAO) report, rising incomes and firm regional and international demand have favored dairy production growth in Latin America and the Caribbean. South American milk production expanded by over 5% in 2011 and a similar rate of increase was expected for 2012, with an output of 71 million tons.

The FAO report points to favorable pasture production and an optimistic outlook on the international market for dairy products as factors that led to increased investment in new technology and improved animal genetics.

“Agribusiness is made up of three major sectors: crops, cattle/meat and dairy,” notes Richard Peña, area manager, Latin America and the Caribbean (LAC) at dairy equipment provider Paul Mueller. “Dairy is a key component and in certain countries, the highest per hectare revenue producer. As an example, Uruguay dairy produces US\$900 of revenue per hectare, and this is compared to about US\$700 for soybeans and about US\$150 for cattle/meat production. Now, there are different production costs associated with this revenue stream. But dairy is usually the highest revenue producer in the Southern Cone countries per hectare.”

■ 20% returns

He explains that there are two types of dairy production companies in Latin America: listed food companies that sell dairy products as part of their consumer products portfolio; and private, mostly family-owned companies with a focus on dairy products, which are “ripe for private equity investors that can offer value added.”

“In the Southern Cone countries of Argentina, Brazil, Chile, and Uruguay you have a number of private equity investors from

Oceania and Europe investing significant funds into the dairy processing and dairy farming sectors,” Mr. Peña says.

“Olam from Singapore is present in the Southern Cone region, and their investment started at the dairy farm level with outside management running the farms. There are challenges to this type of investment, as Olam has found, and you need to understand the dairy business and the production cycle to make your investment profitable. But well managed dairy farms are seeing about 20% returns without land appreciation, and this is appealing to investors. And the processors are seeing even better returns than the farms.”

■ Price slump

Investors should be aware that global dairy prices have reached their lowest level since 2011. Rabobank recently cut its dairy commodity price forecast by as much as US\$950 a ton, pointing out that the slump in prices since February had taken values below levels it saw as “sustainable in the long term.”

But despite forecasting price recovery to take a long time, the bank expects world milk output to remain strong, with producer margins protected by low feed prices. “All signs suggest that a prolonged period of low prices will be required in order to clear the international market. Market rebalancing will be a slow process,” Rabobank said.

Mr. Peña agrees that, as in any international agribusiness endeavor, weather and pricing are risk factors. He explains that in South America dairy farming is directly correlated to the crop sector, and in particular to the soybean market.

“As soybeans continue to plunge in price, dairy becomes more attractive,”

he says. “The barrier to entry for dairy is that it takes more investment in equipment, dairy cows, and personnel to enter the space. But the difference in revenue per hectare with soybeans below US\$350 a ton is quite attractive for farmers and investors alike. The other limiting factor is that dairy takes more hands-on effort to manage the business than crops.”

■ Consumption

Global demand for dairy grows more and more each year, boosted by population growth, rising incomes, urbanization, and westernization of diets, particularly in developing countries such as China and India.

And while India recently overtook the European Union as the largest milk producer in the world (OECD), milk supply in China, as well as regions in Southeast Asia and Africa, is not keeping pace with this growth, leaving other milk producing regions – including South America – with the opportunity to meet increased demand.

Asia accounted for 34% of all dairy imports in 2011 – 53% of the world’s skim milk powder and 40% of the world’s whole milk powder imports. China alone reached 25% of the world’s milk demand by February 2014. But demand is also growing within Latin America, which bodes well for the future of the regional sector.

“Per capita consumption numbers are key to local production, which is the reason Argentina and Uruguay are the leading dairy producers in LAC,” Mr. Peña says. “You have over 200 kilos per capita of dairy consumption in Argentina and Uruguay. The average for the rest of the region is about 10-15 kilos per capita.”

“The good news is that as per capita income increases, more dairy consumption

will follow as we have seen in the Central America and Caribbean region. In the entire LAC area, dairy is a well received and a desired food choice seen by many emerging middle class consumers as healthy and an excellent value proposition. Today, dairy consumption is growing at about 2% over per capita GDP growth. And the consumption patterns are influenced by local tastes, with cheese being

Global demand for dairy grows more and more each year, boosted by population growth, rising incomes, urbanization, and westernization of diets, particularly in developing countries such as China and India.

the most consumed followed by ice cream in the region. Brazil and Mexico are major cheese buyers and are also large consumers of ice cream,” says Mr. Peña.

■ Political uncertainty

Another factor influencing the dairy market in South America is political uncertain-

ty in Brazil, Argentina, and Uruguay, three of the largest dairy producers in the region. Brazil’s presidential election is moving into a runoff on October 26 after incumbent president Dilma Rousseff failed to win the majority she needed to secure a second term against Aécio Neves on October 5.

According to Mr. Peña, neither candidate really knows how to lead Brazil out of recession. “Today, Neves is up by 10% over Rousseff. This lead is about the same as Brazil’s inflation rate year-to-date 2014, and neither Rousseff nor Neves has plans on how to contain it.”

“I was visiting with a very large farmer from the Rio Grande de Sul province last week and he told me that he is uncertain about future investment plans to keep growing. I asked him who he was going to vote for, and he said neither because they both had no idea of what it takes to manage an economy that is struggling. Now that is devastating,” he says on his website agribusinesslac.com.

October 26 will also be election day in Uruguay, with former president Tabaré Vasquez, as well as Luis Lacalle and Pedro Bordaberry all hoping to take over from current President Pepe Mujica. According to Mr. Peña, a victory for Vasquez would be the most negative result for the country’s agribusiness.

“The last two Frente Amplio (Vasquez’s party) governments did not create the needed policies to keep agribusiness growing. Currently, Uruguay finds itself becoming a developed economy but a very expensive place to invest and do business. All three candidates are facing a slowing economy after 10 years of incredible GDP growth fueled by the agribusiness sector. This strong financial performance is possible due to strong agribusiness exports, but

soybean will be US\$350 a ton by November. The question now is will the lower commodities prices slow GDP growth? Or will it be the Frente Amplio's higher land tax proposal?" he asks.

Meanwhile, Argentina's inflation rate just hit 41%, and most of the country's eco-

nomic sectors are in distress, but dairy remains an attractive investment. According to the USDA foreign agricultural service, despite the domestic economic uncertainties, Argentina's well-known natural conditions for dairy production make it very attractive for local and foreign investment. Argentine milk output for 2014 is expected

to reach 12.2 million tons, and investment is forecast at US\$221 million over the next two years, providing additional capacity to process 6.8 million liters a day.



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The most challenging projects that have come across my desk this year involve domiciling emerging and offshore funds and finding custodian partners in established trustworthy jurisdictions for the funds' daily operations. It may seem an easy task, but most banks in the US, UK, or Ireland will not be as friendly to your Argentina fixed income portfolio or your BVI small cap strategy fund as you'd like.

What the Fund?

■ Jonathan Rivas

I started this year working with several LatAm investment funds that needed a custodian bank or a clearing agent, tasks that could easily be accomplished within 30 days for any fund structured in the US, UK, or Ireland.

But why are custodians so cautious about any jurisdiction that is not a top 10 global financial hub? It is true that new regulatory changes worldwide are playing a significant role in banks being more selective regarding the clients they want to service. After working directly with banks in the selection and onboarding process, I have learned that in this case the biggest deal

breaker is fear of the unknown. Custody and trust bankers are simply not fully aware of rules, regulations, and restrictions that govern funds based in emerging markets or other offshore jurisdictions. As a fund manager or leader of your investment firm, it is your job to educate them. Below I outline some ice-breaking topics I discuss with custodian banks when onboarding my clients.

■ Speak the same language

If you are working with a bank outside your jurisdiction, learn the terms, rules, and regulations of the jurisdiction that will be

doing your safekeeping. Make sure your banker knows what your needs are by identifying them clearly. A custodian account, for example, might not have the same functionalities in the UK as it does in the US.

■ Explain your investment strategy and your growth potential

Custodial banking is fee-based, so any banker will be more inclined to help you if they can easily determine what assets they will be doing custody for, the number of annual trades to be executed, and the risks involved within the investment strategy.





main ones should include your client onboarding policy, AML policy, and privacy and reporting policy. You should consider adding policies required in other jurisdictions, as this may help you form a new relationship with a bank without affecting your core business strategy.

■ Form relationships

■ Draw a map of your jurisdiction

You should not assume that banks are fully aware of how funds in Uruguay are regulated, or the rules and restrictions faced by broker-dealers in Argentina, or the reporting requirements for a fund in New Zealand. Similar to a business plan, you should explain in writing the regulatory framework you are supervised under,

the similarities between your jurisdiction and a major investment hub, and the risks and rewards of working with a client from your jurisdiction. Most importantly, tell the bank why you can be such a great future client and partner.

■ Show your compliance cards

Be ready to share all the policies and procedures you will be following. Some of the

Chances are that if you are not managing a minimum of US\$50 million in your fund, top-tier banks will not be fighting over your business. The best relationships I have in banking are with mid-sized banks. These banks are big enough to have recognizable brands and can give you peace of mind about safekeeping, while at the same time small enough to understand that new business means growing together and finding solutions that work for both the client and the bank.



About the Author

Originally from Washington, D.C., Jonathan Rivas acts as Managing Partner of DCDB Group. He attended the Robert H. Smith School of Business at the University of Maryland, and is currently a member of the National Organization of Investment Professionals and the American Bankers Associations. He also holds FINRA Series 6 and 63 Investment Licenses.

Mr. Rivas brings over seven years of global financial experience to DCDB. He has held important positions at prestigious financial firms including Wells Fargo and BlackRock and served as Director of the WorkPlace Banking Division for PNC Financial Services Group in Washington, D.C. Mr. Rivas is fluent in Spanish and Portuguese and has a proficient level in Japanese.

Along with all his financial experience, Mr. Rivas brings his extensive knowledge of linking and globalizing businesses in the US, Europe and Latin America for the purposes of finance, investments, banking and new ventures. jonathan.rivas@dcdbgroup.com

Mapping Frontier Markets

A profile of LR Global

LR Global regularly receives offers to buy its proprietary frontier markets Research and Investment Database (R.A.I.D.) , and for a good reason: it contains effectively the entire universe of securities in frontier markets which have been systematically cleansed of missing or inaccurate data. This enables LR to organize information more efficiently and effectively resulting in an informational edge.

But it will be a long time before the New York-based asset manager agrees to give away what makes it unique.

“I am sure during the rough points in time it might have crossed their minds, but this is Don and Sean’s baby,” business development director Michael St.Germain explains.

Upon launching LR with Murray Logan in 1997 as an investment vehicle for Rockefeller & Co.(the Rockefeller family office), Jack Nash, and Leon Levy, he was one of the first institutional investors to explore markets such as Kazakhstan, Turkmenistan, Korea, and sub-Saharan Africa

– which at the time had received little to no attention.

Together they grew assets from US\$69 million to US\$150 million in five years, without any outside capital injection or the use of leverage. “It didn’t sit in any of the particular asset classes or tick any strategy box that most institutions and consultants were looking to invest in at that time. Murray hated benchmarks; he didn’t want to be compared to anything. He wanted to invest in unexplored markets where he could make heavy bets in undervalued opportunities,” adds Mr. St.Germain.

By 2006, assets had grown to just under US\$1 billion. But in the two years after

that, Mr. Logan and the fund’s three other seed investors all passed away, and LR had to go into redemption mode, liquidating approximately 50% of its assets back to the respective families’ estates.

That meant that LR was already in a fragile state when the global financial crisis hit, and by the end of 2009 Mr. LaGuardia and another ex-Rockefeller & Co. colleague, Sean Wilson, who joined the team when Logan was diagnosed with cancer, made the decision to close the fund and rethink its strategy. That was when the idea for RAID was born.

“The old fund had very opportunistic investment parameters, and although it did



very well over the long term, it also took a lot of big hits. It was that premise that predicated the institutional revolution of the process – they didn’t what to create a secondary fund that would permit the same scenarios,” Mr. St.Germain points out.

■ Building on experience

Realizing that their vision would require significant manpower, which is cost-prohibitive in major financial hubs like New York or London given the capacity constraints in frontier markets, LaGuardia and Wilson opened research centers first in Bangladesh then Vietnam, and proceeded to use their combined experience to strengthen their process and develop new

tools unique to these markets.

“They wanted to create an infrastructure that was the combination of the fifteen years of frontier experience they had at the time, taking into account lessons learned, good and bad and applying Sean’s institutional investment background in quantitative disciplines. There was an astronomical amount of information available, whether it be corporate earnings announcements, company specific news, economic reports, announcements about elections or political changes, which any portfolio manager needs to be made aware of to make a buy, sell, or a stay decision,” Mr. St.Germain notes.

“But we also found that roughly 30% of all

the publicly available corporate financial information either had missing or inaccurate information, such as balance sheets not balancing, income statements that weren’t adding up, or quarterly numbers that didn’t line up with the annual numbers,” he recalls.

To correct that, the duo opened a research center in Vietnam and hired about 30 people to process data under Mr. Wilson’s supervision. Database engineers created a series of programs to flag incorrect or missing information that notifies the analysts to manually research and find the correct data.

“After spending close to a year on essen-



tially purifying all this information, we now have what is effectively a database of the entire universe of securities in frontier markets, exempt of biases, and which also includes cross listings, dual listings, IPOs, pre-IPOs and external listings,” he adds.

■ Facilitation

According to Mr. St.Germain, the genesis of RAID was to act as a central repository to aggregate and organize information on countries, companies, and sectors that most managers can only take the time to obtain for their actual holdings. “It gives us an informational edge because we are able to do it so efficiently and effectively,” he says.

But the database also gives LR a more macro view of the political and economic landscape surrounding the companies it wants to invest in. The database contains economic data on 50-plus frontier markets countries and tracks political and election notifications and updates dynamically.

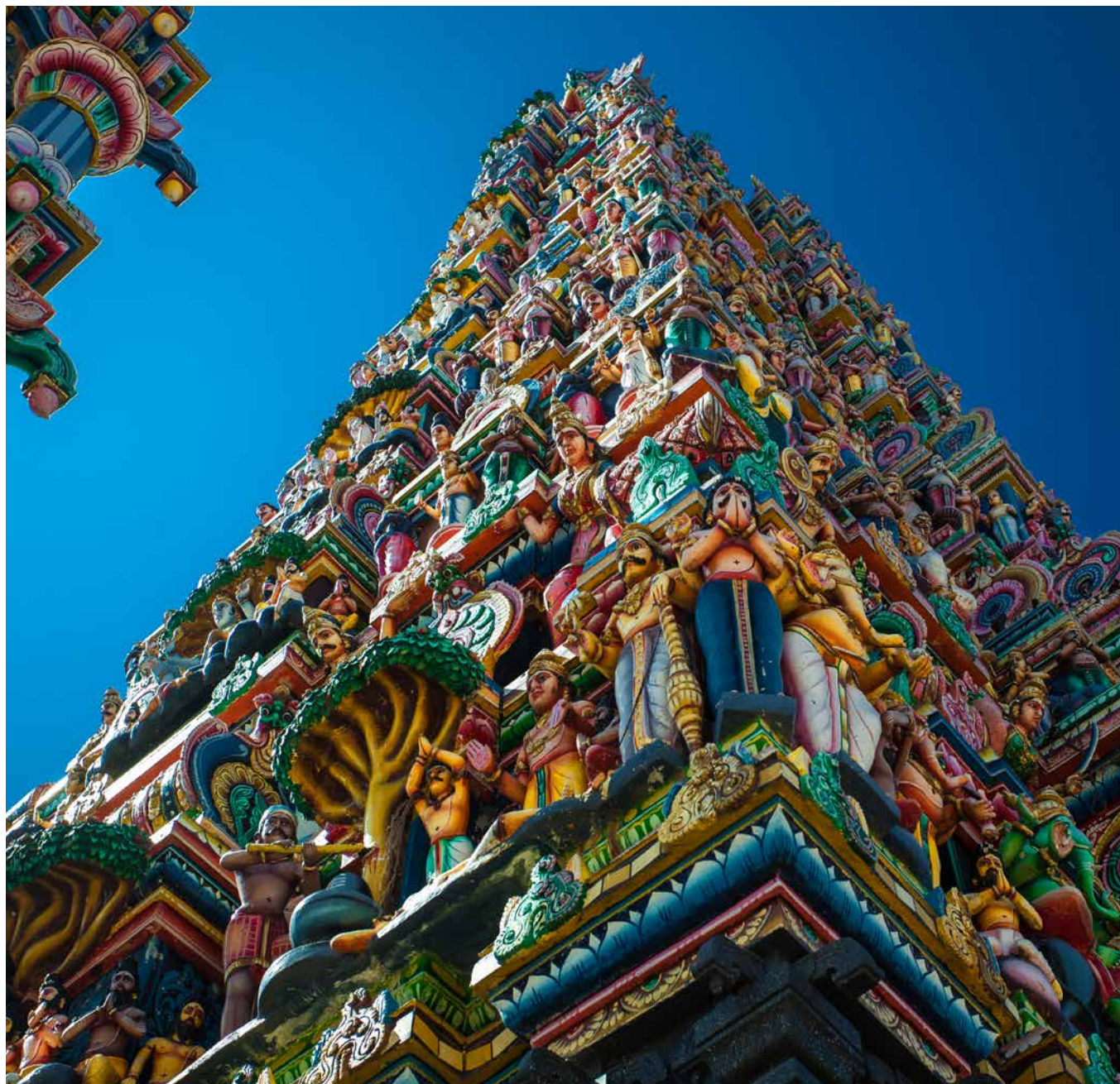
“We are bottom-up stock pickers, which is the bedrock of our investment strategy. But whether it is in a frontier, emerging or developed market – and it is probably more important in frontier markets – we need to be aware of the macro components.”

Nowadays the company sees RAID as an integral part of its equity strategy, which

utilizes bottom-up fundamental and quantitative analysis combined with top-down research. But it does not want to be confused with a quant fund, as the quantitative process, although a key tool, serves as an independent check that complements the valuation-biased fundamental analysis, which can be traced back to their roots at Rockefeller & Co., that the team has been conducting for years. “Our process uses the quantitative tools we designed as mere signposts to direct further research into prospective names and to ‘sanity check’ names in the portfolio, but they are not tools designed or engineered to be decision makers,” explains Mr. St.Germain.

LR combines the use of its database with





a fundamental analysis performed by its portfolio managers, who rank stocks from one to five based on their relative ranking of the stock to its sector peers. The score is based on both relative valuation and an ongoing understanding of the fundamental drivers affecting each company's sector and macro components in the country of interest.

"A lot of what we do is forward-looking, and the reason we spent two years scrubbing and aggregating all this data was to

introduce a quantitative, backward-looking discipline to the investment process. This effectively enables us to make a better holistic assessment of the risk/reward profile of any potential investment."

■ Methodology

Though others may have similar databases, LR believes RAID is more accurate and "clean" than information based primarily on data providers and other publicly available information, due to its proprietary approach.

The database makes it easier for the portfolio team and analysts to cover their respective sectors because they can review more accurate information through its efficient organization. The large and cost-effective staff available to LR enables them to obtain, review, and analyze more information than even most of the largest frontier managers have at their disposal. The research team in Hanoi can methodically scour the globe to update RAID with synthesized sell-side analysis, news reports, earnings calls, economic analysis, and a

host of other material. It also enables the development of proprietary, fundamentals-based sector-specific multi-factor models to quantitatively and independently rank each stock in the universe on a scale of one to five. Each sector's model uses only four to six simple factors. Each factor model was meticulously tested using RAID to measure a variety of factors' ability to determine stock performance. The factors used in each sector model have been selected because they have proven to be the most accurate and predictive indicators of future stock performance.

"Each sector's model uses a combination of factors related to valuation, profitability, growth, leverage, and risk (volatility), and some of the underlying factors are typical of all multi-factor models, such as price to book and net interest margins for banks. Others are more unique, like macro-economic indicators of the country that the security is listed in and a risk valuation based upon our proprietary theoretical option-based methodology," Mr. St.Germain points out.

Each sector model is different, and all areas have been meticulously constructed to reflect the various risks of individual industries and countries, but also their similarities. For example, telecoms and utilities were combined into one sector model, while Islamic banks had to be segregated from the banking segment because of their different business strategy.

LR doesn't invest in countries that are not included in its database, which is why the firm made sure to collect information on all the markets it was interested in before re-launching its strategy – though it now

has the manpower to systematically monitor and report all relevant economic, political, market, and financial information leveraging RAID, which is dynamically

"As increased awareness leads to heightened interest in frontier markets, it is important to consider that we have been successfully investing in these countries since 1997."

Don LaGuardia,
— *Managing Principal* —

updated for live updates and ease of access for LR's portfolio managers.

"On the surface, our strategy may appear like any other long-only frontier fund. However, what makes us unique is our institutionalized investment process that enables us to system-

atically monitor and analyze the full frontier markets opportunity set. The challenges in gathering and processing intelligence from over 50 diverse frontier markets are substantial. As one can imagine, there is a tremendous amount of moving parts when covering more than 50 markets. The constantly changing economic, political, industry and corporate dynamics all need to be identified and analyzed as to their potential impact on the portfolio and new opportunities. Without an infrastructure design to assimilate the continuous stream of news flow, a frontier manager is easily inundated with noise or must accept significant blind spots. Our solution to this informational challenge is to attack the challenge with numbers. The AUM constraints of the asset class place limitations on staffing a large team of research analysts out of New York or London. However, we have done as many multi-national corporates have in tapping the low-cost, but hard working and skilled labor available in frontier markets to build a team of analysts to help us tackle the informational challenges of the asset class. This team, based primarily out of Vietnam, has allowed us to build systems tailored to frontier markets well as an institutionalized investment process. Combining this infrastructure and process with the experience and network of relationships we have built up over the past 17-years of investing in frontier markets creates a unique investment proposition for our clients who are seeking frontier markets exposure that is more than a couple guys living out of a backpack looking for ideas.", says Sean Wilson, Managing Principal.

PROFILE

Debeaking the Vultures

■ Yao Yang

In the midst of the ongoing dispute between Argentina and the “vulture funds” that hold its bonds, a broad consensus has emerged concerning the need for sovereign debt restructuring mechanisms (SDRMs). Otherwise, US Federal Judge Thomas P. Griesa’s ruling that Argentina must pay the vultures in full (after 93% of other bondholders agreed to a restructuring) will give free rein to opportunistic behaviors that sabotage future restructurings.

Most recently, the International Capital Market Association (ICMA) recommended new terms for government bonds. Though the ICMA’s proposal leaves unresolved the hundreds of billions in bonds written under the old terms, the new framework says in effect that Griesa’s interpretation was wrong, and recognizes that leaving it in place would make restructuring impossible.

The ICMA’s proposed contractual terms clarify the *pari passu* clause that was at the heart of Griesa’s muddle-headed ruling. The intent of the clause – a standard component of sovereign bond contracts – was always to ensure that the issuing country treated identical bondholders identically. But it has always been recognized that senior creditors (for example, the International Monetary Fund) are treated differently.

Griesa did not seem to grasp the common understanding of the clause. After Argentina defaulted on its sovereign debt in 2001, vulture funds bought defaulted bonds in the secondary market at a fraction of their face value, and then sued for full payment. According to Griesa’s interpretation of

pari passu, if Argentina paid the interest that it owed to creditors that accepted the restructuring, it had to pay the vultures in full – including all past interest and the principal.

The vultures’ business was enabled in part by litigation over the so-called champerty defense – based on a longstanding English common-law doctrine, later adopted by US state legislatures, prohibiting the purchase of debt with the intent of bringing a lawsuit. Argentina is simply the latest victim in the vultures’ long legal battle to change the rules of the game to permit them to prey on poor countries seeking to restructure their debts.

In 1999, in *Elliot Associates, LP v. Banco de la Nacion and the Republic of Peru*, the Second Circuit Court of Appeals determined that the plaintiff’s intent in purchasing the discounted debt was to be paid in full or otherwise to sue. The court then ruled that Elliot’s intent, because it was contingent, did not meet the champerty requirement.

Though some other courts accepted the Second Circuit’s narrow reading of the champerty defense, the vultures were not



satisfied and went to the New York state legislature, which in 2004 effectively eliminated the defense of champerty concerning any debt purchase above US\$500,000. That decision contradicted understandings according to which hundreds of billions of dollars of debt had already been issued.

Investors who acquire defaulted sovereign debt at huge discounts should not expect repayment in full; the discount is an indi-

cation that the market does not expect that, and it is only through litigation that one could hope to receive anything close to it. An important change in the legal framework, such as the elimination of the champerty defense, is *de facto* a change in “property rights,” with the debtors losing, and creditors who purchase the bonds intending to sue if they are not paid what they want – the vultures – gaining. The vultures were thus unjustly enriched, dou-

bly so with the novel and unjustified interpretation of the *pari passu* clause.

Will so-called collective-action clauses (CACs) – another aspect of the ICMA “reform” aimed at debeking the vultures – save the day? In many countries, CACs stipulate that if, say, two-thirds of the investors accept a company’s (or a country’s) restructuring proposal, the other investors are bound to go along. This mechanism



prevents speculative holdouts from holding up the restructuring process and demanding ransom. But CACs do not exist for sovereign debt written in many jurisdictions, leaving the field open for the vultures.

Moreover, CACs are no panacea. If they were, there would be no need for domestic bankruptcy law, which spells out issues like precedence and fair treatment. But no government has found CACs adequate for resolving domestic restructuring. So why should we think that they would suffice in the much more complex world of sovereign-debt restructurings?

In particular, CACs suffer from the problem of “aggregation.” If a CAC required, say, 75% of the holders of each bond class, vultures could buy 26% of only one bond class and block the entire restructuring. The recent Greek debt restructuring had to confront this issue.

The ICMA’s new framework seems to provide a way out: The supermajority would be defined by the acceptance of the aggregate principal amount of outstanding debt

securities of all of the affected series. The supermajority’s decisions would be binding on all other investors.

But this, too, poses a problem: The more junior creditors could vote to have themselves treated in the same way as more senior creditors. What recourse would the senior creditors then have? In bankruptcy court they would have grounds for objecting, and the judge would have to weigh the equities.

These issues are especially important in the context of sovereign debt restructurings, because the claimants to a country’s resources include not only formal creditors; others, too – for example, pensioners – might not be paid if bondholders are paid in full. Chapter 9 of the US Bankruptcy Code (which applies to public entities) recognizes these rights – unlike Griesa and the vultures.

Today, the international community faces two challenges. One is to deal with the hundreds of billions of dollars of debt written under the old terms, which can-

not be restructured under Griesa’s ruling. The second is to decide on the terms that should be imposed in the future.

The investing community has made a serious proposal. But changes of this magnitude must be based on discussions among creditors and debtor governments – and more is needed than tweaking the terms of the agreements.

An initiative at the United Nations to encourage the establishment of SDRMs is receiving the support of prominent academic economists and practitioners. Global efforts are good first steps to remedy the damage to international financial markets that the US courts have inflicted. For the sake of a healthy global economy, the vultures must be grounded.

About the Author

Yao Yang is Dean of the National School of Development and Director of the China Center for Economic Research at Peking University.





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Africa Beyond Ebola

■ Ana Palacio

Among this summer's grave global worries, the spread of the Ebola virus has monopolized the discussion of sub-Saharan Africa and reinvigorated hoary notions of disorder and despair – at a time when a new image of a dynamic Africa was emerging. In fact, there is still strong reason for optimism about the region's prospects.

The Ebola outbreak overshadowed three key events affecting the region. On July 1, a major organizational restructuring at the World Bank Group was implemented. Two weeks later, the BRICS (Brazil, Russia, India, China, and South Africa) announced the establishment of

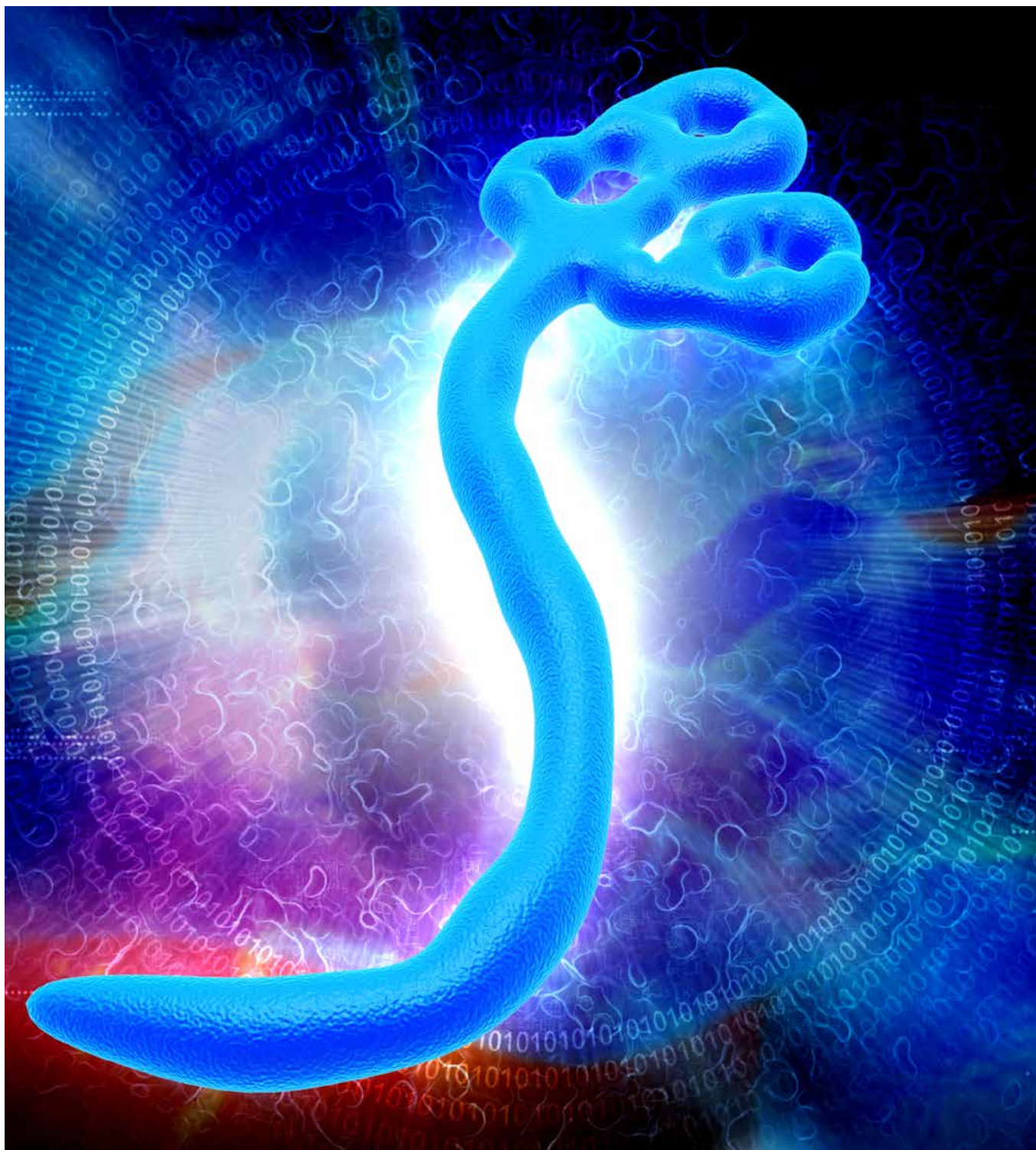
the New Development Bank. And in early August, African government and business leaders gathered in Washington for a summit that could portend transformative private investment in Africa.

Such investment is essential in a world in which net private capital flows to develop-

ing countries outstrip official development assistance by a margin of ten to one. If this is to be a turning point for Africa rather than another false dawn, this summer must be the start of a prolonged effort to stimulate private-sector engagement.

The reorganization of the World Bank is a central part of a larger effort under its president, Jim Yong Kim, to reposition the Bank as a facilitator *vis-à-vis* the private sector, rather than a primary provider. From 2009 to 2013, new investment commitments by the International Finance Corporation, the World Bank's private-sector lending arm, have risen 73%. Meanwhile, the Multilateral Investment Guarantee Agency, the Bank's provider of political risk insurance covering investments in developing countries, has moved to expand its activities,





both by broadening the types of projects that it supports and widening existing definitions to allow greater coverage.

July's restructuring occurs in the context of these broader moves. In reorganizing the World Bank Group's central component, the International Bank for Reconstruc-

tion and Development, Kim has adopted a management consulting model that unites expertise with regional coverage. Seeking to eliminate the bureaucratic "silos" that have isolated regional experts from one another, 14 global practice groups in areas such as energy, water, and education have been established to bring to bear the full

force of the World Bank's considerable knowledge on projects and partnerships.

Just as the World Bank was repositioning itself, the BRICS agreed to establish their own bank. There are significant outstanding issues about how the New Development Bank will operate, but early indica-

tions suggest that infrastructure will be central to its activities, with an emphasis on Africa.

The World Bank estimates that insufficient infrastructure reduces productivity in Africa by approximately 40%. The entrance of a new player with initial authorized capital of US\$100 billion – along with the United States' Power Africa program, which has garnered US\$26 billion in commitments since its launch last year, and the World Bank's new Global Infrastructure Facility – promises to help ease infrastructure financing significantly.

But, as of now, the New Development Bank is little more than a statement of political solidarity, and whether it comes into existence remains to be seen. Even if it does begin to function, the BRICS lack what gives development banks, and the World Bank in particular, legitimacy and weight: a staff composed mostly of dedicated experts who are among the world's best.

Finally, the high profile of the US-Africa Leaders Summit, with more than 40 heads

of state in attendance, as well as President Barack Obama's direct involvement, generated buzz about Africa. US businesses and investors certainly gained more awareness about Africa's potential and a deeper understanding of the variety of investment climates throughout the continent.

But, though the summit may be called a success, its long-term implications are unclear, particularly given the uncertainty about what will follow. At the moment, there does not seem to be a plan to institutionalize the summit.

Moreover, the participation of so many heads of state overshadowed that of African business leaders. The practical connections that US companies will need when deciding whether to invest could have been cultivated on the summit's margins, or in its aftermath, but were not. Laying a foundation for future engagement requires ongoing commitment and effort that goes beyond mere publicity.

The same could be said about the World Bank. There is much work to be done in integrating the new organizational model

with existing Bank structures and practice areas. Even if this transition occurs seamlessly, the Bank faces a serious internal struggle against entrenched bureaucratic interests and a pervasive institutional mindset that is overly risk-averse and fixates on processes rather than outcomes.

In recent years, Africa, once a land of pity, has emerged as a land of opportunity. If it is to become a land of performance, the goal must be to facilitate investment, both domestic and foreign. That will demand effort and commitment; given that a stable international order increasingly depends on a prosperous and growing Africa, it is a goal that the world cannot afford to miss.

About the Author

Ana Palacio, a former Spanish foreign minister and former Senior Vice President of the World Bank, is a member of the Spanish Council of State and a visiting lecturer at Georgetown University.

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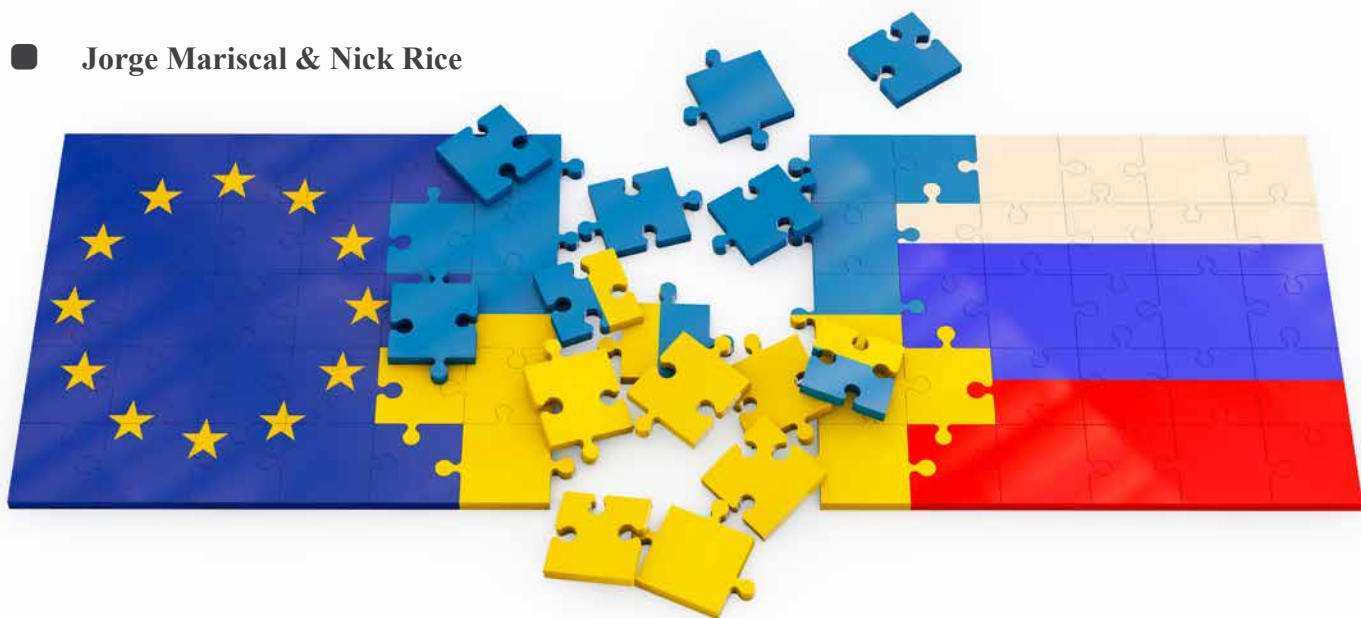
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‘Whatever It Takes’ in Ukraine

■ Jorge Mariscal & Nick Rice



Europe’s efforts to revive its flagging economy and confront the crisis in Ukraine may seem to be two entirely separate challenges. But policymakers, struggling to contain Russian designs and find an acceptable long-term settlement on the European Union’s eastern borders, could learn a lot from the way that European Central Bank President Mario Draghi has managed to stabilize the eurozone economy.

In early September, Draghi repeated his pledge “to do whatever it takes” to keep the eurozone functioning, announcing more innovative measures to revive the currency union. Although Draghi has not implemented the sort of far-reaching monetary-policy measures witnessed in the United States over the past six years, his approach nonetheless provides European leaders with some valuable lessons in policymaking, espe-

cially when faced with clashing national interests. Similarly, when it comes to marshaling a united approach to the Ukraine crisis, EU leaders could do worse than adopting the Draghi approach.

The first lesson of that approach is simple: Do not compromise on the essentials. This was demonstrated by Draghi's original 2012 "whatever it takes" pledge to place a floor under the eurozone crisis, thereby creating the bedrock for recovery. Similar considerations are at play in Ukraine. Russia has clearly shown how far *it* will go to keep Ukraine within its sphere of influence, and prevent Ukraine from following Estonia, Latvia, and Lithuania into the EU and – more importantly – NATO. Europe needs to show that it, too, will do whatever it takes to defend Ukraine's territorial integrity and prevent Russia from weakening and subordinating its neighbor. This may then set the tone for an agreement.

To achieve this goal, the EU must learn Draghi's second lesson: pre-empt rather than react (which becomes even more important in the context of the current tenuous cease-fire). Instead of improvising sanctions in a belated response to Russian intervention in Ukraine, Europe should draw clear lines and set out concrete, effective punishments if those lines are breached. Tough rhetoric but moderate sanctions will not work. Draghi's announcement in 2012 of the ECB's "outright monetary transactions" program backed his bold pledge, restoring confidence so quickly that the OMT scheme never had to be deployed.

To unite Europe's disparate interests behind such measures, policymakers should heed Draghi's third lesson: Show leadership on issues that are not in dispute, and then mollify dissenters on marginal questions so that they, too, fully support the main strategy. Despite Germany's opposition to the OMT policy, Draghi united the

eurozone's rival core and periphery countries by focusing on their one undisputed common goal – the preservation of the euro. As a result, he was able to present a common-sense plan to achieve it.

Europe's national wrangling during the eurozone crisis is echoed in the discordant negotiations over sanctions on Russia. The differences might be overcome if the EU's major powers, along with some independent voices, were to forge a common front based on a single, non-negotiable point – the principle of territorial integrity. Those EU leaders might then find it easier to rally the rest of the EU around other common-sense measures, thereby creating a united and credible front against Russia.

In addition, Draghi kept some of his powder dry in case new threats emerged. For example, earlier this month he announced asset purchases in response to low eurozone inflation. Draghi has proved that a comprehensive, pre-announced plan does not require deploying all of one's firepower at once.

If the EU shows that it will do whatever it takes to prevent Ukraine from sliding toward the Russian-dominated Eurasian Union while also acknowledging Russia's own determination to check NATO and EU eastern expansion, Ukraine will have a chance of gaining a lasting peace. In 2008, after all sides recognized that Russia's attack on Georgia had ended Georgia's hope of joining NATO, Russian interference and domestic instability waned. Georgia even signed an EU Association Agreement earlier this year.

A least-bad scenario for Ukraine might resemble Georgia's position, but only if European policymakers learn from and act upon Draghi's lessons. While taking Russia's strategic interests into consideration, the EU should also threaten to hit Russia's

economy hard, using both the carrot and the stick to persuade Russian President Vladimir Putin to agree to a lasting solution. Putin's popularity rests on maintaining national pride and prosperity. If the EU were forced to carry out its threats, Russia's economy would suffer far more than Europe's (although this assumes that Russia would care as much about such hardships).

In any event, hardships suffered by EU citizens could be lessened if the eurozone followed Draghi's final prescription – providing more fiscal and monetary stimulus in some areas to offset reform and fiscal consolidation in others. By selectively addressing the most dangerous risks, Draghi was able to minimize them. Policymakers should do the same when it comes to sanctions against Russia, mitigating their impact on those Europeans who stand to suffer the most.

European policymakers have the tools and the intelligence to retain influence in Ukraine. If they look to the ECB, they will find the right model for deploying them.

About the Authors

Jorge Mariscal is Emerging Markets Chief Investment Officer at UBS Wealth Management.

Nick Rice is Executive Director in the Chief Investment Office at UBS Wealth Management.

Should Venezuela Default?

■ Ricardo Hausmann & Miguel Angel Santos

Will Venezuela default on its foreign bonds? Markets fear that it might. That is why Venezuelan bonds pay over 11 percentage points more than US Treasuries, which is 12 times more than Mexico, four times more than Nigeria, and double what Bolivia pays. Last May, when Venezuela made a US\$5 billion private placement of ten-year bonds with a 6% coupon, it effectively had to give a 40% discount, leaving it with barely US\$3 billion. The extra US\$2 billion that it will have to pay in ten years is the compensation that investors demand for the likelihood of default, in excess of the already hefty coupon.

Venezuela's government needs to pay US\$5.2 billion in early October. Will it? Does it have the cash on hand? Will it raise the money by hurriedly selling CITGO, now wholly owned by Venezuela's state oil company, PDVSA? A different question is whether Venezuela *should* pay. Granted, what governments

should do and what they will do are not always independent questions, because people often do what they should. But "should" questions involve some kind of moral judgment that is not central to "will" questions, which makes them more complex.

One point of view holds that if you can make good on your commitments, then that is what you should do. That is what most parents teach their children.

But the moral calculus becomes a bit more intricate when you cannot make good on all of your commitments and have to decide which to honor and which to avoid. To date, under former President Hugo Chávez and his successor, Nicolás Maduro, Venezuela has opted to service its foreign bonds, many of which are held by well-connected wealthy Venezuelans.

Yordano, a popular Venezuelan singer, probably would have a different set of





priorities. He was diagnosed with cancer earlier this year and had to launch a social media campaign to locate the drugs that his treatment required. Severe shortages of life-saving drugs in Venezuela are a result of the government's default on a US\$3.5 billion bill for pharmaceutical imports.

A similar situation prevails throughout the rest of the economy. Payment arrears on food imports amount to US\$2.4 billion, leading to a substantial shortage of staple goods. In the automobile sector the default exceeds US\$3 billion, leading to a collapse in transport services as a result of a lack of spare parts. Airline companies are owed US\$3.7 billion, causing many to suspend activities and cutting overall service by half.

In Venezuela, importers must wait six months after goods have cleared customs to buy previously authorized dollars. But the government has opted to default on these obligations too, leaving importers with a lot of useless local currency. For a while, credit from foreign suppliers and headquarters made up for the lack of access to foreign currency. Given mounting arrears and massive devaluations, credit has dried up.

The list of defaults goes on and on. Venezuela has defaulted on PDVSA's suppliers, contractors, and joint-venture partners, causing oil exports to fall by 45% relative to 1997 and production to amount to about half what the 2005 plan had projected for 2012.

In addition, Venezuela's central bank has defaulted on its obligation to maintain price stability by nearly quadrupling the money supply in 24 months, which has resulted in a 90% decline in the bolivar's value on the black market and the world's highest inflation rate. To add insult to injury, since May the central bank has de-

faulted on its obligation to publish inflation and other statistics.

Venezuela functions with four exchange rates, with the difference between the strongest and the weakest at a factor of 13. Unsurprisingly, currency arbitrage has propelled Venezuela to the top ranks of global corruption indicators.

All of this chaos is the consequence of a massive fiscal deficit that is being financed by out-of-control money creation, financial repression, and mounting defaults – despite a budget windfall from US\$100-a-barrel oil. Instead of fixing the problem, Maduro's government has decided to complement ineffective exchange and price controls with measures like closing borders to stop smuggling and fingerprinting shoppers to prevent “hoarding.” This constitutes a default on Venezuelans' most basic freedoms, which Bolivia, Ecuador, and Nicaragua – three ideologically similar countries that have a single exchange rate and single-digit inflation – have managed to preserve.

So, *should* Venezuela default on its foreign bonds? If the authorities adopted common-sense policies and sought support from the International Monetary Fund and other multilateral lenders, as most troubled countries tend to do, they would rightly be told to default on the country's debts. That way, the burden of adjustment would be shared with other creditors, as has occurred in Greece, and the economy would gain time to recover, particularly as investments in the world's largest oil reserves began to bear fruit. Bondholders would be wise to exchange their current bonds for longer-dated instruments that would benefit from the upturn.

None of this will happen under Maduro's government, which lacks the capacity, po-

litical capital, and will to move in this direction. But the fact that his administration has chosen to default on 30 million Venezuelans, rather than on Wall Street, is not a sign of its moral rectitude. It is a signal of its moral bankruptcy.

About the Authors

Ricardo Hausmann, a former minister of planning of Venezuela and former Chief Economist of the Inter-American Development Bank, is Professor of the Practice of Economic Development at Harvard University, where he is also Director of the Center for International Development.

Miguel Angel Santos is a senior research fellow at Harvard's Center for International Development.



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Brazil Imposes Ban on Privacy Apps

■ Adler Martins

I have recently been to Moscow for the first time. The city is lovely and the people warm. In spite of all the beauty, I couldn't help but notice an article in the Moscow Times that mentioned Russia's plans to make its internet sovereign and less dependent on Western servers. The article also mentioned the worries of specialists, who said this program could be used to bolster government control over the internet.



The article briefly mentions that, according to Russian law, all internet companies collecting personal information from Russian citizens are obliged to store that data inside the country.

This has caught my attention, since a similar provision was debated when the Brazilian Congress was discussing the new internet law (Marco Civil da Internet). In the end the provision for mandatory storage of data inside of the country was defeated. Nevertheless, the proposal shows that Brazilian legislators have been influenced by other large developing countries when formulating internet policies.

This bias toward government control can be easily seen in a recent judicial decision, in which a Brazilian judge effectively banned the use and sale of mobile applications allowing the private exchange of messages without identification of the users. The apps in questions were called “Secret” and “Cryptic.”

The lawsuit was filed by the Public Prosecutor’s office in Espirito Santo State, following a series of complaints of breach of privacy, abuse, and even exchange of illegal pornography.

The Brazilian judge based his decision on an article of the Brazilian constitution that deals with free speech. The article protects

free speech but prohibits anonymity and the publication of anonymous statements.

To make the decision effective, the judge ordered Apple, Google, and Microsoft (which were plaintiffs in the lawsuit) to remove the apps from the mobile phones of its Brazilian users. The decision has been executed by the companies and the apps were, in fact, deleted from many cell phones or otherwise blocked.

The harshness of the decision and the speed of its implementation have raised questions about the protection of free speech in Brazil and about the vulnerability of Brazilian internet systems to government controls.

On the first topic, I must say that the rationale used in the decision deserves criticism. The judge mentioned in his decision that “free speech is not absolute.” This statement, true as it may be according to Brazilian law, has been used several times by other courts in the country to justify the censorship of movies, political propaganda, and books. The judge further elaborated his reasoning by saying that the constitutional ban on anonymity would prevent a social network or app based on the concept of exchange of anonymous messages. But this justification fails to consider innumerable instances in which anonymity is embraced and even encouraged in Brazil, and that are not subject to scrutiny of constitutional challenge. These include the presentation of anonymous criminal complaints and the use of anonymous sources by journalists. Also, it is common knowledge that some computer programs allow anonymity while browsing the web.

Regarding the expansion of government control over the internet, this decision is a good example of the new Brazilian internet law put to use. The example is imperfect, since the judge did not explicitly cite the “Marco Civil da Internet” in the deci-



sion. Even so, the Marco Civil provides a framework for administrative and judicial control of the internet that will make the enforcement of similar decisions much easier in the future. This is because Brazilian internet law subjects internet providers (and not only technology companies such as Google) to heavy penalties if they do not comply with government decisions. The penalties may include, in theory, the prohibition of providing internet connection to users.

Furthermore, Brazilian internet law allows the imposition of fines on foreign companies that control Brazilian subsidiaries. This means that the Brazilian judiciary may impose fines on Microsoft in the US, not only Microsoft's subsidiary in Brazil.

If you put together the powers made available to the Brazilian government and judiciary and the inspiration of the Brazilian

About the Author

Adler Martins is a Law graduate from one of Brazil's greatest Law Schools: The Federal University of Minas Gerais (UFMG). He is also a MBA by Fundação Getúlio Vargas. Presently attending Masters Course credits (LLM) at Pontifical Catholic University of Minas Gerais and a Post Graduation Course in Financial Planning at São Paulo City University. He can speak English, Spanish, Portuguese, German and some Chinese [Mandarin]. Mr. Martins has working experience in Argentina, Mexico, India, England, China and Dubai, aside from extensive experience in Brazil.

He is the co-founder of UFMG's group on the study of International Trade Law (GEDI-CI) and has represented UFMG at the Vis Arbitration Moot, in Austria. He is also a pioneer in legal research of contracts among Brazil, Russia, India and China.

Mr. Martins has lectured on Foreign Investment Regulation in Brazil to audiences in Brazil and India. Recently, he lectured about Brazilian Import Regulations at the Ecommerce expo 2011, in London, as a guest speaker. Currently, he works advising companies and entrepreneurs on how to do business in Brazil.

internet law, it is easy to see that Brazil's internet is becoming less and less a safe

place for users to express their thoughts. Freedom of speech is imperiled in Brazil.



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■ Javier Canosa

(Over) Regulation of the (Financial) Markets

Is It Working? Where Are We Going?

In recent years we have seen an increase in the regulation in the markets in general and in the financial markets in particular. Many legislative initiatives have been initiated, such as Sarbanes-Oxley in the US, initiatives of Organization for Economic Cooperation and Development like the Financial Action Task Force, and various rules implemented in different international financial centers. Is this approach really working? Has the public in general benefited from these regulations? Have the economies benefited from this increase in regulation?

In order to approach a possible answer, we will focus on the case of Argentina, a country that has shifted from a relatively liberal economy to a highly regulated economy in the past decade.

■ Exchange controls

In October 2011 Argentina imposed exchange controls. This move was intended

to prevent money laundering, and it began with the tax authorities requiring the filing of certain forms and documents in order to allow the purchase of foreign currency by Argentine residents. The regulation was implemented as a consequence of commitments agreed to by Argentina under the FATF. Any Argentine resident who wanted to purchase foreign currency had to request authorization from the tax authorities and establish the origin of the funds.

After this measure was imposed, Argentines who wanted to purchase foreign currency (mainly US dollars) went running to the banks to file the required forms in order to obtain approval for the purchase of foreign currency. Most of the transactions were rejected by the tax authorities, and the issue became public when a famous TV personality commented on the air that although she had substantial income, the tax authori-



ties had rejected her request to purchase foreign currency.

In addition, there were no clear standards as to who would be authorized and who would not. In fact, one officer of the tax authorities stated that “it is not the Coca-cola formula, but it is very similar,” and that “it is a formula that changes periodically, it has ingredients of the Central Bank, of the tax authorities and other ingredients put forth by God.”

Of course, the system was evolving, and this obviously had consequences. The first consequence: a black market for the US dollar. When these regulations and requirements did not exist, there was no difference between the official and the unofficial rates of exchange, but as soon as the regulation was imposed, a black market was created. Before the regulations were imposed the dollar was exchanged at 4.15 pesos per dollar. When the regulations were imposed (October

2011) the dollar was exchanged at 4.28 pesos per dollar and the unofficial exchange rate was 4.67.

The gap between the official and the unofficial rates varies according to the time and measures imposed between a difference of 50% and 78%. Currently, the official rate is 8.40 pesos per dollar for the official rate and 14.70 pesos per dollar for the unofficial rate.



Other consequences: people started withdrawing money from ATMs overseas. The response of the government was more regulation: you could no longer withdraw money with debit cards. More consequences: people started withdrawing cash from credit cards. Consequently, the government set up a limit on withdrawing money using credit cards overseas.

Then they said, wait, why don't we discourage the legal purchase of foreign mon-

ey by taxing it? So they introduced a 20% withholding tax on money spent on credit cards overseas, but soon 20% was not enough because the difference between the official and the black market rates was too big, so they increased that to 35%. (They could not increase this further because it would have exceeded the highest rate of income tax at 35%.)

These measures were imposed with the aim of preventing money laundering and avoid-

ing FATF sanctions. Did the government manage to do this? Not really. Argentina is still on the FATF gray list. In the mutual evaluation report of the FATF Argentina was rated non-compliant (NC) or partially compliant (PC) on all of the core and key recommendations of the FATF. As a result of this lack of compliance with the core and key recommendations, the FATF Plenary placed Argentina in an enhanced follow-up process. The follow-up process is a desk-based review that monitors whether a country takes

the necessary steps to strengthen its AML/CFT framework. Thus far, Argentina has not addressed all the issues raised by the FATF.

But one could argue that in fact the exchange regulations were imposed to protect the reserves of foreign currency in the Central Bank, to prevent inflation, and to prevent a run on the peso.

Let us see the consequences:

- Reserves of the Argentine Central Bank when the regulations were imposed (October 2011) were US\$47,523 million; now (September 2014) they are at US\$28,385 million.
- Inflation (according to private reliable sources) in 2011 was 22.80% and in 2014 it will be 40.8%; and
- The peso was at 4.28 per dollar in October 2011 and is now (September 2014) at 8.40 per dollar.

■ Restrictions on international trade

We have seen that government regulation does not always serve its direct or indirect purposes. We have seen the case of exchange controls that were imposed with the stated goal of preventing money laundering (and indirectly, to preserve reserves, control inflation and prevent a run

on the peso). We saw that none of those purposes was accomplished.

There is another area into which the Argentine government decided to intervene and regulate in order to improve it, and that is the international trade sector.

Again, in January 2012 the Argentine tax authorities provided for an “informative” system called “Anticipated Sworn Statement for Imports” or “DJAI.” This system provides that before importing any goods (or services) into Argentina, importers have to make a filing with the tax authorities in order to proceed with the relevant import.

It is still unclear what was the actual purpose of this regulation. The regulation states that its purpose is “insuring and facilitating world trade through the anticipation of information in order to obtain transversal coordination of the different areas of the government, which will optimize efficiency in the government’s affairs.” In spite of this nice declaration of principles, nothing of the kind has happened. This regulation has caused imports to fall sharply in 2012-2014, which resulted in a very significant reduction in exports of manufactured goods.

We have to admit that in the case of Argentina, excessive regulation was in fact

disguising economic measures of another type, so as a matter of fact the regulation was aiming at something different.

■ Excessive regulation

This debate is very current, and it is important to have it. In fact, there are some laws that will be approved soon in Argentina aiming at more and more government intervention and regulation, and the results may be the same as those noted above.

There are currently three legislative proposals that will provide for more power and intervention by the government in the lives of its citizens. I refer to the law for the establishment of courts for consumers, the law that creates an “observatory of prices and services,” and the amendment to the “supply” law. These pieces of legislation will enable the government to intervene with companies in the setting of prices.

But the real debate is whether these laws really work or if, in fact, they provide an opportunity for corruption and government abuse. We prefer “government abuse” to corruption, because in fact every act of corruption is an abusive use of the power or funds of the government.

Country	Ease of Doing Business Rank	Corruption Index (Transparency International)
Chile	34	22
Venezuela	181	160
Uruguay	85	19
Argentina	126	106
Peru	39	83
Bolivia	162	106



The question then is whether there is a relationship between excessive regulation and government abuse. Let us take six Latin American countries in order to see whether this is an issue and, if so, whether this a particularly Latin American issue.

Consider Chile, Venezuela, Uruguay, Argentina, Peru and Bolivia. We will also use two widely accepted indexes for the ease of doing business for 2014 (or the less regulated economy) and the corruption index of Transparency International (latest available for 2013).

Paradoxes of the regulation, or in fact a clear-cut relationship between government abuse and government regulation?



About the Author

Javier Canosa is a partner in the BA firm Canosa Abogados. his practice develops in corporate law issues, advising several national and foreign companies in various corporate matters, including investment vehicles, corporate management, directors' duties and responsibilities, audits, risks detection and distribution, documents, policies and corporate contracts, and design and implementation of a suitable corporate form for each business.

Canosa Abogados – Montevideo 711 4th Floor – C1019ABO – Buenos Aires -Argentina Tel: 54 11 5252 2462 and Fax: 54 11 5252 2463
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Zimbabwe

Current State of Political Risk

■ James Knight

In mid-September one of the world's best platinum resources was declared open for business. The Darwendale mine, in Zimbabwe, expects to receive US\$3 billion of investment, making it the largest FDI project in the country.

Who is backing it? A complicated co-venture involving three Russian parties, the Zimbabwean government, and Zimbabwean private investors. Once production starts in 2017, it anticipates production of 600,000 ounces a year, and direct employment for 8,000 people.

Current forecasts put the precious metal at an all-time high of US\$1,800 per ounce by 2017, creating an annual turnover of US\$1.08 billion. That's a sizeable slice of a GDP that was less than US\$13 billion in 2013.

A Russian delegation was also in Argentina earlier in the year, hot on the heels of a Chinese visit, trying to mop up some of the deals their predecessors had passed on. Meanwhile, Malaysian oil major Petronas announced its own entry to the much-prized Vaca Muerta shale asset in Neuquen province, one of the hottest plays in the world right now, promising US\$457 million of investment. This follows Chevron's commitment to invest US\$1.24 billion in 2013 for another part of the same field.

Zimbabwe, Argentina. Very different places, with well-deserved reputations for difficulty of enforcing contracts, protecting assets, or independent judicial recourse. Neither is a stranger to inflation, or charged political rhetoric that demonizes Washington Consensus-led conspiracies. But both are blessed with enormous agricultural and mineral resources – Zimbabwe was known as the “bread basket” of Africa; Argentina's soy and beef are the envy of the world. Zimbabwe has diamonds and platinum; Argentina has gold, copper and lithium.

■ Political drivers of change

With elections in both countries next year, their respective charms are becoming too attractive to ignore. What is sure is that change is coming: in Argentina, current President Cristina Fernandez de Kirchner cannot stand for a third consecutive term. Robert



Mugabe's longevity seems almost boundless, but as age and illness stalk him talk of succession is, if not being openly discussed, an issue that is gaining traction.

Frustrated by the narrative that dominates in the west, both countries have turned elsewhere to woo investors and bring in desperately needed foreign exchange. Russia and China are full of

state-owned companies operating for strategic rather than financial benefit, not beholden to shareholders or corporate governance regulations in the same way as their western competitors, which often puts them at an advantage in frontier markets.

However, with global capital beginning to flow again, and low yields continuing in more established markets, it does seem as



though some participants are waking up to the fact that maybe, just maybe, the time for the smart money to pile in is now, when assets are going to be far more attractively priced than in another six or twelve months. This is based on the assumption that while the bottom may not have been scraped yet in either country, the reasonable expectation is that an election holds a brighter future for both.

■ Think creatively

Plenty of imagination is on show from those who are braving these markets. Look at former Goldman Sachs trader Russell Abrams, who is now shelling out on taxi cab licences in Buenos Aires in the expectation that the value of the asset class will rise. Zimbabwe is a less sophisticated market, but the Soros Economic Development Fund is active, focusing on improving productivity of smallholder farmers, as no large-scale agriculture is left in the country. The country's tourism offering remains a huge potential revenue-generator. Both countries can count on dynamic domestic entrepreneurs who are successful precisely because, not in spite, of having to deal with crisis on a daily basis – I'm thinking of Strive Masiwa, or Gustavo Grobocopatel, for example. What better local partners could one hope for?

Of course, potential investors need to tread carefully. These markets are on the edge of the investment map for a reason, and not for the faint of heart: Zimbabwe is still, technically, ostracized, with EU sanctions in place on key officials (although the expectation is that they will be relaxed before the end of the year). Argentina is isolated from international capital markets, and has technically defaulted this year; it is fighting against the clock to come up with a settlement with its international creditors before the end of the year that will not jeopardize its existing obligations.

Therefore, identifying the right local partners, and the risks, will be key. But the fact is that the bargains are too attractive for money to stay away forever. For those who choose to see things differently, these are exactly the kind of places one should be looking, rather than the frothier pools in which everyone else is swimming, for true value investments.



About the Author

James Knight is a consultant with ten years' experience of working in and with emerging market countries. He is Director of Pionero Partners, a UK-based risk and strategic advisory consultancy serving international clients. He previously handled projects for Barclays Bank plc, the World Bank, and the United Nations. He started his career as a journalist, working for The Sunday Times, Reuters, The Economist, and Africa Confidential covering business, investment and conflict. He holds a degree from Cambridge University.



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During 2013, the performance of frontier markets was well above that of the emerging markets. The reference index for emerging economies, the MSCI EM, ended 2013 falling 2.6%, while the benchmark of funds operating in the frontier markets, the MSCI FM, gained 26.3%. The BRICS stock markets experienced significant declines, with the Chinese stock market the exception, whereas frontier markets became the most profitable on the planet. In the cases of Bulgaria, UAE, Argentina, and Kenya profits were above the 50%. Currently, this trend continues. So far this year, the MSCI FM has increased 18.5%, over the 5.1% of the MSCI EM, and frontier markets' stock returns remained positioned among the highest.

The Rise of Frontier Markets Multinationals

■ Tomás Guerrero

These results are not merely a matter of chance. Behind the returns reaped by frontier markets are a group of multinationals that, propelled by the improvement in the fundamentals of their domestic economies, are leading the growth of this

diverse set of countries and therefore their stock markets. They are frontier markets multinationals (FMMs).

If we pay attention to the FMMs that make up the Top 10 constituents by weight of the major indexes developed by industry

for these markets (including the newly created FTSE Frontier Index Series), we find that companies in the financial sector, such as the Nigerian Guaranty Trust Bank and the National Bank of Kuwait, and the oil & gas industry, like Argentina's YPF or the Kazakh KazMunaiGas,



Main listed FMMs by market value*

Company	Country	Sales	Profits	Assets	Market Value	Industry
Saudi Basics	Saudi Arabia	\$50.4 B	\$6.7 B	\$90.4 B	\$94.4 B	Chemicals
Saudi Telecom	Saudi Arabia	\$12.2 B	\$2.6 B	\$23.3 B	\$35.6 B	Telecommunications
Tenaris	Argentina**	\$10.6 B	\$1.6 B	\$15.9 B	\$26.1 B	Oil Services
Dangote	Nigeria	\$2.4 B	\$1.3 B	\$5.3 B	\$24.3 B	Construction
Ooredoo	Qatar***	\$9.3 B	\$0.7 B	\$26.8 B	\$12.4 B	Telecommunications
Zain	Kuwait	\$4.4 B	\$0.8 B	\$11 B	\$9.7 B	Telecommunications
Petrovietnam	Vietnam	\$3.1 B	\$0.6 B	\$2.4 B	\$7.5 B	Oil & Gas
KazMunaiGas	Kazakhstan	\$5.4 B	\$0.9 B	\$10.3 B	\$5.8 B	Oil & Gas
Essar Energy	Mauritius	\$27.8 B	\$-0.3 B	\$16.1 B	\$1.5 B	Oil & Gas
State Oil	Pakistan	\$11.6 B	\$0.2 B	\$3.3 B	\$1.1 B	Oil & Gas

Source: Forbes, May 2014. *Excluding financial institutions. **The tax domicile is in Luxembourg. ***Currently upgraded with UAE to emerging market.

continue to dominate the top positions (Table 2). But it's not all about commodities and banks. In recent years FMMs focused on other sectors, such as telecommunications, industry, and consumer goods, have begun to attract the attention of large investors and gain greater weight within the major benchmarks for frontier markets. This new trend is the result of

the effort that some frontier markets are putting into moving from extractive economies based on commodity exports and manufacturing to innovation economies based on the intensive use of knowledge in the production and development of the transformational industry and services sector. Examples of this phenomenon can be found in the rise of the Saudi chemi-

cal company Basics, the Nigerian brewing company Nigerian Breweries and the Moroccan telecommunication company Maroc Telecom.

These multinationals, unlike most companies from developed markets, have several features that are benefiting their growth and expansion.

MSCI Frontier Markets			
1	National Bank of Kuwait	Financials	Kuwait
2	Kuwait Finance House	Financials	Kuwait
3	Zain	Telecommunications	Kuwait
4	Nigerian Breweries	Consumer Goods	Nigeria
5	Kazmunaigas	Energy	Kazakhstan
6	Guaranty Trust Bank	Financials	Nigeria
7	YPF	Energy	Argentina
8	Zenith Bank	Financials	Nigeria
9	Maroc Telecom	Telecommunications	Morocco
10	Nestle Foods Nigeria	Consumer Goods	Nigeria

FTSE Frontier Index Series			
1	YPF	Energy	Argentina
2	Masraf Al Rayan	Financials	Qatar
3	Guaranty Trust Bank	Financials	Nigeria
4	Qatar National Bank	Financials	Qatar
5	Zenith Bank	Financials	Nigeria
6	Qatar Industries	Industrials	Qatar
7	Nigerian Breweries	Consumer Goods	Nigeria
8	FBN Holdings	Financials	Nigeria
9	Ooredoo	Telecommunications	Qatar
10	Vodafone Qatar	Telecommunications	Qatar

Russell Frontier Index			
1	Oil Search	Energy	Papua New Guinea
2	National Bank of Kuwait	Financials	Kuwait
3	Commercial Intl Bank	Financials	Egypt
4	Guaranty Trust Bank	Financials	Nigeria
5	Kuwait Finance House	Financials	Kuwait
6	Masraf Al Rayan	Financials	Qatar
7	YPF	Energy	Argentina
8	Qatar National Bank	Financials	Qatar
9	Ahli United Bank	Financials	Bahrain
10	Zain	Telecommunications	Kuwait

S&P Frontier BMI			
1	Emaar Properties	Real Estate	UAE
2	YPF	Energy	Argentina
3	National Bank of Kuwait	Financials	Kuwait
4	Kuwait Finance House	Financials	Kuwait
5	Zain	Telecommunications	Kuwait
6	Masraf Al Rayan	Financials	Qatar
7	Guaranty Trust Bank	Financials	Nigeria
8	First Gulf Bank	Financials	UAE
9	National Bank of Abu Dhabi	Financials	UAE
10	Qatar National Bank	Financials	Qatar

Not risk-averse. Being born and developed in countries with persistent political, economic, and social instability allows them to have a greater horizon of internationalization, enabling them to penetrate markets with similar or higher levels of

country risk than that of their home countries. A clear example of this internationalization pattern is found in FMMs such as the Nigerian cement company Dangote (which has in recent years invested US\$4 billion to open new plants in Senegal,

Zambia, Tanzania, Ethiopia, Republic of Congo, Gabon, and Benin), the Kuwaiti telecommunications company Zain (with a market share of 49% in Iraq and 41% in Sudan), and the Vietnamese oil company Petrovietnam (which operates several oil



blocks in Cuba and Venezuela, where it has decided to suspend its operations as a result of the rampant inflation plaguing the country).

Easier access to finance. The close relationship with the governments of their home countries, in many cases owners of 100% or a significant stake, allows the FMMs access to public funding under very advantageous conditions over its competitors. It allows them to finance themselves at a lower cost and thus be more competitive than companies from developed markets. This phenomenon, a result of the desire of governments to create “national

champions” in order to control strategic sectors, is more common in FMMs owned by governments – as in the case of the Moroccan multinational Office Chérifien des Phosphates (OCP) or the oil & gas company Saudi Aramco – than in the listed FMMs, which, although to a lesser extent, also benefit from this preferential funding.

Government corporate diplomacy. The presence of senior administration officials on the board of the FMM, in many cases of ministers or government-linked figures, allows these companies to define and deploy a government strategy to facilitate its internationalization, asset acquisition,

and the achievement of certain objectives within their domestic markets. The most obvious cases are found in the Middle East FMMs, where members of different royal families are responsible for directing, protecting, and promoting these companies inside and outside their countries.

Obviously both lower risk perception and government corporate diplomacy are factors that may play against the FMMs and generate economic losses resulting from bad investment decisions, rent seeking, and low management capacity. For now, it appears that they are doing well.



About the Author

Tomás Guerrero is a researcher at ESADEgeo-Center for Global Economy and Geopolitics of ESADE Business School and SovereignNET Research Affiliate at Tufts University's Fletcher School. He specializes in frontier markets, sovereign wealth funds, halal industry, and entrepreneurship.

Turning Scarce Water into Chinese Wine



■ Pierre Ly & Cynthia Howson

Chinese wine just keeps getting better. But the country's water crisis may be one of the most serious obstacles to overcome. Water is a crucial resource for wineries. Waterfootprint.org estimates that the global average water footprint of making 1 liter of wine is 870 liters of water. The South of China has plenty of water but its climate is (with some exceptions) often unsuitable for wine grapes. Meanwhile, in the dry North, where promising wine regions such as Ningxia and Xinjiang are located, economic growth has led to fierce competition between agricultural, industrial, and residential users of water.

To address water shortages in the North, the government has led some major engineering projects such as building dams along rivers or redirecting water from the wet South to the dry regions in the North. But these large-scale water infrastructure projects are often controversial because they fail to address what many observers and environmentalists view as unsustainable consumption. In response, the Chinese government has set strict rules to regulate demand and improve water governance. But according to political scientist Scott Moore, lack of cooperation and conflicts of interest between various national and local authorities continue to undermine these efforts. Local officials

have to promote economic development and employment, so the relative contributions of competing water uses to regional economic growth play a big role in its allocation. In Ningxia and Xinjiang, wine producers can compete by showing their potential to create jobs and innovate in sustainable water usage.

■ Ningxia: From Yellow River to vineyards

Ningxia is one of China's most promising wine regions. The determination of the local government to turn Ningxia into a wine leader has attracted enthusiastic domestic and foreign investors. Combined with the dry climate, the Yellow River is a serious

asset, providing vineyards with a source of essential irrigation water. But the ambitious plans to expand the wine industry must deal with chronic water constraints, due to years of overuse of groundwater and pollution of the river.

There are clearly efforts to regulate agricultural use, including drip irrigation projects and a system of water rights. In the city of Qingtongxia, where promising new vineyards have been planted, farmers usually get irrigation water coming through trenches that the municipal government supplies at regular intervals every few weeks. The downside is that you have to wait between times of delivery. For businesses seeking more control, water can also be drawn from reservoirs. They are owned by the city, but a given reservoir is shared by a handful of wineries, each with their own pump to draw water. Of course, this is more expensive than waiting for the trenches to fill.

Interestingly, the wine industry is a key partner in a recent Asian Development Bank project to promote sustainable agriculture in Ningxia. This is an attempt to align environmental goals with the local government's drive to promote quality wine as an economic development tool. The funding helps not only to build drip irrigation systems to save water in the vineyard, but also includes a budget to pay for foreign wine consultants. One advantage here is that winemaking consultants tend to encourage lower yields to improve quality, in part by discouraging excessive irrigation.

■ Southern Xinjiang: Get in line for water

The problem is even more acute in the far west province of Xinjiang. In Turpan, located south of the Tian Shan mountain range, grape growing is an important part

For the Chinese wine industry, finding effective ways to harvest and recycle water is as important as improving viticulture and winemaking. Like in other countries facing water shortages, improving water efficiency makes good business sense for wineries.



of the economy, and the local government is promoting wine to attract investment and create jobs. Turpan officials have set aside a large chunk of land to encourage dozens of new wineries to develop. Irrigation has been possible thanks to melt water from nearby mountains, but with the growth of industrial, agricultural and residential use, more groundwater has to be exploited. With the extreme lack of rainfall, supplies are low, so restrictions apply. When they want to irrigate, wineries must call the government to get on the wait list for the water supply of the day, which takes some work, and there may not be much left for the ones further down the queue. The traditional method of flood irrigation can make it difficult to control quantity and even distribution over a vineyard. Drip irrigation is ideal, but it is unable to reduce soil salinity. This is a common drag on plant growth in arid climates, and it requires enough fresh water to wash out the salts accumulated in soils. It doesn't help that in such climates, irrigating with groundwater that is often high in salt exacerbates the problem.

As in other provinces, finding ways to increase supply may be less politically sensitive locally than regulating demand. In

2010, Xinjiang's government proposed an ambitious pipeline project that could channel seawater from Southern China to the province. Of course, it is very controversial, and critics emphasize the usual downsides of large-scale water infrastructure projects, as well as challenges posed by desalination technology.

■ Will water governance sustain Chinese wine?

For the Chinese wine industry, finding effective ways to harvest and recycle water

is as important as improving viticulture and winemaking. Like in other countries facing water shortages, improving water efficiency makes good business sense for wineries. But of course, making wine uses a lot of water no matter how efficiently we use it. And the limited supply has to be shared with many other users. So wineries may only have a small part of the solution in their own hands. The good news is that the wine industry can use far less water than industries like coal and natural gas. In any case, the future of Chinese wine depends in many ways on the politics of water governance in China.

About the Authors

Pierre Ly is Associate Professor of International Political Economy at the University of Puget Sound. Cynthia Howson is Lecturer in Political Economy at the University of Washington Tacoma. Their research explores the emerging Chinese wine industry.

Recommended reading if you want to follow the latest news in China's wine market: Jim Boyce's Grape Wall of China Blog (<http://www.grapewallofchina.com/>) and Winechina.com (<http://www.winechina.com/en/>)





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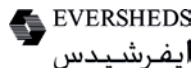
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