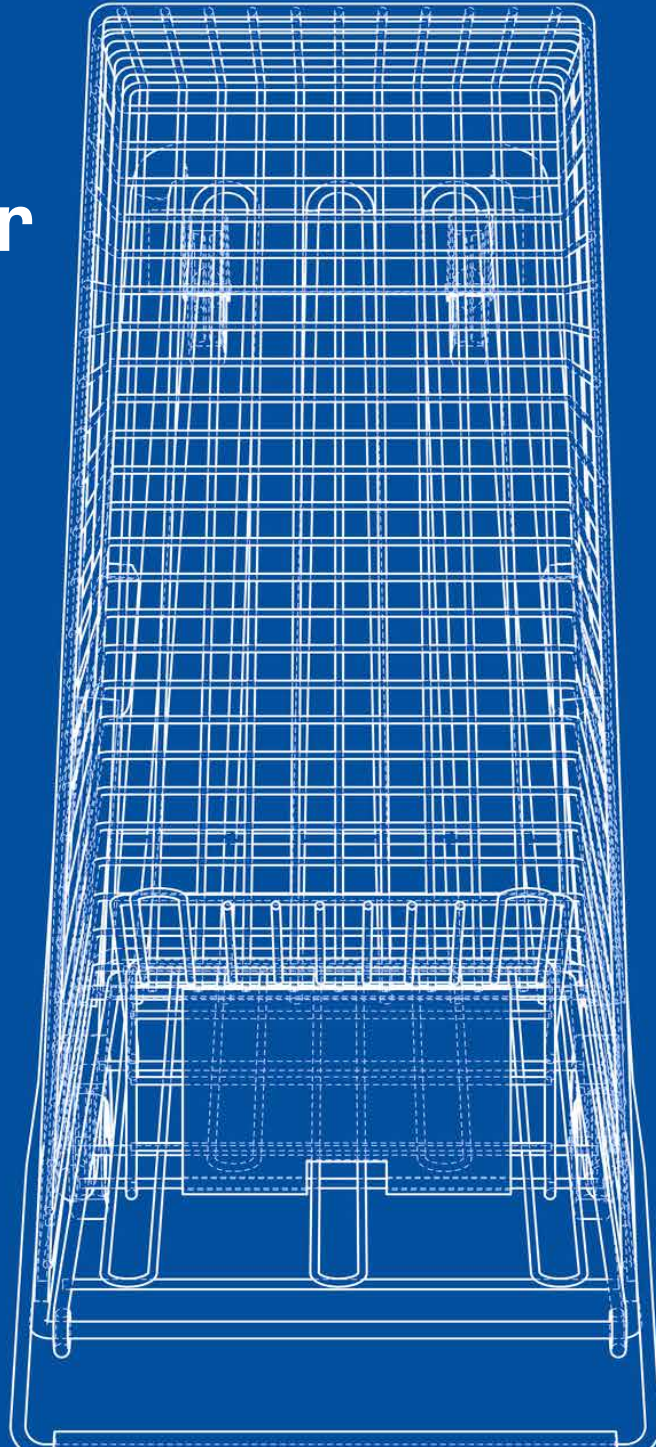


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A handwritten signature in black ink, which appears to read "Nate Suppaiah". The signature is fluid and cursive, with a long horizontal stroke at the end.



Managing Editor

Nate Suppaiah

Public Relations Director

Tiffany Joy Reyes

Editorial Contributions

Euromonitor International

CEIC

Institutional Real Estate

EOS Intelligence

Mergermarket

FIS Group

FocusEconomics

Will Shipley

Design

Arman Srna

Contact

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

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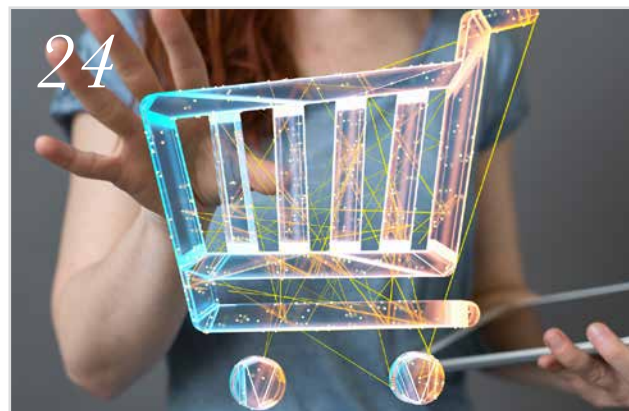
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Industry Impact of Consumer Trends In Emerging Asian Markets 2018

 **Ivan Uzunov, Research Manager**
Ruby Bui, Research Analyst
Samuel Huynh, Research Analyst

The Asian economy has often been cited as one of the key motors of global trade. After the financial crisis of 2008, however, the real economy took a strong hit, and many international players withdrew their attention from the region, focusing instead on their diminishing sales at home.

10 years later several emerging markets are again entering the spotlight with rapid economic growth, and the fast pace with which local consumers adopt global trends. Although many such markets still present risks and face instability, Euromonitor International has outlined Bangladesh, Sri Lanka, Myanmar, Cambodia and Laos as some of the most promising for the future. In a recent ebook, titled *Industry Impact of Consumer Trends in Emerging Asian Markets*, Euromonitor provides an overview of the main consumer trends in the region and address some of the challenges that fast moving consumer goods (FMCG) market players face as they attempt to expand their presence in five emerging markets.

The economic structure of all emerging markets in the region look similar. All economies, and especially those of Laos and Bangladesh, are primarily agricultural. In Bangladesh farming accounts for around two-thirds of the labour force, and around a third of GDP. Many people involved in agriculture remain deeply impoverished, and are very conservative in their consumption habits.

All five markets in question have recently witnessed a rapidly-growing middle class, especially in the large metropolitan areas of cities such as Dhaka, Colombo and Phnom Pen. The new urban consumers are quickly and enthusiastically adopting global trends, often spurred by social media. Regional trends are also rapidly adopted through the fast-growing popularity of Korean pop music, Bollywood movies and Western TV series. With the opening of borders, more wealthy consumers have the chance to travel, while more economic migrants spend at least some period living and working abroad. This allows an increasing number of con-

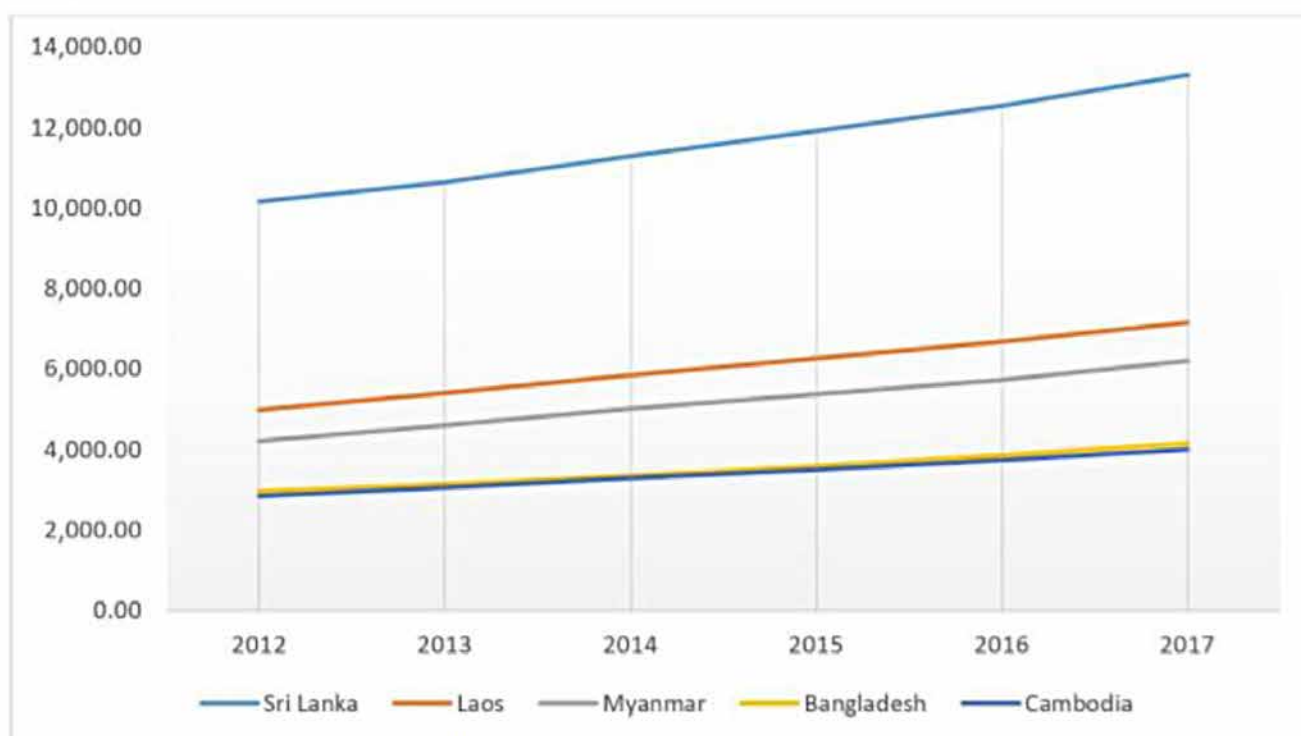


sumers from all layers of society to experience global consumer trends first-hand abroad, and bring their new knowledge and habits back home with them.

Over the forecast period, economic growth is expected to be underpinned by strong investment activity and

gradual policy reforms. Economic imbalances, however, will also rise. All of the five focus markets are in a strategic location, and their proximity to the dynamic regions of East and Southeast Asia should serve them well, as manufacturers move around the region in search of lower labour costs. Their economies, how-

GDP per capita, measured at Purchasing Power Parity, international dollars



Research Sources: GDP Measured at Purchasing Power Parity: Euromonitor International from national statistics/Eurostat/OECD/UN/International Monetary Fund (IMF), International Financial Statistics (IFS)

ever, remain on a narrow base, depending almost exclusively on energy and agriculture. Yet all of these countries have a young labour force and could benefit significantly from their strategic location in a dynamic region.

Potential investors in these five markets face several major obstacles. Countries such as Laos, Myanmar and Cambodia are some of the region's most impoverished, following years of civil war, social instability and international isolation. Although those days are now in the past, many of the countries maintain only weak financial and trade links with the West. Sometimes this is determined by the political stance of local regimes. Laos, for example,



EUROMONITOR INTERNATIONAL

About the Author

Euromonitor International is the leading provider of global strategic intelligence on consumer markets, with offices in London, Chicago, Singapore, Shanghai, Vilnius, Dubai, Santiago de Chile, Cape Town, Tokyo, Bangalore and Sao Paulo and in-country analysts worldwide. For more than 30 years, Euromonitor has published internationally respected market research reports, business reference books and online information systems, providing strategic business intelligence for the world's leading FMCG multinationals.

China Sees LatAm M&A Opportunity Amid Shifting Geopolitical Dynamics

 **Thiago Barrozo in Sao Paulo and Jennifer Zhang in Chongqing, with analytics by Elizabeth Lim.**

Analysis

- China seeks LatAm investments beyond commodities and energy
- “America First” policy to favor China’s growing leadership in LatAm
- LatAm’s high inflation, corruption, and cultural differences present challenges

The rise of geopolitical tensions between China and the US alongside the former’s increasing protectionism is likely to strengthen the role of Latin America as a key market for Chinese outbound investment, experts told Mergermarket.



The symbiotic relationship between Latin America, a region with strong demand for foreign direct investment, and China, which depends on overseas markets to secure inputs as well as consumers for its exports, is expected to gain momentum amidst the shifting of geopolitical dynamics.

In fact, both regions have progressively joined forces to address their own needs. Mergermarket data shows that Chinese outbound M&A into Latin America hit a record 16 transactions worth USD 11.5bn in 2017. It was the third highest year for value on Mergermarket record, since 2001.

Speaking at the Latin America Update panel at the World Economic Forum on Latin America held last month in Sao Paulo, Ricardo Vilela Marino, Executive VP and Member of the Board of Directors at Latin America's largest financial conglomerate Itau Unibanco [BE: ITUB4], said China is likely to soon surpass the US as the region's main partner.

Marino noted that US President Donald Trump's "America First" policy should also contribute to make more room for China to exercise its leadership in the region.

A Chinese executive in the automotive manufacturing industry pointed that China's increasing investment in Latin America echoes with Beijing's One Belt One Road initiative,

which aims to create a global economic platform.

While the US and many European countries have grown hostile to Chinese investments, Latin America, on the other hand, has thus far presented a friendly investment environment for the Asian giant, the source noted.

Diversification

Deal value involving Chinese/Hong Kong bidders and Latin American targets peaked in 2010 with USD 16.9bn (about half of which was due to Beijing-based China Petroleum & Chemical Corp's USD 7.1bn bid for a 40% stake in energy company Repsol Brazil from Madrid's oil & gas company Repsol [BME:REP]. The second highest deal value recorded was in 2016: USD 12.4bn.

Additionally to ramping up investments in Latin America, China has increasingly engaged in transactions beyond the energy and commodity niches. Alicia Barcena Ibarra, Executive Secretary for the United Nations Economic Commission for Latin America and the Caribbean (ECLAC), who also joined the panel, noted that the Asian country has actively invested in other industries, such as telecom, financial services, industrials & chemicals, and services.

Mergermarket data reinforces this

trend. In February, Shanghai-based conglomerate Fosun International Limited agreed to acquire a 70% stake in Brazil-based investments brokerage firm Guide Investimento for BRL 290m (USD 89.58m) plus the payment of earn-outs of up to BRL 120m.

In January, Beijing-based mobile transportation platform Didi Chuxing Technology purchased Brazilian ride-hailing services company 99 for nearly USD 900m. And in December, Zhejiang-based Wolong Electric Group announced the acquisition of General Electric Company [NYSE: GE]'s Mexico-based small industrial motor business for USD 142m, as reported.

On the sidelines of the event, Denise Dresser, Political Analyst at Instituto Tecnológico Autonomo de Mexico (ITAM), said Trump's decision to renegotiate the North American Free Trade Agreement (NAFTA), the two-decade old deal that binds the Mexican economy to the US and Canada, has led the Latin American country to reach out to other foreign partners to draw investments in areas like oil & gas and infrastructure.

China, which is already Mexico's second biggest trading partner, is eager to tap into these emerging opportunities, Dresser noted.

A source working for a Chinese state-owned energy company that has done multiple acquisitions in South America said that Latin

America's energy industry would still be one of Chinese investor's favorites, especially in the niches of hydropower, oil & gas and electricity distribution.

Central America is also expected to see more investments coming from China. Speaking at the same panel, Isabel Saint Malo de Alvarado, Vice-President of Panama, noted that the Central American country has just established diplomatic relations with China after cutting long-standing diplomatic ties with Taiwan.

On 17 November, Chinese President Xi Jinping and Panamanian President Juan Carlos Varela announced the signing of 19 deals, including a feasibility study on a free trade agreement (FTA). The first meeting of the joint feasibility study on China-Panama FTA was held in mid-January in Beijing, as reported.

The Asian giant already has FTAs with three Latin American countries: Chile, Costa Rica and Peru.

Major Challenges

Both Chinese sources said, however, that Latin America still holds a few challenges that prevent more deal making from happening.

The first source pointed that cultural differences between the regions have usually translated into high in-

vestment costs and low productivity. It noted that its company needed to temporarily shut down a manufacturing plant in Uruguay due to conflicts with the local labor union. The Chinese source in the energy sector said Latin America's inflation, which remains relatively high in several countries, is another mat-

ter of concern. Corruption has also been an issue, the source added, saying that he was asked for a bribe sometimes during dealmaking. Although his company refused to pay the bribe, he learned that other bidders have done so to close a deal.



About the Author

Mergermarket part of The Mergermarket Group, is an unparalleled, independent M&A intelligence tool used by the world's foremost financial institutions to originate deals. It provides proprietary intelligence on potential deal flow, potential mandates and valuations via the world's largest group of M&A journalists and analysts who have direct access to the most senior decision-makers and corporates.

Incorporated in December 1999 by founders Caspar Hobbs, Charlie Welsh and Gawn Rowan Hamilton, it has since become the fastest growing business in its sector. As well as expanding its coverage across Europe, Americas, Latin America and the Asia-Pacific region, the company continues to launch ground-breaking products and services.

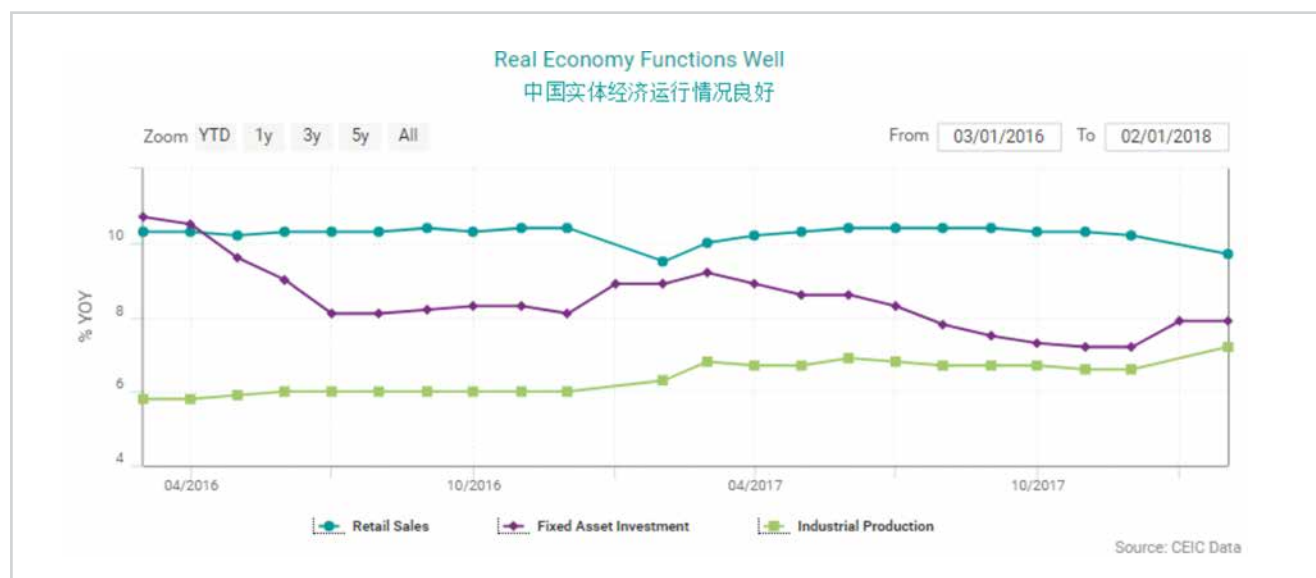
How will the Chinese Central Bank Respond to the Fed Rate Hike?

We believe the Chinese central bank PBOC is very likely to raise open market operation (OMO) rates should the Fed increase the fund rate. First of all, the Chinese real econo-

my functioned well in January and February, with bullish performance in retail sales, investment, and industrial production on both year-over-year (y-o-y) or month-over-month (m-o-m) bases. Meanwhile,

CPI accelerated to 2.9% y-o-y in February, allowing sufficient room for an OMO rate hike.

Secondary, 10-year treasury spreads between China and US have been





gradually shrinking in recent months, while the value of the Chinese Renminbi is standing high against the US Dollar since exchange rate reform in August 2015. Therefore, China needs to keep in step with the US this time to help stabilize treasury spreads and the exchange rate (hence prevent capital outflows) in light of a more hawkish monetary stance from the US Fed.

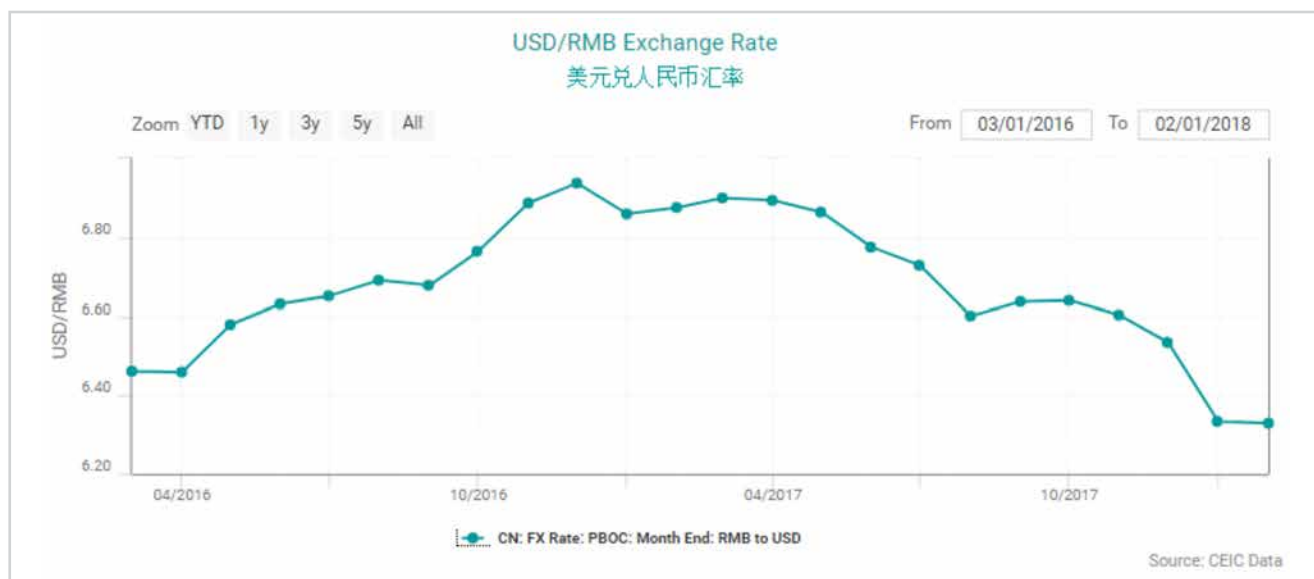
The market has priced in an OMO rate hike, yet has not reached consensus on the extent and pace. We project there would be at least a 10 bps increase this time, and in total three rate hikes in 2018. Similar to last year, the PBOC is likely to raise OMO rates twice in 1H 2018 and once in 2H 2018, as there could be more economic headwinds in the second half.

Currently, 10-year treasury spreads between China and US have shrunk to 100 bps, very close to the lev-

el in Jan-Feb 2017. In February and March 2017, the PBOC raised OMO rates twice by 10 bps each. This one is more timely, as central banks have more coordination in interest rate normalization given a synchronized recovery in the world

economy. A 10 bps (or more) increase in Chinese OMO rates not only follows the global normalization trend, but also sticks to monetary neutral and financial deleveraging stances, which can effectively hedge against capital outflow risk.

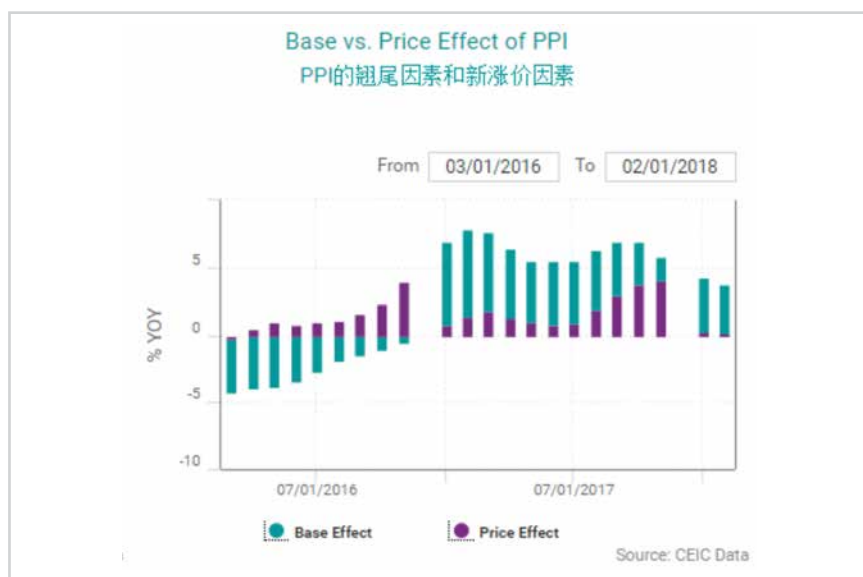
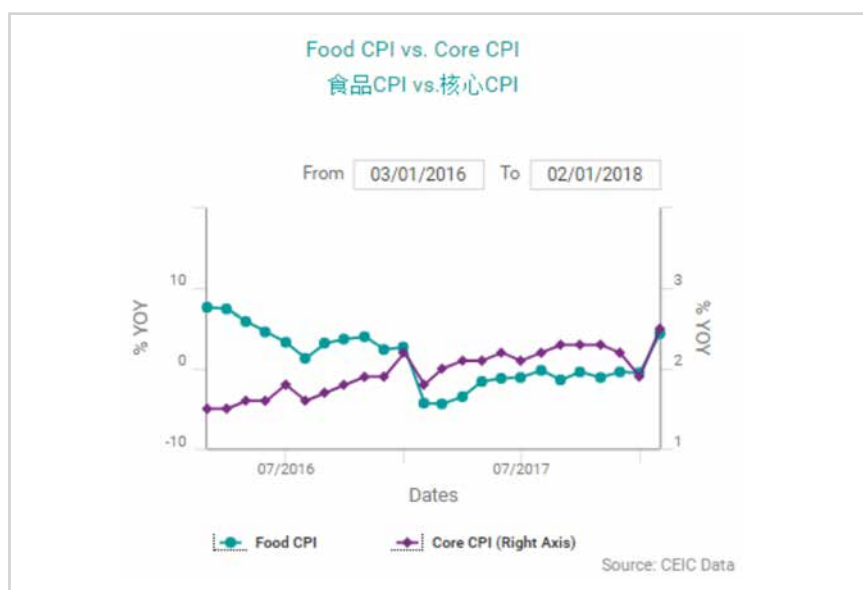




On the other hand, the US labor market saw bullish employment and payroll rises, thereby lifting inflation expectations. This exacerbates upward risk in US treasury yields. By contrast, a newly issued Chinese Household Survey shows that ONLY 26.4% of domestic urban citizens have an inflation expectation, which contradicts recent views from the PBOC that 'there could be upward pressure on inflation'. Therefore, the PBOC needs to keep up with the Fed pace to maintain treasury spreads at a reasonable level and recalibrate inflation expectations in the domestic market.

However, we believe there is a low probability for a benchmark interest rate hike, which would send a strong tightening signal to the market. After all, the Chinese economy and inflation are not overheated, and the financial market remains tight.

On the inflation side, inflation pressure indeed exists, but not ex-





cessively. The major drivers for CPI are food price inflation and core inflation. Annual CPI for 2018 would climb higher towards (but not reach) 3%. By contrast, PPI lacks drivers mainly because the base effect would quickly fade away in 2018 given the soaring PPI level last year, and because investment demand would weaken in light of disciplined fiscal spending. Divergence between PPI and CPI would shrink dramatically. Their weighted

average, the GDP deflator, is expected to remain stable this year.

On the financial market side, a tightened financial condition puts downward pressure on expansion of total social financing and Renminbi loans. Nominal GDP growth has surpassed M2 growth for the first time since 2012, signaling a tightened monetary stance. Additionally, after three OMO rate hikes last year, China's weighted average lending rate has

gone up, a clear sign that real economy is affected. Thus, there's no need to increase the benchmark interest rates in the near term.

In summary, we expect monetary policy to remain neutral in 2018. In other words, the PBOC will raise OMO rates rather than benchmark interest rates to respond to Fed rate hikes, and meanwhile use targeted RRR cuts to keep domestic economy resilient.



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About the Author

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To learn more about CEIC products, please contact James B. Boyko 212.610.2928 jboyko@ceicdata.com

Unfulfilled demand:

Lessons from India's past decade and opportunities for the next

 **Prakash Kalothia**

India has seen macroeconomic stability improving over the past three years, with sustained high GDP growth, stable currency, inflation under control, and fiscal and current account deficits at reasonable levels.

Given strong urbanisation trends (with about 150 million people moving to cities in the next 10 years), a young population (with a median age of 27 years), and a fast-expanding middle class with per capita income expected to double in the next 10 years, demand for high-quality real estate should remain strong across property types.

India is an under-built and capital-starved market, and we are enthusiastic about opportunities in real estate.
Evolution of the Indian real estate landscape

India's policy for foreign direct investment in real estate has been progressively liberalised over the years. When India allowed FDI in real estate in 2005, it was largely restricted to equity investments in large-scale greenfield developments. During 2006–2007, developers made commitments in excess of their execution capacity, and GPs in general underestimated execution risks. Hence, those investments faced several challenges, including high valuations, inappropriate deal structures, and large-scale developments in far-off locations.



Since the global financial crisis, several commingled funds either closed down their businesses or reduced their activity significantly in India, leaving a much smaller number of surviving funds. In 2009, SUN-Apollo/Lapis India Capital decided to make a mid-course correction in investment strategy by moving up the capital structure to quasi debt and preferred-equity structures, and concentrating on for-sale, mid-income housing in India's top three markets: Delhi, Mumbai and Bengaluru. This refocused strategy worked, and is delivering returns of about two times multiple and roughly 20 percent IRR (largely-realised performance).

In light of liberalisation of FDI norms that occurred in 2011, a few large global GPs and sovereign funds started to acquire suburban business parks. Although most of these investments have not been exited yet, they are likely to generate positive returns, given attractive in-place yields, rental growth and reduction of interest rates over the past three years. REIT regulations are now favourable for listings, which will provide li-

quidity to funds that have acquired and/or developed rent-yielding business parks.

Key changes in the real estate market in recent times

At an overall market level, the Narendra Modi administration has taken several steps, most notably the Goods and Services Tax (GST) and the Real Estate Regulation Act (RERA), to make the market more transparent and business-friendly. RERA will ensure all important project information such as land title, any encumbrances on the project land, status of construction, sales data, etc, is available publicly. GST will make the country a unified national market. These steps should also help to bring more businesses in the fold of the formal economy.

The interface with local municipalities is relatively easier now and more transparent than it was, and zoning

and building approval processes are being simplified across cities.

In addition, the quality of information itself has significantly improved. Today, it is possible to obtain tenant-by-tenant rent data for all office buildings in any major market. Similarly, on the residential side, it is possible to obtain data on stage of construction, units sold, capital values, price growth and sales velocity for almost all developments in all major markets across India.

Capital-starved market

Considering about 300,000 units are absorbed annually in the top seven cities, at an average price of US\$100,000 per unit, the funding requirement for the residential market is approximately US\$30 billion annually. Assuming a conservative equity requirement of 20 percent to 30 percent in the capital stack, it means a US\$6 billion to US\$9 billion equity requirement per year. Against this, the dry powder available from commingled funds today would add up to roughly US\$1 billion, leaving a large gap. Similarly, a significant gap exists between the availability and demand for institutional capital for the commercial, retail, industrial and hotel sectors, presenting opportunities for real estate investors across property types.

Residential real estate

We believe the market has significant unfulfilled demand at affordable price points.

Despite this, sales have been slow over the past four years due to delayed completions, high ticket sizes given large unit areas and high price growth in the past, and lack of transportation and social infrastructure at some locations (such as Dwarka Expressway in Gurgaon).

To address affordability, the end-user demand and sentiment, the focus needs to be on designing and building more compact, efficient units that have one-, two- and

three-bedroom configurations, in infill locations that are close to existing commercial hubs and connected to transportation nodes, and sponsored by strong, reputed developers at competitive price points.

Implementation of RERA, in our view, will boost customer confidence gradually. We foresee increasing opportunities for equity and debt going forward, as demand for pre-sales reduces and real estate developers seek to develop residential buildings to a certain acceptable stage before commencing sales.

The established markets of Mumbai, Delhi and Bengaluru will remain attractive, underpinned by employment generation and high office-space absorption.

India presents a sizeable opportunity in what is an under-built and capital-starved market, and we are enthusiastic about opportunities across property types backed by strong demand for high-quality real estate.

The office sector

The CBD/SBD office space in Indian cities is largely strata sold and, as a result of fractured ownership, buildings in general are not well maintained. Given the low focus on maintenance and the harsh tropical climate, these buildings tend to deteriorate very quickly.

A case can be made for “build-to-core”, Western-quality, grade A CBD/SBD offices, selectively, considering the low vacancy rates; the ability to grow rents; and the fact even in major markets such as Delhi and Mumbai, not many truly-grade A office buildings have been built. The challenge is to find zoned land parcels at a sensible basis.

REIT regulations are now favourable for listings in India, which will provide liquidity to asset owners.

Retail property

E-commerce has been growing rapidly. We believe both e-commerce and bricks-and-mortar retail will continue to co-exist. Today, very few high-quality retail centres are in India — overall mall supply is about 75 million square feet (7 million square metres) for a population of 1.3 billion, compared with roughly 4.3 billion square feet (400 million square metres) in the United States for a population of approximately 320 million. Several retail malls that became operational during the past decade were sub-scale, ill-conceived and in weak catchments having inadequate parking, inconvenient access and a poor tenant mix, and as a result these malls struggled to generate sales to sustain contracted rent. The owners typically resorted to strata sales to service debt, permanently disabling the mall and leading to its decline.

As 100 percent FDI in single-brand retailing is now permitted, several major foreign brands have entered the Indian market, and more brands are expected to establish operations in India. Most brands, however, find quality real estate is sparse, even in cities such as Mumbai, Delhi or Bengaluru.

Given this trend, well-designed malls in strong catchments will do well and continue to present an attractive opportunity. Greenfield development of malls, however, has a longer timeline for stabilisation com-

pared with other asset classes and, therefore, is best suited in the hands of more patient capital.

Industrial assets

GST will allow businesses to plan larger-size quality warehouses based on their distribution and demand, as opposed to several sub-size warehouses, which were the result of the pre-GST multiple taxation structure. Also, due to the lack of adequate bricks-and-mortar retail stock in India, combined with improving transportation infrastructure, the share of online retail is growing fast, creating a strong demand for quality warehousing spaces.

India is generally under-built across property types — more so, as far as industrial property is concerned. India has only about 110 million square feet (10.2 million square metres) of warehousing space, compared with approximately 10 billion square feet (992.0 million square metres) in China and roughly 9.5 billion square feet (882.6 million square metres) in the United States. Apart from certain warehouses built with the support of institutional capital, most warehouses in India would fall within the so-called “cheap and cheerful” category.

A lot of the existing and currently under-construction warehousing is closer to manufacturing hubs, given the availability of land. As manufactured goods are constantly under pricing pressures, however, we are not keen on such locations because it would be difficult to grow rents. We prefer warehousing closer to large consumption centres and key infrastructure, such as ports and airports. It is difficult, however, to find land in such areas at a reasonable cost. As a result, it is hard to earn an attractive development yield, given current rents.

Other than one portfolio transacted recently, not much is available to acquire in the industrial space in India. The opportunity is largely on the development side.

Key ingredients of a successful investment

In our experience, a combination of five factors have the ability to drive successful investment outcomes in India: (1) well-located infill properties with reasonably-sized projects (four- to five-year business plans) having efficient designs, (2) teaming up with reputed local partners having requisite execution capabilities, (3) enforceable contracts with carefully-drafted exit options and adequate control rights (eg, control over cash/bank accounts, voting rights over important partnership decisions), (4) underwriting rigor with an adequate margin of safety, and

(5) intensive asset management in the face of emerging market uncertainties.

In summary, India presents a sizeable opportunity in what is an under-built and capital-starved market, and we are enthusiastic about opportunities across property types backed by strong demand for high-quality real estate. In addition, the firm standing of the ruling Bharatiya Janata Party-led government, steadily-improving macroeconomic fundamentals, acceleration of the pace of policy reforms, and the large potential demographic dividend from a young population, make India a very attractive long-term investment market. Several large sovereign wealth funds have been increasing their direct investment exposure, and pension and endowment funds are also increasingly warming up to the India opportunity.



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About the Author

Prakash Kalothia is CEO and managing director with Lapis India Capital, based in Mumbai. This article originally published in Institutional Real Estate Asia Pacific.

Powerful demographic and economic trends in countries such as China, India and Indonesia are fueling demand for all types of real estate in markets throughout Asia Pacific. Institutional Real Estate Asia Pacific provides investors with the necessary information, data and insights to help them shape their decision-making and investment strategies in the region's mature and emerging markets. The magazine features articles on capital flows, cross-border investing trends, market and property type profiles, and the latest on investment strategies, new investment products, fundraising and property transactions.

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Latin America is the World Leader in eCommerce Growth Despite Serious Challenges

 **Miriam C. Dowd**

eCommerce in Latin America is booming, and with the number of people using the internet and social media growing by the day, there is plenty of opportunity for companies selling online, also known as “eRetailers”. In fact, online sales are expected to grow 19% in the next five years – well above the global average of 11% – and are foreseen doubling in value to \$118 billion in 2021. Two of the three fastest-growing eCommerce markets in the world are in Latin America: Colombia and Argentina.

Despite these impressive statistics, eRetailers face many challenges in Latin America, including online payment security, low banking services usage among citizens, and serious logistics issues, according to Patricia Galina of IEBS. The World Bank highlights some key areas where Latin America lags behind other regions as “lack of adequate roads and railways and port and airport efficiency”. It also cites corruption and cumbersome customs as major concerns. Lower purchasing power and tricky government regulations present yet another major roadblock. In addition, there are challenges related to trade and financial structures, such as the aforemen-

tioned banking penetration rates, along with low levels of confidence in electronic payment systems and lack of free flow of data. Analysts believe that companies must find a way to overcome these barriers to realize their full potential in this very promising market.

Market Overview

Next year, eMarketer forecasts that 155 million of the 650 million people in Latin America will shop online, an impressive increase of 40 million over 2015. This is thanks in part to a rise in internet and smartphone usage, especially in urban areas. Statista reports that in 2016, 27% of internet users made a pur-

chase on their mobile phones and 40% of those people did so monthly.

Not only will the number of online shoppers increase substantially in the next three years, but the average revenue per user is expected to grow from \$275 to \$330. Brazil leads the pack in online spending, with nearly \$17 billion worth of purchases in 2016. Mexicans bought \$7 billion online in the same year, and Argentinians spent \$5 billion. A study conducted by América Latina Business Review, found that, “87% of people who made an online purchase felt that the transaction was secure, which lead 97% of them to say they would buy online again.” That said, the average

number of online transactions per person per year in the region was the lowest in the world at just 9.2 in 2016, as reported by eMarketer. The challenge for eCommerce companies is to tap into this market by making it easier and more appealing to buy online.

The booming eCommerce growth of recent years took place against a backdrop of a struggling economy. Now that the region is on healthy recovery path following the recession in 2016, it seems the sector will continue to see impressive results. A Consensus Forecast of economic analysts projects GDP growth of 2.3% this year, nearly a full percentage point above 2017, and sees it reaching 2.7% in 2019.



At the same time, inflation is moderating. “Regional inflation excluding Venezuela is seen coming in at 5.5% at the end of 2018. In 2019, inflation is seen ending the year at 4.8%” says Angela Bouzanis, Senior Economist for Latin America at FocusEconomics. In a variety of countries, growth in retail sales are forecast to nearly double in 2018 and pick up further in 2019, with continued growth through 2021. In the biggest economies, Brazil and Mexico, retail sales are seen picking up this year and next, while consumer confidence is expected to remain steady.

A Look at the Major Players

Some of the key players vying for a bigger stake in this exciting eCommerce market are MercadoLibre, Amazon, Walmart and Alibaba. MercadoLibre is by far the most popular online retailer in the region, with operations in 18 markets. With more than 50 million unique visitors per month in 2016, it outpaced Amazon and Brazilian B2W. Mateo Valdivieso of SeekingAlpha says that one of MercadoLibre’s strengths is that it, “offers technological and commercial solutions that address the distinctive cultural and geographic challenges of operating an online commerce platform in Latin America.” Billy Duberstein of investing site The Motley Fool concurs: “MercadoLibre has strong

roots in Latin America and knows the idiosyncrasies of the culture, for now at least, this offers it a clear advantage over Amazon.”

MercadoLibre’s strong market position has not fazed the competition. Latin America is seeing somewhat of a gold rush from international players looking to cash in on its impressive growth. Amazon is breathing down MercadoLibre’s neck: When the U.S. giant entered Brazil in October 2017, the regional leader saw a 10% stock selloff shortly thereafter, although it has since recovered. Alibaba is also trying to get a foothold, as is Walmart, both of which are aiming for a strong position in Mexico, among other countries.

Additionally, within each country, there is fierce competition from local players. Often these companies have found ways to overcome some of the key challenges such as logistics, yet they will have an uphill battle competing against multinationals with money to burn.

Formidable Challenges Must be Overcome

The challenges these and other eCommerce companies are up against are daunting. Logistics, traffic and infrastructure are major issues in Latin America, where logistics alone can amount to 15% of

the cost of what’s sold, well above other regions. Many online retailers have put logistics on the back burner for years, focusing on the user experience through purchase, and as a result it can take weeks for a purchase to arrive at the customer’s door, according to Bloomberg and Simpliroute.

Adding to logistics issues are a myriad number of regulations and rules, which are different in each country. The International Development Bank states that, “among other factors, [is] the much-needed updating of many of the legal underpinnings for commercial transactions. [...] payment mechanisms, dispute settlements, and devices to ensure that contracts are upheld are all areas in which the legal structure of trade needs to adapt to the new ways of trading that this revolutionary technology has brought.”

Another barrier occurs at the time of payment. Access to secure, credit card-based payment methods is limited, and, while card use is growing, it is relatively uncommon in the region because many people do not use a formal banking system, according to an article by Jason Harvey. Those who have a debit card are often not permitted to use it for online transactions. Retailers have found ways to manage this reality. eShopWorld reported that 36% of online consumers prefer to utilize PayPal, and 35% use Cash on

Delivery. That said, in the largest markets – Argentina, Brazil and Mexico – consumers’ preferred payment method is in fact via credit card. This is just one of the many indications of the disparity between the largest economies in the region and their smaller neighbors.

Who will come out ahead in eCommerce in Latin America? Will Amazon dethrone MercadoLibre, or will the Latin American giant hold its ground? Can local players step up and fill the needs of consumers and meet challenges they best understand, keeping global players at bay? Only time will tell.

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About the Author

Miriam C. Dowd is a marketing professional with over 15 years of experience in Europe and the United States. She currently holds the position of Marketing Manager in the macroeconomic research firm FocusEconomics, and previously worked in NGOs and multinational companies. Miriam has a master’s degree in marketing from Universitat Pompeu Fabra in Barcelona and a master’s degree in literature from University College Dublin. She is a freelance writer for the blog Latinoamerica 21 where this article originally appeared.

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E-commerce in Mexico is witnessing a steady growth and is slowly becoming one of the most dynamic sectors of the country's economy. In the last five years, e-commerce market in Mexico has grown significantly, as retailers strengthened their digital strategies to grow sales. The online channel is becoming an indispensable part of retail and despite all operational challenges that exist in the market, opportunities are too attractive to be missed.

Mexico's E-commerce Sector to Rise Amidst Challenges

 **EOS Intelligence**

In recent years, Mexico has attracted interest from global brands to expand in the country, where online retailing is expected to grow substantially – revenue generated by e-commerce is expected to reach US\$ 17.6 billion by 2020, growing at a rate of 16.6% annually. Mexico's distinctive geographic and demographic characteristics make it one of the most promising e-commerce markets in Latin America, where global companies are looking to expand. Its proximity to the USA is advantageous, making it an attractive target for USA-based retailers looking to grow internationally (Amazon, Walmart, Best

Buy, among others). Additionally, the growing population of young, working-age, tech-savvy Mexicans with sufficient disposable income is the key target for global retail chains, particularly for companies eyeing growth through e-commerce channel.

In the last five years, e-commerce has witnessed double-digit growth and the trend is likely to continue in the long term. However, the market faces few challenges, which are impeding growth.

To begin with, low consumer confidence in online transactions is a

major barrier. Mexican users are skeptical when it comes to internet-based transactions due to distrust in payment methods and fear that the banking information provided will be misused, amidst high level of banking-related frauds prevalent in the country. According to a study conducted by Aite Group¹, in Q2 2016, 83% of the interviewed respondents witnessed identify theft, while 70% were victims to online banking frauds.

Consumer willingness to make online purchases is further shattered by the unsatisfactory online shopping experience delivered by some retailers due their relatively poor website designs and product display. According to a joint study by The Cocktail.com and ISDI, Challenges of E-commerce Mexico in 2017, consumers typically lost confidence in the online purchase process when trying to look for information on the products sold, making payments, understanding shipment and delivery policies, and dealing with returns.

Mexico is a cash-based economy, with 90% Mexicans preferring to make payments in physical currency. High dependence on cash is largely caused by limited access to modern financial infrastructure – as of 2016, there were only 37.7 ATMs and 10.3 bank branches per 100,000 people. Moreover, large proportion of the population remains unbanked along with low credit card penetration in the country. The dominance of physical currency in Mexico limits e-commerce growth, which is dependent on online payments. To overcome this challenge, players are adapting to align with customer preferences, as the significance of cash is impossible to overlook in Mexico. E-commerce players are introducing hybrid payment systems. For example, Linio and MercadoLibre allow customers to pay in cash, through banks, pharmacies, and convenience stores (OXXO and 7-Eleven), for items bought online. Walmart has introduced more than 2,000 kiosks in its physical stores,

where customers can pay in cash for products bought online.

EOS Perspective

Although several large players, such as Amazon, Walmart, and MercadoLibre operate in the market, e-commerce sector still faces several obstacles and has yet not developed to the levels of other e-commerce markets that exist globally. For the Mexican e-commerce market to grow, it is imperative for the retailers to boost consumer confidence by ensuring that the buyer is safe; one way to achieve that is to make sure that the purchase process does not end with payment confirmation. Instead, the complete purchase process should be made transparent by enabling consumers to track all orders, receive notifications on shipping process, as well as making the return policy/process agile and convenient for shoppers.

In spite of all quirks and challenges of the market, undoubtedly, Mex-



What Is Happening In Mexico's E-commerce Market

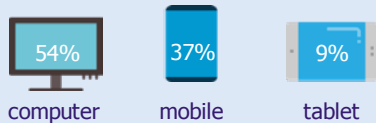
Number of online shoppers, million



Top e-commerce categories – 2017 (% of online shoppers)



Devices used for making online purchases – 2017



Top three e-commerce players - 2017



How Challenging Is The Mexican E-commerce Market To Operate In?



Payment

90% Mexicans prefer cash over card

As per CONAIF¹, only **38.7%** Mexicans had an account with a financial institution in 2016, 15.5% less than the global average

Low level of banking penetration and higher preference for cash-based transactions is hindering development of e-commerce, which relies on online payments



Logistics

Ranked 54th by LPI (Logistics Performance Index) in 2016 among 160 countries based on logistics infrastructure

El Puerto de Liverpool deliveries take more than **five shipping days** when demand is high

Although players like Amazon have introduced shorter delivery times, quite a few players still struggle to make quick deliveries, adversely affecting customers' willingness to order online



User Experience

Website usability is low for some e-commerce websites

Product **search tools** are unsatisfactory

Some e-commerce websites deliver subpar shopping experience, as quite a few players do not offer shopping assistance to users, in the form of chatbots on websites, and have poor product display lacking full product description or pictures from all angles



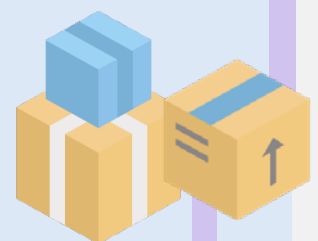
Distrust

67% Internet users doubt security of their data while shopping online²

40% Internet users do not indulge in online purchases due to distrust in payment methods³

56% Mexicans experienced card fraud in 2016⁴

Users are afraid to make online transactions due to distrust in payment system and fear that products will not be delivered or their banking information will be misused



What Is Trending In The Market?

Growing Offline Payments: Players are offering offline payment options to accommodate cash-based transactions



Linio and MercadoLibre allow customers to shop online and pay in physical currency across selected banks, pharmacies, and convenience stores (OXXO and 7-Eleven)



In 2018, Amazon launched its debit card, Amazon Rechargeable, which can be recharged at convenience stores using cash, and can be later used to make online payments

Expanding Operations: Players are expanding operational footprint across Mexico to fuel growth



In 2018, Amazon will open its one million sq ft warehouse near Mexico City, which will triple Amazon's distribution space in Mexico



In 2018, MercadoLibre announced plans to open two large distribution centers close to Mexico City



1) CONAIF - Mexican National Financial Inclusion Council
2) 2016 Global Connected Commerce study by Nielson

3) According to the study 'Challenges of E-commerce Mexico in 2017'; n = 213
4) 2016 Global Consumer Card Fraud study conducted by Aite Group; n = 5,861

ico offers a promising future for e-commerce with its sizable up-sides – high internet and mobile penetration, growing purchasing power among consumers, declining smartphone prices, presence of e-commerce giants, such as MercadoLibre and Amazon looking to expand operations, among others. According to the Mexican Association of Online Sales (AMVO), five years ago in Mexico, online sales of large retailers including Walmart, Sanborns, Sears, Liverpool, and Palacio de Hierro comprised merely 1% of their total sales. This share rose to nearly 20% by 2017.

The e-commerce market is developing, demonstrated through sustainable and constant improvements – for instance, the country is making efforts to steadily develop infrastructure, customers are offered wider payment options through offline channels, and Amazon's entry in the market has acted as a catalyst to e-commerce development, boosting customers' trust in online shopping websites. With the launch of Amazon Prime in 2017, Amazon reduced shipment time to 1-2 days and expanded fre

e shipping option across Mexico – a significant step that would revolutionize online retailing with other players trying to follow Amazon's lead.

Mexico is ripe for e-commerce to boom. Even though the market is at nascent stage of development and faces challenges, it is also laden

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About the Author

EOS Intelligence is a professional services firm that delivers decision-enabling research and analysis services targeted at corporate, consulting and investment organisations.

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The firm's portfolio of services cuts across supporting corporate and business unit strategy assessments, new market opportunity analysis, competitor benchmarking and supply chain rationalisation.

With research teams in India, Brazil and Slovenia, and local partners in several other emerging and frontier markets, EOS Intelligence is able to deliver critical, on-the-ground intelligence to its clients, powering informed decision-making.

with myriad of opportunities. Online shopping accounts for a small share of the total annual retail sales in Mexico – e-commerce comprised 1.6% of total retail sales in 2016 and is likely to grow to 2.6% by 2019 – which represents a huge opportunity for players, as Mexicans have just begun adopting shopping through e-commerce. Players operating in the market understand the

tremendous future growth prospects that the market offers, hence, are focusing to expand operations. With the right growth strategy, understanding of the market, and knowledge of consumer buying behavior, it is possible to survive and grow in the market, even though it is packed with challenges.

Profile: Caye International Bank

Interview with Luigi Wewege, Senior Vice President

Caye's history began in 1996 as a mortgage company in Belize. After several years of continued success, we decided to become an international bank, and on September 29th, 2003, Caye received an unrestricted Class-A International Banking License from the Central Bank of Belize.

Caye is the only international bank headquartered on the island of Ambergris Caye in Belize, which is on the Caribbean Coast next to Mexico and Guatemala. It's absolutely gorgeous. Our bank is global in its operations, and we focus on offering financial services to any international individuals and corporations located outside of Belize. The bank offers a full range of traditional and non-traditional banking services, plus various savings accounts in multiple currencies.

Caye has built up considerable knowledge of the Central American financial market, thanks to our many years of experience providing services to corporate customers and individuals all over the region. The bank's mission is to help our clients succeed in their financial affairs right now and in the future. Our banking goals stem from our mission, which is to offer financial services while delivering top-quality customer support.

Private offshore banking

Caye has expanded remarkably since our early days as a mortgage company, and then as a bank from 2003 onwards. In fact, just this year, in 2018, Global Finance Magazine listed us among the World's Best Private Banks, and as the best bank in Belize. Now, with the bank's ever-growing international client base, plus a network of global strategic alliances, we're poised to continue our growth well into the future.

Our bank's success to date has been made possible with the help of our visionary board members, dedicated staff, and loyal customers. Our bank's directors give guidance and leadership, and in general are a source of motivation and inspiration for all of us at Caye.

In Belize, reserve requirements are three times higher than in the United

States, and Caye Bank has liquidity approximately double the legal minimum of Belize. With one of the highest liquidity ratios of any global bank, Caye has a track record nearly two decades long within the Central American region. Caye's mission has always been to provide financial services based on trustworthiness, with an underpinning of strong corporate values, and this formula has certainly paid off. Our bank has grown with a diversified revenue structure, a balance sheet with excellent asset quality, diversified funding sources, and a strong capital base.

The scale of economic activity and stability in Belize and throughout Central America has brought robust growth to Caye in all of our bank's core products. In addition to this, we believe the diverse range of international finance services that we have offered over the last two decades has allowed us to play an integral role in the growth and prosperity of not just the island of Ambergris Caye, but all of Belize itself.

The Bank's Strategy

The most important investment for future growth is increasing our bank's customer acquisition, which should contribute to a rise in value for our shareholders.

Our bank's focus on customer financing, providing a variety of loans, will continue to be an important element for diversifying assets. Also, focusing on loan growth within strict criteria for risk and value creation will ensure our bank's continued growth into the future.

Leveraging and optimizing the online digital platforms is expected to help attract a new, much younger demographic of clients, as well as an added revenue stream for our bank.

The retail deposit base of our bank is predicted to grow exponentially over the next year. To maximize profitability, the deposit base cost will be improved by identifying better investment returns for the bank.



Caye International Bank team

Our bank's ongoing investments will be in new products, human capital, and technology—coupled with strategic diversification into new business areas, as well as increased attention to risk management, liquidity and successful regional diversification. I am confident that this will firmly establish Caye International Bank as a major financial institution within the Central American region over the next sev-

eral years, and will give the bank a platform to expand into international jurisdictions farther afield.

Outlook and Development

The banking industry is expanding globally, due to continued wealth creation that is being driven by

positive savings rates and long-term capital appreciation. The attractive growth of the industry continues to exceed the GDP growth of many Western nations. Today we have a strong footprint in Central America, and our goal is to achieve above-market growth, as well gaining market share in our three core activities. This calls for investments in our business model, which we are making on a targeted basis.

With our international bank accounts, we aspire to become the leading savings provider in the region, as well as continuing to tailor our offerings to the specific needs of European customers. To increase awareness of Caye, we continue to expand our team of professional regional directors located in major cities around the world, who provide business development within their areas concerning the bank's core products and services.

In financing, we want to gain further market share based on our positioning as a well-known, established bank that offers a superior level of customer support, and is willing to work with customers who take out loans by being flexible with repayment schedules and underlying terms.

Our financial services, offering innovative solutions as well as our continued focus on improving our technological capabilities, give us very strong foundations for the bank's further growth. Across all of our core activities, we aim to use the benefits that come with digitalization to improve the client's experience and to enhance the effectiveness and efficiency of our service delivery.

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Profiting from MSCI Reclassifications: Oases of Alpha or Mirages in the Desert?

 **Adam Choppin, Investment Officer, Asst. Portfolio Manager of Emerging Market Strategies**

When MSCI makes changes to their country classifications, trillions of dollars follow. A recent article in the CFA Institute's Financial Analysts Journal attempts to apply some academic rigor to understanding how financial markets tend to react to these changes and puts forward a broad trading recommendation.

Unfortunately, in simply examining past market outcomes from the top-down, the analysis ignores what was happening “on the ground” in these markets at the time these classifications occurred, and thus draws correlated, but not causal inferences.

The analysis also suffers from statistically questionable decisions, as well as failing to account for the broader structural context of MSCI's own rule-based classification decisions, which by definition, results in a structural correlation between the dependent and independent variables in the study. In this edition of FIS Foresights, we will review the recent article, break-down its flaws, and look ahead to the next set of expected upgrades, providing our views on how to trade around these opportunities given the individual contexts of these markets.

Argument Summary

The authors of *Investing in the Presence of Massive Flows: The Case of MSCI Country Reclassifications*, take on an admirable task of studying the applicable country classification changes (upgrades and downgrades) that MSCI has made since 2000 in order to set forth a systematic trading recommendation. The authors include academics from New York University and Chapman University, and one practitioner from Acadian Asset Management. The analysis tracks all 17 country classifica-

tion changes by MSCI since July 2000, categorizes them into changes from less benchmarked to more benchmarked indices, and looks at the pure returns of those respective MSCI country indices for the period from the announcement date to the effective date and for one year following the effective date. Ultimately the article finds that on average markets moving from less benchmarked indices to more benchmarked indices significantly outperform from the time of the announcement until the effective date of the upgrade and then underperform thereafter. The inverse is true for markets moving from more benchmarked indices to less benchmarked indices.

Flaw #1 – The UAE/Qatar Case Study

The article's findings of significant outperformance from markets changing to more benchmarked indices rely substantially on the case studies of UAE and Qatar (see Table 1) which made the simultaneous switch from MSCI's frontier markets index to MSCI's emerging markets index in June 2014. But as we already elaborated in exhaustive detail in our September 2014 article, *Arabian Nights: Mysteries on the Frontier*, there was much more

Table 1 - Internet Appendix. Returns around MSCI Market Reclassifications

Announcement Date	Effective Date	Market	Old Index	New Index	Upgrade	More Benchmark	(Announcement, Effective) Return (%)			(Effective, +1 Year) Return (%)		
							Total	Total - Old	Table - New	Total	Total - Old	Total - New
Jun -13	Jun -14	Qatar	FM	EM	Yes	Yes	54.30	27.40	52.70	(12.10)	(13.00)	(19.50)
Jun -13	Jun -14	UAE	FM	EM	Yes	Yes	98.30	71.80	89.80	(11.30)	(11.30)	(16.60)
Jun -13	Dec-13	Greece	DM	EM	No	Yes	52.40	40.00	44.20	(11.70)	(19.60)	(19.60)
Jun -13	Dec-13	Morocco	EM	FM	No	No	3.60	(4.60)	(1.10)	4.80	(3.40)	(19.60)
Feb-11	Jun-11	Trinidad and Tobago	FM	Standalone	No	No	8.10	13.30	8.10	9.70	23.30	9.70
Feb-10	May-10	Bangladesh	Standalone	FM	Yes	Yes	3.10	3.10	5.00	(30.40)	(30.40)	(41.10)
Jun-09	Jun-10	Israel	EM	DM	Yes	No	15.90	(7.10)	1.70	11.90	(17.30)	(16.80)
May-09	Jun-09	Trinidad and Tobago	Standalone	FM	Yes	Yes	(2.50)	(2.50)	(10.70)	(9.10)	(9.10)	(26.00)
Mar-09	Jun-09	Pakistan	Standalone	FM	Yes	Yes	16.90	16.90	(13.40)	25.10	25.10	21.90
Feb-09	Jun-09	Argentina	EM	FM	No	No	5.30	(45.10)	(32.50)	66.20	44.70	61.10
Dec-08	Jun-09	Pakistan	EM	Standalone	No	No	(50.10)	(51.30)	(50.10)	2.50	(1.60)	2.50
Jun-08	Dec-08	Jordan	EM	FM	No	No	(48.70)	7.70	1.30	0.10	(61.30)	(2.20)
Apr-06	Jun-06	Venezuela	EM	Standalone	No	No	(3.20)	6.70	(3.20)	42.50	3.90	42.50
Feb-01	Jun-01	Sri Lanka	EM	Standalone	No	No	(11.70)	(7.50)	(11.70)	93.40	88.00	93.40
Jul-00	Jun-01	Egypt	Standalone	EM	Yes	Yes	(23.50)	(23.50)	(4.40)	(35.90)	(35.90)	(47.10)
Jul-00	Jun-01	Greece	EM	DM	Yes	No	(31.70)	(11.40)	(24.30)	(21.70)	(28.40)	(9.60)
Jul-00	Jun-01	Morocco	Standalone	EM	Yes	Yes	(13.60)	(13.60)	6.50	(14.00)	(14.00)	(21.30)

Source: *Investing in the Presence of Massive Flows: The Case of MSCI Country Reclassifications*, Financial Analysts Journal, vol. 74, Issue 1, CFA Institute, Q1 2018.

to this episode than MSCI market moves. MSCI's announcement of the markets' upgrades happened amid a massive recovery in both local economies, especially the real estate markets, following the sell-off and financial slump brought on by the post-2008 debt crisis in Dubai in particular. In our 2014 article, we demonstrated through a detailed stock-by-stock analysis of the markets' performance, that these markets' meteoric rise during this period was disproportionately led by the three listings with the highest respective exposure to the real estate market (Arabtec, Emaar Properties, and Masraf al-Rayan). Moreover, the rally did not commence with the upgrade announcement, and there was a wide dispersion of intra-market returns during this period, ranging from +226% for Arabtec to -7.69% for Dana Gas in the UAE or in Qatar between +118% for Masraf al-Rayan versus a mere +10% for Qatar National Bank (QNB). Indeed, the sparse relative returns of QNB, the largest cap stock in the MSCI Qatar index, but which underperformed the broader Qatari market's returns by nearly 30% during the upgrade period, is a clear rebuke of the simplistic story that it was MSCI's upgrade announcement that sent the market surging forward.

Conclusion – The UAE/Qatar examples clearly undermine the study's core thesis, invalidating two key data points.

Flaw #2 – Questionable Sampling

Over the study period of the article, MSCI's country classifications had multiple different types of moves to examine. These included upgrades from frontier to emerging (as profiled in the UAE/Qatar case study); upgrades from emerging to developed (Greece 2001 and Israel in 2010); upgrades from standalone to frontier (Bangladesh 2010, Trinidad and Tobago 2009, and Pakistan 2009) and from standalone to emerging (Egypt 2001 and Morocco 2001). Then of course, there were also downgrades from emerging to frontier (Argentina 2009 and Jordan 2008); from emerging to standalone (Sri Lanka 2001, Venezuela 2006, and Pakistan 2009), and from frontier to standalone (Trinidad and Tobago 2011). To make sense of these many different variables, as seen in Table 1, the authors of the study under review sought to make broad claims by attributing

each MSCI country classification change to one of two categories: moving from a more benchmarked index to a less benchmarked index (generally for downgrades) or from a less benchmarked index to a more benchmarked index (generally for upgrades). In this way the authors could (in theory) examine the net effects of added liquidity as the controlled variable in the study.

While we agree with the logically sound principle of this two-prong classification system, where the ratio of benchmarking is very close, as is the case between developed and emerging markets (35% vs 40%, respectively for the 2013 downgrade of Greece) we don't believe that the data supports a statistically sound conversion of the dependent variables (market classification) to the analysis' more/less benchmarked claim, at least not for the 2013 downgrade of Greece from developed to emerging markets. The study then also does not provide supporting data to justify the claims that the other moves from emerging to developed markets (Greece in 2001 or Israel in 2010) were indeed from more to less benchmarked indices as the authors claim.

Conclusion – The claims that the three classification changes between developed and emerging

	Total Returns	Total Excess Returns vs Old Index	Total Excess Returns vs New Index
Original Study	23.2%	15%	21.2%
Original Study excluding UAE, Qatar, and Greece	-3.9%	-3.9%	-3.4%

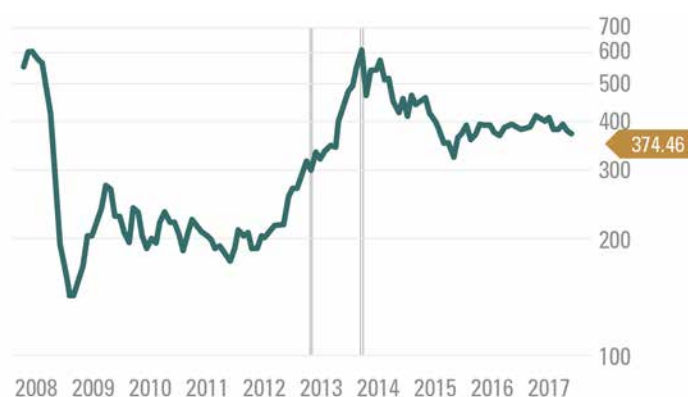
markets can be categorized clearly between changes from less to more benchmarked indices are not sufficiently supported by the evidence in the study. Removing these three examples and the UAE/Qatar examples, changes the outcomes dramatically (see Table 2). No longer do upgrading markets outperform during the period between announcement and upgrade, but they do lose less money than during the one-year period following the upgrade's effective date.

Flaw #3 - Upgrades/ Downgrades are Structurally Correlated to Market Returns

Perhaps the biggest flaw in this analysis is in ignoring the structural correlation between MSCI country classification changes and market performance. MSCI has a list of requirements for a market to be considered for inclusion in its country classification system. These broadly fall into the categories of access, size, and liquidity. Access is defined as openness to foreign ownership, availability of derivative markets, free convertibility of the currency, etc. Size relates to the investible market cap or free float of the respective country's stock market and liquidity

Chart 1 - MSCI United Arab Emirates

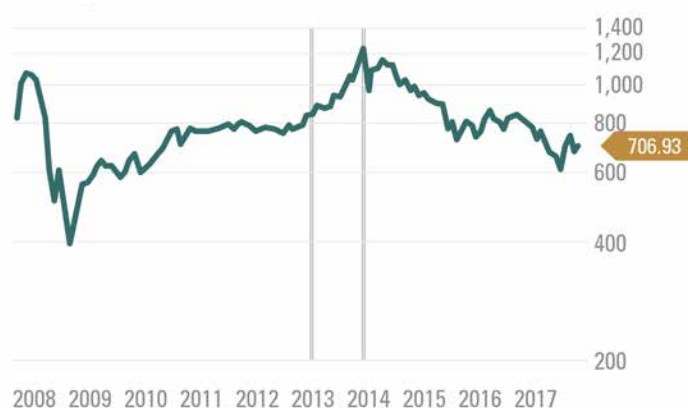
Index Returns (SR)(USD)



Source: FactSet

Chart 2 - MSCI Qatar

Index Returns (SR)(USD)



Source: FactSet

Chart 1 - MSCI Greece

Index Returns



Source: FactSet

is generally measured as a function of the average daily trading volume over the recent period. Size and liquidity are generally the other side of the same coin as price performance in a market and access is generally a prerequisite to all. Thus, the problem with seeking to examine the effects of country classification announcements on price performance is that country classification decisions are already dependent upon price performance based on their sister criterion in size and liquidity. To that end, country classification upgrades are already generally made during a period of positive market performance and downgrades during a period of poor market performance. Thus the article's finding that markets outperform during the initial period after an upgrade announcement is made and vice versa can also be seen as little more than acknowledging a momentum trade in the market. Graphical examples of the four most recent country classification changes by MSCI (that have also been effected already) – UAE, Qatar, and Pakistan (upgrades) and Greece (downgrade) – show how each classification announcement was made in the midst of pre-existing market trends that were themselves significant factors in the country classification change in the first place (see Charts 1-4).

Conclusion – Trading based on MSCI announcements alone might be no different than a momentum trade. The variables are not sufficiently independent to justify a statistically sound broad study.

What Comes Next?

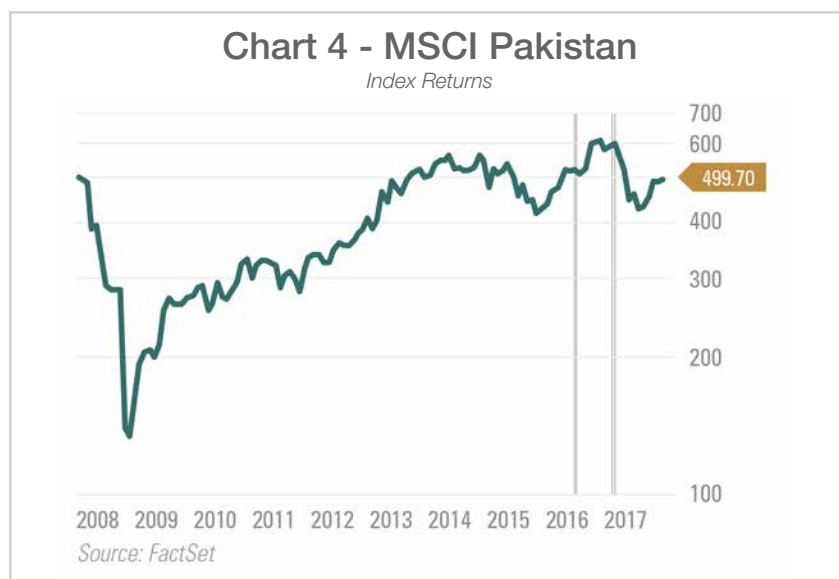
Hoping that we have sufficiently rejected the thesis from the article that a general trading rule around country classification announcements exists, we can now roll up our sleeves and look case-by-case at the forthcoming expected or possible upgrades and posit our own recommendations of how one might look at trading around each event based on each individual market's circumstance.

China A-Shares – In June 2017, MSCI announced that it will be including Chinese A-shares in its global indices. As we profiled in last year's article, Whither the GEM manager, this will eventually have a profound effect on the composition of global indices, and in particular, the MSCI Emerging Markets Index. But unlike with most of its other country classification changes, MSCI is adding A-shares to its global indices gradually, over the course of several years, thus diminishing the expectation among index front-running speculators to drive up prices in advance of passive flows. Moreover, the "MSCI expectations rally", or at least a first go at it, may have already happened. The 75% spike in the A-share market in the Spring of 2015 was fueled in some part by speculation around MSCI inclusion (unfounded, as it turns out, but it was one of the stories the local brokers were spinning

to their retail clients, nonetheless). Thus, we see the scope for another such rally as more limited in the future.

Argentina – Given recent market reforms, Argentina is widely expected to be flagged for MSCI (re) upgrade to emerging markets from frontier in its forthcoming country classification review in June 2018. But in Argentina's case, the upgrade was already widely expected in mid-2017 and was preceded by a huge rally that was buoyed by massively improving economic fundamentals, access, and liquidity, as well as an expectation of eventual MSCI upgrade. As such, in this case we also do not see a long trade in Argentina on the back of potential MSCI announcements, though we do remain cautiously optimistic on the market in general, though a bit more cautious than we were at the time of publication for our 2018 Frontier Markets Outlook.

Romania – As mentioned in our 2018 Frontier Markets Outlook, Romania is just an uptick of liquidity away from being upgraded to EM by FTSE and being watch-listed for EM upgrade by MSCI, either of which should in turn buoy some local investor enthusiasm, but here again, we believe most of this is already priced in. The Romanian Government made MSCI upgrade a political priority some 2-3 years ago, which is what led to the flurry of structural access reforms to make the current consideration by FTSE and MSCI even the possibility it is



today. As such, local investors have been watching, and we believe pricing in, this event already, while positive market fundamentals have buoyed the market for a few years now. But as we also mentioned in our 2018 Frontier Markets Outlook, Romania may be at the end of this economic cycle, or at least due for some economic slowdown, over the coming 1-2 years. Thus, an upgrade announcement, should it come based on market technicals, may coincide with a slowing economic outlook, and thus does not present a high conviction long in our opinion.

Kuwait – In September 2017, FTSE/Russell announced Kuwait’s promotion to emerging markets following the establishment of t+3 and DVP settlement. We also expect Kuwait to be added to MSCI’s watch list for upgrade this June 2018. The market already traded up about 10% on the news last September before falling back amid underwhelming economic and earnings news. We believe there is some upside to the

Kuwait upgrade trade, or at least the prospect of MSCI announcement provides a floor to a long call that is otherwise supported by fundamentals, as profiled in our 2018 Frontier Markets Outlook. We further believe that Kuwait will be a

market that is better received by EM investors than it has been by frontier investors as the former are already a little less dogmatic about requiring a true “developing economy” to drive their investment research, having already crossed that bridge in comparably wealthy markets in Korea, Taiwan, the UAE, and Qatar. Meanwhile active frontier investors have generally eschewed Kuwait for its lack of strong economic growth prospects or pure developing economy “story”, not to mention higher relative valuations given the strong local investor base. Therefore, we believe that Kuwait could fare even better once it is fully integrated into the EM investor universe (including high dividend and other smart beta screens) than it could ever be expected to do with frontier investors.

About the Author

Adam Choppin is a global equity analyst at FIS Group, a \$5bn Philadelphia-based manager-of-managers specializing in emerging and entrepreneurial managers. FIS serves its primarily institutional clientele by capturing the alpha of undiscovered managers through cost-efficient solutions. Mr. Choppin joined FIS in May 2013 where he is the primary analyst for emerging and frontier markets strategies on both the manager research and investment strategy teams. Mr. Choppin is also on the leadership team of the Association of Professional Fund Investors as its Lead Representative for North America.

From 2008-2013, Mr. Choppin founded and ran a boutique investment advisory firm which advised on private investments in South America, Africa, and the Middle East. Previously, Mr. Choppin worked for several U.S. Government agencies including as a trade and economic affairs liaison in Iraq, Afghanistan, Cape Verde, Sierra Leone, Ghana, and Mozambique. Most notably, in 2008 he organized the first official U.S. Government trade mission to Iraq in over 25 years.



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