

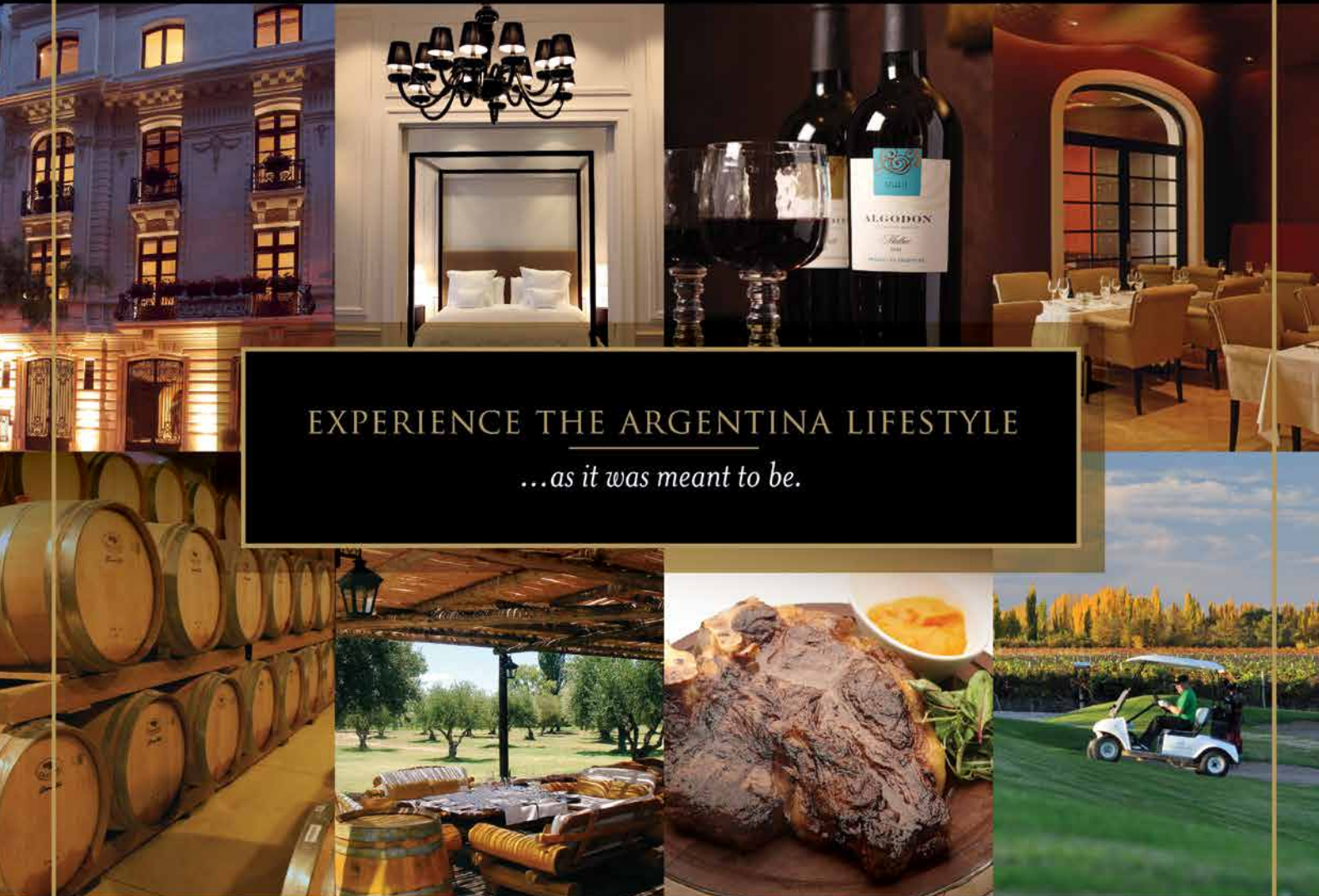
EMERGING MARKETS' BUBBLE TROUBLES

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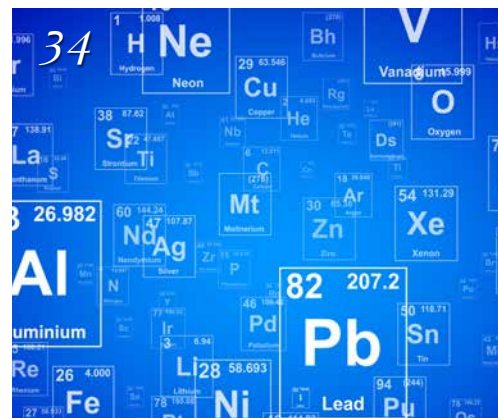
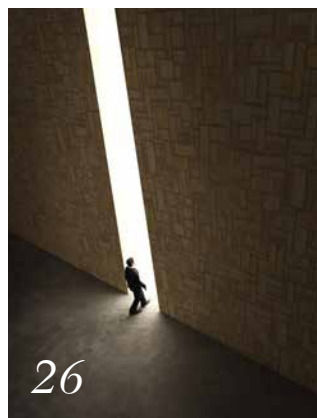
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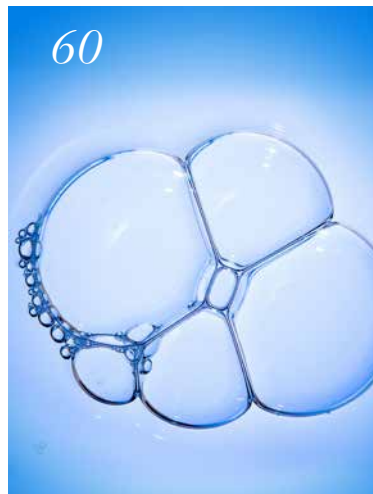
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LatAm Hedge Funds at Turning Point

After a pretty flat 2013, LatAm hedge funds could capitalize on high volatility for risk-adjusted returns in 2014. Between 2000 and 2008 the number of hedge funds in Latin America grew fivefold, while assets under management (AUM) went from less than US\$5 billion in 2000 to over US\$60 billion in 2010 (source: EurekaHedge). Compared to the exponential growth of the start of the millennium, the past few years have been rather flat, but experts still see bright prospects for the hedge fund industry in the region.



Victor Rodriguez, President and CEO of financial services company LatAm Alternatives, tells AEI, “In 2013 we’ve been repeating the pattern of low-ball activity, and because of this the curve of growth and changes of assets has been pretty flat. However, the region has been able to position itself as a very interesting emerging market with a mature history.”

“What we are going to see in 2014,” Mr. Rodriguez continues, “is that the rounds of due diligence that started after 2010 will start to materialize in commitment and allocation, such as managed accounts that major institutional players are willing to set up with hedge fund managers across the region to make sure they can control ownership and transparency. People will also start paying more attention to the re-

turns of the hedge funds industry specifically compared with the volatility.”

“2013 was not a stellar year for the region, but I’m assuming that this was the necessary step to guarantee that after 2014 they have the best managers and the ability to show the global market that they have consistent returns in terms of risk-adjusted environments,” Mr. Rodriguez says.

He notes that the past year saw some smaller funds going out of business and others being created, particularly in Brazil, Mexico and Chile. “As soon as the local legislators start to set the presence of these alternative investments or risk-adjusted vehicles there will be a proliferation of more and more managers.”

■ Volatility

The main factor that will influence the success of the LatAm hedge fund sector in 2014 is volatility. In a more volatile market, institutional investors rely on hedge fund managers for their expertise in risk-adjusted returns.

“Big investment vessels will be able to really appreciate the active management of the portfolios and why they are paying these fees to hedge fund managers. It’s important to keep understanding that it’s not only about returns, it’s about certain costs – am I willing to take returns at any cost or do I want returns with a very controlled volatility in the portfolio, that’s the bottom line,” says Mr. Rodriguez.

As volatility hits and pension fund officers look for risk-adjusted low-ball liquidity portfolios, they might also be willing to convince regulators to invest in these managers, further boosting the sector.

“You will see a fantastic opportunity where these global asset managers will want to partner with local asset managers in order to be able to get some sort of allocation from the pension fund, but you’ve got to remember that in order for this to happen the legislator has to be able to change or modify some of the legislation again, which will be one of the triggering points,” he adds.

Volatility will also help hedge funds build up liquidity, a strategy that will attract even more investors.

■ Regional disparities

Because of its maturity, Brazil is still seen as a point of reference in the region. Now that major investors are willing to pull the trigger, they want a stable market in terms of managers, which is something Brazil can provide. Moreover, the upcoming World Cup and Olympics taking place in the country are expected to boost its economy, creating further investment opportunities.

However, because of the country’s low volatility and very tight links to China’s slowing economy, some investors have questioned its ability to deliver returns – fears that Mr. Rodriguez deems unjustified.

“I’ve been seeing people a little bit afraid of Brazilian behavior,” he says. “Brazil has been one of the most important economies in the world, and the global growth that we might see is going to start feeding the potential growth of China, which at the end of the day will fuel demand for Brazilian goods and services.”

“You have to be very granular in your research, but Brazil is full of talented managers, especially in Rio de Janeiro. I would encourage major institutional allocators to pay a trip to Rio in the first quarter of 2014 to get first-hand information about these potential opportunities,” he says.

Argentina has been very slow in terms of investor interest as well as fund creation, but possible changes in administration in the coming year could spur opportunities some people are already preparing for.

“You have to be aware that as soon as the internal political and economic policies change in Argentina the country will present a great opportunity to put some money to work, understanding that the

result will not be immediate,” says Mr. Rodriguez.

He points out that the same thing could happen with Venezuela, as distressed prices in both countries will represent an interesting risk-adjusted opportunity in the long term. “If you are willing to cope with volatility in terms of the political situation in the country, you can have an interesting rate of return.”

With a tremendous number of opportunities projected in 2013, Mexico remains an attractive market for Rodriguez. “I remain completely bullish for the country in 2014. The managers that have been operating in the country have a unique talent and they know exactly how to make sure that they can exploit the country’s imperfections and deliver alpha, which is what major institutional investors are asking for.”

Finally, although Chile, Colombia and Peru have experienced various levels of performance, they should achieve more cohesion in 2014 via the Mercado Integrado Latinoamericano (MILA). “Up to a certain point everybody was very focused on their own country, but I think at the end of the year it will be very difficult to separate the region, and I’ve even heard lately that Brazil is interested in having an involvement with MILA,” says Mr. Rodriguez.

“What we have to do is unite and integrate more our countries’ business and stop creating division. Managers are seeing Latin America as a whole, and I don’t think they want to differentiate Mexico and Brazil from MILA; they want to invest in Latin America, and the region as a whole has a bright outlook, despite volatility challenges.”



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Private Equity

Bright Prospects for African Private Equity

2014 is expected to bring great deals to the African continent, with more sizable investments and a diversification from the traditional natural resources markets.



It is the deal that got everybody talking: In June 2013 Dubai-based private equity firm Abraaj Group acquired Ghanaian dairy company Fan Milk for an undisclosed sum. In October dairy giant Danone joined the deal, buying a 49% stake, with Abraaj remaining the majority shareholder.

According to Michelle Essomé, CEO of the African Private Equity and Venture Capital Association (APEVCA), the deal can be considered transformational for several reasons. “First, there are so few deals of that size [over US\$350 million as reported by the Financial Times]. When you are fundraising you have to show a deal pipeline, so this deal will add a bit more credibility to what these pipelines look like, and create the ability to attract other opportunities of that size,” she says.

The other way the Fan Milk deal is likely to change the face of private equity in Africa is by paving the way for investment into fast-moving consumer goods. This type of diversification is needed on a continent that has seen the majority of foreign investment focused on oil and mining, and reflects the opportunities created by its growing middle class. “As Africans are getting wealthier and increasingly sophisticated in their tastes from what they see in the Western world, these desires are permeating into emerging and frontier markets. People have more disposable income, which leads to more choice around the cars they drive, or the type of houses that they build or how they construct their lives. As Africa becomes more global and exposed to Western consumer and luxury goods, opportunities for the consumer are growing,” Ms. Essomé adds.

She believes other African success stories will soon attract the attention of private equity investors, and more and more deals will be made away from the natural resources sector, with retail as a big contender. “In Nigeria, for example, there is an Amazon-like company [Jumia] which is great because you don’t have to wait for your next trip to London to buy the things that you can’t get locally. It is tailored to the Nigerian market, so I understand that they take cash on delivery because they don’t want people to worry about not getting their goods. It is all a matter of filling needs in a under-served market, catering to your local market, being able to tap into more disposable income, the affluent, and providing people with the same products and services without having to take a six-hour flight to London.”

Other sectors that are predicted to get investor interest in 2014 are financial services, telecoms, healthcare and infrastructure. Unfortunately, as opposed to Latin America, African governments rarely support these start-ups financially, and they sometimes struggle to find the initial investment they need to launch. Essomé points out that in some African markets, “entrepreneurs have historically been financed by wealthy families particularly with East Africa start-ups. We are now also seeing European families with high risk appetites, a deep affection for the continent and/or local knowledge looking to support SMEs. For most pan-African fund managers, investing in start-ups may not necessarily make sense; however, this part of the ecosystem definitely needs investment. There is more that needs to be done to help entrepreneurs looking for

venture capital for Africa and, in doing so, this feeds the pipeline for bigger PE deals further up the chain.”

■ Successful 2013

Investor enthusiasm for Africa has been largely reflected in statistics. According to Thomson Reuters, African target mergers and acquisitions (M&A) totaled US\$40 billion in 2013, up 65% from 2012 and marking the highest year since 2010. African M&A accounted for nearly 2% of 2013 announced activity worldwide.

APEVCA will launch an exits report in April 2014, but Essomé explains that so far the firm has recorded more exits in 2013 than there have been since 2007. “The good news is that private equity funds have been sourcing, investing, transforming and exiting great companies across Africa for long time. What I think is exciting at this point in the cycle is that there are now a number of African GPs who have done the full life cycle and can demonstrate successful exits. Over the next few years, I’m confident that we’ll see more exits from other well-known players, which will reinforce the fact that when you have a great company, there will always be a buyer.”

International investors made up half the total value of African M&A in 2012, with 255 deals worth US\$20 billion, out of a total of US\$39.5 billion and 758 deals. In terms of structure, joint ventures and club deals remain a favorite, as they mitigate risk for all investors, but Essomé explains other structures are gaining momentum.

“A lot of African and global funds-of-funds are speaking with investors across the globe about Africa and raising capital for Africa. I think it is fantastic because they can provide access through manager selection, help investors to diversify their African commitments across different sec-

tors, fund sizes and geographies. These new funds-of-funds players also have the ability to do co-investments for those sophisticated LPs looking for these types of transactions, so there are many options and ways to play the opportunity. In addition, we’re seeing some GPs transform into listed investment holding companies which then seek a listing, allowing them to raise permanent capital,” she says.

■ How to get started

Although investing in Africa is easier for large multinationals, Ms. Essomé believes scale should not be used as an excuse to stay away from the continent. “When thinking about a typical emerging market private equity allocation, Africa may be a small part of it. If you are a very large LP with hundreds of billions of dollars, although it may be smaller than a typical commitment, LPs should definitely consider it as a way to start to understand the market. Opportunities in Africa won’t last forever. Size of market should not be an inhibitor to investment,” she says.

“What we hear a lot from global LPs is that there are few fund managers that are big enough for the size of commitments they typically make. If you think of large public pension plans, which might make allocations in the range of US\$150-175 million, there are few firms – at present – that are able to accommodate this. But why not make an exception with a smaller initial allocation, learn about the market, build a deeper relationship with your GPs, see how they source deals, manage the investment, execute the exit – otherwise if you wait, you might never invest in Africa, and miss an opportunity.”

Summing up the different options for LPs wanting to invest in Africa, Ms. Essomé says, “Funds of funds can provide diversification and select the best managers. Al-

ternatively, you can invest with a pan-African manager who has an on-the-ground presence, good networks for deal sourcing and a successful track record of doing exits. Investors can also access co-investing opportunities, and we’re even seeing more DFIs in this space as well.”

Africa is also expected to receive a lot of domestic investment in 2014, with an emerging LP class currently looking at where to inject money. South Africa, for example, now has the ability to invest in alternative XFA, which should lead to an increase in the number of African LPs in funds. “A lot of education needs to be done around where to start, how to construct programs, how to choose a good manager – a domestic or regional GP, or a pan-African one, governance and alignment issues, for example. Many GPs are focusing their fundraising efforts on African investors, which could potentially in time attract a significant amount of capital to African private equity.”

It also makes sense for African LPs to invest in their continent’s private equity, as the money they put into circulation helps African economies increase employment, education and tax revenue.

“The great thing about Africa is that it is not just a one story place; there are so many attractive investment opportunities. No, it is not easy: as a frontier market there are challenges, obstacles, and it takes a lot of patience,” Ms. Essomé notes.

“You need to do your due diligence in the same way that you would do any other emerging or frontier market. You need to go visit the continent, you need to talk managers, you need to visit portfolio companies and make your own judgments. But if you sit on the sidelines and just wait around, you will completely miss the boat.”



Spain

A Global Halal Hub?

■ Tomás
Guerrero
Blanco



For too long, we have been watching as the decline of domestic demand in Spain and the absence of alternatives push small and medium-sized farms to close. Farms need to keep moving up the value chain and reinvent themselves. However, this is a sector with very low accumulated unemployment, as it has served as a safe shelter for a large proportion of the workers “expelled” from the construction sector.

A solid bet for the future of the Spanish food sector could be reorienting a great part of its production toward a booming market: halal food. There are over 1.6 billion Muslim consumers, and the market is valued at over a trillion dollars a year. The market for sharia-compliant food represents an excellent opportunity to relaunch a sector that desperately needs to be strategic.

A report recently presented in Dubai on the occasion of the Global Islamic Economy Summit shows the enormous potential that the halal food sector holds:

In 2012 Muslim consumers spent over a trillion dollars on food, equivalent to 16.6% of global spending that year. It is expected that in 2018 this amount will surpass US\$1.5 trillion, which would represent 17.4% of the total spending.

Of the trillion dollars disbursed in 2012, it is estimated that about US\$915 billion went for the purchase of halal food by the Muslim community of the 57 member countries of the Organization of Islamic Cooperation (OIC). Indonesia led halal food consumption, spending US\$197 billion, followed by Turkey, Pakistan and Egypt with US\$100 billion, US\$93 billion and US\$88 billion, respectively. In the countries that don't belong to the OIC but with representative Muslim communities, like Russia or France (halal markets valued at US\$34 billion and US\$11 billion, respectively), the scarce

presence of halal food in commercial premises obliged many Muslims to consume kosher food.

The OIC member countries imported food valued at US\$191 billion in 2012, equivalent to 10.5% of global imports. Within OIC's imports, meat and livestock for human consumption reached a value close to US\$15.4 billion. 91% of these imports (US\$14 billion) came from countries outside the OIC, like the US or Brazil.

Beyond the figures, which undoubtedly describe an encouraging horizon for companies that choose to bet on this market, Spain has all the elements to configure a halal food hub around the triangle traced by the cities of Cordoba, Malaga and Granada: a dynamic agribusiness environment, high-quality products, excellent infrastructure for exports, a prestigious and recognizable brand (Ál-Andalus), an institution in charge of halal certification (Halal Institute, Cordoba) and three cities with strong cultural and economic relationships with the Islamic world.

Why shouldn't we take advantage of all this potential to supply a non-cyclical demand like halal food? Why shouldn't we aim to build a halal food hub similar to the one recently developed in Malaysia (Tanjung Manis), a country where halal exports add up to US\$11.57 billion? Why shouldn't we use this hub's development to attract Hassad Food (the Qatar Investment Authority's agribusiness arm) to Spain, or to catalyze new investments from other Emirati funds? Why shouldn't we think that the implementation of this initiative might bring job creation, offering new horizons to our producers and attracting companies already specialized in the production of halal food? These would include Brazil's BFR (one of the 10 biggest companies in the world and the major producer and distributor of halal chicken) or the Swiss company Nestlé

(with 150 factories with halal certificates).

The possibilities are endless and extend beyond agribusiness. Halal industry is valued at US\$2.5 trillion, and is forecasted to reach US\$10 trillion by 2030, offering a universe of business opportunities that go from cosmetics to tourism or pharmaceutical products. All of these are sectors to which we can also reorient much of our production to go further from the halal food cluster, to create a global halal hub.

In Cordoba, the Agropolis Foundation and the Halal Institute have already begun work toward making Spain a global hub with an industrial park focused on the halal brand. But for this project to thrive, the Spanish government needs to support it. Are we going to miss this opportunity?



Tomás Guerrero

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2013 Overview:

Key Trends in Asian Hedge Funds

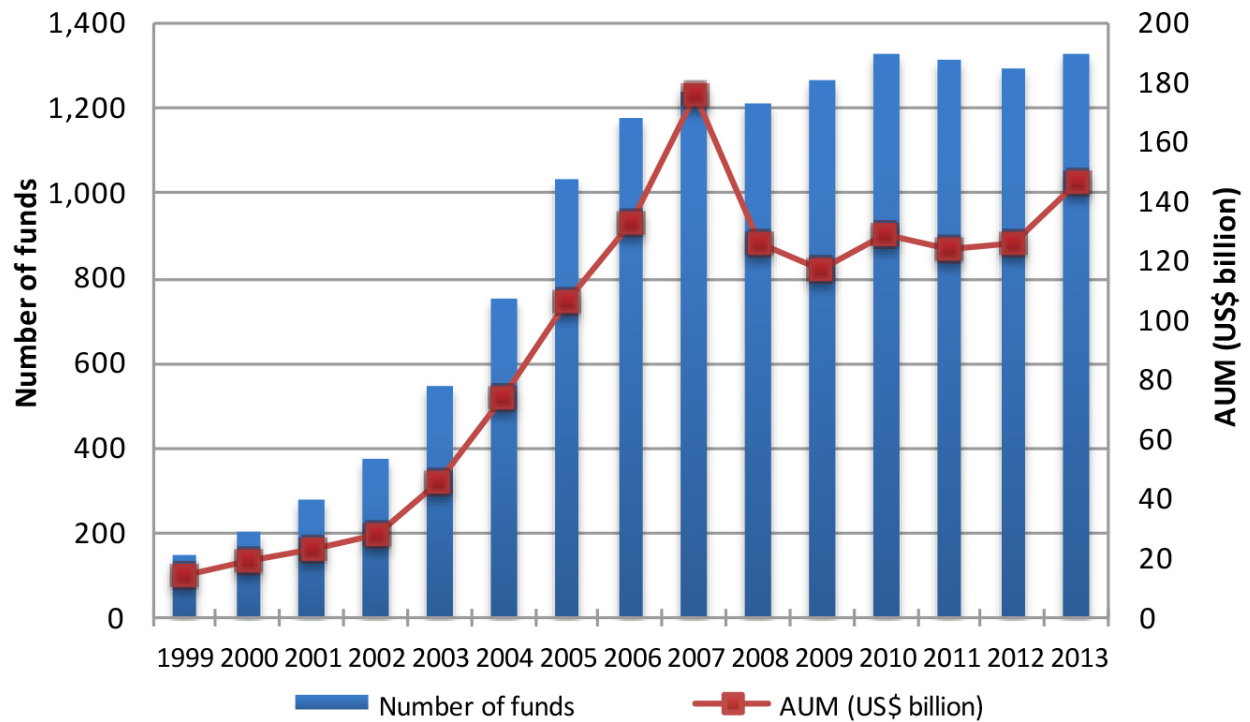
The Asian hedge fund industry delivered excellent performance in 2013, beating underlying markets and outperforming its global peers during the year. The Eurekahedge Asia Hedge Fund Index gained 16.10% in 2013 with total assets under management (AUM) increasing by US\$20.6 billion. This brings the total size of the Asian hedge fund industry to US\$147.0 billion managed by a population of 1,333 hedge funds.

The size of the industry stood at US\$14 billion at end-1999, and over the next eight years it grew to US\$176 billion by end-2007 – a period which saw a strong growth in the hedge fund industry's tilt toward Asia. At end-2007, the total fund population in the region stood at 1,237 funds, up from 145 funds in 1999. Gains

realized over this period were partially reversed by the advent of the global financial crisis, which saw the Eurekahedge Asia Hedge Fund Index decline by 20.31% in 2008, ushering in a spate of fund liquidations as managers struggled to deal with negative returns and redemption requests from investors. The industry bottomed out in April 2009 with AUM declining to

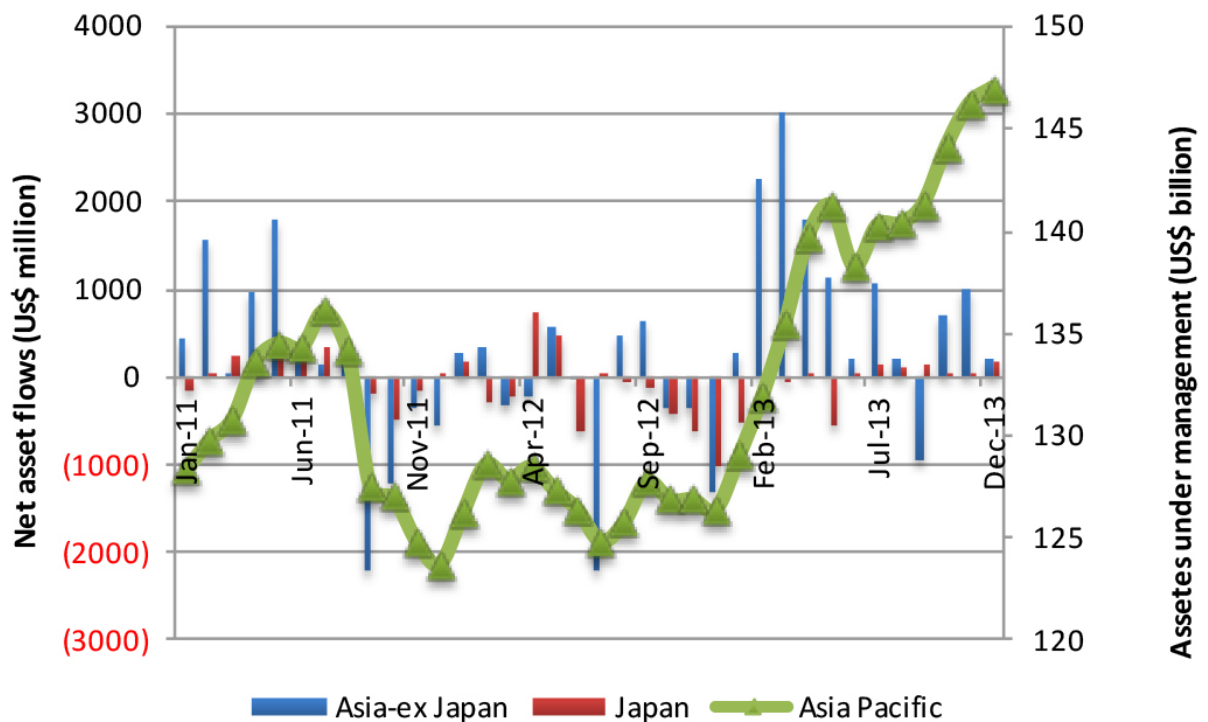
a low of US\$104.8 billion before witnessing a rebound of sorts amid rallying equity markets and some positive asset flows in the second half of 2009. The industry continued its upward trajectory in 2010, realizing strong performance-based growth as the Eurekahedge Asian Hedge Fund Index gained 9.07% during the year.

Figure 1: Industry growth since 1999



Source: Eurekaledge

Industry composition and growth trends



Source: Eurekaledge

As illustrated below, in 2011 the industry shed some of its earlier gains as the Eurozone sovereign debt crisis dominated market sentiment resulting in US\$6.4 billion worth of performance-based losses for fund managers in the second half of the year alone.

While 2012 saw Asian managers post a mild recovery in terms of performance, net asset flows were in the red with the industry losing US\$4.4 billion through redemptions.

2013 provided the much needed turnaround for the industry, with performance-based gains of US\$10.0 billion and net asset allocations of US\$10.6 billion as the theme of a global economic recovery began to gather more credence. As emerging market woes in Asia crystallize, fund managers are likely to face hardship in wooing investors. Overall in 2013, Asian hedge fund AUM grew by 16.3% but is yet to breach its 2007 peak of US\$176 billion.

■ Asset flows

Table 1 on the right gives the breakdown of Asian hedge fund AUM by performance and net asset allocations. The year 2011 built on the momentum of 2010 and saw net asset inflows of US\$7.1 billion in the first eight months of the year, but the fortunes of the industry were reversed in the second half of 2011 as managers suffered performance-based losses and redemptions to the magnitude of US\$6.4 billion and US\$4.2 billion, respectively. Asset flows remained mixed throughout 2012 with total AUM increasing marginally by US\$2.7 billion as performance-based gains were eroded by net outflows from the industry. 2013 saw a resurgence in the industry with net asset inflows totalling US\$10.6 billion with total performance-based gains of the order of US\$10.0 billion.

Table 1: Monthly asset flows in Asian hedge funds since December 2010

	Net growth (performance)	Net flows	Assets at end
2010	7.2	4.0	128.6
Jan-11	(0.5)	0.3	128.3
Feb-11	(0.1)	1.6	129.8
Mar-11	0.8	0.3	130.8
Apr-11	1.7	1.1	133.6
May-11	(1.2)	2.1	134.5
Jun-11	(0.9)	0.7	134.3
Jul-11	1.3	0.5	136.1
Aug-11	(2.4)	0.5	134.1
Sep-11	(4.3)	(2.4)	127.5
Oct-11	1.3	(1.7)	127.0
Nov-11	(1.7)	(0.5)	124.9
Dec-11	(0.6)	(0.5)	123.7
2011	(6.7)	1.9	123.7
Jan-12	2.0	0.5	126.2
Feb-12	2.3	0.1	128.6
Mar-12	(0.2)	(0.6)	127.9
Apr-12	0.1	0.5	128.5
May-12	(2.2)	1.1	127.4
Jun-12	(0.3)	(0.6)	126.4
Jul-12	0.7	(2.2)	124.9
Aug-12	0.5	0.4	125.8
Sep-12	1.5	0.5	127.8
Oct-12	(0.1)	(0.8)	126.9
Nov-12	1.0	(1.0)	126.9
Dec-12	1.8	(2.3)	126.4
2012	7.0	(4.4)	126.4
Jan-13	2.8	(0.2)	129.0
Feb-13	0.7	2.2	131.9
Mar-13	0.6	3.0	135.5
Apr-13	2.4	1.8	139.7
May-13	0.9	0.6	141.3
Jun-13	(3.2)	0.3	138.3
Jul-13	0.8	1.2	140.3
Aug-13	(0.2)	0.3	140.4
Sep-13	1.8	(0.8)	141.3
Oct-13	2.1	0.7	144.1
Nov-13	1.0	1.1	146.2
Dec-13	0.4	0.4	147.0
2013	10.0	10.6	147.0

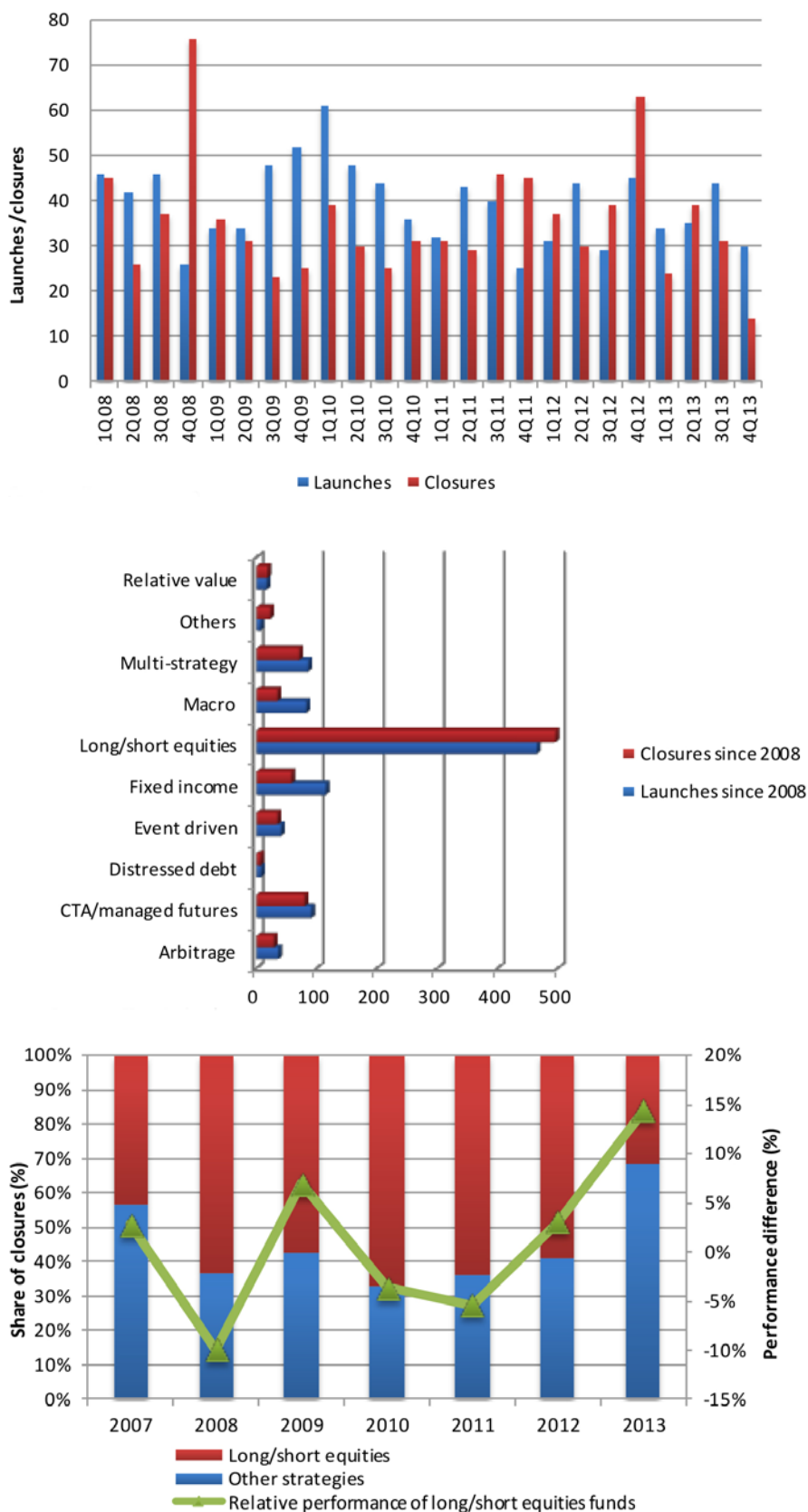
■ Launches and closures

Figures 2a and 2b track the pace of launches and closures in the Asian hedge fund space since 2008. Hedge fund attrition rates spiked up following the financial crisis, with a total of 184 fund liquidations in 2008. The number of fund closures dwarfed launches in the fourth quarter of 2008 as fund managers posted heavy losses amid a global financial meltdown following the collapse of Lehman Brothers. The industry saw some respite from mid-2009 to end-2010 as launch activity picked up while fund liquidation was relatively subdued. This period saw a number of fund managers set up shop in Asia, in particular Hong Kong and Singapore, as financial regulation in the US clamped down on investment banks' proprietary desks. The second half of 2011 saw another spike in fund liquidations amid the worsening global economic outlook – with Asia ex-Japan and globally focused funds seeing the highest attrition rates. Liquidation rates remained high throughout 2012, taking their toll on the smaller hedge funds, which failed to qualify for their performance fees.

Although 143 new funds have been launched in Asia in 2013, a substantial number of the smaller hedge funds were liquidated as the industry moves toward greater consolidation.

Figure 2b shows the breakdown of fund launches and closures by strategic mandate. Almost 50% of fund launches have been dedicated to long/short equities strategies, with fixed income, macro, CTA/managed futures and multi-strategy sharing almost 40% of the fund launches between them. As illustrated below, attrition rates for long/short equities managers exceed total launches in the last six years on account of it being the most utilized strategy in the region.

Figure 2a-2c: Launches and closures of Asian hedge funds



Source: Eurekahedge

Figure 2c depicts some interesting results observed in 2013 whereby the share of fund closures for long/short equities funds has declined substantially – from 59.2% in 2012 to 31.5% in 2013 as the average long/short equities hedge fund in the region outperformed other strategies by almost 14.4%.

■ Fund size

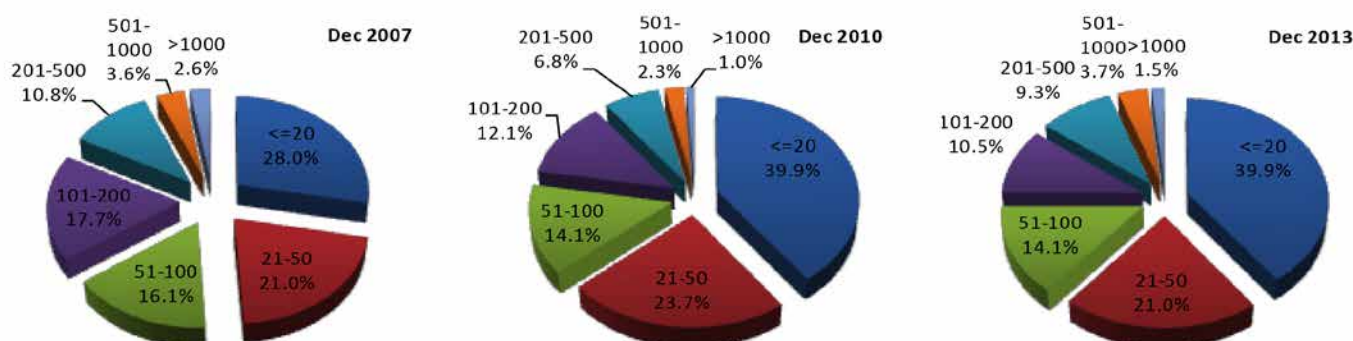
The breakdown of the Asian hedge fund industry by fund size displays interesting trends emerging in the industry. The percentage of funds managing up to US\$100 million in assets has increased from 65.2% in 2007 to 75.0% by 2013 – peaking over 75% briefly in 2010 on the back of re-

newed launch activity in the region, which saw a number of small hedge funds enter the industry. The proportion of hedge funds managing less than US\$100 million in the region remains high, however, as investors have increasingly shied away from the smaller hedge funds, limiting their ability to grow their fund size.

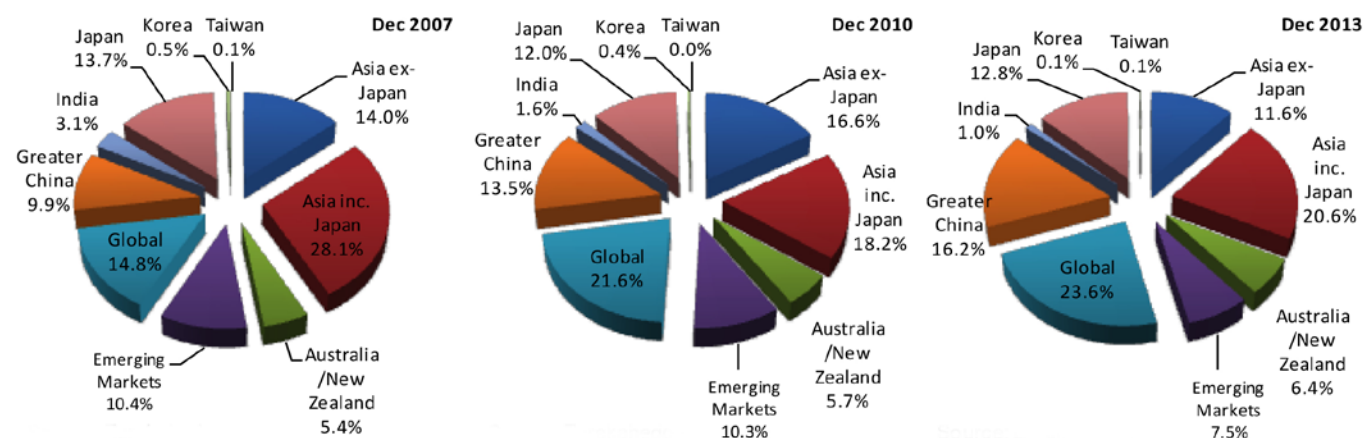
Funds managing assets between US\$100 million and US\$500 million controlled 28.6% of the Asian hedge fund space in 2007, with their share dropping to 18.9% by 2010 on the back of performance-based losses and heavy redemptions following the financial crisis. Their share has since marginally recovered to 19.8% by 2013. A similar pattern emerges for funds man-

aging over US\$500 million. In 2007 they controlled 6.2% of the market, their share declining to 3.3% by 2010 and recovering to 5.2% by 2013. Although investors focusing on Asia have increasingly preferred the larger funds at the expense of the smaller ones, this is an extension of the global trend in the hedge fund industry whereby increasing regulatory costs, a downward pressure on fees and an increasingly uncertain global macroeconomic environment are pushing the industry toward greater consolidation so as to achieve economies in the overall running of the operations.

Figures 3a-3c: Breakdown of fund population by fund size (US\$ million)

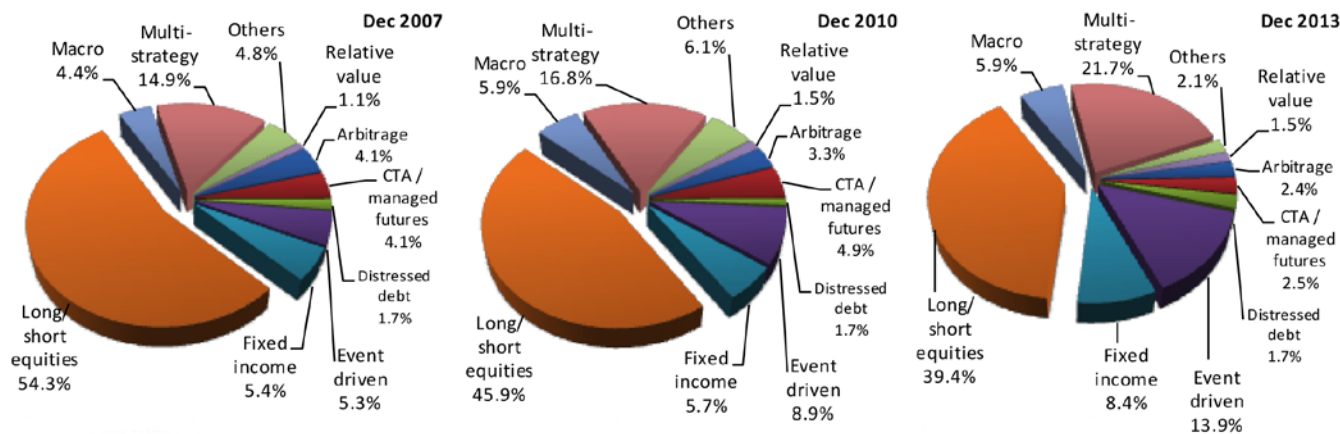


Figures 4a-4c: Geographic mandates by assets under management



Source: Eurekahedge

Figures 5a-5c: Strategic mandates by assets under management



Source: Eurekahedge

Geographic mandates

Asset allocation by geographic mandate in Asia has been influenced by an overall decline in AUM in the region and a general rebalancing of manager portfolios to gain wider exposure to the underlying markets. This trend has driven an increase in the AUM of globally mandated funds, which have seen their share increase from 14.8% in 2007 to 23.6% by 2013. Asset allocations to single country mandated funds, such as those focused on Japan, India, Korea and Taiwan, have also collectively decreased from 17.5% in 2007 to 14.0% by 2013, as managers have sought to diversify their regional exposure. The share of emerging markets focused funds has also dropped by 2.9% since 2007, as

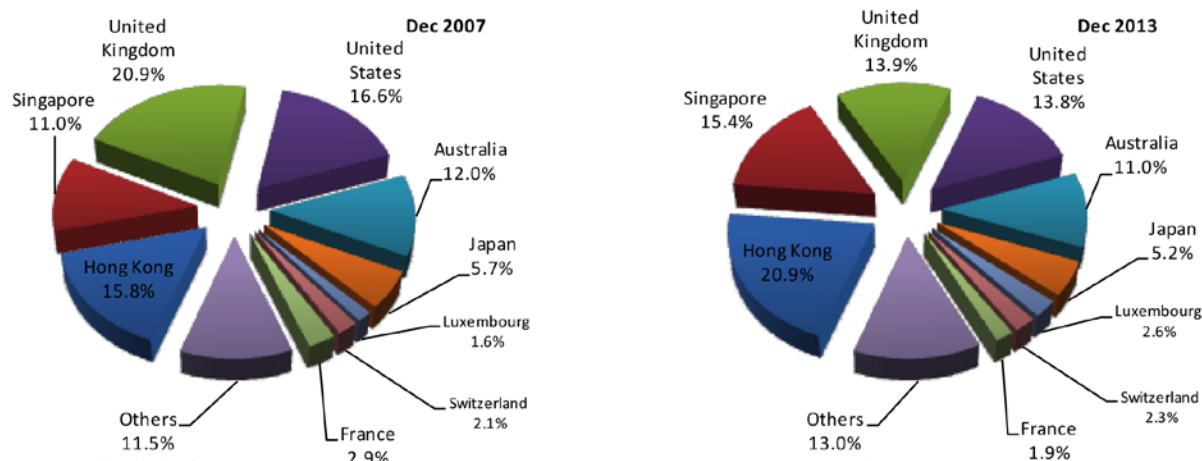
investors have sought exposure to the underlying markets via globally mandated funds. As emerging markets come under further pressure on the back of the wind-down in the Fed's QE, this trend is likely to gain additional momentum. Managers investing in Greater China have seen their share of AUM increase by 6.3% since 2007 as fund managers are attracted by the growth in the population of high net worth individuals (HNWI) in the region. Greater China focused hedge funds delivered an impressive 18.88% in 2013, comfortably outperforming underlying markets.

Strategic mandates

In terms of the composition of the industry by strategic mandate, the Asian hedge fund industry delineates some interesting trends

– the most striking being a 14.9% decline in the share of long/short equities funds since 2007. A great part of this contraction happened during the financial crisis; the Eurekahedge Asia Long Short Equities Hedge Fund Index declined 21.6% in 2008 as long/short equities managers posted heavy losses. Furthermore, as the Asian hedge fund industry has matured, managers have diversified away from long/short equities strategies (which are strongly correlated to the underlying markets) toward event-driven, multi-strategy, relative value and fixed income strategies, which have seen their share of AUM increase by 8.6%, 6.8% and 3.1%, respectively, since 2007. We expect this diversification to increase in the region, especially for Greater China focused funds as the Chinese economy

Figures 6a-6b: Head office locations by number of funds



Source: Eurekahedge

transitions to relatively lower rates of economic growth, which will squeeze gains derived from a largely beta driven approach.

■ Head office location

Figures 6a and 6b display the changes in head office location of Asian hedge funds over the years. In 2007, 37.5% of the funds were based either in the US or UK, which has declined to a share of 27.7% by 2013, as Asia has seen strong launch activity centred on its key financial centres. Hong Kong is now the premier choice of location for Asian hedge funds, increasing from a market share of 15.8% in 2007 to 20.9% by 2013. A similar shift has been seen in favor of Singapore, which now hosts the second largest population of Asian hedge funds; 15.4% by market share. Australia's share has declined marginally, although it still ranks in the top five locations of choice for fund managers in Asia.

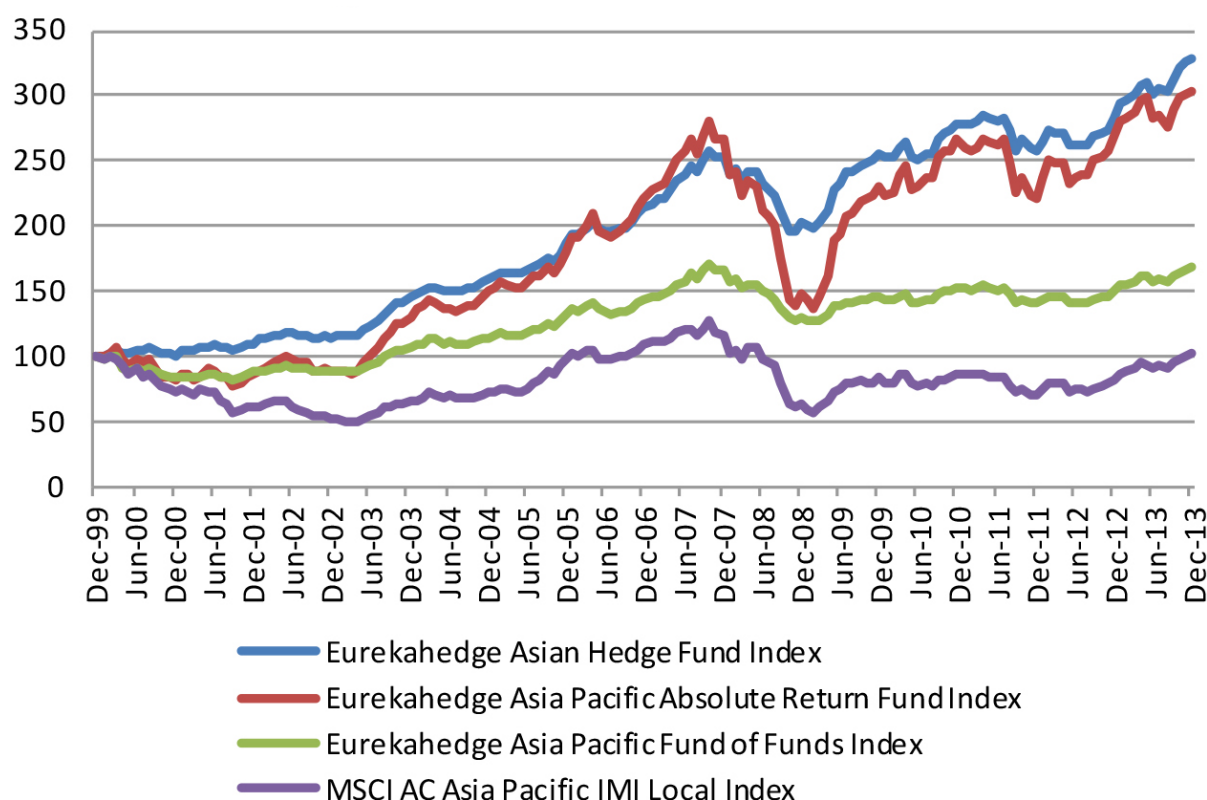
The above trends have been driven by a combination of factors that have pushed investors away from the more developed hedge fund markets in the West toward the high growth economies in the East. Regulatory pressures and relatively higher taxation rates in Europe and the US, coupled with an increasingly competitive hedge fund landscape, have made it difficult for fund managers to trade profitably. Asian markets, on the other hand, are growing and less crowded, hence offering ample opportunities for managers. The exponential rise in the number of accredited investors (HNWI) in Asia tempts fund managers with a pool of potential investors, so the prospects of locating in Asia have appeared even more attractive. Local factors, such as the presence of seasoned traders who have built their expertise through years of experience in the financial markets, have further contributed to the gravitation toward Asia.

■ Performance review

Let's take a look at the overall performance of the Asian hedge fund industry by comparing their returns with alternative investment vehicles. We'll also evaluate the performance of Asian hedge fund managers across regional and strategic mandates and conclude with a comparison of their returns across various fund sizes.

Figure 7 shows that Asian hedge fund managers have outperformed competing investment vehicles, with the Eurekahedge Asian Hedge Fund Index gaining 229.07% since December 1999, compared with the MSCI AC Asia Pacific IMI Local Index, which was up 1.49% over the same period. Hedge fund managers have also beaten absolute return vehicles, which gained 204.40% over the same time period. In Figure 8 the Eurekahedge Asia Pacific

Figure 7: Performance of Asian hedge funds versus market index and other investment vehicles



Source: Eurekahedge

Table 2: Performance across alternative investment vehicles

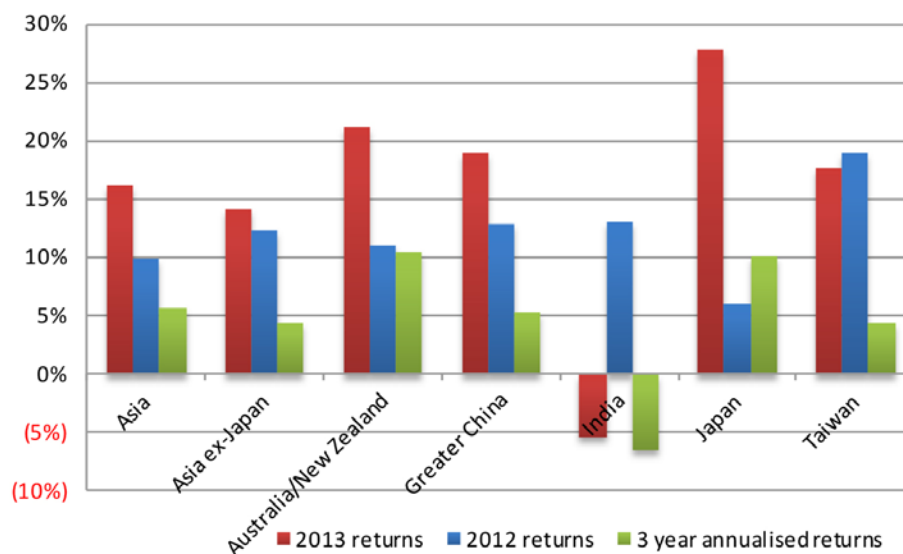
	Asia	Asia ex-Japan	Australia/ New Zealand	Greater China	India	Japan	Taiwan
2013 returns	16.10%	14.05%	21.07%	18.88%	(5.38%)	27.78%	17.73%
2012 returns	9.83%	12.31%	11.02%	12.88%	12.98%	5.95%	18.92%
3 year annualized returns	5.68%	4.28%	10.49%	5.28%	(6.59%)	10.12%	4.31%
3 year annualized standard deviation	7.43%	9.87%	6.89%	11.42%	16.74%	6.55%	13.63%
3 year Sharpe ratio (RFR = 2%)	0.50	0.23	1.23	0.29	0.51	1.24	0.17
5 year annualized return	10.24%	11.72%	15.83%	13.62%	6.50%	8.96%	11.26%
5 year annualized standard deviation	7.86%	10.40%	7.87%	12.03%	18.82%	6.46%	13.47%
5 year Sharpe ratio (RFR = 2%)	1.05	0.94	1.76	0.97	0.24	1.08	0.69

Absolute Return Fund Index appears to be closely trailing the Eurekahedge Asian Hedge Fund Index, but it was almost twice as volatile with an annualized standard deviation of 15.5% compared with 7.5% for the Eurekahedge Asian Hedge Fund Index (based on data from January 2000 to December 2013). Asian hedge fund managers have also adapted better to market volatility post the financial crisis, and offer the best reward-to-risk profile – Sharpe ratio of 0.50 and 1.05 over the last three and five years, respectively.

Figure 8 shows the performance of Asian hedge funds across geographic mandates,

with all regional mandates except India ending 2013 in positive territory. Japan focused funds delivered exceptional performance with the Eurekahedge Japan Hedge Fund Index gaining 27.78% during the year. A combination of anti-deflationary fiscal and monetary policies code-named “Abenomics” saw the Japanese markets post strong rallies on the back of a declining yen, which depreciated 18.39% against the US dollar in 2013. Fund managers who were “short Yen and long Japanese equities” realized handsome gains as a consequence. Australia/New Zealand focused hedge funds were up 21.07%, outperforming the ASX All Ordinaries, which gained

14.76% during the year. The weakening Australian dollar led to income sourced from overseas (non-AUD revenue streams) playing an important role in influencing hedge fund returns. Greater China investing hedge funds were another prominent success story for Asian hedge funds with the Eurekahedge Greater China Hedge Fund Index outperforming the Hang Seng Index by more than 16% during the year, consistently beating underlying markets in 2013 on account of their superior stock picking and calculated short bets on the CSI 300 Index. Pan Asia investing hedge funds were up 16.10% in comparison to Asia ex-Japan focused hedge funds, which

Figure 8: Performance of geographic mandates

Source: Eurekahedge

Table 3: Performance of geographic mandates

	Arbitrage	CTA/ managed futures	Event driven	Fixed income	Long/ short equities	Macro	Multi- strategy	Relative value
2013 returns	2.75%	3.29%	22.72%	1.21%	19.25%	9.15%	5.37%	7.38%
2012 returns	6.98%	4.27%	13.69%	11.81%	9.68%	6.65%	6.77%	16.57%
3 year annualized returns	1.93%	6.37%	12.08%	4.15%	5.87%	6.61%	2.05%	5.42%
3 year annualized standard deviation	3.99%	5.06%	7.62%	7.44%	8.25%	4.57%	5.66%	8.91%
3 year Sharpe ratio (RFR = 2%)	(0.02)	0.86	1.32	0.29	0.47	1.01	0.01	0.38
5 year annualized return	5.55%	8.29%	13.72%	11.82%	10.26%	8.75%	6.69%	11.17%
5 year annualized standard deviation	3.91%	5.26%	6.95%	8.40%	8.65%	4.75%	5.88%	8.64%
5 year Sharpe ratio (RFR = 2%)	0.91	1.20	1.69	1.17	0.96	1.42	0.80	1.06

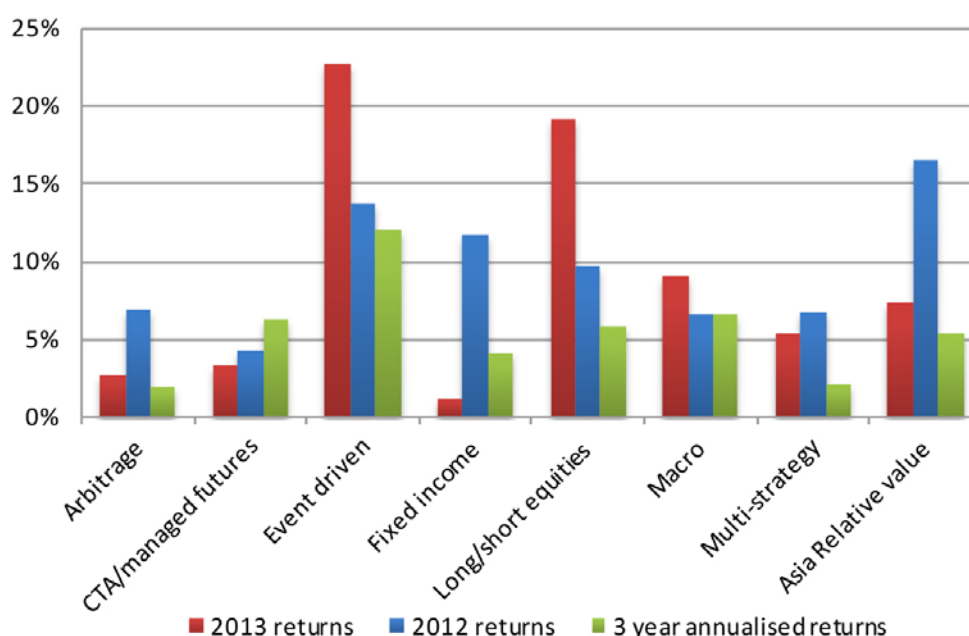
gained 14.05% in 2013, as exposure to Japanese markets paid off for the former. The Eureka hedge India Hedge Fund Index was down 5.38% in 2013, realizing large losses in the three month period from June through August (down 16.4%) as the

“Fed’s taper scare” spurred capital flight from the country leading to increased market volatility.

Table 3 summarizes the key performance indicators for Asian hedge funds by re-

gional mandates over both a three-year and a five-year time horizon. In terms of their reward to risk profiles, Australia/New Zealand focused funds have delivered excellent risk-adjusted returns (Sharpe ratios of 1.23 and 1.76 for both time periods).

Figure 9: Performance across strategic mandates



Source: Eureka hedge

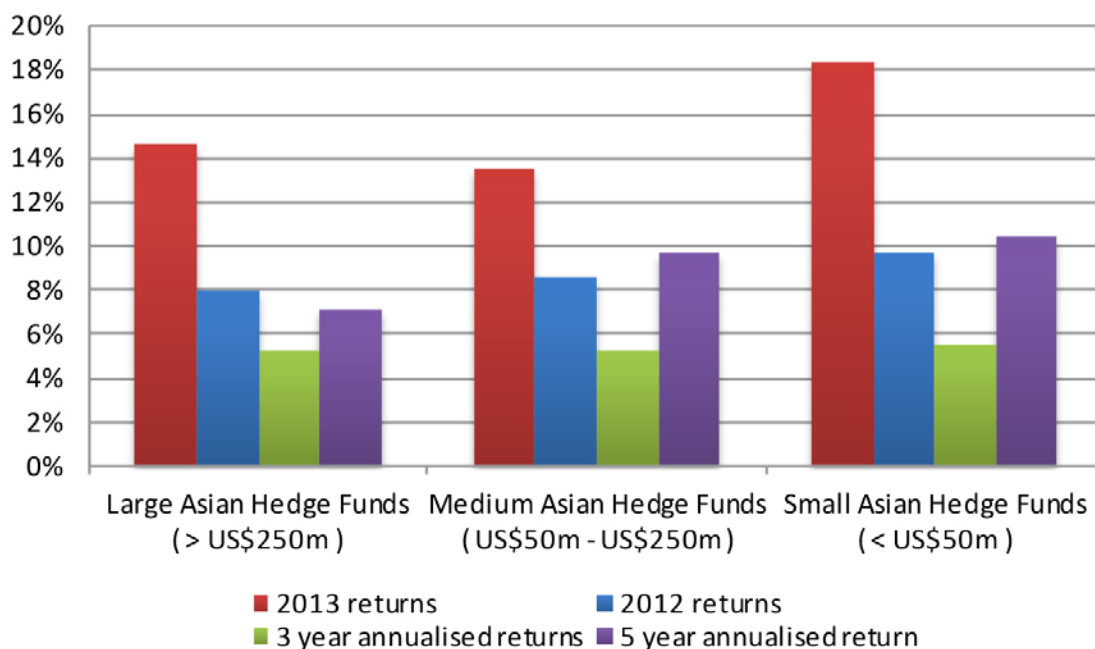
Table 4: Performance across strategic mandates

	Large Asian Hedge Funds (> US\$250m)	Medium Asian Hedge Funds (US\$50m - US\$250m)	Small Asian Hedge Funds (< US\$50m)
2013 returns	14.66%	13.50%	18.32%
2012 returns	7.99%	8.60%	9.66%
3 year annualized returns	5.25%	5.27%	5.54%
3 year annualized standard deviation	5.72%	6.33%	8.42%
3 year Sharpe ratio (RFR = 2%)	0.57	0.52	0.42
5 year annualized return	7.09%	9.67%	10.48%
5 year annualized standard deviation	5.79%	6.84%	8.96%
5 year Sharpe ratio (RFR = 2%)	0.88	1.12	0.95

Japanese hedge fund managers, following their stellar returns in 2013, boast a three- and five-year Sharpe ratio of 1.24 and 1.08, respectively. It is also interesting to note that they offered the least annualized volatility for both time periods under consideration, which is in stark contrast to other single country investment mandates such as India and Taiwan.

Figure 9 segregates the Asian hedge fund industry by strategy employed with all strategic mandates ending 2013 in positive territory. The Eurekahedge Asia Event Driven Hedge Fund Index was up 22.72% followed by long/short equities managers who were up 19.25% as underlying equity markets rallied in the region on the back of improving macroeconomic data from the

US, although the themes of QE-tapering and China's economic growth jolted regional markets from time to time. Asian hedge fund managers deploying macro strategies delivered a handsome 9.15% in comparison to their global counterparts, who were up 2.05% in 2013 as markets were increasingly driven by news flows.

Figure 10: Performance of Asian hedge funds by fund size

Source: Eurekahedge

Table 5: Performance by fund size

	Eurekahedge Asian Hedge Fund Index	Eurekahedge Asia Pacific Absolute Return Fund Index	Eurekahedge Asia Pacific Fund of Funds Index	MSCI AC Asia Pacific IMI Local Index
2013 returns	16.10%	13.32%	12.09%	22.08%
2012 returns	9.83%	21.07%	6.97%	16.42%
2011 returns	(7.43%)	(16.61%)	(8.29%)	(18.20%)
3 year annualized returns	5.68%	4.59%	3.22%	5.15%
3 year annualized standard deviation	7.43%	12.90%	6.29%	13.15%
3 year Sharpe ratio (RFR = 2%)	0.50	0.20	0.19	0.24
5 year annualized return	10.24%	15.38%	5.38%	9.81%
5 year annualized standard deviation	7.86%	15.20%	6.21%	14.64%
5 year Sharpe ratio (RFR = 2%)	1.05	0.88	0.55	0.53

Table 4 below shows that event driven strategies offered the best reward to risk profile over a three-year time horizon (Sharpe ratio 1.32) followed by macro (1.01) and CTA/managed futures (0.86). Long/short equities, which is the most popular strategy among Asian hedge funds posted risk adjusted returns of 0.47 and 0.96 over a three- and five-year time horizon.

■ Performance and hedge fund size

Figure 10 and Table 5 below show the performance of Asian hedge funds according to fund size. In 2012, Small Asian Hedge Funds (AUM < US\$50 million) posted the strongest returns (up 9.66%) in comparison to medium and large sized hedge funds. Over a three-year time horizon, Large Asian Hedge Funds (AUM > US\$250 million) have posted the best risk adjusted returns (Sharpe ratio 0.57) while over a five-year time horizon Medium Asian Hedge Funds (AUM between US\$50 and US\$250 million) have per-

formed better. In both time periods under consideration, Large Asian hedge funds (AUM > US\$250 million) have posted

the lowest annualized standard deviation, pointing toward an increased emphasis on risk management.



About the Author

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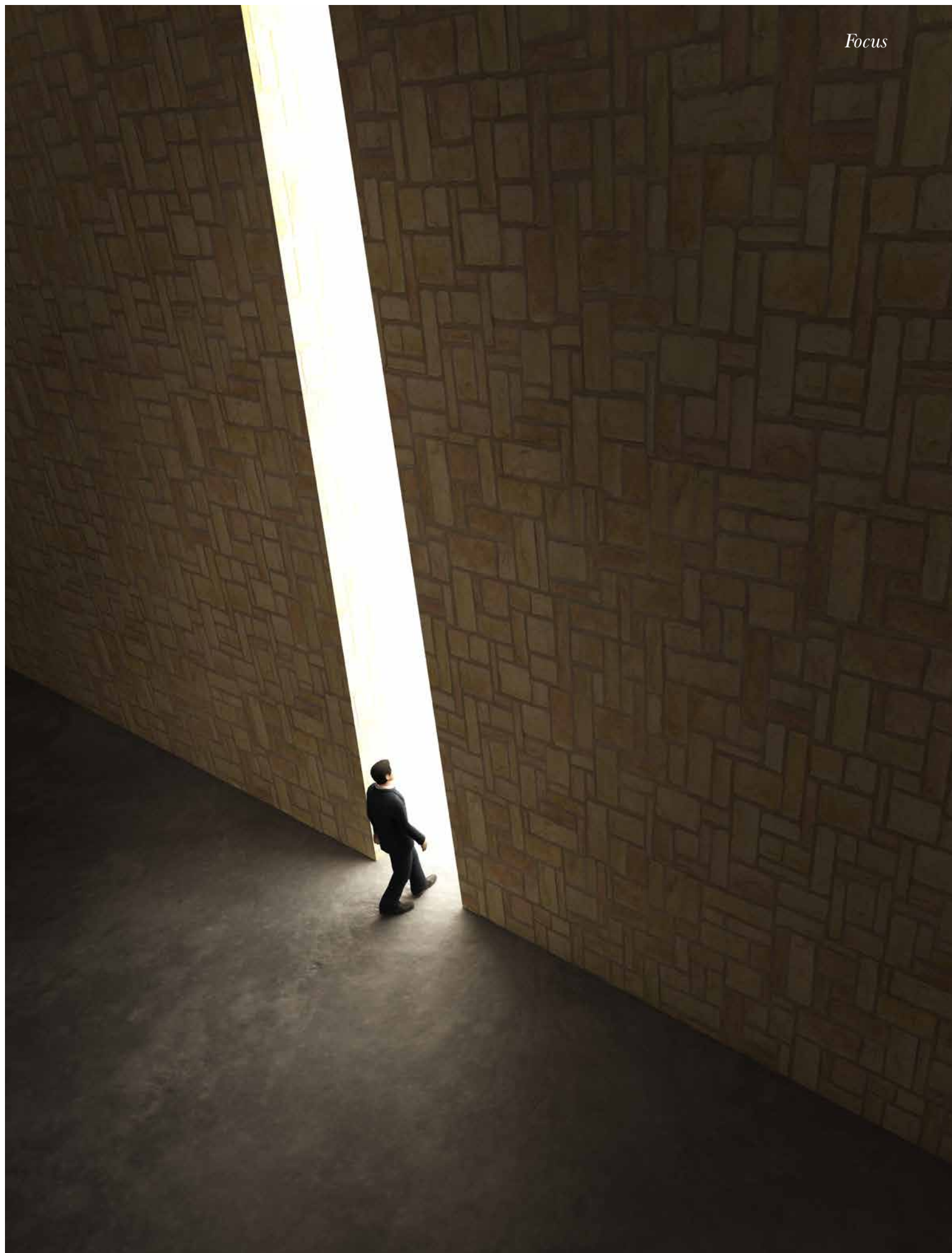
Emerging Economies on Their Own

■ José Antonio Ocampo

There was a remarkable similarity between European Central Bank President Mario Draghi's statement after a recent meeting of the ECB Governing Council and US Federal Reserve Chair Janet Yellen's first testimony to Congress: both asserted that their policy decisions would take into account only domestic conditions. In other words, emerging-market countries, though subject to significant spillover effects from advanced economies' monetary policies, are on their own.

This confirms what emerging-country authorities have known for a while. In 2010 – following the Fed's announcement of a third round of quantitative easing – Brazilian Finance Minister Guido Mantega accused advanced coun-

tries of waging a global “currency war.” After all, advanced economies' policies were driving large and volatile capital flows into the major emerging markets, pushing up their exchange rates and damaging their export competitiveness – a phenomenon that Brazilian President Dil-



ma Rousseff later referred to as a “capital tsunami.”

Recently, the impact of the advanced economies’ withdrawal of monetary stimulus has been just as strong. Since last May, when the Fed announced its intention to begin tapering its asset purchases, capital has become less accessible and more expensive for emerging economies – a shift that has been particularly painful for countries whose large current-account deficits leave them dependent on foreign finance. In response, Raghuram Rajan, Governor of the Reserve Bank of India, has called advanced-country policies “selfish,” declaring that “international monetary cooperation has broken down.”

To be sure, emerging economies have plenty of their own problems to address. But there is no denying that these countries have been victims of advanced economies’ monetary policies, which have increased capital-flow volatility over the last three decades. According to the International Monetary Fund’s April 2011 *World Economic Outlook*, though the volatility of capital flows has increased worldwide, it is higher in emerging market economies than in advanced economies. Boom-bust financial cycles are driven largely by shocks generated in advanced economies, but they are key determinants of emerging markets’ business cycles.

Moreover, the spillover effects of advanced economies’ monetary policies extend beyond financial shocks. Emerging economies are also suffering from the effects of developed countries’ external imbalances – particularly the eurozone’s swelling current-account surplus.

In the last few years, the deficit economies of the eurozone’s periphery – and, more recently, Italy – have undertaken massive external adjustments, while Germany and

the Netherlands have sustained their large surpluses. As a result, the burden of offsetting the eurozone’s rising surplus has fallen largely on emerging economies, contributing to their growth slowdown.

Such spillover effects are precisely what international policy cooperation – such as

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the “mutual assessment process” that the G-20 established in 2009 – was supposed to prevent. The IMF has created an elaborate system of multilateral surveillance of major countries’ macroeconomic policies, including the “consolidated multilateral surveillance reports,” the spillover reports for the so-called “systemic five” (the US, the United Kingdom, the eurozone, Japan

and China), and the “external sector reports” assessing global imbalances.

But this system has proved to be utterly ineffective in preventing spillovers – not least because the Fed and the ECB simply ignore it. Given that the US dollar and the euro are the top two international reserve currencies, spillovers should be considered the new normal.

Adding insult to injury, the 1.1 trillion appropriations bill for federal-government operations agreed last month by the US Congress does not include any money to recapitalize the IMF, the main instrument of international monetary cooperation. That decision represents yet another setback for IMF reforms aimed at increasing the influence of emerging economies.

Given the considerable benefits that stable and prosperous emerging countries bring to the world economy – exemplified by the role that they played in propping up global growth in the wake of the recent crisis – it is in everyone’s interest to change the *status quo*. The G-20 and the IMF’s International Monetary and Financial Committee must work to align reality with the rhetoric of macroeconomic policy cooperation. For that, the recent statements by Draghi and Yellen should be treated as ground zero.

About the Author

José Antonio Ocampo, former United Nations Under-Secretary-General for Economic and Social Affairs and former Finance Minister of Colombia, is Professor and Member of the Committee on Global Thought at Columbia University. He is the co-author (with Luis Bértola) of *The Economic Development of Latin America since Independence*.



Emerging Market Risk and Reward

■ Nouriel Roubini



One definition of an emerging-market economy is that its political risks are higher, and its policy credibility lower, than in advanced economies. After the financial crisis, when emerging-market economies continued to grow robustly, that definition seemed obsolete; now, with the recent turbulence in emerging economies driven in part by weaker economic policy credibility and growing political uncertainty, it seems as relevant as ever.

Consider the so-called Fragile Five: India, Indonesia, Turkey, Brazil and South Africa. All have in common not only economic and policy weaknesses (twin fiscal and current-account deficits, slowing growth and rising inflation, sluggish structural reforms) but also presidential or parliamentary elections this year. Many other emerging economies – Ukraine, Argentina, Venezuela, Russia, Hungary, Thailand and Nigeria – also face significant political and/or social uncertainties and civil unrest.

And that list does not include the perilously unstable Middle East, where the Arab Spring in Libya and Egypt has become a winter of seething discontent. Civil war rages in Syria and smolders in Yemen, and

Iraq, Iran, Afghanistan, and Pakistan form a contiguous arc of volatility. Nor does it include Asia's geopolitical risks arising from the territorial disputes between China and many of its neighbors, including Japan, the Philippines, South Korea and Vietnam.

According to the positive narrative about emerging markets, industrialization, urbanization, *per capita* income growth, and the rise of a middle-class consumer society were supposed to boost long-term economic and sociopolitical stability. But in many countries recently wracked by political unrest – Brazil, Chile, Turkey, India, Venezuela, Argentina, Russia, Ukraine and Thailand – it is the urban middle classes that have been manning the barricades. Likewise, urban students and the middle classes spearheaded the Arab Spring, before losing authority to Islamist forces.

This is not a complete surprise: in many countries, working classes and rural farmers have benefited from *per capita* income increases and a broadening social safety net, while the middle classes feel the pinch from rising inflation, poor public services, corruption and intrusive government. And now the middle classes tend to be more vocal and better politically organized than in the past, in large part because social media allow them to mobilize faster.

Not all of the recent political unrest is unwelcome; a lot of it may lead to better governance and greater commitment to growth-oriented economic policies. Among the Fragile Five, a change in government is likely in India and Indonesia.

But uncertainty abounds. In Indonesia, economic nationalism is on the rise, implying a risk that economic policy will follow an inward-looking course. In India, the opposition Bharatiya Janata Party's prime ministerial candidate, Narendra Modi, if elected, may or may not be able to implement at the

national level the growth-oriented policies that he successfully implemented at the state level in Gujarat. Much will depend on whether he can shed his sectarian attitudes and become a truly inclusive leader.

By contrast, a change in government is unlikely in South Africa, Turkey and Brazil. But the current rulers, if reelected, may shift policies. South African President Jacob Zuma has chosen a pro-business tycoon as his vice-presidential candidate and may move toward market-oriented reforms. Turkish Prime Minister Recep Tayyip Erdoğan cannot realize his dream of a presidential republic and will have to follow his opponents – including a large protest movement – to the secular center. And Brazilian President Dilma Rousseff may embrace more stable macroeconomic policies and accelerate structural reforms, including privatization.

Even in extremely fragile and risky cases, such as Argentina, Venezuela and Ukraine, political and economic conditions have become so bad that – short of becoming failed states – the situation can only get better. Argentine President Cristina Fernández is a lame duck, and any of her potential successors will be more moderate. In Venezuela, President Nicolás Maduro is a weak leader who may eventually be unseated by a more centrist opposition. And Ukraine, having gotten rid of a kleptocratic thug, may stabilize under a Western-led economic revival program – that is, if the country can avoid civil war.

For the Middle East, risks remain abundant, with a bumpy economic and political transition likely to take more than a decade. Even there, however, gradual stabilization will eventually lead to greater economic opportunities.

So in most cases there is reason to hope that electoral change and political upheaval will

give rise to moderate governments whose commitment to market-oriented policies will steadily move their economies in the right direction.

Of course, the risks should not be discounted. Emerging economies today are more fragile and volatile than in the recent past. Structural reforms imply the need to pay short-term costs for longer-term benefits. State capitalism of the sort exemplified by China has strong support among policy-makers in Russia, Venezuela and Argentina, and even in Brazil, India and South Africa. Resource nationalism is on the rise, as is a backlash against free trade and inward FDI. Indeed, rising income and wealth inequality in many emerging markets may eventually lead to a social and political backlash against liberalization and globalization.

That is why economic growth in emerging markets must be cohesive and reduce inequality. While market-oriented reforms are necessary, government has a key role to play in providing a social safety net for the poor, maintaining high-quality public services, investing in education, training, health care, infrastructure, and innovation, enforcing competition policies that constrain the power of economic and financial oligopolies, and ensuring genuine equality of opportunity for all.

About the Author

Nouriel Roubini, a professor at NYU's Stern School of Business and Chairman of Roubini Global Economics, was Senior Economist for International Affairs in the White House's Council of Economic Advisers during the Clinton administration. He has worked for the International Monetary Fund, the US Federal Reserve, and the World Bank.



Until relatively recently, countries' so-called middle-income transitions were largely ignored – in part because what was supposed to be a transition often became a trap. A few economies in Asia – particularly Japan, South Korea and Taiwan – sailed through to high-income status with relatively high growth rates. But the vast majority of economies slowed down or stopped growing altogether in *per capita* terms after entering the middle-income range.



Today, investors, policymakers and businesses have several reasons to devote much more attention to these transitions. For starters, with a GDP that is as large as the combined total of the other BRICS countries (Brazil, Russia, India and South Africa) plus Indonesia and Mexico, China has raised the stakes considerably. Sustained Chinese growth, or its absence, will have a significant effect on all other developing countries – and on the advanced economies as well.

Second, the developed economies are out of balance and growing well below potential, with varying but limited prospects for faster growth on a five-year time horizon. By contrast, emerging economies, with their higher growth potential, increasingly represent large potential markets to tap.

Third, a majority of the large emerging economies (Indonesia, Brazil, Russia, Turkey and Argentina, but not China) unwisely relied on large inflows of abnormally cheap foreign capital, rather than domestic savings, to finance growth-sustaining investments. As a result, their current-account balances deteriorated in the post-crisis period.

Now, with the onset of monetary tightening in the advanced economies, the imported capital is leaving in a slightly panicky mode, creating downward pressure on exchange rates and upward pressure on domestic prices. The adjustment now underway requires launching real reforms and replacing low-cost external capital with domestically financed investment.

Market uneasiness reflects uncertainty about the duration of the growth slowdown that is likely to result, the implications for credit quality and valuations, herd effects, and the negative returns from bucking the trend. Moreover, there is concern that an overshoot in capital outflows

could produce the kind of self-reinforcing damage to stability and growth from which it is more difficult to recover. These large emerging economies received an apparently free pass to growth: an ability to invest without pursuing arduous reform or sacrificing current consumption. But it is easier to take the detour than it is to return to the main road.

But this narrative is largely irrelevant to China, where excess savings and capital controls still limit direct exposure to monetary-policy externalities spilling over from advanced countries. China is not risk-free; its risks are just different.

Even so, amid growing concerns about emerging economies' prospects, China is attracting attention because of its scale and central position in the structure of global trade (and, increasingly, global finance). As a result, risk assessment in China focuses on the magnitude of the structural transformation, resistance from powerful domestic interests, and domestic financial distortions.

In particular, there is considerable uncertainty about the Chinese version of shadow banking, which has grown in large part to circumvent the restrictions embedded in the state-dominated official system. Shadow banking has given savers/investors access to a larger menu of financial options, while small and medium-size enterprises – which play an increasingly important role in generating growth and employment – have gained broader access to capital.

The Chinese authorities need to address two issues. The first, establishing regulatory oversight, will be easier to resolve than the second: the potential for excessive risk-taking as a result of the implicit government guarantees that back state-owned banks' balance sheets. The authorities need to remove the perceived

guarantee without triggering a liquidity crisis should they let some bank or off-balance-sheet trust fail.

The list of other challenges facing China is long. China needs to rein in low-return investment; strengthen competition policy; correct a lopsided fiscal structure; monitor income distribution across households, firms, asset owners, and the state; improve management of public assets; alter provincial and local officials' incentives; and overhaul the planning and financing of urban growth. Thoughtful analysts like Yu Yongding worry that the difficulties of managing imbalances, leverage, and related risks – or, worse, a policy mistake – will distract policymakers from these fundamental reforms, all of which are needed to shift to a new, sustainable growth pattern.

Little wonder that financial markets are feeling slightly overwhelmed. But the swing is excessive. Not all advanced-economy investors who were chasing yield have deep knowledge of developing-country growth dynamics. As a result, the trend reversal will almost surely overshoot, creating investment opportunities that were missing in the previous environment, in which asset prices and exchange rates were strongly influenced by external conditions, not domestic fundamentals.

The major emerging economies are adjusting structurally to this new environment. They do not need external financing to grow. In fact, since World War II, no developing economy has sustained rapid growth while running persistent current-account deficits. The high levels of investment required to sustain rapid growth have been largely domestically financed.

China's challenges are idiosyncratic and different from those of other emerging



economies. The structural transformation required is large, and the imbalances are real. But China has an impressive track record, substantial resources and expertise, strong leadership, and an ambitious, comprehensive and properly targeted reform program.

The most likely scenario is that most major emerging markets, including China,

will experience a transitional growth slowdown but will not be derailed by shifts in monetary policy in the West, with high growth rates returning in the course of the coming year. There are internal and external downside risks in each country that cannot and should not be dismissed, and volatility in international capital flows is complicating the adjustment.

The problem today is that the downside risks are becoming the consensus forecast. That seems to me to be misguided – and a poor basis for investment and policy decisions.

About the Author

Michael Spence, a Nobel laureate in economics, is Professor of Economics at NYU's Stern School of Business, Distinguished Visiting Fellow at the Council on Foreign Relations, Senior Fellow at the Hoover Institution at Stanford University, and Academic Board Chairman of the Fung Global Institute in Hong Kong. He was the chairman of the independent Commission on Growth and Development, an international body that from 2006-2010 analyzed opportunities for global economic growth, and is the author of *The Next Convergence – The Future of Economic Growth in a Multispeed World*.

The Agriculture Periodic Table

A framework for examining the interesting universe of opportunities beyond farmland

■ Pranav Garg

While agriculture has gained prominence as an alternative-asset class over the last decade, the vast majority of alternative investments in agriculture have gone into farmland. With farmland in developed markets having generated attractive returns in the last few years, and with reduced expectations for future upside, our clients frequently ask our advice regarding opportunities “beyond farmland.”

The quality of these “beyond farmland” discussions has been murky due to the lack of a systematic framework or language for describing this universe of opportunities. Without a universal framework, you are forced to consider the opportunities that knock on your door. However, such opportunities come with an unfortunate bias known in behavioral economic circles as the “availability bias” – that is, overweighting of evidence that is easily available. We are sure you agree that there should be a more rigorous bar for your investment

prospects than the next CEO you happen to meet at the airport lounge.

A systematic, universal framework can help you uncover opportunities that benefit disproportionately from the secular growth in food & agribusiness, but that are not widely advertised in the marketplace, offering growth at a reasonable price. The purpose of this article is to propose such a framework. Because of its universal nature, we like to think of the framework as a type of periodic table – only this one is not for elements but for agriculture. We call it the “Ag periodic table.”

To create this table, we adopted the concept of the value chain, focusing primarily on food-oriented end use markets. The same concept can be expanded to other markets, such as those for fuels or fiber. Further, we boiled down the transformative steps in the value chain to just production and processing, and considered on a standalone basis the respective inputs, supporting activities, markets and underlying business model variants. In combination, these variables can yield insights regarding unique investment segments and help you uncover interesting investment theses.

Table 1 Ag Periodic Table

Transformation Step	Farming/Production		Processing
	Annual	Perennial	
	Cereals Oil-bearing (e.g. soybeans) Sugar-bearing Pulses Roots & Tubers Fiber crops Vegetables Tobacco Dairy Livestock Aquaculture	Oil-bearing (e.g. palm) Fruits & Berries Nuts Coffee Cocoa Tea Spices & Condiments Herbs Rubber Timber	Milling, Grinding, Pulping Baking Slaughtering, Curing, Smoking, Packing Sorting, Separation, Straining, Filtration, Clarification/Purification Extraction, Refining Spraying, Soaking, Bleaching Drying Roasting, Toasting Cooking, Frying Pasteurization Steeping, Brewing, Fermentation Salting, Pickling Ginning, Pressing, Bailing, Spinning, Weaving (Fiber) Blending, Mixing Emulsification Refrigeration, Freezing, Freeze-drying Bottling, Packaging
Inputs	Seeds Nutrients/Fertilizers Crop protection Water/Irrigation Weather Land Labor Farm Machinery Fixed Property/Storage Infrastructure		Raw Produce/Products of Farming Water & Chemicals (for Extraction, Refining, Purification. etc.) Enzymes Microbial cultures Additives (Antioxidants, Emulsifiers, Flavors, Colors, Preservatives, Physical) Packaging materials Land Labor Processing Equipment/Machinery Fixed Property/Storage Infrastructure

Support Activities/ Services	Storage & Transportation (Bulk, Container/Packaged, Cold Chain) Merchandizing/Distribution (Brokers, Wholesalers, Distributors) Trading/Risk Management (Exchanges, OTC Markets) Operations/Yield Management Marketing & Product Development Testing, Inspection, Certification Services Insurance Loans/Financing/Financial Structuring Regulatory Compliance – Labeling, Environmental, Food Safety Waste Management Food Chemistry/Sensory Analysis/Food Physics Utilities/Energy Management, Sustainability Process Technology/Automation IT/Big Data/Analytics Market/Competitive Intelligence/Consulting/M&A Services
Markets	End Use Markets: Retail (Supermarkets, Hyper-markets, Department Stores, Mom & Pop Stores), Food Service (Hotels, Restaurants, Catering, Bakeries) Geographies: N America, S America, W Europe, E Europe, Middle East & Africa, E Asia, S Asia, SE Asia, Australia & New Zealand
Underlying Market Needs, Business Model Variants	Low Cost, Commodity Foods: Basic staple foods at affordable prices Convenience: Prepared/Ready-to-eat Foods, Away from home Ethnic Foods: Asian/Latin Prepared Foods Health & Wellness: Gluten-free, Organic, Whole grain, Sugar-free, Ancient Grains, Omega-3, Antioxidants, Trans-fat free, GMO-free, Low-Sodium Sustainability: Fair-trade certified, Organic, Bio-based nutrients and crop protection, recycled and/or bio-degradable packaging, Energy and Water usage, Waste Stream recycling Food Safety: Pesticide-Free, Antibiotic-free, Hormone-Free

If the Ag periodic table appears complex and theoretical, we outline in Table 2 a few real-world examples of investment opportunities that can be derived from its

possible combinations. Note that these examples are selected for illustrative purposes only, with complete disregard for their investment attractiveness or viability.

Further, neither HighQuest nor the author maintains any client relationship or ownership interest in these companies.

Table 2 Illustrative examples

Opportunity/Segment	Illustrative Example of Target
Provider of inspection, testing, and certification services for agricultural and other bulk commodities across major global markets	Cotecna (Private)
Manufacturer of grain storage and handling equipment in Brazil	Kepler Weber (Public, Sao Paulo)
Provider of natural, yield enhancing plant products, active in the European agricultural and horticultural markets	Plant Health Care (Public, London)
Agricultural harvesting machinery leasing/rentals to farms producing major cereals or oilseed crops in the United States	MachineryLink (Private)
Full service flavor development company focused on food & beverage markets in North America and Europe	FONA International (Private)

These are just a few examples we could glean from the Ag periodic table. The wider set of combinations from the periodic table can yield quite an interesting uni-

verse of competing opportunities. Without a doubt, some of these opportunities will yield better risk-adjusted returns than farmland in the coming years.

We hope that you will use this framework as a starting point in looking at a wide range of opportunities in agriculture, well beyond farmland.

About the Author:



Pranav Garg is Managing Director and Co-Head of HighQuest Partners' Strategy Consulting Practice. Mr. Garg helps clients build winning business models/strategies and achieve top-quartile financial performance in agribusiness & food markets.

Mr. Garg is passionate about the role of technology in building winning models, and has helped build/advised innovative technology startups.

Prior to HighQuest, Mr. Garg was at Newpoynt Partners where he advised private equity and industry clients on Latin America M&A transactions. Prior to Newpoynt, Mr. Garg held leadership roles in Strategy, Finance, and Corporate Development at Bunge. At Bunge, he engineered the financial transformation of a US\$2 billion Latin America division, achieving top-quartile volume growth, cash generation, and returns on investment.

Prior to Bunge, Mr. Garg was a management consultant at Arthur D. Little and Charles River Associates. He is a graduate of the Indian Institute of Technology (IIT) and Tufts University. Mr. Garg is fluent in English & Hindi, and has intermediate proficiency in Spanish.

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Political Risk in Malaysia

■ James Knight

I was in Malaysia when news broke of the loss of flight MH370. In fact, I had flown there with the same airline. At time of writing, more than a week after the event, there was still no coherent narrative of what had happened, and no confirmed sightings of debris or wreckage.

This is a humanitarian tragedy, unimaginably traumatic for the families of those passengers and crew who still know very little about the fate of their loved ones. The final hours of the flight will doubtless become less of a mystery over time, although what really happened aboard may never be known fully.

In terms of reputational risk, lessons can be learned from the response to the incident. Crisis communications is a growth area, especially for multinationals with a global image to protect. It exists precisely for this eventuality, in order to handle as smoothly as possible the response to extraordinary or difficult events – acts of terrorism, insecur-

ity, civil unrest, labor relations, natural disasters, acts of God. The handling of MH370 is made even more difficult because the cause of the loss is still not known. But it does have an effect on the bottom line – Malaysia Airlines shares plunged 18% on the first day of trading after the disappearance.





■ Out of control

The story threatened to get away from the airline company quickly as the lethal cocktail of the demands of a global 24-hour news cycle and the viral qualities of social media combined. In the first 72 hours after the flight's disappearance, an array of erroneous information was circulated – often rumor first nourished online and then picked up by television news outlets that had nothing else to report on at the time. Malaysia Airlines did its best to get out what little information it had, while trying to manage expectations about what the information meant; for instance, that oil slicks had been seen off the coast of Vietnam but that this did not guarantee the plane had been found. The challenge it faced was that every day the mystery deepened.

Could anything have been done differently? I felt that in the days following the disappearance, the agenda was dominated by the Malaysian government. Obviously, a decision was taken to treat the search and rescue response as a national emergency, with government assets pressed into action. But this was only part of a wider response that, in my view, the company should have led. Govern-

ment voices do not insulate the company from criticism, but make it look either too weak or too incompetent to manage the issue itself.

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■ Unintended consequences

Crisis communications is a firefighting business. And the firestorm can blow in strange directions. For example, the revelation that two passengers were traveling on fake European passports shone an uncomfortable but completely legitimate

spotlight on Malaysia's well-deserved reputation as a people-trafficking hub. It seems highly unlikely that the individuals had anything to do with the plane's disappearance, but an important debate has opened up about the country's role as a transit point within Southeast Asia. Then, once it was known that the plane's tracking systems had been disabled in-flight, focus shifted to the pilot, linking his state of mind to developments in internal opposition politics in Malaysia.

These are both issues that a single airline cannot be expected to control. They also have the messy potential to be distorted and massaged for political ends. The company needs to avoid being dragged into these debates as much as possible, and acknowledge that there are limits to what it can monitor about both its passengers and crew members.

We take a risk whenever we board a plane, but it is still statistically much safer than getting into a car. Despite having a safety record in line with competitors from middle-income countries, much of the damage has already been done for the company. And as crisis mode eventually evolves into consolidation, the challenge of long-term reputational repair begins for Malaysian Airlines.



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 U.K.-based risk and strategic advisory consultancy serving international clients. Prior to his current role he advised a Hong Kong-based fund on various LatAm projects, and previously worked at Barclays Bank plc. He has also handled targeted communications projects for the World Bank and the United Nations. He began his career as a journalist, freelancing for Reuters, The Economist, The Sunday Times, and Africa Confidential covering business, investment and conflict. He holds a degree from Cambridge University.



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Effects of Foreign Exchange Controls in Argentina

■ Javier Canosa

In October 2011 Argentina once again imposed foreign exchange controls. The government opted to maintain a high convergence of the exchange rate of the local currency against the US dollar. On one side, this helps explain the overwhelming victory of the governing party in the 2011 presidential election because it allowed for high consumption of goods at low prices denominated in dollars, but at the same time it created a massive flight of Argentine pesos to the dollar, as the dollar was perceived as “cheap” against the peso.



Of course, exchange controls are not new in Argentina. The question should be whether they were ever effective. We have had exchange controls in the past, in the periods 1931-1945, 1946-1958, 1959-1971, and 1971-1981. In addition, other countries like Venezuela have been experience with this type of state intervention in the exchange market.

We do not want to go too far into analyzing the effects of exchange controls in previous periods. However, there are some strong effects – both intended and incidental – that become clear in any evaluation of the results:

- A steep fall in central bank reserves, although not as significant as the one

seen prior to the implementation exchange controls, indicating that the implementation helps at least manage the leakage.

- Higher inflation owing to the lack of a price for imported goods and services.
- A wider gap between official and unofficial exchange rates.
- A sharp decrease in foreign and local investment.

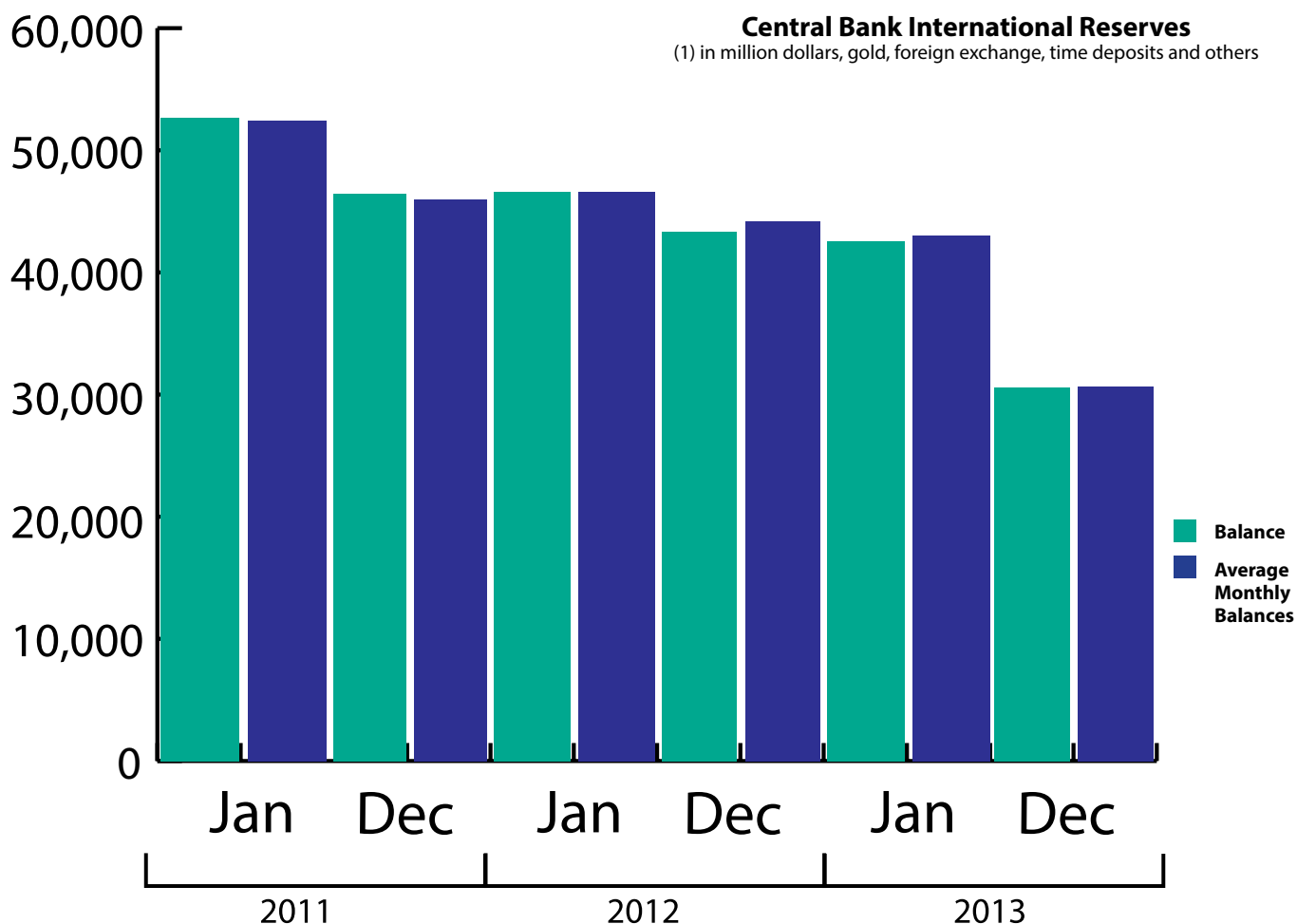
The graph below shows central bank reserves from 2011 to 2013.

Reserves have stopped the dramatic fall seen in early 2011, but still, even with the exchange controls, the de facto ban on imports and the de facto ban on dividend payments, central bank reserves have continued to fall. In other cases, exchange

controls have been efficient in softening the fall in central bank reserves, but this effect is temporarily and is also attributable to complementary measures aimed at correcting the general inconsistencies of the economy.

Let's consider inflation in the same period.

Inflation has not taken a break. On the contrary it has gained momentum because it is very difficult to obtain prices when you cannot know the value of the foreign currency or cannot get access to it. What is your reposicion cost if you cannot predict the cost of that currency in time? There is some element of self-fulfilling prophecy in this, but ultimately with no investment and a dearth of information on the cost of goods, inflation is bound to rise.



But one could ask whether these controls have managed to contain the exchange rate. The results? A higher exchange rate has created a very wide gap between the official and unofficial rates of exchange.

This, again, sows the seeds of financial speculation, higher inflation (with higher costs for the poorer people) and all sorts of cheats to access foreign currency.

But perhaps the most dramatic effect is the sharp decline in foreign direct investment. Why would you invest in a country where you cannot get your dividends out or where the gap between the official and unofficial exchange rates is so wide that it is unbearable for any legitimate business? It is easy to see that the effects of exchange controls have been the following:

- Further and increased loss of central bank reserves;
- Increased inflation;
- Higher exchange rate; and
- Decreased FDI.

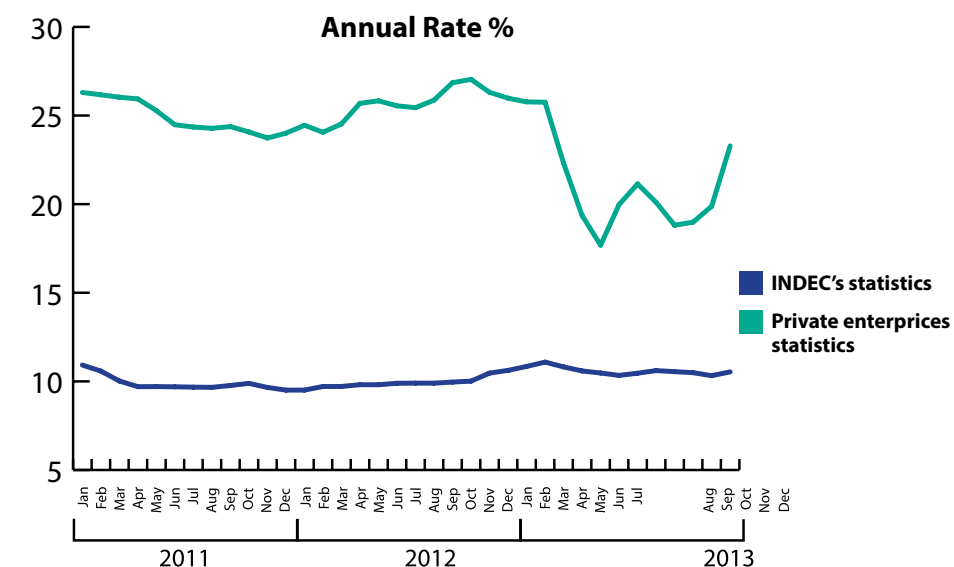
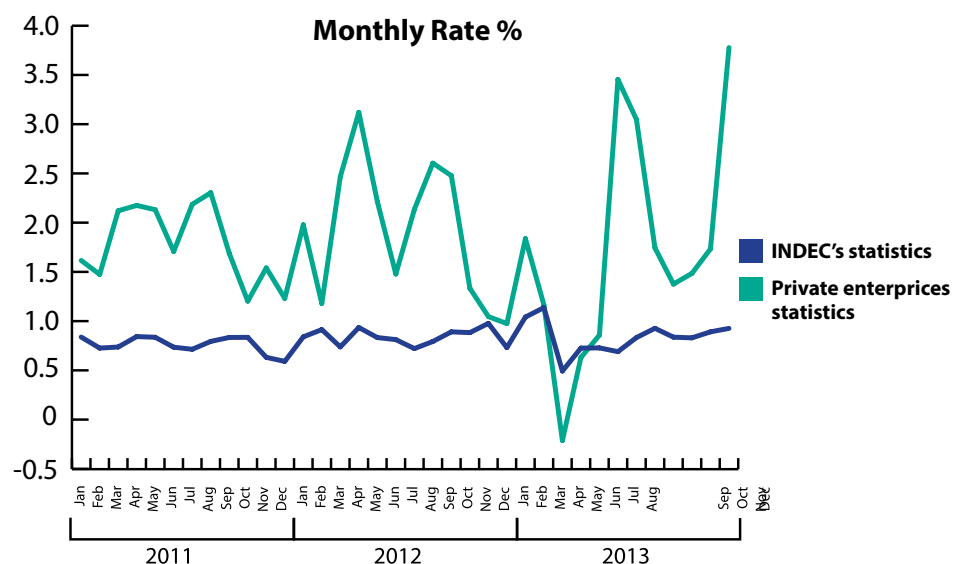
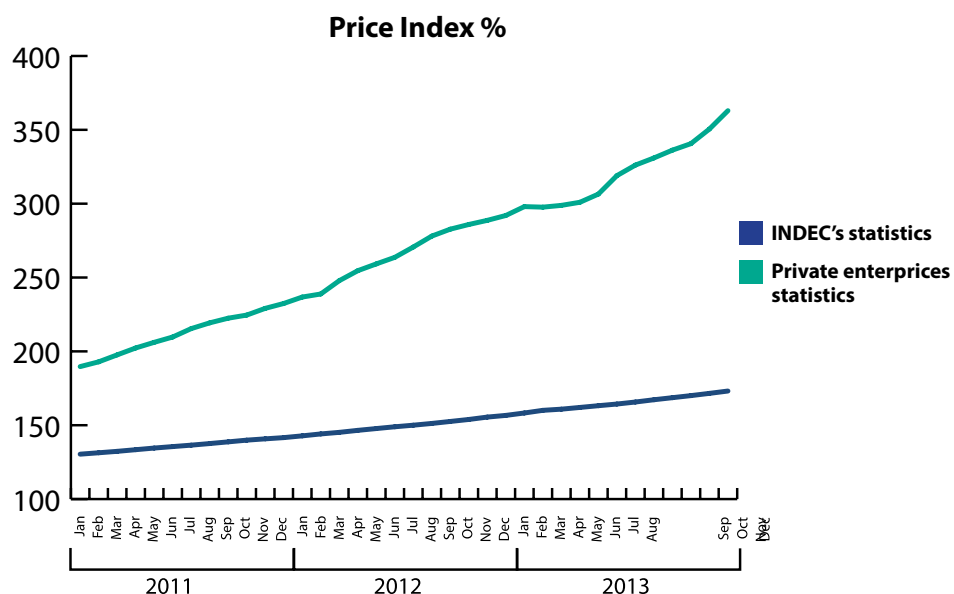
Why did the government impose exchange controls in the first place? Well, these controls have been quite successful in stopping the bleeding of reserves from the central bank observed between January and October 2011. Reserves kept falling but at a slower pace, so the policy managed to deal with this situation.

Why is the government maintaining exchange controls? Because lifting the ban on foreign currency would cause people to rush to the dollar and thus produce a run against the peso.

■ Hopes for the future?

There is room for optimism.

After a large devaluation in January 2014, the government has eased exchange re-



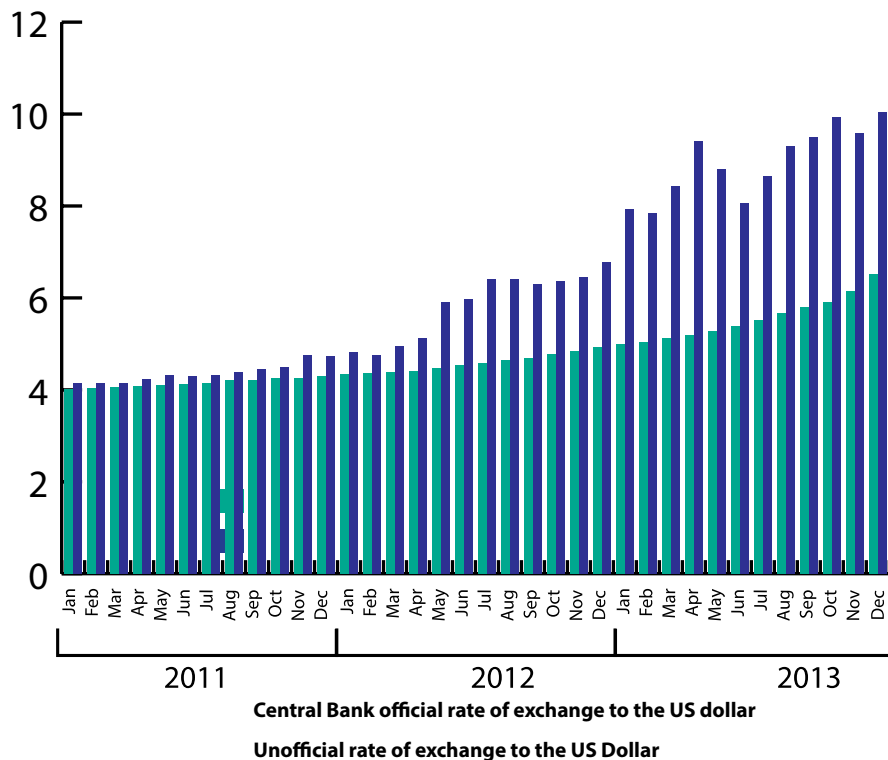
strictions, reopened discussions with the Paris Club, and settled litigation with Repsol for the nationalization of the local oil & gas company YPF. Meanwhile, the new statistics bureau has demonstrated the government's ability to deal with re-

ality and look for solutions to longstanding issues.

For the last month, the situation with regard to the exchange rate and the draining of central bank reserves seems to have

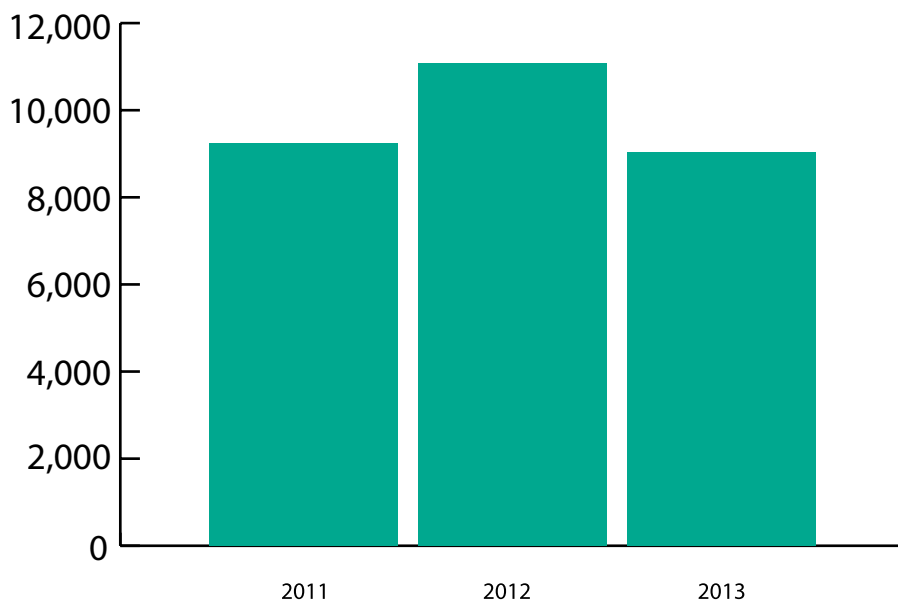
been stable. Perhaps it is time to begin slowly dismantling the tangle of rules and restrictions regarding foreign currency. We may still have time to swerve and avoid another crisis. Let us be optimistic.

Argentina Rate Of Exchange (1)



Net Foreign Direct Investment

(1) in million dollars



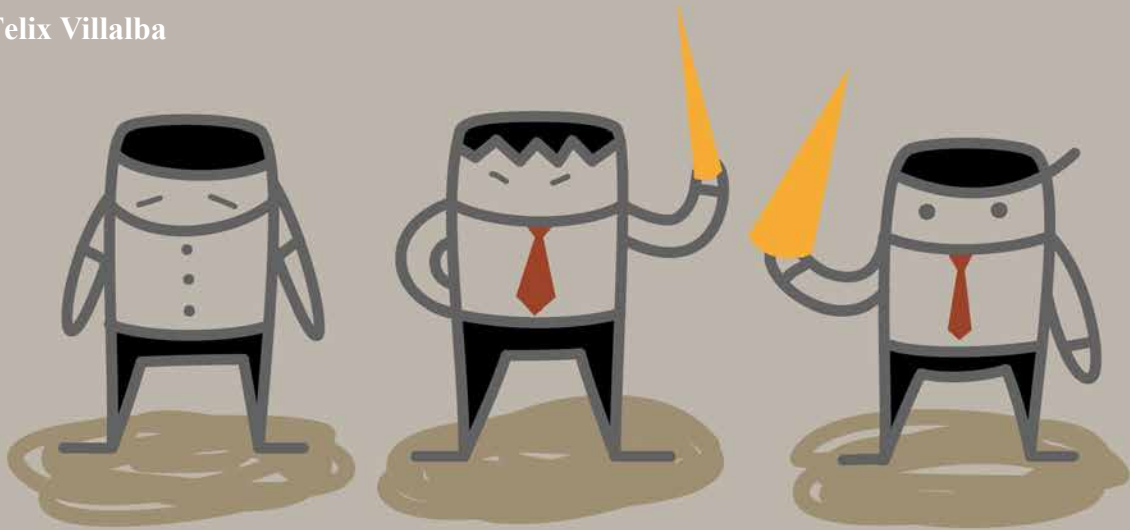
About the Author

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

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Monopolistic Tendencies in Colombia

■ Felix Villalba



Economics is not an easy science to understand given all the moving parts; consider the failure of central planning experiments in Eastern Europe, Russia, China, etc., and, most recently, Venezuela. Leaders mistakenly believe that they can control it all, a naïve assumption driven by large egos. Free capitalistic markets self-correct but also need some oversight to avoid abuse. This delicate balance between oversight and a free market economy will determine the success of emerging economies like Colombia in the coming decades. As the Colombian market grows and companies become multinationals, monopolistic and oligopolistic tendencies increase.

...mayors and city planners need to make sure that they are not being used in a strategic game to create monopolies.



■ Facing rising interest rates

Rising interest rates in the global economy will present a temptation to many politicians to create mechanisms to control the inevitable. Many politicians will try to sway central banks in the Latin American region to overreact. In some countries, like Argentina, Ecuador and Venezuela, politi-

cal control over these decisions will certainly be stronger than in a system like Colombia's. In Colombia we have a strong, independent central bank, the Banco de la Republica. However, a lot of energy will be spent on political discussions trying to sway the bank one way or the other. In addition, fiscal policy, as usual, is likely to be slow to act when it comes to implementing

necessary adjustments, and there will inevitably be over- or under-reactions.

■ Monopolistic tendencies

While politicians will be fighting a losing battle trying to control interest rates and inflation in emerging economies, they may easily forget or ignore for convenience a

more important foe: monopolistic tendencies by the new large Latin American companies.

One such example is what is currently happening in city planning in Barranquilla, Colombia, where the movements of Argos and its Situm subsidiary could be construed as monopolistic behavior. Several coincidences are cause for suspicion. Camacol Barranquilla is chaired by an Argos executive. Camacol is the only development and construction industry association in the city with any pull with respect to new city planning rules.

The city of Barranquilla is creating new rules and regulations that will guide the city's growth for the next 30 years. Cer-

tain aspects of these new rules seem to side with Argos. For example, the master plan prohibits the building of high rises in high-end areas of the city – except, conveniently, for the land owned by Situm/Argos.

Land owned by Situm/Argos is only sold in exceptionally large parcels, and the deals involve special selection of buyers. Usually, large builders are the only ones selected to purchase this land, and local builders are left out. One very large local builder is an exception, and has a seat in the Board of Camacol (along with Situm/Argos).

The land owned by Situm/Argos is the only land left in the city where upper-income and upper-middle-income buyers wish to

live. This land is located north of the city and has land-locked the city's growth.

The situation outlined by these facts may boil down to just optics. However, a prominent company like Argos should be careful to avoid the appearance of monopolistic practices. Meanwhile, mayors and city planners need to make sure that they are not being used in a strategic game to create monopolies. So we are left with some questions: Are politicians being naïve? Are large companies like Argos building monopolies in Colombia? Are politicians quietly participating in the creation of these monopolies? In the absence of serious oversight in fragile emerging economies like Colombia, we can only wait and see.



About the Author

Felix Vallalba has over 15 years of experience on both the operating side and the investment side of business transactions. After his MBA, Mr. Vallalba worked for captive financial services companies at Dell and Whirlpool, and later spent over five years as CFO with two venture backed technology companies. Dell's successful effort to start Dell Financial Services marked his official involvement in the venture industry in 1997. It was after that when he joined an Austin Ventures backed company that later led to his joining Pacesetter Capital Group. At Pacesetter, Private Equity firm, he was Vice President and served as Portfolio Manager for several inherited deals, some of which required intervention strategies. In 2009, Mr. Vallalba formed his own Private Equity management firm, Accordo LLC and raised Accordo Fund 1 and 2 placing investments in residential and hospitality developments in Colombia.

Brazil:

Coping with the Challenges of Wealth Transfer

Complex planning challenges require sophisticated wealth transfer strategies

■ **Diego Polenghi,**
Managing Director,
International
Planning Group

Despite a recent economic slowdown, Brazil remains firmly entrenched as an economic superpower, thanks in large part to its vast natural resource wealth. The country's enviable growth during the last decade led to the creation of great fortunes as entrepreneurs seized on the China-led global commodity boom to mint, according to Credit Suisse, nearly 230,000 millionaires. With a GDP of US\$2.2 trillion, Brazil's economy is larger

than India's and is nearly twice the size of Mexico. Brazil is positioned to remain a critical market for wealth managers and other service providers focusing on the high net worth segment.

According to Wealth-X, Brazil is home to more than 4,000 ultra-high net worth individuals, holding US\$770 billion of wealth – the highest level in Latin America. Unlike many other markets, especially those of developed economies, Brazil's high net

worth population has some unique characteristics that create interesting dynamics, challenges and opportunities. According to Forbes, only 6% of Brazil's ultra-high net worth individuals have inherited their wealth, which indicates the overwhelming majority amassed their own fortunes or have shrewdly invested their nominal inheritances.

Being a continent-sized country, Brazil's high net worth population has distinct



regional differences that demand customized approaches. On the one hand, a significant number of Brazil's millionaires remain concentrated in the country's two main cities – São Paulo and Rio de Janeiro. High net worth individuals in these cosmopolitan urban centers often operate globally connected conglomerates that require highly sophisticated financial and legal strategies to manage both domestic and international operations.

However, because the country's natural resource driven wealth creation has largely occurred in the more rural areas, the industrious entrepreneurs emerging from these parts tend to be more nationalistic in their business, travel and outlook. These individuals typically operate businesses only in Brazil, and by and large they maintain a strictly local business structure. In fact, many of these individuals fuel Brazil's luxury market, as they are less inclined to travel overseas to make purchases and prefer to shop within Brazil's notoriously high-priced borders, making the country a top performer for fashion powerhouses like Gucci and Louis Vuitton.

Regardless of where in the country they reside, wealthy residents of Brazil are exposed to the legal and regulatory limitations of a country that only three decades ago was emerging from a military dictatorship. Brazil has generally not had the time to create sophisticated frameworks capable of properly addressing the complexities involved in managing and transferring large fortunes. Having succeeded in building their wealth, many of these individuals now face their greatest challenge – preserving that wealth, and ensuring its smooth and efficient transfer to the next generation.

■ The challenges of wealth transfer in Brazil

While the proper transfer of significant wealth in Brazil certainly requires the ex-

ecution of well prepared legal documents, this also requires a clear vision for one's financial legacy, which entails the careful management of emotions, personalities and complex family dynamics.

As most wealthy Brazilians trace the majority of their wealth to the value of a closely held business, business-related planning challenges abound. Wealthy Brazilians have to determine if and how their business will suffer upon their death, per-

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haps because they hold key customer, vendor or governmental relationships. They also must determine how business equity should be transferred to heirs, especially in cases where some heirs are actively involved in management and others are not. Further, they must determine whether their heirs have the necessary skills and desire to partner with existing shareholders, and whether doing so would add new challenges to the business. Finally, business owners need to evaluate whether the value of their business relative to their overall

portfolio creates a significant diversification risk.

Further, as many members of the next generation will not have the same level of success as their predecessors, wealthy individuals should consider how to preserve their wealth over time. This means they need to determine if wealth should be earmarked not just for their spouse and children, but also their grandchildren and great-grandchildren. Decisions need to be made about whether wealth should be transferred to both bloodline and non-bloodline family members, and if estate funds should be used to repay outstanding debt obligations, meet philanthropic giving desires and/or fund education or retirement plans for their heirs. It also requires assessment of the various currency, sovereign and liquidity risks associated with the asset profile.

These are not often easy issues to tackle when the discussion of wealth transfer commonly surrounds the uncomfortable subject of death and the accompanying concerns about privacy and confidentiality. According to Barclays Wealth Insights, 34% of global high net worth individuals do not trust their children to protect their inheritance, 20% believe assets should be allocated differently between children and 40% have experienced wealth as a source of conflict within the family.

These challenges create an unprecedented need for high net worth Brazilians to plan for their wealth transfer. Solutions that create liquidity, provide flexibility and offer peace of mind should be sought.

■ Fostering a planning culture

As Brazil's current wealth is a recent phenomenon, the process of recognizing and

addressing these challenges has not been practiced by multiple generations, and a culture of planning has only recently begun to develop.

Wealth management advisors to high net worth Brazil residents typically focus on helping clients grow their assets. However, aiding them to preserve, structure and transfer their wealth is important to providing complete wealth management services.

Advisors who fail to address these issues not only impact their clients, but also jeopardize their own businesses in the long term. The Institute for Preparing Heirs suggests 90% of inheritors will change advisors upon receiving their inheritance, generally because the heirs have limited relationships with their parents' advisors and have not been engaged in the wealth transfer planning process.

Alternatively, properly initiated and managed wealth transfer discussions help advisors solidify relationships with heirs and build new relationships with business partners and extended family members, while aiding them in identifying new assets and complementary business opportunities.

■ Life insurance as a solution

While there are a variety of solutions available to aid residents of Brazil in meeting their wealth transfer needs, there is one highly attractive solution that can inject liquidity to an estate when needed most: life insurance.

Life insurance is often an ideal planning solution due to its ability to offer a death benefit that is a multiple of the premium, cash value in the event an early surrender is required, flexible premium schedules,

attractive policy provisions and guarantees from highly rated entities.

As the domestic Brazil life insurance market is not highly developed and offers coverage amounts that are often insufficient to meet the needs of the growing high net worth population, more sophisticated strategies need to be considered in order to bridge the liquidity gap faced by affluent Brazilian families.

■ The taxation of life insurance in Brazil

Due to the social and economic benefits of life insurance, the tax laws of many countries have evolved to exempt life insurance death benefits proceeds from income taxation.

Eduardo Avila de Castro, partner of Machado, Meyer, Sendacz e Opice Advogados in São Paulo, says, "Brazil's tax law generally exempts death benefits proceeds of life insurance from income tax. Any life insurance based planning solutions should be evaluated and implemented with careful consideration for the relevant laws and planning objectives. Due to the changing international tax landscape, I suspect an increasingly growing number of advisors will consider the use of life insurance based solutions to meet the changing needs of their clients."

■ The result

The widespread planning and liquidity needs of Brazilians, combined with the attractiveness of available life insurance offerings, creates the most attractive opportunity in Latin America to serve high net worth clients. Practitioners who become educated on how to address and solve these complex needs will surely reap the brand, monetary and associated benefits of highly satisfied clients.



About the Author

Diego Polenghi is Managing Director, Latin America for International Planning Group. From Switzerland and the US, Mr. Polenghi has served ultra-high net worth Latin American clients throughout his 30 year career with various global financial institutions. International Planning Group is a global provider of life insurance based planning solutions to meet the liquidity and financial security planning needs of international ultra-high net worth individuals and families.

Payment Platforms in Brazil

■ Adler Martins

Many providers of international payment services have been seeking to enter the Brazilian market. The companies, both big and small, operate mainly through websites and focus on the intermediation of payments for merchandise. Several also offer direct transfer services, especially between individuals.

The Brazilian market is very particular, however, due to its high level of automation and to its very strict regulation. Brazil has implemented quasi-real-time retail, interbank and forex payments infrastructures in the form of automated clearing houses overseen by the Brazilian Central Bank.

The direct participation in such clearing houses is heavily regulated and demands

investments in risk mitigation and technical infrastructure. Brazil's Central Bank will also perform a very detailed authorization process before allowing any company to become a financial institution able to take part in the Brazilian payment system. Smaller companies in Brazil have been able to participate in the market by acting as point of sale operators, intermediating the relationship between a highly dispersed customer base and a relatively concentrated base of retail providers.

The scene for international payment providers, however, remains a little opaque. A number of companies are starting to do business in Brazil, concentrating their operations on a proprietary base of clients located in one specific country. For example, one company may specialize in bank transfers made between a Brazilian community in Portugal and another specific Portuguese community in São Paulo.

These payment solution companies (PSCs) might be, in effect, creating a separate, private clearing house for their own payments. This would happen, for example, if the PSC waited for similar order to be transmitted from one country to the other (one person in Brazil who wants to send 100 USD to Portugal and one person in Portugal who wants to send the same value to Brazil), and then compensated the orders within the respective countries (by depositing the US\$100



sent from Brazil directly to the bank account of the person who wanted to receive money from Portugal, for example).

This kind of informal clearing of deposits would be absolutely illegal because it would be made outside of the Brazilian payment system administered by the Central Bank.

Finally, transactions that use virtual coins, such as Bitcoin, *inter alia*, are outside the scope of regulation of the Brazilian Central Bank and therefore might theoretically be performed by PSC companies, even if they are not registered as or acting on behalf of financial institutions in Brazil.

Operation of web sites for foreign payment solutions in Brazil might be subject to two or three very different sets of rules, depending on details about how the transactions are conducted.

To further complicate things, though, one must consider that if the PSC acts exclusively as a point-of-sale terminal, receiving data from credit cards and transmitting it for clearance before officially endorsed financial institutions in Brazil, its activities would be subject to significantly looser regulation. On the other hand, these PSCs should be prepared to aid the Brazilian sellers or consumers in obtaining proper tax documentation regarding the transaction, as receipts for payments generated electronically often do not contain all the details required by Brazilian authorities.

The conclusion is that the operation of web sites for foreign payment solutions in Brazil might be subject to two or three very different sets of rules, depending on details about how the transactions are conducted. The operations must be carefully planned in order to avoid falling afoul of public policy regulations. Further regulatory development, especially regarding the use of virtual coins, is expected to take place soon.



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). Adler 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 (GEDICI) 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. Adler 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.



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The Current State of the **Wealth Management Market in Malaysia**

Malaysia's wealth management industry has major potential for growth in the next few years if regulators continue to liberalize the industry and if banks are able to become more customer-centric and maintain their talent. But as of now, the industry is still in its early stages, and the majority of the Malaysian banks' wealth management industry continues to be sales-oriented, focusing on the sale of products instead of on their clients' needs.



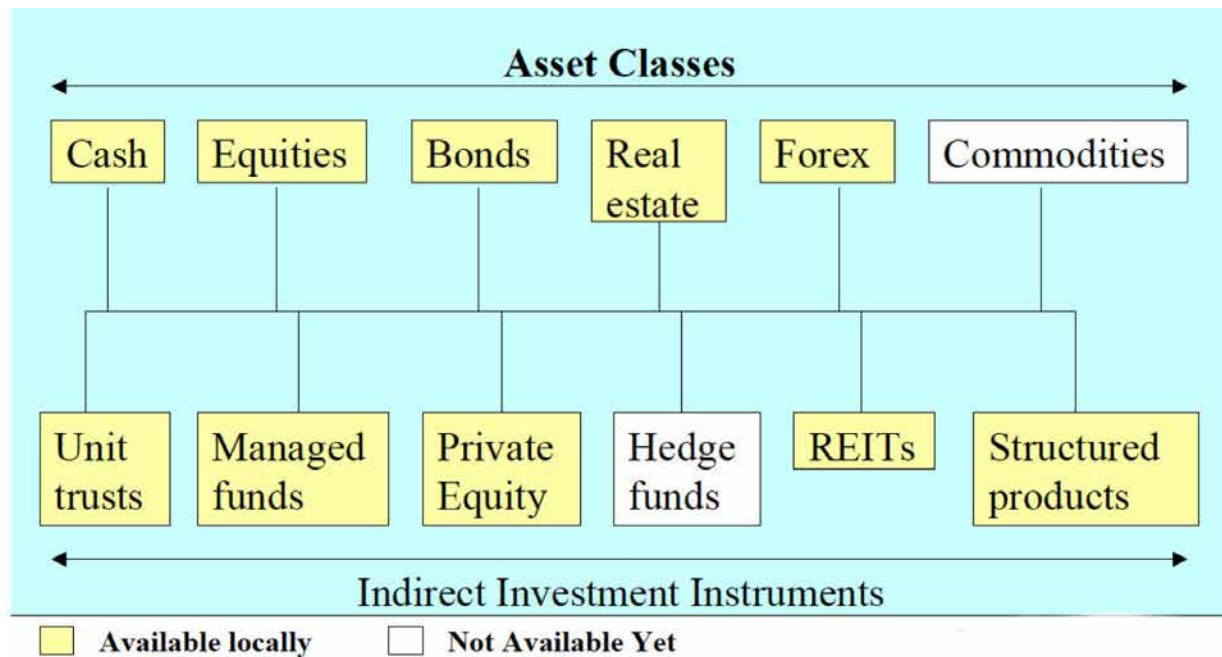
Malaysia's wealth management industry growth is slowed down by regulations that prevent certain financial instruments, such as structured products, hedge funds, and absolute return funds. Due to the fact that Malaysian banks are not allowed to sell certain financial instruments in the market, Malaysian high-net-worth individuals (HNWIs) continue to hold their

assets in real estate or in deposits. The main financial instruments that Malaysian HNWIs invest in are still savings bonds, unit trusts, transaction accounts, life insurance, and deposits. This is compelling more sophisticated Malaysian investors to move their liquid assets. The Malaysian regulator has recognized that the country's wealth management market needs to be liberalized to allow the market to include more wealth management

products, but it is moving slowly and incrementally, allowing the process to happen.

A significant issue that Malaysian wealth management departments are facing is acquiring and maintaining talented staff. All the banks we interviewed say finding talented staff that understand the details of wealth management, including financial advisory, stock broking, and insurance,

FIGURE 5: Malaysia's Wealth Management Industry: Asset Classes 2013



Source: MILSTE & CIMB Private Banking

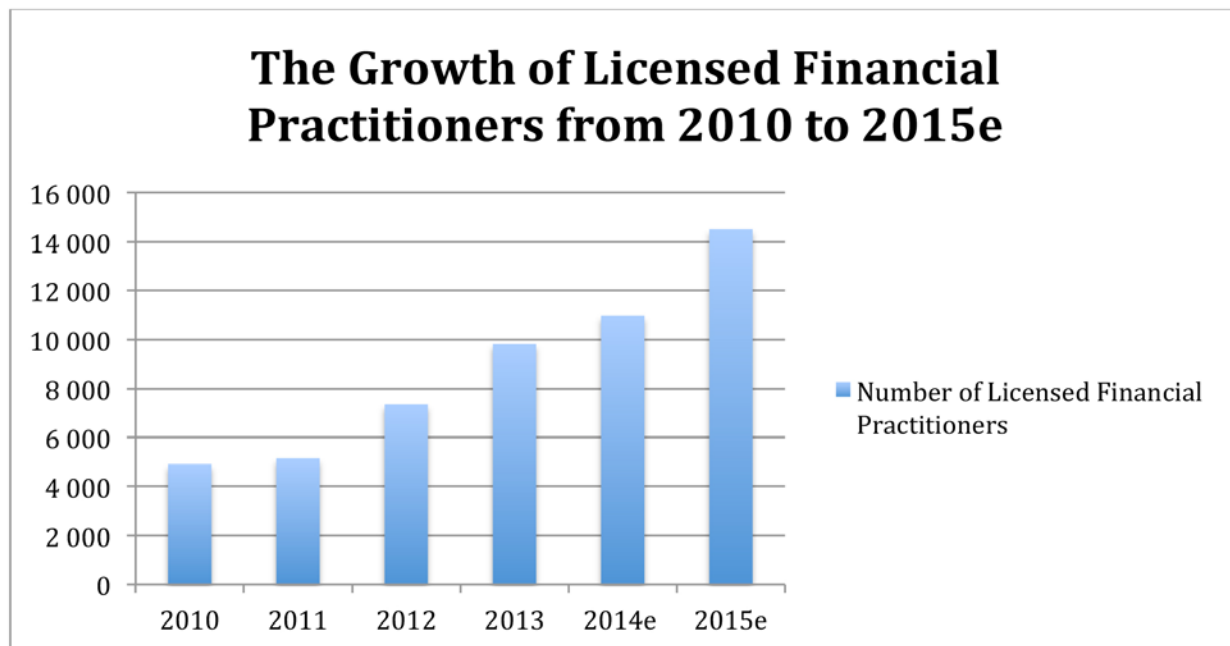
are still in high demand and are difficult to maintain. We calculated that although there are around 201,000 financial practitioners in Malaysia, only around 10,000 are qualified and licensed.

Currently fewer than 150 financial practitioners in Malaysia have a broad collection of licenses, and around 100 of the country's financial professionals have overseas experience. Since the country has a population of

around 29 million, there is a clear need for more competent and professional advisors.

In order for Malaysia to mitigate its talent problem, the government needs to stream-

FIGURE 6: The Growth of Malaysia's Licensed Financial Practitioners



Source: MILSTE

line regulations governing the licensing process that would enable more practitioners to begin working. In other words, there should be a single licensing scheme that gives financial advisors what they need to serve customers in a customer-centric way.

Even Malaysian HNWIs are still relatively unaware of the benefits of wealth management products compared with their peers in other advanced Asian countries. There is a lack of financial awareness of individuals in the early stage of their lives, as it usually isn't taught until undergraduate courses when they are studying business administration, finance and accounting.

Finally, although the quality of service has improved in the last few years in Malaysia's wealth management industry, there is still significant room for improvement. The relationship managers and wealth management officers are still highly sales-

oriented and are trying to expand their clientele as much as possible. The economic rewards in terms of commissions affect the professionalism of the financial planners and compel them to sell the most expensive product instead of what each particular customer needs.

The wealth management competition between banks has also drastically changed in the last few years. Although Malaysia's top banks are the leaders in the market, foreign banks are playing a larger role and are increasing their market share, especially Citibank and Standard Chartered. Foreign banks are attempting to absorb more market share in the next few years by leveraging their international talent and resources to gain a strong footing in the market. The foreign banks in the Malaysian market are heavily regulated, but they are bringing a customer-centric business model to the country, which will in the future ultimately force their domestic competitors to change.

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About the Author

MILSTE aids in creating awareness amongst our clients in understanding business opportunities within Asia Pacific's financial industry and strives to help them gain a competitive advantage throughout the region via strategic and research intensive intelligence. Our research covers The Asia Pacific's financial services industry in various segments including technology, wealth management, retail banking, risk management, and capital markets.

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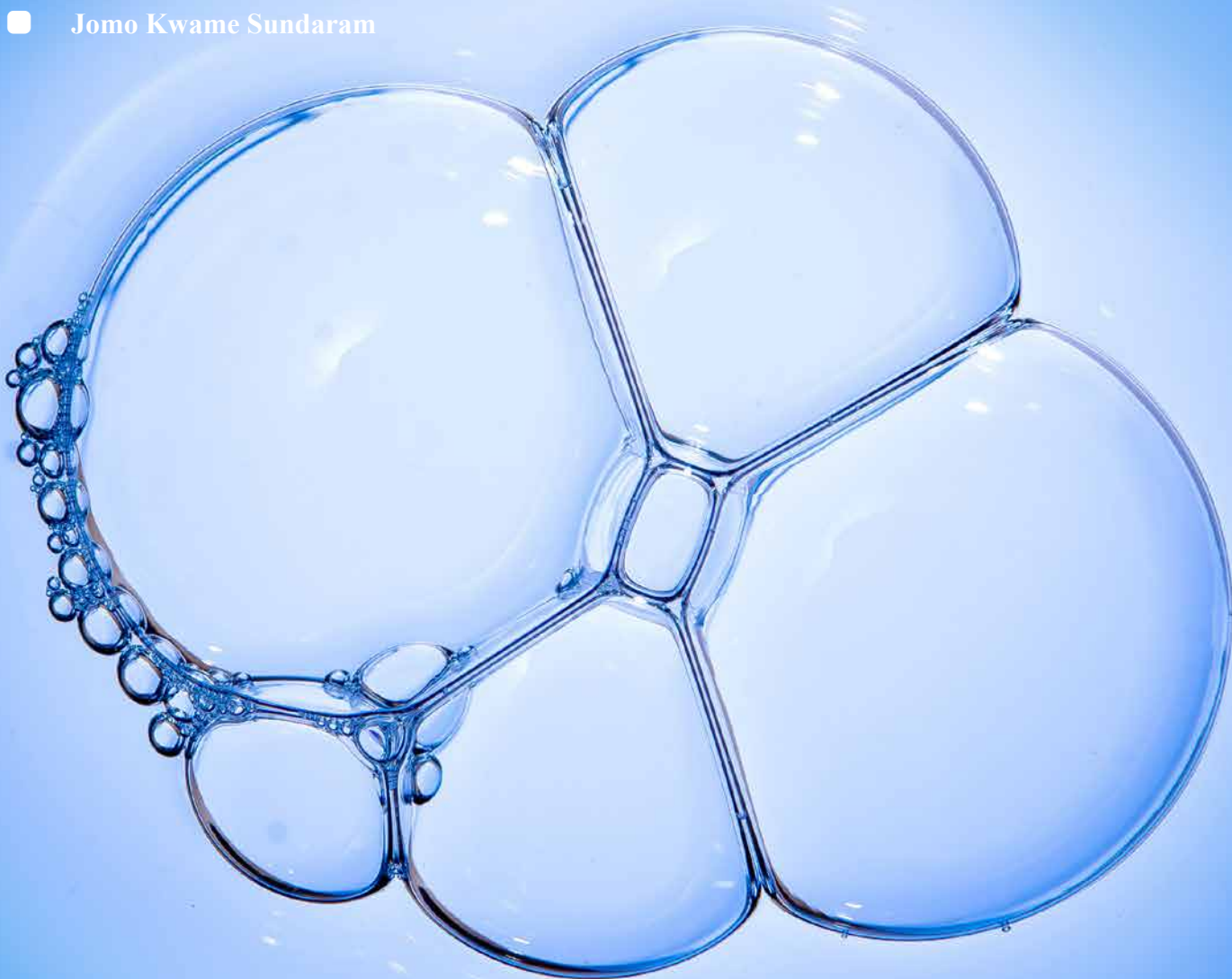
FIGURE 7: Malaysia's Wealth Management Challenges



Source: MILSTE

Emerging Markets' Bubble Troubles

■ Jomo Kwame Sundaram



Some of the developing world's larger countries, flush with capital after being recognized by investors as "emerging-market economies" (EMEs), have been pursuing policies with little regard for the lessons of the financial crises of 1997-1998 and 2008-2009. As a result, countries like India, Brazil, South Africa, and Indonesia have been hit by the US Federal Reserve's gradual exit from so-called quantitative easing (QE) – not just capital-flow reversals, but also a sharp decline in domestic asset prices.

Various developments last year raised expectations that the Fed would begin to taper its US\$85 billion-per-month open-ended bond-buying program sooner rather than later. This drove up US government-bond yields, and reduced the appeal of higher-yielding EME currencies. As a result, several EME currencies, from the Indian rupee to the Turkish lira, declined sharply.

Moreover, some EMEs have experienced financial-market disruptions and slowing economic growth. Such developments often lead to perverse economic behavior, as rumors and pessimistic predictions become self-fulfilling.

Typically, after international investors “discover” an EME, it receives massive – but easily reversible – capital inflows. The influx of cash fuels domestic asset-price bubbles and booms in related sectors of the real economy, pushing up the real exchange rate and, in turn, weakening incentives for domestic producers.

This drives investors to put even more of their money in non-tradable sectors, such as construction and real estate. The growing current-account deficit is largely ignored, as long as capital inflows continue to cover it and economic growth remains strong. Short-lived market rallies make matters worse, frequently inducing further unfounded exuberance. And when officials recognize the problem, hurriedly announced policy measures, such as capital controls, are usually too little too late, and can have adverse effects in the short term.

Investors long encouraged to take a short-term view may be surprised by such developments. But there is little excuse for the failure of policymakers and researchers to anticipate the recent capital-flow reversal. After all, while the Fed’s tapering of

QE undoubtedly has contributed to recent events, many EMEs have been in trouble for quite a while, with output growth decelerating gradually and private investment declining.

Capital-fueled economic booms do not significantly improve most people’s lives, because public expenditure on infrastruc-

Debt-driven bubbles have long been known to be unsustainable. But those who have warned of the EMEs’ impending busts have been dismissed as “prophets of doom” who underestimate the EMEs’ potential.

ture, health care, sanitation, education and social protection does not rise adequately to compensate for adverse consequences. These consequences include accelerating consumer-price inflation (despite slowing GDP growth) and worsening external balances as currency appreciation weakens export growth and feeds a growing appetite for imports.

Many recent EME booms have involved debt-financed consumption binges and investment spree that relied largely on short-term capital inflows. Making matters worse, the euphoria accompanying bubbles in stock and property markets has fueled credit expansion for businesses

and households, with rising private and, in some cases, public debt, as well as current-account deficits, increasingly financed by “hot money” from abroad.

Such debt-driven bubbles have long been known to be unsustainable. But those who have warned of the EMEs’ impending busts have been dismissed as “prophets of doom” who underestimate the EMEs’ potential. The marginalization of economic history in economics education is now exacting a high toll.

The facts are simple: bubbles can collapse easily and quickly, and controlling a panic is virtually impossible. Once markets turn, many of the policies – and policymakers – celebrated during the boom are recast in a far dimmer light. Former US Federal Reserve Chairman Ben Bernanke may be blamed this time, but EME busts can easily be triggered by anything from a minor change in global conditions to an unexpected growth hiccup or domestic political instability. Even economic difficulties in a neighboring country could be sufficient to prick a bubble.

The resulting crisis, by reducing employment and incomes, stands to hurt many innocent bystanders, most of whom did not benefit significantly from the boom. This is already happening in several EMEs, just as it has occurred many times elsewhere. How many more such episodes must the world endure before they are recognized as the avoidable disasters that they are?

About the Author

Jomo Kwame Sundaram is Assistant Director General and Coordinator for Economic and Social Development at the Food and Agriculture Organization of the United Nations.

2014



What's Holding Brazil Back?

■ Otaviano Canuto

One often hears that Brazil's economy is stuck in the "middle-income trap." Since the debt crisis of the 1980s, Brazil has failed to recapture the structural transformation and *per capita* income growth that had characterized the previous three decades. But with the right mix of policies, it could finally change its fortunes.

The prevailing explanation for Brazil's failure to achieve high-income status lumps the country together with other middle-income economies, all of which transferred unskilled workers from labor-intensive occupations to more modern manufacturing or service industries. While these new jobs did not require significant upgrading of skills, they employed higher levels of embedded technology, imported from wealthier countries and adapted to local conditions. Together with urbanization, this boosted total factor productivity (TFP), leading to GDP growth far beyond what could be explained by the expansion of labor, capital, and other physical factors of production, thereby lifting the economy to the middle-income bracket.

Progressing to the next stage of economic development is more difficult, reflected in the fact that only 13 of 101 middle-income economies in 1960 reached high-income status by 2008. According to the dominant view, success hinges on an economy's ability to continue raising TFP by moving up the manufacturing, service, or agriculture value chain toward higher-value-added activities that require more sophisticated technologies, higher-quality human capital, and intangible assets like design and organizational capabilities.

In short, middle-income countries seeking to reach the next stage of development can no longer simply import or imitate existing technologies or capabilities; they

must build their own. This requires a robust institutional framework – including, for example, a strong education system, well-developed financial markets, and advanced infrastructure – that encourages innovation and can support complex supply

Another impediment to Brazil's development has been what could be called an "exclusion trap." While Brazil's average per capita income currently puts it among upper-middle-income countries, a substantial share of the population has remained mired in poverty, even as the country has captured higher positions on some global value chains, such as technology-intensive agriculture, sophisticated deep-sea oil drilling, and the aircraft industry.

chains. According to this logic, Brazil's inability to continue its ascent up the income ladder is rooted in its failure to modify its institutional environment.

While this broad assessment is useful, it neglects critical aspects of Brazil's story

– namely, that the country's three-decade rise to upper-middle-income status created additional growth traps. A targeted strategy for addressing these problems is just as important to Brazil's continued development as the value-added-based imperative. The good news is that Brazil's leaders increasingly seem to understand this. Indeed, Brazil has already taken steps to address the first growth trap: the legacy of macroeconomic instability in the 1970s and 1980s. While it took more than two decades to address the issue effectively, when the necessary policy and institutional reforms were finally implemented in the 1990s – and validated after a change of government – the resulting "stabilization gains" contributed to a growth spurt in the mid-2000s.

Another impediment to Brazil's development has been what could be called an "exclusion trap." While Brazil's average *per capita* income currently puts it among upper-middle-income countries, a substantial share of the population has remained mired in poverty, even as the country has captured higher positions on some global value chains, such as technology-intensive agriculture, sophisticated deep-sea oil drilling, and the aircraft industry. With inadequate education, poor health conditions, and a lack of on-the-job training preventing a large proportion of workers from increasing their productivity, Brazil's potential economic growth has been compromised.

But Brazil has also been making progress in this area. Despite low average growth rates, the income of the bottom quintile of the population grew by more than 6% annually in the 2000s, owing largely to cost-effective social policies. Provided that the government continues to pursue a comprehensive poverty-reduction strategy – including improved access to health care, financial services and education – Brazil's

overall productivity should improve in the coming years.

Even so, Brazil has a long way to go. For starters, anemic investment in traditional infrastructure since the 1980s has become an increasingly heavy drag on TFP, contributing to waste and inefficiency in existing production systems. This could be addressed by fine-tuning the division of labor in infrastructure investment and management between the public and private sectors, with the goal of crowding in the latter.

Of course, Brazil should also address the value-added issue that affects all middle-income economies, which implies the need to improve the private sector's operating environment. As it stands, key features of that environment – including

high man-hour requisites to pay taxes, and cumbersome bureaucratic requirements – make the cost of doing business in Brazil incompatible with complex production chains, while undermining productivity by wasting human and material resources.

Finally, in order to support improvements in the delivery of services, Brazil should launch a broad-based review of public expenditures. Public spending beyond what is needed to finance the government's basic functions comprises a major share of Brazil's GDP. Cutting spending that is not aimed at eliminating the exclusion and infrastructure growth traps would enable the government to increase investment in the areas that need it most or reduce the tax burden on the private sector.

Brazil is well positioned to escape the middle-income trap. It is up to its leaders to make the most of that opportunity.

About the Author

Otaviano Canuto, Senior Adviser and former Vice President of the World Bank, is the co-author of *The Day After Tomorrow: A Handbook on the Future of Economic Policy in the Developing World*.

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China's Growth Puzzle



■ **Stephen S. Roach**

Once again, all eyes are on emerging markets. Long the darlings of the global growth sweepstakes, they are being battered in early 2014. Perceptions of resilience have given way to fears of vulnerability.

The US Federal Reserve's tapering of its unprecedented liquidity injections has been an obvious and important trigger. Emerging economies that are overly dependent on global capital flows – particularly India, Indonesia, Brazil, South Africa and Turkey – are finding it tougher to finance economic growth. But hand-wringing over China looms equally large. Long-standing concerns about the Chinese economy's dreaded “hard landing” have intensified.

In the throes of crisis, generalization is the norm; in the end, however, it pays to differentiate. Unlike the deficit-prone emerging economies that are now in trouble – whose imbalances are strik-

ingly reminiscent of those in the Asian economies that were hit by the late-1990s financial crisis – China runs a current-account surplus. As a result, there is no risk of portfolio outflows resulting from the Fed's tapering of its monthly asset purchases. And, of course, China's outsize backstop of US\$3.8 trillion in foreign-exchange reserves provides ample insurance in the event of intensified financial contagion.

Yes, China's economy is now slowing, but the significance of this is not well understood. The downturn has nothing to do with problems in other emerging economies; in fact, it is a welcome development. It is neither desirable nor feasible for China to return to the trajectory of 10% annual growth that it achieved in the three decades after 1980.

Yet a superficial fixation on China's headline GDP growth persists, so that a 25% deceleration, to a 7-8% annual rate, is perceived as somehow heralding the end of the modern world's greatest development story. This knee-jerk reaction presumes that China's current slowdown is but a prelude to more growth disappointments to come – a presumption that reflects widespread and longstanding fears of a broad array of disaster scenarios, ranging from social unrest and environmental catastrophes to housing bubbles and shadow-banking blow-ups.

While these concerns should not be dismissed out of hand, none of them is the source of the current slowdown. Instead, lower growth rates are the natural result of the long-awaited rebalancing of the Chinese economy.

In other words, what we are witnessing is the effect of a major shift from hyper-growth led by exports and investment (thanks to a vibrant manufacturing sector) to a model that is much more reliant on the slower but steadier growth dynamic of consumer spending and services. Indeed, in 2013 the Chinese services sector became the economy's largest, surpassing the combined share of the manufacturing and construction sectors.

The problem, as I argue in my new book, *Unbalanced: The Codependency of America and China*, is not with China, but with the world – and the United States, in particular – which is not prepared for the slower growth that China's successful rebalancing implies.

The codependency construct is rooted in the psychopathology of human relationships whereby two partners, whether out of need or convenience, draw unhealthy support from each other. Ultimately, codependency leads to a loss of identity, serious frictions, and often a nasty breakup – unless one or both of the partners becomes more self-reliant and strikes out on his or her own.

The economic analogue of codependency applies especially well to the US and China. China's export-led growth miracle would not have started in the 1980s without the American consumer. And China relied heavily on the US dollar to anchor its undervalued currency, allowing it to boost its export competitiveness.

The US, for its part, relied on cheap goods made in China to stretch hard-pressed consumers' purchasing power. It also became dependent on China's savings surplus to finance its own savings shortfall (the world's largest), and took advantage of China's voracious demand for US Treasury securities to help fund massive budget deficits and subsidize low domestic interest rates.

In the end, however, this codependency was a marriage of convenience, not of love. Frictions between the two partners have developed over a wide range of issues, including trade, the renminbi's exchange rate, regional security, intellectual property and cyber attacks, among others. And, just as a psychologist would predict, one of the partners, China, has decided to go its own way. China's rebalancing will enable it to absorb its surplus savings, which will be put to work building a social safety net and boosting Chinese households' wherewithal. As a result, China will no longer be inclined to lend its capital to the US.

For a growth-starved US economy, the transformation of its codependent partner could well be a fork in the road. One path is quite risky: If America remains stuck in its under-saving ways but finds itself without Chinese goods and capital, it will suffer higher inflation, rising interest rates, and a weaker dollar. The other path holds great opportunity: America can adopt a new growth strategy – moving away from excess consumption toward a model based on saving and investing in people, infrastructure, and capacity. In doing so, the US could draw support from exports, especially to a rebalanced China – currently its third-largest and fastest-growing major export market.

Compared with other emerging economies, China is cut from a different cloth. China emerged from the late-1990s Asian financial crisis as the region's most resilient economy, and I suspect the same will be true this time. Differentiation matters – for China, Asia, and the rest of the global economy.

About the Author

Stephen S. Roach, former Chairman of Morgan Stanley Asia and the firm's chief economist, is a senior fellow at Yale University's Jackson Institute of Global Affairs and a senior lecturer at Yale's School of Management. He is the author of the new book *Unbalanced: The Codependency of America and China*.



FOOD SECURITY

■ **Stephen Kaczor**

Food security is realized when people have physical and economic access to sufficient, safe and nutritious food. Recent Food and Agriculture Organization (FAO) estimates find that two-thirds of the world's hungry people live in seven countries with little to no food security.

Trade policy is how nations affect domestic food security. Global trade in agricultural products depends on a few exporting countries. Writing on the subject of “Food Security and Trade Issues for Poor and Small Vulnerable Economies” Michanne Haynes and Teddy Soobramanien explain how impact on agricultural production has an amplified effect on global food availability. “An increasing response to this dependency has been a drive towards self sufficiency and enhanced investment in domestic agricultural production in food importing countries.”

It is interesting to compare countries that are net food importers vs. net food exporters. Variables include diet, sufficiency and

affordability of supply, agricultural infrastructure, volatility of agricultural production, and market efficiencies and inefficiencies. Countries that score top rating are the US, Denmark, Norway and France. Such countries have great potential to export agricultural products, but they face tariffs and non-tariff barriers obstructing agricultural trade.

People in the United States and other advanced nations consume an average of 1,200 calories per day more than those in low-income countries. Developed nations have ample supplies, high incomes, low costs for food relative to other expenses, and make significant investments in research and development for food production.



The least secure nations were largely found in Africa where finding fresh water proves difficult. The United Nations believes the world will need at least 50 percent more food by 2030 in order to feed a growing population. The Obama administration says the US and other members of the G8 group of industrialized countries are working with African leaders to increase agricultural investment and enhance productivity.

The food security index was commissioned by DuPont and launched by the Economist Intelligence Unit, a research and advisory firm. Among its findings: “While the average individual needs 2,300 calories per day to live a healthy and active life, in wealthy nations there is enough food for each person to eat 1,100 calories above that benchmark. In low-income countries, national food supplies fall, on average, 100 calories short.”

The food security index can be found at www.foodsecurityindex.eiu.com. DuPont CEO Ellen Kullman hopes the index will promote collaboration to help feed the growing population. “To ensure that efforts are laser-focused to deliver real solutions, we needed a tool to inform decision making and facilitate a common language,” she says. (Source: Reuters)

The rising costs of engaging in agriculture will ultimately affect food security for all of us, most of all the poor. The Economist recently reported that, “when food prices increased sharply between 2006 and 2008 – 217% in just two years in the case of rice – the rapid response of the international community with food aid in places where it was needed kept the death toll in check.” A similar increase in food prices in the past, without aid, would have caused a much higher death toll, according to Cormac Ó Gráda at University College Dublin.

“Economists now see the next great challenge for the international community as reducing the negative consequences of malnutrition rather than famine. Just because fewer people around the world are dying of starvation does not mean that what they are eating is good for them,” according to Lynn Brown, consultant for the

The rising costs of engaging in agriculture will ultimately affect food security for all of us, most of all the poor. The Economist recently reported that, “when food prices increased sharply between 2006 and 2008 – 217% in just two years in the case of rice – the rapid response of the international community with food aid in places where it was needed kept the death toll in check.”

World Bank. The Food Policy Research Institute suggests that food vouchers and cash benefits can be a cheaper method of relieving poverty than food aid, boosting nutrition at the same time.

One of the simplest solutions may be to provide seeds for home gardening,

in my humble opinion as a part-time farmer. For billions with no experience in farming, gardening or canning, food security depends greatly on policy decisions by governments who often create food insecurity, and this is a scary proposition.



About the Author

Stephen Kaczor is Chairman 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. In addition to consulting and writing, he is passionate about sustainable agriculture, Latin American culture, travel, and the ecology.

www.BigRiverFoundation.org

Made in China: Wine Edition

■ **Pierre Ly, Cynthia Howson and Jeff Begun**

Some people still find it hard to believe, but yes, China is now one of the largest producers of wine by volume in the world. Last summer we were fortunate to spend a few weeks meeting some of the wonderful people who make up China's booming wine industry. And we tasted some truly delicious wines along the way. In China, like anywhere else, wine is great – but wine and a story is even better, as our friend the Wine Economist likes to say. One of the best stories to pair with Chinese wine is one about local land management. A tour of Chinese wineries provides a fascinating peek at the many ways in which agribusinesses cope with sometimes ambiguous and always evolving land regulations.

■ **From 'coffee grounds and ashtray' to 'lovely ripe black fruit'**

Chinese wine didn't always have a good reputation, to put it mildly, and some tasters' experiences were a bit scary. However, the evolution of critics' tasting notes year after year constitutes vivid evidence of outstanding progress. Improve-

ments are visible across many wine producers, small or gigantic, public or private (or both), and some wines have gained international recognition.

So what does the story of Chinese wine have to do with land management? In 2012, celebrity winemaker Michel Rolland urged Chinese wineries to work on their vineyards. Ready-to-use winemaking technology and expertise are easy to import, but

growing high quality wine grapes in new places is risky and takes some trial and error. To make this even more challenging, given China's rural land regulations, wineries cannot establish control over vineyards easily. In his 2011 book, *Wine Wars*, Mike Veseth noted that the small scale of Chinese agriculture was one of the most significant obstacles to overcome. If wineries have to work with hundreds of small growers on contract, how can they ensure



Despite the near impossibility of purchasing rural land in China, most wineries have control over some land they can farm with hired labor, so they can call the shots to grow at least some of their grapes. Wineries can expand their vineyards by requesting an allocation of use rights over a tract.

a consistent supply of high quality wine grapes year after year? To make it even more challenging, contracts may be informal and difficult to enforce. Given these serious hurdles, we can only admire the amazing progress Chinese wineries have made.

■ Wine is made in the vineyard

Despite the near impossibility of purchasing rural land in China, most wineries have control over some land they can farm with hired labor, so they can call the shots to grow at least some of their grapes. Wineries can expand their vineyards by requesting an allocation of use rights over a tract of land from the government. However, given the widely publicized controversies over farmers' land rights, reallocations of rural land are carefully regulated. In poorer, more remote provinces like Ningxia, unused land is more widely available than on the coast, but it doesn't make it easy to access. It helps to find a local business partner who already has land, as Moët & Chandon has done in Ningxia for its sparkling wine project.

In more developed regions like Shandong, unused land is rare and farmers have good access to markets for the products they grow. In this context, two wineries we visited established their vineyards by renting a group of small plots from many farmers to consolidate them into one vineyard. Of course, rental agreements with a large number of small farmers entail significant transaction costs and enforcement issues. But many village collectives have helped coordinate land leases. In fact, it is a common arrangement used to promote rural industrialization beyond the wine industry, and it takes many different forms.

Despite all these local arrangements, many barriers remain to the development of rental markets for rural land. Where land is lacking, many wineries still have to buy a significant portion of their grapes from hundreds of individual growers. While working with so many farmers can be a daunting task, many of the delicious wines we tasted had to be made this way. To make it work, successful wineries like Grace Vineyard, based in Shanxi, have established good relationships with growers by providing credit, fertilizers and paying bonuses for better quality.

■ Searching for extreme wine terroirs

Our last tasting in China illustrated another way to control land and grapes. Jim Sun, chief editor of Winechina.com, generously welcomed us to his cellar in the heart of Yantai, to share his insights as well as truly distinctive wines. One of them, branded "Altiwine," is made from grapes grown at high altitude vineyards in Yunnan province. Some of the best new world wines are made at high altitude for a reason. But getting to the top of the mountain isn't so easy. As long as only a handful of wine-makers risk the adventure, difficult access is balanced by lighter competition for land and grapes. As one Chinese winemaker told us, "opportunities and challenges come together."

So what's next for Chinese wineries? How will future land reform affect them? Whatever happens, China's emerging wine industry turns out to be a fascinating lens through which to observe the many ways agribusinesses cope with ambiguity.

About the Authors

Pierre Ly is Assistant Professor of International Political Economy at the University of Puget Sound in Tacoma, WA. Cynthia Howson and Jeff Begun are Lecturers in Politics, Philosophy and Economics at the University of Washington Tacoma. Their current 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 www.grapewallofchina.com and Winechina.com www.winechina.com/en/



Understanding the Rise of Argentine Vineyard Value



Ranked the world's fastest-growing region by Knight Frank's Global Vineyard Index 2013, Argentina's Mendoza area presents undeniable appeal for wine investors. With its 25% increase in vineyard value in the year to June 2013, Argentina placed itself ahead of Italy, New Zealand and Chile.

According to Pedro Bernacchi, chief operating officer at real estate investment firm Algodon, this result is not surprising. "Prices of good quality vineyards in good locations are constantly going up in Argentina, in some years faster than in others. They appreciate mainly be-

cause land values in Argentina are greatly undervalued generally due to political and economic volatility. On the commercial side, good quality vineyards are highly prized and sought after, especially vineyards that are associated with high quality wines. Over the past two decades, Argentina has greatly elevated its profile as one of the world best quality wine producers. From the individual buyer's perspective, you have many wine lovers with a romantic view of owning their own vineyard and producing their own high quality wines. This is a lifelong dream for many. And in Argentina, these people can buy top quality vineyards at drastically lower prices than places like Napa or Tuscany. Even when you compare to similar quality locations in other countries in South America like Chile and Brazil, we are probably one tenth of their cost," he says.

Even though he believes 25% is a best-case example, Mr. Bernacchi has consistently

observed increases of 10-12% annually over the past five or six years, making Argentine vineyards a very stable investment. He says that undervalued land, owners desperate to sell (and therefore open to negotiation) and growing wine production and quality are what have boosted the vineyard investment market in recent years.

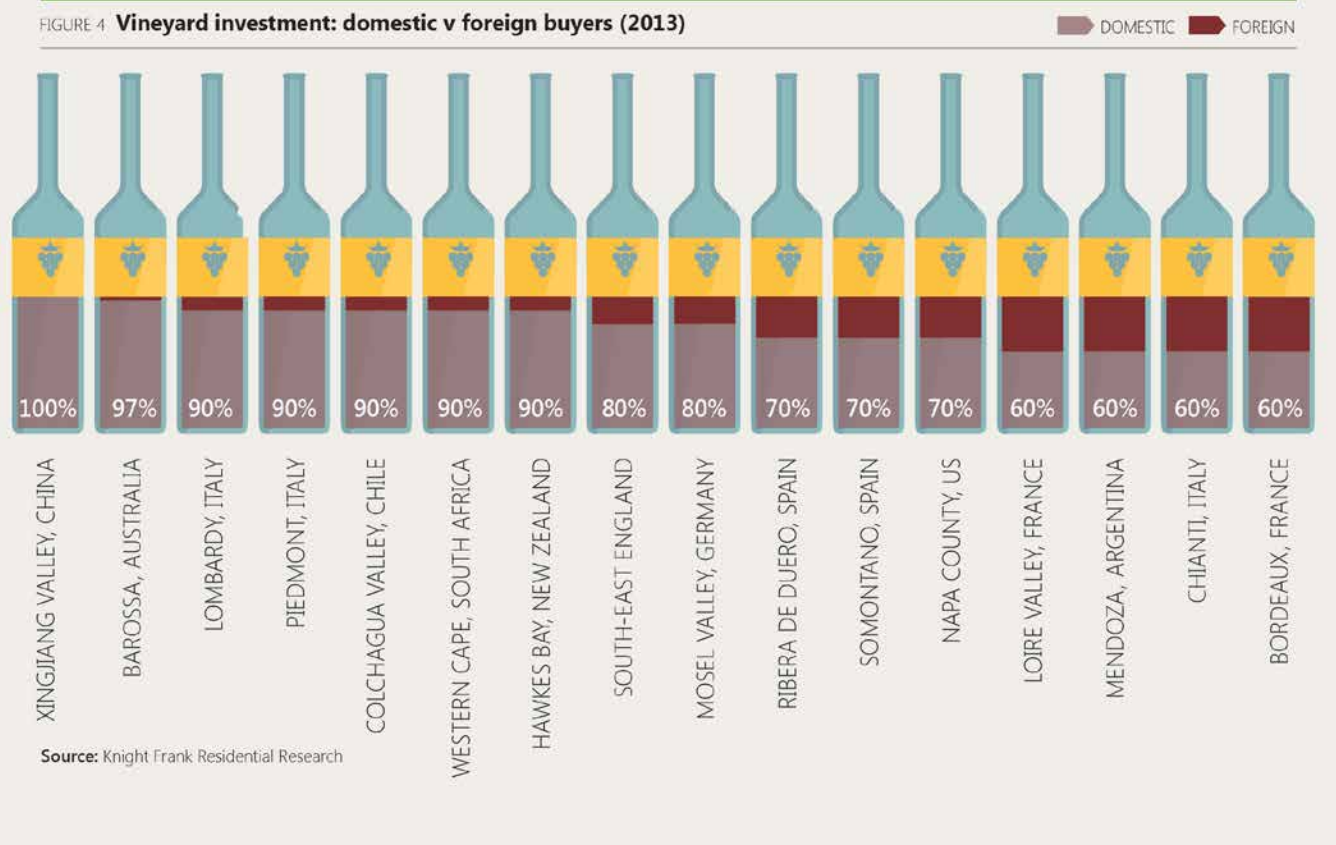
Despite a certain degree of uncertainty, Argentina currently receives high levels of interest from domestic and foreign investors, notably American, European, Chilean, Brazilian and Chinese. In fact, Mendoza is amongst the least domestically owned wine-producing regions in the world, at 60%. This is on par with the Bordeaux and Loire Valley regions in France and the Chianti region in Italy, but much lower than the Colchagua region of Chile (90%) for example. (See figure 4.)

The types of foreign investors range from large professional corporations to

individual investors looking for an excuse to spend a couple of months a year in a sunny destination as they enjoy their own estate-cultivated, customized wines. "These are oriented to smaller-scale private vineyards, which of course have to be taken care of. They are attracted by turnkey vineyard propositions like Algodon where you can find residential proposals in the middle of the vineyards but without the headaches of really owning an independent property with your own employees, off-season land maintenance, and year-round property management," Mr. Bernacchi points out.

There are various reasons why foreign investors look at Argentina. First, as everywhere in the world, political uncertainty creates investment opportunities, as long as one is willing to accept the risks. Second, Argentina has encouraging real estate investment policies.

FIGURE 4. Vineyard investment: domestic v foreign buyers (2013)



“Here in Argentina the process and rights of owning real estate is the same for anybody – it doesn’t matter if you are a foreigner or Argentinean. Also, there is no talk about the government invading private property in any way; there are some restrictions and other procedures, of course, but there are no threats to private property. Because of that we Argentineans in general have treated good quality real estate as our bank, the way to protect our capital. When I receive questions comparing Argentina to Venezuela I say despite what you read, the Argentinean society is totally different, as it has a big middle class,” Mr. Bernacchi adds.

■ Government restrictions

Argentina’s political turmoil and nationalistic policies in recent years have not been without consequences on the real estate market, but things are looking up. “Economic uncertainty usually drives professional investors away, both Argentine and foreign. We have experienced a slow-motion market with a lower number of enquiries and deals being closed, more difficult negotiations, particularly with Argentineans, as prices in dollars remained high. But Algodon, among others, was able to survive and actually grow slowly and gradually with more sales, increased winery capacity, increased area with vines, etc. Over the past six or seven months, since the political and economic tides are seemingly changing for the better, we have seen a distinct increase of interest from abroad and from Argentineans. The belief is that this government will change in less than two years, and whoever comes in next will have a more investor-friendly approach, which we hope could be the beginning of a significant economic turnaround. This may increase the value of all Argentine assets, vineyards and real estate being among those. There is nowhere to go but up,” says Mr. Bernacchi.

Despite currency restrictions implemented by the current government, with a 20% tax rate on dollar purchases, investors are not inclined to complete real estate transactions at the unofficial blue rate. “Argentine real estate prices are treated in dollars, and legally all must be done at the official exchange rate, which is around 8 pesos to the dollar, around 10 pesos at the blue rate as of March 2014. I would say that no real estate deals are done at the blue rate. Maybe a private buyer dealing directly with an individual sale could do that, but there is no way a development like Algodon or any other company can take dollars in the unofficial market,” says Mr. Bernacchi, adding that although deals are marketed in dollars, payment is made in pesos.

Scott Mathis, chairman and CEO at the firm, explains that the relaxation of some of the country’s currency control will also help foreign investors in the future. “Argentina has set the stage for its financial future by a recent reversal of certain economic policies, including the gradual relaxation of currency controls. This would allow the peso to float freely against the dollar and bring the exchange rate more in line with the unofficial blue rate,” he says.

And although local residents always have an advantage in buying property, being familiar with the country’s business culture and the ins and outs of local real estate transactions, foreign investors can leverage their easy access to US dollars. For that reason, collaborating with a real estate investment firm such as Algodon can be a sound option. “We believe that Algodon has a strategic competitive advantage in the real estate sector because our corporate headquarters in New York City has maintained real estate offices in Buenos Aires and Mendoza since 2007, and we understand well the local and regional markets,” adds Mr. Mathis.

Similarly, the government’s tough stance on international trade has mainly affected imports, meaning that exports of commodities like wine, which doesn’t require foreign supply, are off the hook.

“The only frustrations and complications are for imports – with all its faults and craziness, however, the government is prompting exports as much as possible,” Mr. Bernacchi explains. “There are no restrictions on exporting our wines, for example. So for wine producers like us, the situation now is even better than six months ago because the official exchange rate went up due to the government’s devaluation of close to 20% at the end of the year. So before I was getting less than six pesos per dollar on bank payments and now I am getting eight or higher. This is good news for the wines and good news for Algodon because the market is more attractive. There is an expectation that a new devaluation of 5-10% will be done in 2014, maybe after June or July when the last crops are sold, so from a wine export perspective Argentina is looking very good.”

But according to Mr. Mathis, success depends on how quick investors are at seizing current opportunities. “We anticipate Argentina’s real estate and stock markets will continue to move forward in the years ahead and that asset values may increase dramatically, but you’ve got to invest before the crowd. Latecomers always rush in when the politics turn, however no wealth has ever been created by getting in late,” he concludes.

About the Author

Index provided by Knight Frank Residential Research www.knightfrank.co.uk/research/

After several Bitcoin exchange platforms lost millions of dollars worth of the virtual currency – along with the trust of their customers – to hackers at the start of March, one might think investors would have been turned off. But experts believe Bitcoin, though still in its infancy five years after its creation, is getting closer to finding its true value on financial markets.

The Real Value of Bitcoin

Bitcoin funds Poloniex, Fl-excoin and Mt. Gox reported thefts of US\$50,000, US\$600,000 and YS\$400 million, respectively, and the latter, the first and once largest exchange platform, went on to declare bankruptcy. This blow to the Bitcoin market hasn't gone unnoticed, and consequently the value of the virtual currency has plummeted from US\$1,242 to US\$419 per coin.

But for Lars Holdgaard, deputy chairman at the Danish Bitcoin Foundation, the currency's monetary value is not what in-

vestors should focus on. "Everyone talks about how Bitcoin will gain value, but to me, this is the least important part. I don't care about the price of a single Bitcoin. As a company, as someone interested in technology, the only thing that matters is what Bitcoin can do, which is make anything in the financial sector more efficient by getting rid of fees and processing times."

He explains that Bitcoin is gaining momentum in the remittance or cross-border transfer market, as it saves users the fee charged by Western Union and other service providers. According to him, Mt. Gox

going out of business could even be what Bitcoin needed to set itself apart. "This is really a step from what we have seen so far, in that Bitcoin used to be a new company run by people who didn't know anything about driving a serious business. Now it is becoming serious. The new players in the market have funding from the biggest companies in Silicon Valley. They have experience and sponsors. The change is happening in the Bitcoin exchange market, but also with payments, whereby shops can accept Bitcoin and get US dollars or pounds without having to take a risk on the Bitcoin exchange rate."





Although Bitcoin could be disruptive to companies such as Paypal and Western Union, these are showing a lot of interest. Paypal is developing a bigger wallet able to hold Bitcoin and other virtual currencies, and its CEO has declared his support for the currency, while Western Union has been hosting conferences about it. “The whole industry understands there might be a revolution coming – not necessarily Bitcoin, but some similar digital currency,” adds Mr. Holdgaard.

The day Mt. Gox went out of business, technology investor Fred Wilson, whose company Union Square Ventures has shares in Twitter, Tumblr, Foursquare and Etsy, among others, announced that he was personally buying more Bitcoins. Mr. Wilson is also an investor in Coinbase, a virtual wallet company allowing its customers to do business in Bitcoin – going back to the purpose mentioned by Mr. Holdgaard.

According to Andreessen Horowitz, another well-respected Silicon Valley investment expert, far from sealing Bitcoin’s tragic destiny, recent events are just part of its evolution. “This is like MF Global, not some huge breakdown of the underlying technology or other exchanges,” he says in a CNBC interview. “Bitcoin protocol is unchanged, and other exchanges and companies are doing fine.”

■ Regulations

One thing that will play a pivotal role in Bitcoin’s success or failure is the way governments approach it. The European Central Bank was the first to acknowledge Bitcoin in 2012, although it did not establish whether the currency was legal. Many countries have made some sort of statement on Bitcoin, and regulations vary. In Germany Bitcoin is legal but regulated like money, while China banned financial institutions from handling Bitcoin transac-

tions at the end of 2013. Japan recently announced its intention to regulate the virtual currency, and other countries are bound to follow.

“Technology enables financial systems to become more efficient, but as we’re talking about money, there has to be regulation, and there have to be banks. A lot of people just want to have the Bitcoin in the hands of everyone, but I don’t think you can run a society where there are no regulations regarding money. These will also help make the technology much more efficient.”

“Right now,” Mr. Holdgaard continues, “Bitcoin is merely an idea and has no one behind it, so its whole value is based on trust, and that’s one of the reasons why it might not succeed. It could be a genius idea, and maybe it is the way it works, but it’s also possible that that’s not how it’s supposed to work. Maybe governments should be providing this kind of government coins based on the same technology. Money is trust, but money is backed by a state and Bitcoin isn’t; that’s the difference.”

And although he strongly believes the technology behind Bitcoin will prevail, Bitcoin itself might only be the first of many versions of a market-changing virtual currency. “It all comes down to the regulation of Bitcoin, because if it becomes illegal, it will definitely not make it easier for anyone. But if regulations remain positive I definitely expect some use starting this year or next,” he adds.

■ Investment prospects

Although investing in Bitcoin on an exchange platform could potentially win you big, experts believe investors who want to be part of the evolution of the currency – by betting on Bitcoin service providers,

for example – will reap the best long-term benefits.

“When there’s easy money to make people will flock to that. Of course it’s fine, but I don’t like that it’s all about the monetary value of the currency. Some of these Bitcoin funds and brokers will make huge money, but I would say those enabling easier Bitcoin transactions, for instance on remittance markets, will have a lot to gain. If you are somehow able to send Bitcoins to some Philippines company and make money providing that service, that will be worth quite a lot, and I expect a lot of competition soon in that area,” says Mr. Holdgaard.

He concludes by saying investors should look at the big picture when it comes to Bitcoin. “I never compare Bitcoin to Microsoft or Linux; I usually compare it to Napster. It was a technology ten times better than buying CDs, a genius product, but illegal. It wasn’t that easy to figure out, but then some years later we saw better, though still illegal products. And in the end Napster won, but as iTunes and Pandora, not Napster. Just like with Napster we don’t quite know what Bitcoin is yet, but has the potential of being developed into something amazing.”



Puerto Rico celebrated selling USD 3.5bn general obligation bonds with a 8.727% interest rate on Tuesday (11 March). This indicated that Puerto Rico placated the market and led the way for its future bond sales, agreed market participants.

The five-time oversubscribed bond offering was a 16.7% increase from the original USD 3bn floated on Monday (10 March), and the coupon was well below the initial double-digit yield that the commonwealth was willing to accept. But yield tightened swiftly in subsequent heavy trades in the secondary market, with an average yield of 8.331%, according to Electronic Municipal Market Access.

The increasing price in the secondary market may have been a function of market participants, said Senior Municipal Strategist Jim Colby of Van Eck. With a larger mix of hedge funds, leveraged investors and alternative investors than a traditional municipal bond, their trading style may have influenced the market, Colby said.

Puerto Rico seduces corporate investors
The increased appetite from hedge funds and other crossover investors was no coincidence.

Pickings are slim in the corporate world. Comparable deals over the past 12 months in the taxable market offered much lower yields, given the fact that Puerto Rico's paper is triple tax-exempt and results in taxable equivalent yields between 11.09%-14.79%, according to Debtwire Municipals' own analysis.

Compare that to this winter's USD 3bn 6.875% senior unsecured bond due April 2022 issued at par this winter by Community Health Systems. What a snooze-fest.

Puerto Rico rocks your corporate world

■ By Ellie Ismailidou, Maryellen Tighe, and Simone Baribeau

“Puerto Rican government officials were quoted in the press before the issue was brought to market saying, in essence, that any price required to sell the bonds was acceptable.”



"It was very difficult for retail shops like ours to get bonds," said Conor O'Grady, trader at FMS Bonds. "It was kind of a feeding frenzy. It was like dropping one little goldfish to an ocean filled with sharks that hadn't eaten in a year," O'Grady said.

It is likely that many buyers of this issue chose to participate only if they felt the bonds offered both a return commensurate with the perceived risk and the possibility of price appreciation in the secondary market, said Chris Mier, chief strategist at Loop Capital.

"The trading that was occurring might well have been fueled by a handful of people that were just trying to push the market higher," Colby said.

Mixed reactions to the price

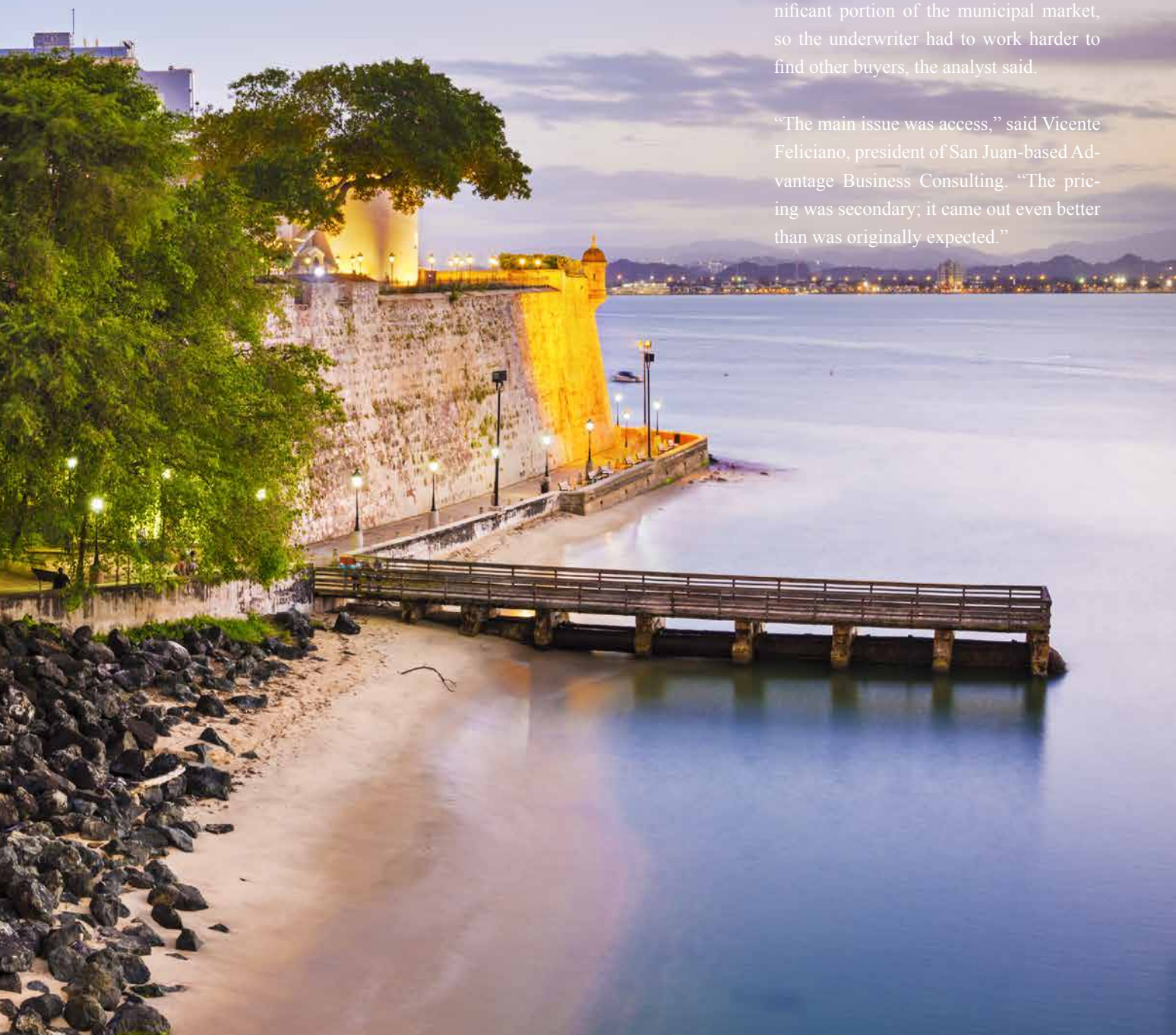
Most analysts and politicians on the island have embraced the oversold issue with enthusiasm, said Heidi Calero, president of Puerto Rico-based Calero Consulting Group. One of the most quoted statements is that this indicates the market has confidence and trusts Puerto Rico's ability to pay its public debt, Calero said.

But the minority leader in Puerto Rico's House of Representatives, Jennifer Gonzalez, called the yield "price-gouging" in a press release and cautioned that it will lead to an unprecedented curtailment of government services.

"Could [Puerto Rico] have gotten a better price? Theoretically, yes; but this is your market, this is where you fill this book," said a buy-side credit analyst.

Because of the downgrade to junk status, Puerto Rico probably got cut out of a significant portion of the municipal market, so the underwriter had to work harder to find other buyers, the analyst said.

"The main issue was access," said Vicente Feliciano, president of San Juan-based Advantage Business Consulting. "The pricing was secondary; it came out even better than was originally expected."



The legislature said that 9% would have been acceptable when it was approved, and there has been talk of rates as high as 10%, Feliciano said.

Puerto Rican government officials were quoted in the press before the issue was brought to market saying, in essence, that any price required to sell the bonds was acceptable, Mier said.

The dire financial condition of the issuer, the 14 pages of risk disclosures in the official statement, and the widespread discussion of yields on the new issue requiring around 10%, all made it clear that it was the buyers that were going to have the greater influence in determining the price at the time of pricing in the primary market, and not the issuer or their representatives, Mier said.

Under that scenario where the majority of the negotiating power is vested with the buyers, it is not surprising that the bonds might trade higher in the secondary market, Mier said.

"I think the underwriters did a very good job," said Tom Spalding, a portfolio manager for Nuveen. The bonds are trading up against a backdrop of strong interest rates with lots of cash on the sidelines, he said.

■ Next steps for the commonwealth

The new deal gave the market a lot of confidence in Puerto Rico, including other Puerto Rico credits because of the close ties of the commonwealth, said Dan Heck-



About the Author

Debtwire Municipals is the leading source for breaking news on distressed and high-yield single-name borrowers in the USD 3.7tn municipal bond market.

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man, senior fixed income strategist at US Bank. If the commonwealth had pushed for lower rates and was not able to place the entire deal it would have damaged the psyche of the market, he said.

"The difference between 8.5% and 9% is inconsequential compared to the change of market confidence," Heckman said.

What the issue was meant to accomplish was provide some breathing space for fiscal measures to be implemented and the economy to start turning around, Feliciano said. Now the commonwealth is ready to discuss other issues, such as possibly placing some Sales Tax Financing Corporation (COFINA) bonds, he added.

Puerto Rico wanted to make nice with the market so that they can come back and is-

sue another USD 900m, said the buy-side credit analyst.

But Gonzalez cautions that the recent deal almost consumed the island's debt margin, which limits the commonwealth's capacity to issue future debt for infrastructure investments.

The administration promised a balanced central government budget in FY 2015, Calero said. Such a balancing act will require curtailment of government services, hopefully not jobs; and, unless the private sector steps up and fills the reduction in public services, I am afraid our economy will still continue in negative territory, she added.

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