ALTERNATIVE
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Issue 3

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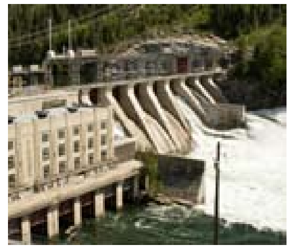


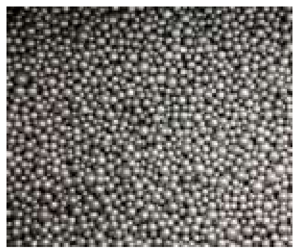

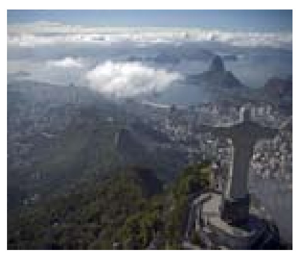

Letter from the Editor

A new year, a new decade, a new light at the end of a two year tunnel. 2010 ushers in a new sentiment of optimism within the investment community as managers continue to rebuild, raise capital and begin transitioning away from highly liquid positions. It has always been my position that this most recent economic hardship has been an opportunity for Latin America to gain ground on the global stage. As one of the least affected regions, investors previously unfamiliar with LatAm began to take notice. In addition, Latin American managers dealing with redemptions and some lack of AuM have begun actively pursuing foreign capital. Nevertheless, despite positive moves in the improvement of the global economy, local politics are an obstacle which will continue to scare investors. Consider the Venezuelan devaluation of the Bolivar by fifty percent, or the creation of the Bicentenial Fund, a fairly transparent ploy by Argentina's president, Cristina Fernández de Kirchner , to guarantee her country's debt using funds from the Central Bank, despite opposition and the subsequent resignation of Central Bank President, Martín Redrado. But despite the challenges put forth by local politics, the opportunities available, particularly in agribusiness, mining and green energy cannot be overlooked and have the potential to provide returns which validate the political risks inherent in the region.

One of the most effective ways to address such risk is to seek out and provide current and insightful information regarding the region, market and, indeed, specific investment vehicles. It is my greatest hope that Alternative Latin Investor will serve as a platform for such information, and that it will continue to in its goal of connecting Latin America with the rest of the world by means of astute research, agile content with a finger permanently on the region's pulse, and top quality, to-the-point reporting from our correspondents and experts on the ground.

Nate

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Real Estate Limited Partners In Latin America

By James T. Anderson

Real Estate investment for Limited Partners (LPs) in Latin America can really be seen as a tale of two countries, namely Mexico and Brazil, and recent experiences there offer important contrasts between each country's different market practices leading up to the global recession, some of the ways in which local participants responded differently, and, ultimately, lessons that the global recession may offer Limited Partners for future investing strategies in Latin America.

For LPs, the contrasts between Brazil and Mexico couldn't be sharper, but identifying the appropriate strategy going forward may not be as clear. There seems to be a general consensus today that investors want to avoid Mexico but remain committed to investing in Brazil. One can't blame them. This situation, in fact, is nearly a mirror image of the situation ten years ago when investors, beleaguered by years of boom and bust in Brazil, concentrated almost exclusively on Mexico as it emerged from the 1994 peso crisis. What we now know, of course, is that investors who were early to the game in Brazil have been rewarded handsomely, while experiences in Mexico are mixed at best.

During the last fund-raising cycle, most investment strategies that came to market were structured as country Funds. The emergence of country Funds, headed by dedicated local management teams, introduced a new era of competition for LP capital, which means LPs now have more options when analyzing investment choices.

This question of how LPs invest going forward will become more prominent as the reality sets in that foreign-based managers are really not set up to deal directly with day-to-day issues on the ground, and one lesson investors may take from the current crisis is that being closer to the investment itself is generally a good thing. This reality check is pushing LPs to look at their investment vehicle choices, their ability to defend their interests, fees they are paying as well as the overall investment strategy.

Issues facing LP investors are further complicated if the Fund is co-mingled. For LPs who had the ability and foresight to demand a seat at the table, either de facto or through negotiations, having more say in the matter when investments turn south turns out to be a pretty good thing. The lesson that LPs need to plan for a downturn when executing agreements is a prominent theme throughout the industry.

Over the last five years, Mexico and Brazil each benefited from a tremendous influx of equity capital, and excessive liquidity permitted global managers to tap into leverage that further increased demand for risk assets. As allocations for alternatives increased, Funds grew in both size and number and, as a result of this heightened demand for assets, the path diverged between Brazil and Mexico as the need to invest relatively larger pools of capital pushed managers to assume the maximum permissible risk each respective market offered.

Due to the expansion of local credit, asset appreciation in Mexico readily exceeded that of Brazil. As an example, pro-forma exit cap rates for commercial retail dipped well into the high single digits at the peak, even though short-term Mexican Treasuries were yielding 8.25% at the time. Stabilized, credit-tenant industrial traded as low as 7.25% on a cap-rate basis. Current estimates put cap rates in the 12–14% range for commercial retail and 9–10% for stabilized industrial. The current spread between short-term rates has widened substantially to 500–800bps as the Banco de Mexico cut rates 375bps and prices fell. For a project that funded in 2006, total estimated losses could easily exceed 50% when converted back to USD. The deterioration of the Mexican peso caught many by surprise but added fuel to the fire of overleveraged real estate.

Brazil, on the other hand, continues to be an all-equity market wherein sales values for stabilized investments tend to track government bond yields, adjusted for IGPM, but the real difference is that most projects were underwritten on an unleveraged basis. That distinction is important, because if Brazil does move toward a bubble, it will most likely be evidenced by an increased use of leverage.

Mexico's GDP was expected to contract 8.7% for 2009, whereas Brazil is expected to pull back 1.5%. The fact that Brazil's GDP is roughly 1.6 times the size of Mexico's only emphasizes the impact this global recession will have on the allure of Brazil as an investment over the next cycle.

By 2007, the rush to invest in Mexico reached a point where clear cases of bad underwriting had emerged. Aggressive assumptions on everything from lease rates, time to stabilization, residential unit pricing, sales velocity and aggressive exit cap rates seemed to justify higher going-in costs across the board. The urgency to put money out overtook the fundamentals, and the technical trade, premised on maximizing the IRR, was squarely the focus. LPs who had the foresight to establish the dual criteria of an xIRR-based hurdle as well as a threshold multiple-on-capital hurdle avoided some of the more painful situations because, from an absolute return perspective, most investments did not pass muster after 2006.

Salaries for senior professionals in Mexico went through the roof, and attrition rates were uncomfortably high. Retaining talent became a major issue because professionals, it seemed, were spending a significant amount of time looking for the next big job opportunity. The tales of who was being paid how much to work for whom, doing who knows what, were rampant. Each week it seemed a new pool of capital was looking for a degreed, bilingual Mexican citizen to oversee their local operations.

The failure in Mexico to retain talent highlights the breakdown of the fundamental need to align management with the investor. Mexico's attrition rate for senior professionals within the industry was demonstrably higher than that of Brazil. Why there was high turnover may have as much to do with cultural issues as it does with compensation practices within the Funds themselves, but the fact remains that LPs entrusted their capital to platforms that couldn't guarantee their senior staff would stick around. The over reliance on local professionals who fit a specific mold more often than not yielded a sub-par professional who lacked the ability to properly vet an investment or say no to the next best career opportunity.

The principal issues facing LPs today depend largely on which countries the LP is exposed to and what the LP wants to do going forward. The strength of Brazil's currency provided not only a safe harbor for foreign investors but, ironically, raises the question of to whether risk-adjusted returns will be as attractive from this point on.

Back in March 2009, revisions to projected returns in Brazil would seem to suggest the currency risk was properly priced because, at that time, the overall projected losses were minimal (no one was projecting much of a profit on a currency-adjusted basis, but they weren't losing their shirts either). The question going forward is will investors, in their rush to capture alpha, push the boundaries too far, because complacency about the currency, coupled with competition for deals, can be a formula for pushing asset prices too far upwards. Equity International, for example, announced intentions to create a Brazil debt program earlier this summer, which in and of itself is not a bad idea, but is an indication that investment inflows to Brazil are forcing capital to seek out new areas of opportunity. Going further out on the risk-reward continuum seems to be one of the features of overpricing assets and under-pricing risk. What Brazil really teaches us is that less leverage is a good thing, and if it isn't broke, don't fix it.

Some of these performance differences can be explained by the strength of the Brazilian Real, but the severity of loss in Mexico appears to fundamentally have much to do with its correlation to the U.S. economy, compounded by the fact that leverage was widely used. When the U.S. slowed, leverage and correlation exacerbated the situation in Mexico. LPs should think about Mexico as a total reset similar to that of the U.S., and as such, risk-adjusted returns should outpace Brazil during the next cycle. This assumes of course that Mexico's correlation with the U.S. will remain true as the U.S. recovers.

In Brazil and Mexico, both residential and commercial retail development were highly favored by investors. While land prices and development costs increased in both countries, Mexico experienced a much sharper increase in cost inputs, which can only be attributed to the impact of leverage. Low-income housing net margins, for example, shrank from 18–20% to 12–14% by 2008. Retail developers began to assume long-term exit cap rates in the 9% range and lease rate increases of 5% or more per year. In their defense, much of this had everything to do with the overall robust sense that things were going really well. As a developer in Mexico, if Wal-Mart said they wanted to build a mall in Veracruz, you basically said, sure, let's get it done! The problem of course is that these deals turned out to be very good for Wal-Mart and not so good for the risk capital partners.

Brazil's experience with retail expansion has resisted the downturn for two core reasons. First, the consumer economy didn't experience a pullback anywhere close to that of Mexico. Second, Brazilian developers assume risk on an all-cash basis. Any downtick in rental rates is temporary and linear. In terms of residential in Brazil, the higher-end markets definitely got ahead of themselves, but when things started to show signs of slowing down, developers quickly slowed construction, which was all equity, and, more importantly, never veered from the basic development model based on pre-sales. Clear signs of a recovery in the upper end are evident today, and developers are simply resuming pre-sales and construction.

Brazil's experience with the middle- and low- housing segments, which are financed through the CAIXA system, remain very active and well financed. The issue for these housing segments in Brazil is that the government's CAIXA program is so efficient that developers really don't need that much capital. It's a great IRR, but the amount of equity is unbearably tiny for most institutional investors.

Mexico's middle- and low-income housing sectors, while still active, were leveraged through the private sector mortgage banks, which in turn had credit lines from international banks. When foreign lenders pulled their lines in 2008, developers were essentially hung out to dry. The principal difference between Brazil and Mexico is how the governments' respective subsidized housing agencies pay developers. In Brazil, a developer is paid according to pre-sales and construction advance, supplanting the need for outside construction financing. Conversely, Mexico's INFONAVIT only pays developers once the certificate of occupancy is delivered and the sale is closed. In an up market, the Mexican model allows free market forces to incentivize the production of more homes, faster, but in a downturn the industry becomes a victim of the scarcity of capital.

In the particular case of Mexico's resort hospitality sector, values reached levels never seen before. The allure of building into what felt like an unlimited demand cycle of foreign buyers drove price appreciation in destinations like Cabo San Lucas and Puerto Vallarta into the stratosphere. A two-bed condominium in Cabo could have fetched $800,000 at the peak. If you wanted a view and access to the ocean, you were probably looking at double that. Foreign investors dove head first into risky beachfront land bets in Mexico that will take years to be made whole. Conversely, Brazil's resort tourism market has remained focused on domestic end users and, perhaps due more to geography, Brazil never came close to exploiting the foreign-buyer market for second homes the way that Mexico did.

Mexico's GDP is expected to contract 8.7% for 2009, whereas Brazil is expected to pull back 1.5%. The fact that Brazil's GDP is roughly 1.6 times the size of Mexico's only emphasizes the impact this global recession will have on the allure of Brazil as an investment over the next cycle. The question for LPs, however, is which country will offer a more compelling entry point a year or two from now, when new capital would be invested?

At a recent conference on Latin America real estate, few

institutional investors planned to allocate either time or money to Mexico, but invariably all were interested in Brazil. Whether or not this situation persists only time will tell, but the dearth of investment capital has negative implications for existing investments in Mexico as well as opportunities for new capital to enter at a much better cost basis than in Brazil. History illustrates that persistent illiquidity mainly serves to push values down further, which, in turn, hastens a new cycle for opportunistic investing. For an LP invested in Mexico today, the question of what to do rests on the willingness to suspend the experience from what just happened and refocus on what will most likely occur over the next several years.

When an investment goes bad, the instinct is turn the page, but to do so with an eye on maximizing proceeds within market-based time constraints is an art. Furthermore, if a manager has no more incentive to maximize proceeds, what mechanisms are left to ensure that the LP's capital is being managed with the maximum level of fiduciary? The short answer is not much. The question for an LP invested in Mexico today is how to re-align interests, because, whatever the ultimate strategy, selling will take time.

The extent to which an LP is able and willing to step up their allocation to Mexico will largely define its options. By increasing the allocation, an LP immediately secures the ability to completely restructure its relationship with the manager, including the fee structure, management retention practices, the investment strategy and the LP's rights. If increasing the allocation is unrealistic, an LP could theoretically incentivize a manager by resetting the cost basis, but that begs the question: why reward failure? The LP, then, is left with either swapping out the manager, which is complicated, or bringing in an outside advisor to monitor the manager, charging the cost back to Fund. The latter seems to be the preferred strategy at this point in time but may prove to be only a Band-Aid over time.

The fact that capital is actively looking to invest in Brazil and that Brazilian managers can point to relative success during the downturn will limit their willingness to negotiate with LPs. All things being equal, an LP should be able to negotiate substantially better terms with a Mexican manager in the current environment. LPs who invested in Brazil earlier this decade already made their money and have their deals cut with the manager, but new investors are up against a wave of interest that will only grow stronger as the global recession recedes.

The absence of leverage in Brazil turned out to be a good thing for many reasons. First and foremost, unleveraged returns are by definition more conservatively underwritten. A manager who has to fund with 100% equity capital will look more closely at an investment because of the simple law of limited resources. The same manager with an ability to leverage that same equity will put less in so that he can fund more investments, because maximizing the number of projects will yield more fees. Because of this, there is an inherent tension between maximizing the number of deals and protecting investor capital, driven mainly by the front-end fee incentive. This is one of the greatest obstacles to maintaining proper alignment of interest. The fact that Mexico is currently undergoing a reset in asset prices means the next wave of capital to enter Mexico will invest on an all equity basis—which is a good thing from an underwriting standpoint, because the LPs will benefit from better underwriting standards and a wider selection of opportunities.

The question of properly aligned fee structures is central. Even though there is strong LP interest in Brazil, fees are being negotiated down with some success. Namely transaction-related fees such as internal acquisition and disposition commissions are being reduced, if not eliminated. Asset management fees are focusing on invested versus committed equity, and LPs are paying close attention to the definition of "inside the box," with an eye on capping exposure to any individual investment.

The most likely areas for opportunity in Brazil will continue to be build-to-suit industrial, mid-rise value-add office and middle-income residential (although it's hard to put a lot of equity out without buying into a developer). Commercial retail is a very competitive market, and the most successful strategies have been joint ventures with solid local developers. It will be interesting to see what the impact of the Olympics will be for the country and Rio de Janeiro specifically, and there will be a real estate angle to be sure.

Opportunities in Mexico are clearly going to be of the distressed variety, which will require a specific personality and skill set. Developers and acquisition folks in general don't make good distressed guys because their strength is execution in an up market, so finding the right manager is the first challenge. The likely areas of opportunity in Mexico will be in the middle-income residential sector, mainly with undercapitalized builders, discounted land and unsold vertical condo. Additionally, there

The likely areas of opportunity in Mexico will be in the middle-income residential sector, mainly with undercapitalized builders, discounted land and unsold vertical condo. Additionally, there are going to be opportunities to acquire stabilized commercial retail and second-generation industrial.

are going to be opportunities to acquire stabilized commercial retail and second-generation industrial. While the office market remains relatively overbuilt in Mexico City, those opportunities are most likely going to be on the debt side. Most would agree that there will not be a distressed debt market like the mid 1990s, simply because the banks are well capitalized and, frankly, operated with prudent lending policies throughout the cycle.

There have been some notable transactions with local developers. One involving a low-income developer, Corporativo Javer, had previously announced a sale of the entire company to Advent International in July 2007 for a rumored $500 million and never closed, but recently announced a 60% sale of the Company for $180 million to a consortium lead by Southern Cross and Evercore Partners, of which Pedro Aspe is a founder. The estimated valuation not only represents a 40% discount to the Advent terms, but the equity injection also carries a 13% preferred return. In many ways, this transaction is a good example of the kind of reset Mexico will likely continue to experience.

While those who invested in Brazil have reaped tremendous benefits, it is unclear if future investments will be as compelling for a new LP. Historically when capital inflows increase, asset prices tend to follow, and the window of opportunity may have a much shorter duration than many are considering. What could happen in Brazil, however, is a simple case of gentle crowding rather than an outright bust. If that is the case, returns in Brazil over the next five years, on a risk-adjusted basis, may actually underperform, because the competition for deals will simply mean less capital gets put to use even though more of it becomes available. Mexico, on the other hand, is going through a full reset, and the terms by which an LP can invest are definitively more favorable than in Brazil.

James T. Anderson

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Mr. Anderson was previously with Mexico Home Capital, a dedicated middle income housing fund. Prior to Mexico Home Capital, he was Vice President with AIG Global Investment Group where he oversaw the Latin America region. While at AIG, he managed a $300 million real estate portfolio, including acquisitions, development and allocation for real estate-backed investments.

After college and graduate school, he lived in Mexico City for seven years and held senior positions with Fenix Capital Group (a Deutsche Bank/JER company), Grupo Protexa and Arthur Andersen. He played a senior role in the formation of Deutsche Bank/JER's Mexico investment platform. In that capacity, Mr. Anderson was responsible for the underwriting and asset management of approximately $500 million in real estate assets. During his tenure in Mexico, he participated in the underwriting of over $7 billion of distressed assets and the acquisition and asset management of over $1 billion of real estate. Mr. Anderson has worked in all major markets in Latin America and the Caribbean, is Spanish/English bilingual, and has a BA in History from Denison University and an MA in International Affairs from Ohio University.

New Constuction Sign of

Economic Revival in Chile

by Nathaniel Parish Flannery

New construction at Chile's stalled Costanera Center, the unfinished 984 foot tall tower in the heart of Santiago's gleaming financial district, is a highly visible reminder that even though the country's economy was rocked off course by the 2009 global financial crisis, in 2010 the country's economy is already starting to recover. A billboard hanging in front of the $US600 million skyscraper, a development that is overseen by Chile's Cencosud S.A., announces that the project is an "icon of Latin American development."

According to Chilean press sources, on December 5, 2009 orst Paulmann, Cencosud's chairman, told close associates that he was ready to re-start construction on the Costanera tower. As the new phase gets under way, the project could employ as many as 3,000 construction workers by March, 2010. On ecember 17, 2009 Michelle Bachalet, then Chile's president, whose administration is widely credited with effectively managing the country's economy both during the early boom years of her administration and during the recent downturn, attended a ribbon-cutting ceremony to mark the official re-launch of the Costanera project. Contacted on anuary 11, 2009, Alfredo Merlet, a market risk analyst at Rabobank Chile, which is located in Santiago's financial district next to the Costanera project, explained that from the street in front of his office he can already see that workers have been called back to the Costanera site. Construction is expected to be completed by the end of 2012.

As workers are now being called back to the site, new construction on the tower can be seen as evidence that the country's economy is emerging from recession.

According to January 2010 data from Adimark GfK, a Santiago, Chile based market research firm, Chile's Economic Perception Index (IPEC), a measure of consumer confidence, has reached a 35 month high.

Chile, Latin America's sixth largest economy, has long been viewed as a model of successful growth. Thomas Trebat, the former Head of Latin America Research at Citigroup, currently the Executive Director of the Institute of Latin American Studies at Columbia University in New York, explained in a recent interview that "from 1990 until 2007 Chile led the region with 17 years of solid growth."

When the Costanera project broke ground in 2006, it was seen as a testament to the country's successful track record and high expectations for its own future. The 7.5 million square foot project was slated to include a 12 screen cinema, a world-class hotel, and more than 300 retail stores, catering to the middle and upper income segments of Santiago's five million residents as well as the estimated 2 million foreign tourists who visit Chile every year. The tower was designed to be a visual reminder of Chile's goal to be classified as a developed country by 2020.

However, like many other countries in the region, Chile had its development plans put on hold by the 2008 financial crisis. On January 28, 2009 Cencosud filed a report with Chile's securities market regulator, the SVS, stating that the company would resume construction on the project "once the economic uncertainty is overcome." No new work on the tower was completed as overall conomic activity in the country slowed.

According to data from Chile's Central Bank, unemployment increased by a third, from 7.6% in April 2008 to 10.2% in September, 2009. Data from basemetals.com, a U.K. based research group, shows that prices for copper, Chile's main export, fell by two-thirds between April and October, 2008. As earnings from copper exports fell, the country experienced its worst recession in a decade, with GDP contracting by 2% in the fourth quarter of 2008.

As long as Chile's economic indicators remained bleak, it was unlikely that any new work would be completed on the Costanera tower. In a telephone interview in early December, 2009, Alfredo Merlet, a market risk analyst, said, "I walk past there every day and have not seen anything new." Merlet explained that only when the country's economy started to recover would work begin again on the tower.

However, despite recent lack-luster performance, many market analysts take a positive view of Chile's long-term prospects. Marpin Binghim, an economist and independent man-

agement consultant who specializes in Latin America, said, "Chile is the most outstanding country in Latin America in terms of macro-economic policy management in the last twenty years." Binghim explained that "even though there is a global crisis, Chile has been able to tap into its rainy-day fund and smooth output, avoiding a major downturn."

Using accounting methods that subtract the cyclical revenues that were earned from unusually high export earnings, Chile's government ran a structural surplus of 1% in 2006, compared to a structural deficit of worth almost one fifth of GDP in Venezuela and a 4% deficit for Latin America as a whole during the same year. Chile's windfall copper earnings were stored in an offshore account which eventually held US$22 billion.

Chile's frugality during the boom years has appeared to pay off. Cameron Brandt, Senior Global Markets Analyst at EPFR Global, a Cambridge Massachusetts based consultancy, explained that "because of its stockpiled copper reserves, now Chile's government can spend a lot of money on its stimulus package, without having to worry about when the bill will come due."

Data from Chile's Central Bank show that despite the fact that the country's economy contracted by 2% in the fourth quarter of 2008, in 2009 Chile has been well equipped to take immediate measures to counteract the effects of the downturn. According to data from the World Bank, in 2009 Chile has been able to implement a stimulus package worth 2.4% of GDP.

Such measures are important, and are part of the reason why Chile's year on year growth is expected to fall by only 1.5% in 2009, compared to a 3.2% drop for Latin America as a whole. Contacted this week, Martin Schwerdtfeger, a Senior Economist who covers Chile for IHS Global Insight, a leading economic research firm, explained that although Chile did feel the effects of the effects of the global financial crisis in 2009 as foreign direct investment (FDI) fell by 7.4%, a US$800 million drop, during the first three quarters of the year, "the country's total fiscal stimulus package amounts to roughly US$7.8 billion, ten times the magnitude of the drop in FDI."

Chile's low interest rates and continued government spending measures are expected to boost business activity, bring down the unemployment rate and help the country's economy recover during 2010. Luis Oganes, the Latin American research director at J.P. Morgan said that "Chile is bound to display particular dynamism in 2010" as growth picks up around the globe. According to Martin Schwerdtfeger, the Senior Economist at Global Insight, Chile will resume growth and report a 4.5% increase in economic output in 2010. According to a study published on Chile's Central Bank website on January 11, 2009, the median expectation for the country's growth in 2010 of a group of 26 economists was 4.6%.

However, although Chile has had success in countering the effects of the global downturn, there is still work to be done in other areas. Chile still has an unemployment rate of over 10% and according to data from the World Bank, ranks as one of the most unequal countries in the world. Even though Chile has been acclaimed for its region-leading efforts to improve social indicators, according to official estimates, more than one fifth of the country's residents still live below the poverty line. Furthermore, even though Chile has been more successful than other countries in the region at diversifying its export base, its economy is still vulnerable to disruptions to the revenues it earns from exporting copper, its principal export.

Alfredo Merlet, a market risk analyst, explained that Chile's economic troubles in 2009 should serve as a reminder that despite the country's advancements in many areas, its "economic health still depends greatly on the price of copper."

Still, a recent uptick in the price of copper and signs of new investment activity bode well for Chile's future. In 2009, Chile's IPSA index jumped 48%. Luis Oganes, Head of Latin America Research at J.P. Morgan explained "a year after the worst crisis the region has experienced in decades, it's nice to see a bounce back in this manner."

Thomas Trebat, the former head of Latin America research at Citigroup, explained even though "like all Latin American countries Chile was hit hard by the deterioration in commodity prices and decline in trade in late 2008, but the country's economy is ready to emerge from the crisis."

Chile has come a long way in recent decades. More or less, the country has successfully weathered the storm of the 2008 financial crisis. As Chile's economic growth picks up it is becoming clear that Chile has laid a solid foundation for itself, and is now crafting a model framework of development for the rest of Latin America.

Nathanial Parrish Flannery is a finance professional currently working on Wall Street and taking classes on Latin America at the School of International Policy and Affairs at Columbia University in New York.

Review and Outlook

Alternative Latin Investor recently spoke with two high profile hedge fund players in Latin America, Otávio Vieira, Portfolio Manager at Safdié and Carlos Rojas Perla, Chief Investment Officer at Compass Group. We were privileged to hear how both managers felt markets had played out in 2009 and to learn of the themes they expect to dominate in 2010, as well as the strategies they were employing to best harness future returns.

The Hedge Fund Landscape 2008 & 2009

The impact of the global financial crisis was undoubtedly felt by Emerging Market and Latin American focused hedge funds in 2008. Since October 2008 a number of regional fund of funds have disappeared or were forced to merge in order to maintain critical mass and viability. Carlos Rojas Perla at Compass Group believes that assets under management of many funds are still 40% below the levels of two years ago. Indeed Rojas Perla explained that "we haven't reached the bottom of the crisis in the emerging market fund of funds hedge fund market" and that new monies will predominately come from Family Offices rather than the traditional (fund of fund) investors.

However the majority of redemptions were seen in late 2008 and early 2009 as investors sought to reduce risk profiles in the face of the global economic downturn. In some cases these liquidations triggered redemption restrictions, but certainly with Compass Group this position has since stabilised with withdrawals in 2009 being matched by new investments generating a net/net asset flow position by the year end.

Performance during 2008 was also impacted by the overall global climate and the market saw that the returns of LatAm hedge funds reflected the fortunes of hedge funds globally. Broadly LatAm funds suffered losses of around 20% during this period with the disparity of manager returns low in relative terms, with losses ranging 10% to 35%. However this picture changed markedly in 2009; a resurgence in equity markets and the risk appetites of investors highlighted a spectacular divergence in the performance of different managers and strategies. In this environment the selection of manager and strategies proved crucial. The Safdié fund of funds vehicle achieved 53% - performance that portfolio manager Otávio Vieira was understandably very pleased with, particularly at a time when the performance profiles of different managers ranged from 8% up to 140%. Vieira believes that performance of the Safdié vehicle was aided by the fund's increased exposure to long only equity strategies, a position which has since closed as Safdié anticipate that in 2010 and 2011 active trading strategies will excel. However, similarly to 2009, maintaining the optimum blend of strategies will be key. The fund is now seeking to increase its exposure to 13 or14 managers from its current stable of ten. This will be achieved whilst ensuring a low correlation between the constituent managers, which is evidenced by the fund's conducting of due diligence on a New York based operation. In this they are citing the different information flow and mindset that would be provided through the addition of a new perspective.

Expectations & Investment Themes for 2010

Moving into 2010, Carlos Rojas Perla at Compass Group believes that the well organised and well regulated principal LatAm economies of Brazil, Chile, Mexico, Colombia and Peru are in good position to benefit from increased fund flows. He expects growth to be driven largely by the domestic market, which in turn will be dominated by two sectors, the burgeoning High Net Worth retail market (largely accessing more sophisticated strategies via Family Offices) and to a lesser extent, institutional investors. The enlarged coffers of the mandatory pension funds of these five core economies are managed in a sophisticated manner and have been increasing their exposure to alternative strategies such as Private Equity and Real Estate, although to date this has often been achieved through their own vehicles in addition to fund investments.

Despite this growing domestic appetite it is clear that hedge funds will continue their courting of investors from Asia and the Middle East. There is an acute awareness that in the wake of the financial crisis developed markets will be increasingly achieving emerging markets exposure through more liquid instruments such as Exchange Traded Funds. Whilst there has been some interest from these countries, particularly in the commodity and infrastructure sectors, it is felt that this has yet to filter down to the hedge fund arena.

Although ultimately LatAm hedge funds may utilise offshore trading and currency/commodity strategies, rather than direct leveraged plays on the LatAm bourses, the fortunes and interest in the market will doubtlessly continue to be heavily influenced by commodity market strength. With the Latin American market often seen as a function of Chinese growth, its continued appetite for commodities will be a key factor in supporting a sustained recovery.

Venture Capital in Argentina

-Modena Technologies Capital Partners

Venture capital in Argentina, particularly at an early stage, requires an active participation in the running of portfolio companies. One can argue that VCs practically play the role of entrepreneurs. In other words, there is no room for "dumb money." Venture capital, for various reasons outside the scope of this piece, has to be "smart" i.e. has to be complemented with experienced management and has to have a wide network of contacts.

Modena's investment

Modena Technologies Capital Partners is an early stage venture capital fund based in Buenos Aires, Argentina. This case study describes Modena's investment in a software factory called Patagonia Technologies. Starting from scratch, the Modena fund grew the factory from a 100 square foot office with a 5 person team to a 1500 square foot office filled with 300 software engineers in merely three years.

Keys to success

This exponential growth was fueled by two factors.

The first one being Modena's active networking. This resulted in big local clients such as -Telecom Argentina, Aeropuertos Argentina 2000, Aerolíneas Argentinas and Metrogas contracting with Patagonia.

The second reason for growth can be found in the strategy that Modena applied to enhance the company's development. Said strategy consisted in promoting synergy between Patagonia and other portfolio companies. For that purpose Modena obtained the representation of the CIO magazine and invested in Agentis Software.

As mentioned previously, the fund brought the CIO magazine to Latin America. This magazine was a direct way to reach the 1500 plus Chief Information Officers operating in Argentina and Chile. Needless to say the magazine brought in a lot of business to Patagonia Technologies.

After U.S. based multinational Agentis Software awarded a contract for software development to Patagonia, Modena's CEO, Omar Arab, convinced the American company to open a subsidiary in Buenos Aires. This subsidiary started its operations in 2005 and served the Latin and Central American markets. It grew from 10 to 100 employees in just a couple of years. To the outside world, Patagonia and Agentis were two different companies but from the inside they were intrinsically linked, the former selling its business solutions to the latter.

Modena TCP successfully exited these investments in 2007. Patagonia was sold to a local investor for USD3 million and Modena's stake in Agentis was bought by some minority shareholders of the company.

This case study shows the need for a hybrid nature in venture capitalists in Argentina. It is not only about Private Placement Memorandums, due diligences, valuation and simulation analysis and board meetings. It is also about focusing on the company's strategy, structure, clients and alliances.

About Omar Arab:

Omar Arab is an engineer with an MBA from Stanford University. Before putting together Modena TCP he spent years working for McKinsey, Oracle and several start-ups.

SPECIAL REPORT: PRIVATE EQUITY

Challenges for Successful Private Equity Investments in Brazil **Part II**

By Zack Henry & Eric Saucedo

Financial Transparency

This is perhaps the mother of all issues when considering the more common challenges in successfully raising private equity capital. And it's not an issue solely relevant to Brazil and/ or Latin America, as it is an issue facing any early-stage or middle-market company worldwide looking to raise capital via the private equity market. It is the subject of much frustration among private equity professionals and company executives alike, and perhaps the single most common reason why most potential transactions reach an unfortunate and untimely death.

Let's first remember that a principal factor of the current financial crisis was the simple annihilation and obliteration of trust. Investors lost trust in the financial system, they lost trust in bankers, ratings agencies, federal regulators, the words "collateral" and "obligation," and in the American dream of home ownership. Even "In God We Trust" lost plenty of strength and credibility as the US greenback fell to and continues to trade at historic lows. Call it "The Great Recession," "The Great Depression 2.0," or just the global financial system going to hell in a hand basket. The point is that financial transparency fell by the wayside and with it went investor trust.

At the 2009 World Business Forum in New York City, David Rubenstein of The Carlyle Group, Nobel Prize winning economist Paul Krugman and former President Bill Clinton addressed many of the important issues regarding the current global economic conditions as a result of the crisis. But Dennis Nally, Chairman of PricewaterhouseCoopers International Ltd., said it best and most succinctly, stating that a global recovery rests upon the notion of restoring trust and "transparency is the lifeblood of investment."

Amen, Mr. Nally. Sounds easy enough. Now let's just get out there and apply that simple principle to private equity investments in Brazil and other emerging markets. As we say here in America, "Giddy up."

Unfortunately, it is the very rare occasion that typically family-owned companies will maintain the accounting and financial controls and reporting sufficient to thoroughly satisfy a comprehensive due diligence process of a private equity fund. Therefore, any sort of summary report prepared by the company's accounting staff or even by the company's accounting firm on the company's financial results and condition will not suffice. Period, end of story. In a nutshell, many family-owned companies do not have the adequate financial and accounting infrastructure to produce the level of information that is typically expected by private equity investors. What might be clear as day to a company executive looking at only two line items of revenue and net income for a seven-month period ending two months prior to the fiscal calendar year and compiled by his sister's husband's second cousin who just graduated with a degree in anthropology and now forms part of the internal accounting staff, will very likely cause most private equity professionals to start breathing into a paper bag.

Again, this is not a criticism in any way imaginable. A privately-held, family-owned company has no legal or regulatory obligation to maintain a complex financial accounting system. As any owner of a family-operated company might tell you, keeping expenses down is the important issue and keeping a tier-1 accounting and financial department is costly and thus very rarely on the agenda. But a lean accounting department that predominantly focuses on daily operational issues and the year-end close will not likely be able to provide the necessary reconciliations and minutia required by private equity investors.

Unfortunately, many companies involved in the due diligence process will inundate the potential investors with endless reams of useless information that only create more confusion and raise even more questions. Perhaps the belief is that if they inundate the potential investors with so much information, maybe they will just stop asking and go away. And the fact is that they will go away. Away from the deal, that is.

The main problem is that few companies seeking private equity capital adequately prepare or take a proactive approach to engage an advisor to prepare them for the due diligence process, most notably the accounting and financial due diligence. Perhaps that's yet another discussion altogether, but having the accounting and financial due diligence performed by an independent third party brings considerably more confidence to the potential investors and provides a higher probability for success in a transaction.

"A transparent and orderly diligence process leaves either a positive or final impression on an investor," said Jose Miguel Fuster, a Senior Vice President with Darby Overseas Investment, Ltd. who focuses on investments in Latin America. "Adhering to accounting and transparency best practices is also about maximizing value for all shareholders at exit."

Active Middle Management

Management gurus worldwide like to discuss the importance of "building the right team" around the CEO, and they often get paid a lot of money to develop great expressions like "getting the right people on the bus." Jack Welch, the legendary CEO of General Electric says in his best-selling book Winning, "You've got the right players on the field. Now they need to work together, steadily improve their performance, be motivated, stay with the company and grow as leaders."

That's all good stuff, and somewhat related to another important challenge for companies looking to raise capital in the private equity market: maintaining an active middle management. We say "somewhat related" because, unfortunately, we really are the last people in the world that anyone should ever want to talk to when it comes to building management skills in an organization. We have our own dysfunctions to deal with and can comfortably say that we will never be included in the same sentence as General Electric, Kraft, Google or others when the discussion centers on the topic of effective management. Highly recommended reading would be books like Patrick Lencioni's The Five Dysfunctions of a Team or Jim Collins' Good to Great: Why Some Companies Make the Leap...and Others Don't. Again, that's another discussion altogether, but a good read if you haven't picked them up yet.

What we refer to as "active middle management" concerns the importance of maintaining active participation of middle management in the capital raising process. Keeping middle management involved in the capital raising process is an extremely important aspect to the successful closing of a transaction. And as is so often the case, such a simple statement can be a very difficult concept to implement successfully.

Putting aside any private equity transaction over US$500 million, most potential private equity activity in Brazil in the next few years will be in what can be defined as the "small- to middle-market." How one specifically defines "small- to middle- market" is not really the issue. The more important issue is that we continue to converge on typically family-owned enterprises where the patriarch, matriarch or a small group of family members serve in the most senior-level positions at the company, including that of the CEO or president. It's very normal –- though Jim Collins might disagree with us –- in such family-owned companies for one or two individuals to maintain relatively firm control over the company's operations. It's not an issue of authoritarianism, and it most definitely doesn't fall within the parameters of any Venn diagram in any of the leading management books on effective team-building. It just is. At least in Brazil, this is often a function of trust, or a lack thereof. Family-owned companies will have a CEO who effectively coordinates all aspects of strategy, finance, marketing, administration and who probably has a strong say on the color, pattern and ply-numerage of the company's toilet paper. Dysfunctional, perhaps. Normal, absolutely.

The CEO or president of a company will most definitely be the person most involved in the capital raising process. That's relatively obvious. The CFO and perhaps one or two other executives may also get involved now and then, but problems arise when the senior management fails to involve, at a minimum, members of the middle management team. It is probably quite subjective as to how far down the organizational structure one should go in terms of involvement in the capital raising process. Our general view is that it can be good when the entire company is at least aware of the capital raising process. However, we're certain that there are numerous examples where such might not be the case. This is an interesting conversation in and of itself, but yet another topic of discussion altogether.

It is extremely important to have active participation of middle management for various reasons. First, private equity investors, while clearly interested in the management and leadership capabilities of its senior management, are similarly interested in the capabilities of middle management, because it provides them with a better understanding regarding the potential necessity to bring outside management into the company once their investment is made. Second, while private equity investors do attempt to keep senior management level positions as stable as possible once an investment is made, the reality is that many members of senior management –- typically major shareholders as well in family-owned companies –- will often not be as involved in day-to-day operations. Funny how that works. Therefore, even if private equity investors install their own CEO into the operations, they will want a capable middle management layer at the portfolio company.

Many company executives and business owners might counter by saying that it is important for senior management to maintain a high level of confidentiality when speaking with potential investors and they therefore argue that it is important to exclude middle management from any discussions pertaining to a potential transaction. Here's why that's a really bad idea. Aside from any discussion relevant to the works of Jim Collins or Peter Drucker, the private equity teams and their battalions of consultants performing the due diligence will specifically seek out all levels of middle management, employees, suppliers, vendors, bankers and anyone else that will talk to them about the company. Therefore, while the CEO might very brilliantly and convincingly describe the expansion into a given market as the two of you twirl your Brandy on the deck of his country club overlooking the 18th hole, the two senior engineers who actually install the company's equipment might in fact be more willing to discuss the company's failed initiatives to do just that. Or the accounting employee might fall off his/her chair when they tell you that the aggressive CAPEX program so beautifully displayed in the financial projections and PowerPoint presentations would never be financed because nobody in the banking community will speak to the company. You get the point.

As Mr. Valenzuela of The Carlyle Group previously stated, it is important that all levels of management as well as employees consistently convey the same message with respect to any given issue. "When the CEO discusses a given marketing strategy, you want the head of marketing and all of the marketing people that you speak with to be saying the same thing," he explained. "They might have differences of opinion as to certain details, but they all recognize the company's overall marketing strategy."

Finding the Right Partner

Most of you just rolled your eyes back much in the same way that your teenager would if you ever dared ask them if you could join them at the mall with their friends. "Finding the right partner" sounds as cliché and corny as it gets. However, it is an extremely real issue and a significant challenge for any Brazilian or Latin American company seeking private equity capital. Finding a partner to write a check is a relatively easy feat to accomplish if you happen to be in an industry that is especially trendy at the time. Finding the "right partner" is a real challenge most notably because it's one of the most important decisions that a company can make.

What is extremely important to recognize is that private equity funds are much more than a simple source of capital. In fact, while private equity professionals are indeed excited about closing a transaction with a good company, they also recognize that their work is just getting started. The right partner –- the right private equity fund –- will bring a literal smörgåsbord of resources to its new portfolio company. Perhaps you always felt that your finance and accounting department was never that good or effective. Enter stage left the new CFO, new head of finance and new accounting system capable of tracking receivables to the nearest minute. Or perhaps your retail food business always showed promise but you always felt that your head of marketing could always use some help. Enter the former CEO of Kraft Foods to meet with your sales and marketing department to improve the marketing strategy.

A significant opportunity for early-stage and middle-market companies in general and for Brazilian companies in particular in this current market cycle is the ability to professionalize their business operations to the highest levels. For the family-owned company that has successfully operated in the local market for decades, the opportunity to enter regional and international markets can finally become a reality. For the family-owned company that might not have the right heir apparent to take over the company, it now has the opportunity to take several first round draft picks to augment its starting rotation. In addition, by bringing in a private equity partner, it can allow a family-owned company to generate a certain level of liquidity in the near-term, yet continue to maintain a significant ownership in the company with the potential to own a portion of a substantially larger company.

Unfortunately, it's only fair to say that it's not always about holding hands and singing kumbaya. Many family-owned companies don't want anyone coming in and telling them what to do, and it doesn't matter if it's the former CEO of Kraft or anyone else from that league. Also, there are plenty of private equity funds that bring little more than a checkbook, and companies will spend more of their time explaining the business to the new private equity board members than receiving any type of operational insights or benefits. In fact, it can often hinder the company, because major decisions will take longer if the new members of the board have to be schooled on everything regarding the business and the industry. Simply beware of the private equity professionals that like to hear themselves speak industry idiom, throwing out impressive sounding buzzwords like "value proposition," "paradigm shifts," "margin compression," and "multiple arbitrage." In fact, many companies soon realize that the benefits of bringing in a private equity partner can be quickly be outweighed by the more burdensome baggage that they can bring as well. Like any marriage, you really need to know your private equity partner before you make your way up to the altar.

Assuming that a company's interests and objectives are properly aligned with their new private equity partner, the relationship between a company and its private equity partner can reap significant benefits, and not simply financial ones. It can help professionalize the business, it can open a company up to new markets, it can bring managerial resources, it can bring a network of contacts never imagined, and, most important, it can launch your company into the major leagues.

For Jack A. Smith, the founder and CEO of The Sports Authority, the relationship with his private equity partners provided the company with the ability to grow at a more aggressive pace than on its own. After leaving his position as COO of Herman's World of Sporting Goods to found The Sports Authority in 1987, Mr. Smith brought in private equity funds Bain Capital and First Chicago Investments, aggressively expanding the company before selling it to Kmart three years later. "Finding the right VC partner is one of the most important decisions an entrepreneur can make," said Mr. Smith. "Having that investor serve on your board is more important to the strategy contribution he can make versus his dollar investment. I was fortunate to have investors who were successful in the retail world that I could rely on their opinions in helping me make the right decisions."

Meritas, founded in Ft. Lauderdale, Florida, and now headquartered in Chicago, Illinois, found it beneficial to partner with Chicago-based private equity fund Sterling Partners. The company is a consortium of elite college preparatory schools around the world, including a school in Latin America, and working with a fund that knew the education sector was important to them. Sterling Partners, having successfully backed such successes as Sylvan Learning Centers and Laureate Education, Inc., was, therefore, the right choice for the company. "We had a few funds that approached us that were interested in giving us capital, but Sterling stood out as someone who clearly understood our company and our strategy," said Mac Gamse, the CEO of the company. "In addition to the significant capital commitment that they provided us, we had access to all kinds of people and other resources from Sylvan, Laureate and many of their other education companies, and that has been invaluable to us as we continue to aggressively expand our operations worldwide."

Conclusion

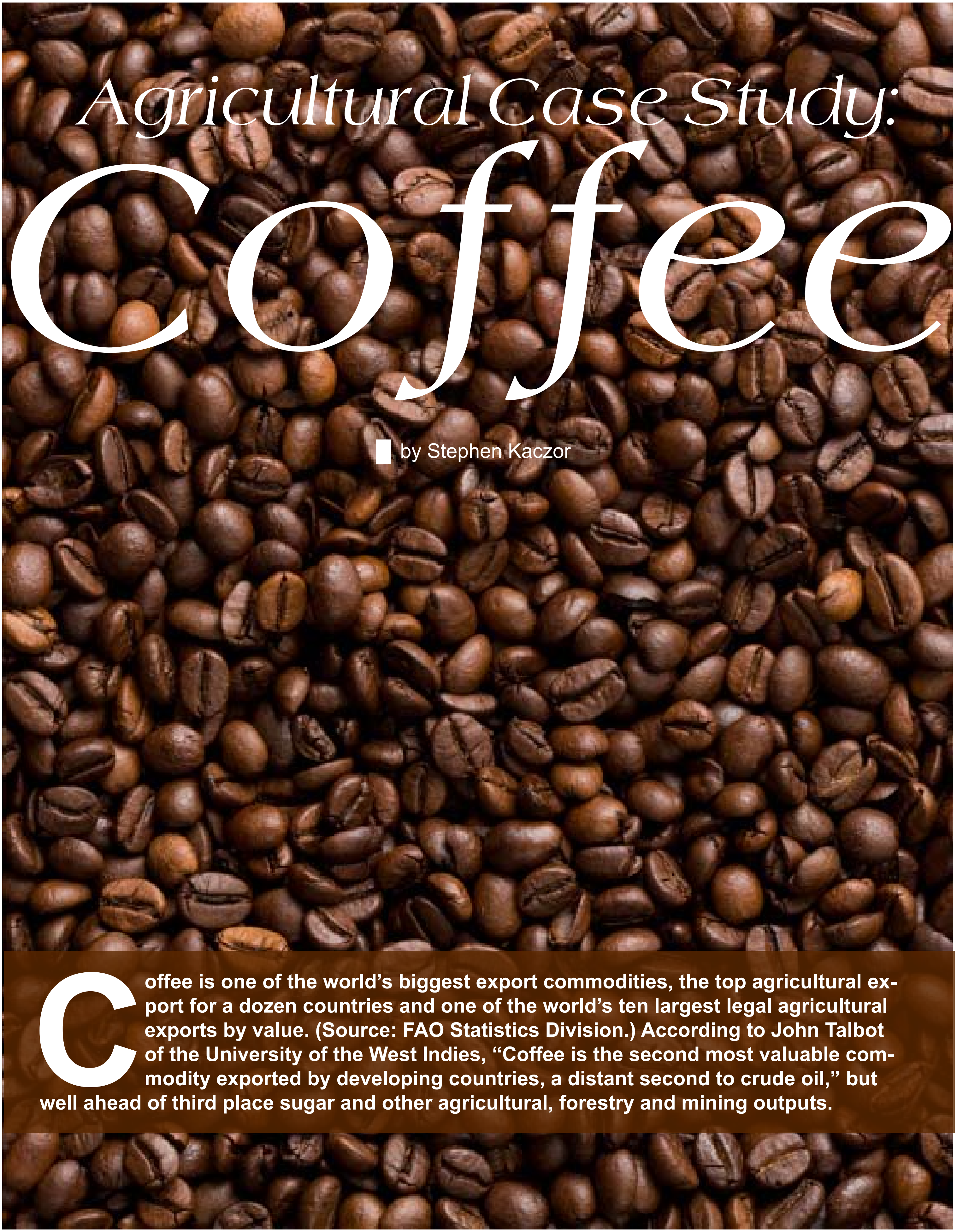
Brazil has a unique opportunity to establish itself as a serious economic power in the world hierarchy. In addition to its strong foothold in the commodity markets, its prowess in the global trade arena, and its overall increasing presence in the global spotlight, the country will need to continue to attract greater amounts of capital to sustain its aggressive levels of growth.

Successful private equity investments in Brazil can prove to be very beneficial for the companies in which the investments are made, as well for the Brazilian economy at large. A strong business environment means more jobs, and a business environment that is receptive, open and transparent to capital investment will allow companies to access the capital, skills and technology it needs in order to sustain growth and profitability. In addition, private equity capital is long-term capital. An investment in a privately-held company is not the same as an investment in the local capital markets, which can often prove to be speculative and short-term in nature. We, together with the rest of the world, hope that Brazil capitalizes on this unique opportunity to benefit not only in the near term from the recent increased interest in its economy, but we hope that it recognizes that long-term economic prosperity for generations to come lies within its grasp.

Brazil stands at a tremendously opportune moment to attract a level of private equity capital perhaps unseen in its history. We can't promise that it will be easy, because there are so many challenges that it will face, and each and every company that enters the private equity market in search of capital will undergo its own unique set of difficulties and challenges. But what we can say with a great degree of certainty is that the world is watching, because we all recognize that this is a once in a lifetime opportunity for the wonderful country of Brazil. Muito bom indeed.

About the Authors

Zach Henry, Principal, and Eric Saucedo, Managing Director, are with the investment banking firm of Tricap Partners & Co. With offices in New York, Miami and São Paulo, Tricap Partners & Co. is an investment banking boutique specialized in advising companies, institutions, family offices and individuals in complex financial strategies and investment decisions. Tricap Partners & Co. is a financial advisory firm specializing in the areas of Mergers & Acquisitions, Restructurings, and Private Placements of debt and equity for early-stage and middle-market growth companies.



Agricultural Case Study:

Coffee

by Stephen Kaczor

Coffee is one of the world's biggest export commodities, the top agricultural export for a dozen countries and one of the world's ten largest legal agricultural exports by value. (Source: FAO Statistics Division.) According to John Talbot of the University of the West Indies, "Coffee is the second most valuable commodity exported by developing countries, a distant second to crude oil," but well ahead of third place sugar and other agricultural, forestry and mining outputs.

"The number of people who depend on coffee for all or most of their living is in excess of 75 million," according to Ric Rhinehart, executive director of the Special Coffee Association of America (SPAA). According to Rhinehart's estimates, coffee is a $90 billion a year industry. His explanation of this figure provides valuable insights into the commodity. In 2008, Rhinehart states, approximately 18 billion pounds of green coffee beans were sold for $22 billion, at an average of $1.24/lb.

"Here is a place where the math gets interesting," according to Rhinehart. "All that coffee gets roasted, reducing its weight to around 14 billion pounds. Of that, roughly 70% is sold for home consumption at about $4.50/lb, yielding about $45 billion." The other 30% is brewed and sold at higher prices for another $45 billion, approximately. Combining sales of roasted coffee with brewed sales produces the $90 billion annual estimate.

Others, including Antony Wild, the author of Black Gold, have suggested that the people and dollars involved in the coffee industry are far in excess of Rhinehart's estimates.

Panama Coffee

It is my privilege to live in Boquete, "the Napa Valley of coffee" according to gentleman farmer John Collins of Finca Lerida. Boquete is located in the province of Chiriqui in the Republic of Panama. Here, roughly 100 plantations of varying size grow many coffee varieties along rainforest mountainsides. The comparison to Napa Valley is apt; Boquete's coffee plantations are at least as picturesque as Napa's vineyards. Here coffee is cupped daily and analyzed for its bouquet. Because of the high altitudes, the beans are very dense and uniform, mild with a medium body, good aroma and high acidity. These estate coffees are considered among the best in the world, and they consistently place in the top ranks at international cupping contests. Boquete coffees begin at $10/lb in the U.S. and often command much higher prices.

Finca Lerida's coffee was recently ranked first among 119 coffees from 15 countries at the cupping pavilion during the Boston SPAA annual meeting. Adjectives overheard at such events are similar to those used at a wine tasting: nutty, fruity, floral hints, smoky, full-bodied, delicate, clean finish, pepper aromas, tangy, spicy, earthy fragrance, hints of caramel. Finca Lerida was established in 1922 by Tollef Monniche, the man who invented and patented the Sifon that is used worldwide in the wet process. The Collins family purchased Finca Lerida in 1958, and the latest generation continues a long tradition of innovation at Finca Lerida. It was fascinating to learn about this industry in the Collins family's new café in the midst of so much coffee history.

There are no Starbucks in Boquete. Here grows some of the world's best coffees, yet a pound of fresh roasted beans retails locally for less than the price of a mocha grande in the U.S. While touring the processing facility of Dra. Maria Ruiz, I learned an excellent local story involving Boquete's Café Ruiz,. The tour guide shares a story about a negotiation between Sr. Ruiz and a buyer from "a well known coffee chain." The buyer asked, "Before I buy this coffee, I would like to know how much you pay your indigenous workers." Sr. Ruiz responded, "Of course, but before I sell you my coffee, I would like to know how much you charge for a double mocha grande in NYC?" As the story goes, the deal was consummated with no further questions.

Premium Boquete coffees are produced on large family-owned farms near the border with Costa Rica. Many growing regions are clustered around the Baru volcano: Boquete (the best known), Paso Ancho, Volcan, Piedra de Candela and Renacimiento. The optimum growing elevation is roughly a mile high, not higher than 6000 feet, not lower than 4000 feet. Quality varies according to microclimates, volcanic soil composition and annual climate conditions. Others observe more common names for growing regions, which correlate with the communities where they are grown: El Salto, Jaramillo, Palmira Arriba, Alto Quiel.

Most Panama specialty coffees are derivatives of the caturra variety and the hybrid catuai. These cultivars are less traditional than gourmet coffees from Ethiopia, whose coffees come from much older cultivars, but they are more traditional than hybrids with robusta in their makeup. Both Finca Lerida and Café Ruiz are planted with Arabica coffees in volcanic soils maintained for ideal balance to produce the best quality coffee. Cherries are delicately hand picked at full maturity by indigenous Ngobe-Bugle workers who leave unripe cherries for future pickings. Harvests occur over many months as the cherries do not all mature at once.

Economics of Coffee in Boquete

On most fincas, indigenous workers are paid $2 per "lata" and provided housing. Lata is local lingo for your standard 5-gallon bucket, which holds 30 pounds of cherries. Some fincas pay more or less, and many provide food as well as housing for workers on their farms. A family might pick 10 latas in a day; women and children pick alongside the men. Everybody helps with the harvest, which is an exciting time in coffee country. Outside the harvest season, Ngobe-Bugle men are paid daily for their work maintaining the crop.

This month, processors in Boquete are paying farmers $6.25–$7.25 per lata. This means small growers are netting roughly $5 per lata, which becomes 4–5 lbs. of coffee after processing. In other words, $1.25 per pound is the high end of a typical farmer's yield. This margin will not cover upkeep and taxes unless economies of scale are obtained through vertical integration from farming to processing, roasting and retailing. Given that gourmet coffee retails in the U.S. for 10 times the amount earned by the grower, the question arises: who is making money in coffee?

One local farmer, expatriate and blogger, Lee Zeltzer, extends an interesting invitation to consumers up north. "When you buy a pound of gourmet coffee, think not only of the pickers who are often labeled as underpaid, but also small growers who subsidize your morning cup of java." Zeltzer rationalizes his crop by noting that his coffee is great ground cover, so he doesn't have mudslides. You can hear the grin in this statement.

With indigenous workers earning subsistence wages and small growers struggling to break even, 90% of coffee revenues are concentrated in the hands of medium-to-large grower/processors, wholesalers, roasters, and retailers. Here investments can be expected to bring an acceptable rate of return.

Local Varieties

A recent visit to Boquete's 600-plus acre Finca Lerida estate led to a discussion with proprietor Collins about varieties, processing techniques and economies of scale. Collins figures he needs to process four times more coffee than he grows on the 100 acres he has planted in order to obtain a healthy scale for his operation. He processes for many growers, as is the practice at Café Ruiz. For Collins, the economics obtain the desired balance by roasting approximately 160,000 pounds annually. Collins is also seeking balance with the varieties he has planted: geisha, criollo, pacamara, caturra, catuai, mocha, java and borbon. Collins is installing state-of-the-art processing systems utilizing Brazilian technology; he also runs an eco lodge and birding tours on the 500 acres of rainforest that envelop his farmland.

Tradeoffs common in the coffee growing regions of Boquete involve conservation and sustainability. Collins, for example, does not plan to plant more acreage. Every harvest removes nutrients from the soil—nutrients that must be replenished. Erosion and chemicals can lead to other problems. Many unplanted hillsides are too steep for farming, and other areas compete with a building boom fueled by expatriate retirees from Europe, North America and neighboring Costa Rica. Purchasing new land for coffee is one barrier to entry in Boquete. The local building boom is driving land prices to levels common in the U.S.

Organic Coffee

Some expatriate farmers are taking a novel approach. Rich

Lipner of El Salto's Finca Dos Jefes is one of a dozen organic growers in the area. Lipner's farm is 100% chemical free. He grows many of the same varieties as Collins. They both prepare their own soils with organic inputs to replace the phosphorous, calcium and potassium removed from the soil by their thriving trees. Lipner, however, practices lunar farming and he uses the natural dry processing method (with the skin on), which ensures more of the sugars from the cherry are retained by the bean. Therefore "Cafés de la Luna" are naturally sweet. Finca Dos Jefes also offers unique tours where guests learn to roast, taste coffee roasted several ways, and then roast a pound to their own specifications to take home.

Upside Potential

The concept of a "Napa Valley of Coffee;" daily cuppings, tastings and tours; and experimentation with varieties and processing methods continue to drive the quality of coffee in Boquete to new heights. One example of success is Café Geisha, pioneered at the Peterson family's Hacienda La Esmeralda. The Geisha variety has traveled to and from Africa and Costa Rica and is now widely planted in Boquete to meet an extraordinary demand.

The Geisha variety has traveled to and from Africa and Costa Rica and is now widely planted in Boquete to meet an extraordinary demand. The success of this varietal at Hacienda La Esmeralda has inspired some to suggest Boquete is to coffee as Bordeaux is to wine.

The success of this varietal at Hacienda La Esmeralda has inspired some to suggest Boquete is to coffee as Bordeaux is to wine. One pound can fetch more than $125 at specialty coffee auctions.

Just as Napa Valley has competition from wine regions in Oregon and Washington, Chile and Argentina, Boquete growers expect increasing competition in coffee from areas such as Guatemala, Mexico and growing regions across South America, such as Boliva, Brazil and Peru. Land prices across Latin America are more favorable than Panama's highlands. Shade-grown coffees from Costa Rica and Mexico fetch very attractive prices given lower labor costs there. Guatemala has superb fruit coffees such as the Huehuetanango from San Juan Pixcaya; Honduras and El Salvador are also contenders.

In conclusion, coffee is a commodity with agricultural investment potential for medium-to-large scale operations. For smaller operators, innovation and vertical integration are essential and return on investment can be modest, outside of the potential quality-of-life benefits derived from living on a coffee plantation. While worldwide demand for coffee continues to grow, the next coffee hot spot waits somewhere in Latin America.

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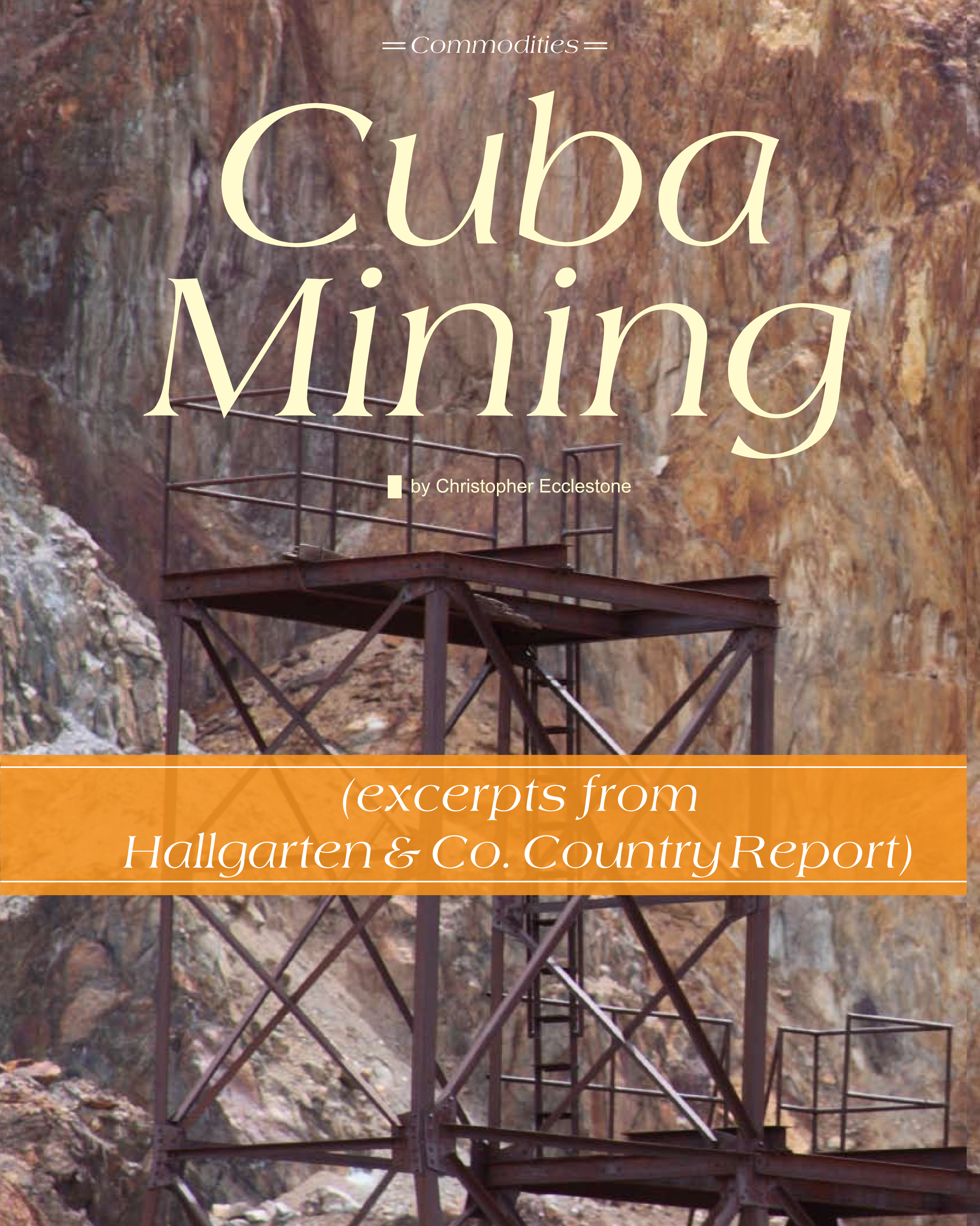
Commodities

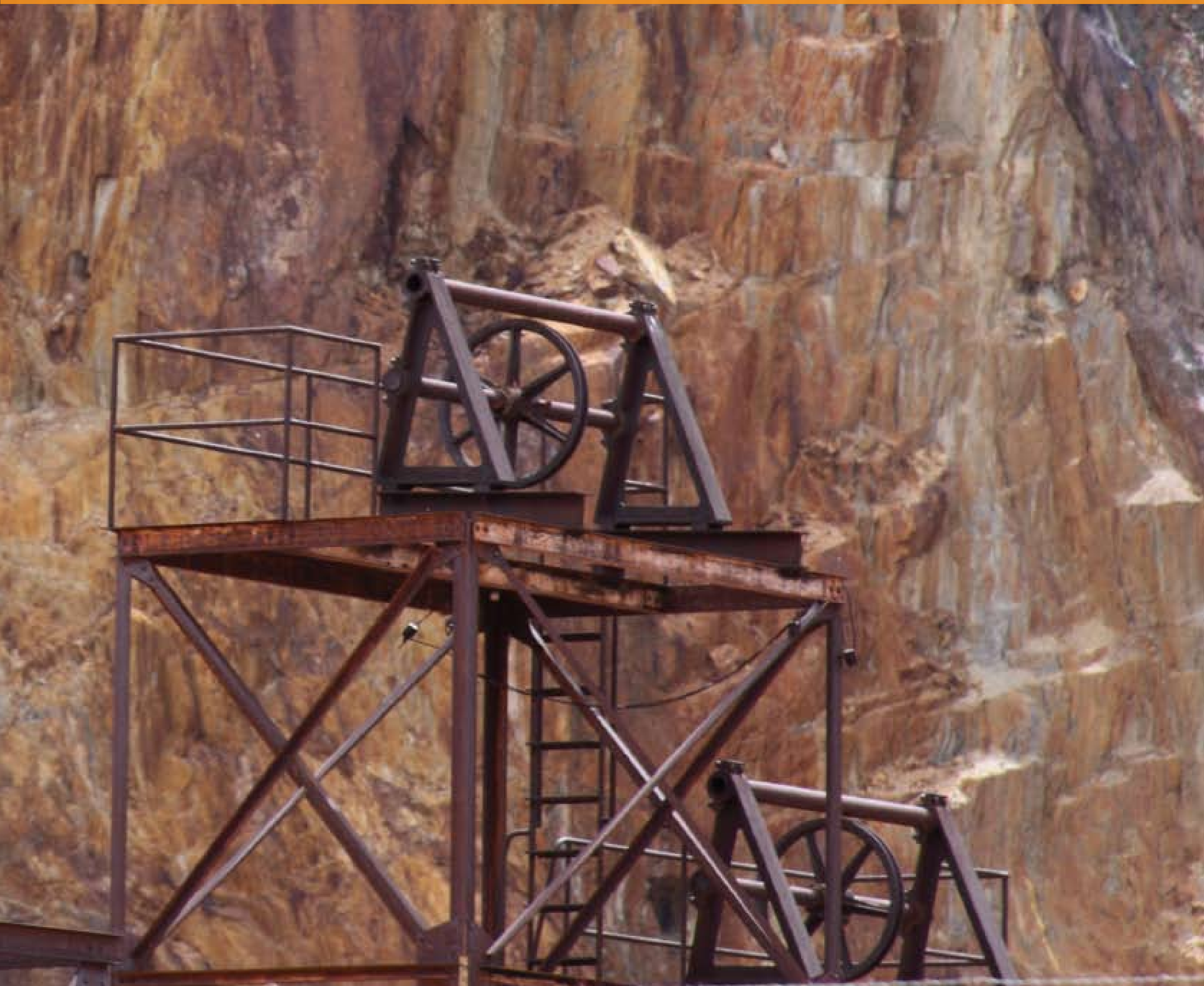
Cuba Mining

by Christopher Ecclestone

(excerpts from Hallgarten & Co. Country Report)



Cuba has a history of mining extending over a period of three hundred years. During the period 1900 to 2002, mining was a permanent activity, and during WWII the mining of manganese, some copper, and nickel was most important. The nickel resource comes from extensive laterite deposits that are considered among the largest reserves in the world, ranking alongside Canada, Russia, Australia and New Caledonia. Cuba is also an important nickel and cobalt producer, ranking sixth in the world in terms of nickel and accounting for 8% of the world's cobalt production. Cuban mineral production is largely state controlled, although the government has made steps to amend the mineral laws and legislation, which will hopefully change the industry's structure. In 1993, Geominera was formed as a private company utilizing state funds. Geominera focuses on gold and base metal exploration, whilst foreign investors are currently developing nickel/cobalt and gold resources.



Cuba 2006 Production (USGS stats)

		t.
Chromite		27,900
Cobalt		
	Oxide	4,300
	Suphide	4,000
Nickel		75,000

Cobalt

In 2006, production of cobalt (including ammonical liquor precipitate, oxide and sulfide) increased to 4,300 tonnes compared to 4,055 tonnes in 2004 and 3,982 tonnes in 2003.

Silver

Holmer Silver (a private Canadian company that used to be listed on the Alberta Stock Exchange) has been working for several years on plans for its Loma Hierro Silver Project. Holmer holds a 50% interest in Plata Cuba S.A. (which holds Loma Hierro) while Geominera S.A. (the state mining enterprise) holds the remaining 50%. The Loma Hierro silver laterite deposit is located in the Pinar del Rio Mining camp in western Cuba. The probable reserves are 550,000 tons grading 10 oz of silver per ton, and exploration indicates potential to increase these reserves. According to the company there are approximately 10 million oz in situ, with the resource distributed in eight separate deposits over a one square kilometer area. Rescan Engineering Ltd, a member of the Hatch Group, completed a bankable feasibility study in 1999. The deposit is amenable to open-pit mining and preliminary metallurgical tests indicate that the ore can be readily treated with excellent recoveries. In January 2008, RJK Explorations Ltd. (RJX.v) announced that it has entered into discussions with Holmer Silver Co. with a view to pursuing opportunities jointly in Cuba, but nothing has transpired since that time as far as we can tell.

Gold

Holmer (again in league with Geominera) has been exploring for gold on their Dora Francisco concession in Pinar del Rio. This property, which surrounds the Loma Hierro concession, includes two former copper-zinc producers with remaining reserves and several significant showings of silver and gold. A state-owned enterprise was mining for gold at the Castellanos gold mine in the early 1980s with annual production being about reported as 17,600 ozs. There is also the Delita gold deposit in Isla de la Juventud, which was being studied for possible open-pit and underground operations; the estimated resource at Delita was about 1.5 million oz with high proportions of antimony and arsenic.

Copper

The Matahambre and the Mina Grande El Cobre copper mines remained closed during the year. Geominera, Miramar Mining Corp., and Northern Orion Resources owned the Mantua copper project for a long time. In September 2002, Northern Orion announced that it had entered into an agreement with Newport Exploration Ltd. whereby Newport could acquire an undivided 50% interest in the Mantua Copper Project in Cuba from Northern Orion. However, negotiations dragged on and the deal fell through in May 2004. The Mantua mine produced 15,000 oz of gold in 1999. A substantial copper resource has been identified beneath the current Mantua ore body. Production at the Mantua mine began 1998, and the mine has proven probable reserves (December 1998) containing 320,000 t grading at 2.2 g/t gold. The copper reserves have been estimated at 7.5 Mt grading at 2.74% copper. Both mines are located west of Havana in the Pinar del Rio province in western Cuba.

Nickel

If Cuba is renowned for any particular metal, it is nickel. Unrefined nickel plus cobalt are Cuba's largest exports, generating around $2USD billion in revenue last year. Cuban nickel is considered to be Class II, with an average 90% nickel content. The ore is processed on the island in two formerly U.S.-owned plants at Nicaro and Moa Bay. Plants are also located at Punta Gorda and Las Camariocas. Holguín Province, where the Moa Bay mines are located, is estimated to contain 34% of the world's known reserves of nickel, or some 800 million tons of proven nickel plus cobalt reserves, and another 2.2 billion tons of probable reserves. The Moa Bay mines were once the property of Freeport in its pre-McMoran manifestation. They were initially started up during Wolrd War II and largely paid for by the U.S. government. Of the $119USD million in capital of the Moa Bay Nickel Company, some $100 million had come from the U.S. government and the rest from Freeport. The processing plant was closed down in 1947. The whole nature of the Cuba/U.S. nickel industry evolution was strange and noncommercial to say the least. It is well worth reading up on for anyone who wants to put the controversies in perspective.

Iron Ore

We might mention in conclusion the iron ore resources of Cuba. These have been viewed as very substantial in the past. There were a variety of companies at the beginning of the 20th century exploiting the Mayari and Diaquiri deposits of "brown" iron ore. One estimate at the time put the size of the Mayari deposit at 600 million tonnes of 46% iron. The Spanish-American Iron Company, a subsidiary of Pennsylvania Steel Company, exploited the biggest mines. Interestingly at that time, "mayari" steel was almost a brand name due to its natural alloy properties emanating from the mineral mix that contained 0.2% to 0.7% chrome and 1% to 1.5% nickel. The Cuban ore was also low in phosphorus. As far as we can work out there is no exploitation of iron ore in Cuba at the moment.

In writing this article our main goal has been to highlight that an opening of the Cuban economy could be in everybody's interests. Believe it or not, even the old oligarchs camped out in Miami and parts thereabouts would have an innate advantage in the land-rush back into Cuba. That they may not get back the toys they accumulated under the corrupt Batista regime is neither here nor there, for they don't have them currently so the difference is merely academic. For "lesser" Cuban émigrés there is the prospect of their relatives left behind getting some economic enhancement and greater social and commercial interchange.

For mining companies the opening of Cuba offers the potential to bring a vast nickel resource into reach of the majors. The same holds for the other minerals on the island. The potential for this sector to experience a major expansion in Cuba is significant.

Who stands to lose out? Well, if Cuba becomes "just any other" LatAm (or should we say Caribbean?) country, then the class of intermediary/pundit/lobbyist/agitators who have serially wheedled their way into the halls of power supposedly to free the Cuban populace from its oppression and instead having remade U.S. policy towards the continent in their own shape will be sent packing to the obscurity they deserve. Rack our brains as we might, we fail to see anybody else who would be worse off from an opening of the Cuban economy, with 11 million Cubans and a flock of the more enterprising émigrés being the ultimate winners.

For further information or to find full report please go to http://www.hallgartenco.com/

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The Future
of Brazilian Energy Integration with Peru

By Francisco Ebeling Barros

November 11th, 2009, Brazil experienced one of its worst blackouts in history. Due to the fall of a transmission line that connects the giant Itaipu Power Plant (the largest operational hydroelectric power plant in the world) to the Brazilian electrical system, the major states of the country had no electricity for more than three hours during the early evening—peak hours for energy consumption. This blackout clearly exposed the fragility of the Brazilian interconnected power system, which is ultra-dependent on the energy generated by the Itaipu Binacional plant.

In the weeks that followed, other stories made the Brazilian news.

The presidents of Israel, the Palestinian Authority and Iran visited the country, marking Brazil's intention to play a role in the global political game. The country's plan is to adopt a neutral and flexible mediator position in the Middle East scenario. In some places criticism has arisen, especially from spiteful right-wing Brazilians who don't believe in the success of the current President. In other circles, however, Brazil is receiving massive praise, especially in global news, and is seen as one of the prevailing global forces of the 21st century. A special report from the prestigious magazine The Economist points out that Brazil is currently growing stronger politically and economically; the report also implies that Brazil has the potential to become an emerging superpower similar to China, but without the uncomfortable burden of a communist market. This same article mentions that Brazil recovered from the financial crisis well before the leading nations of the world and is still in a privileged position in the post-crisis cycle. The Brazilian economic fundamentals are quite strong, indicating Brazilian intentions have the power to be realized. Not only has Brazil just won bids for the Olympic Games and the World Cup, it can also excel at the political game and win over the economic world.

But as we are all tired of hearing, energy is fundamental to this economic development. There is no economy without energy, thus so many conflicts begin when players enter the scene of oil-related interests. It is an industry that moves huge amounts of money and contains within itself the world's largest companies, Exxon Mobil and Royal Dutch Shell. In Brazil this issue is less complex, since the energy is electrical and comes largely from renewable sources, mainly hydropower; nonetheless, the energy issue remains an absolutely crucial and delicate one. The blackout event has exposed a fracture in the Brazilian energy system and is a troubling occurrence from a macro perspective: the economic development that Brazil hopes for is inexorably based on harnessing a massive amount of energy in order to fulfill promises Brazil has recently made regarding potential energy production

But in which direction can we turn?

First we must make clear that the Brazilian power system is good under the circumstances. In places like the United States, large-scale blackouts have occurred that have left, for example, all of New York with no electricity. Europe also has a widely criticized electrical system and fights to consolidate their claims of integration. It should be emphasized that assuring that the country has continental dimensions that make it feasible to assemble and maintain an interconnected system, as is the case in Brazil, is not a trivial task. However, we know the situation is far from ideal. Transmission lines are not 100% reliable, the losses in decentralized networks of distribution are huge and the hydroelectric park has not yet reached maturity. We still have much to do. In the specific case of the recent blackout, the blame falls on outdated and rusty transmission lines. The process of privatization of the electricity sector of the 1990s did not prioritize the quality of electrical service. That bill is being paid now.

Second, resolving the current problem of system reliability, considering its technical dimension and the expansion of the hydroelectric park, is of paramount importance, since the economy is growing at full speed and every day new little Brazilians are born who will also want a refrigerator or a television on which to watch the World Cup.

This is where Brazilian energy integration with Peru comes into play. One of the dynamic factors of the Brazilian economy is the sector of highly sophisticated mechanized agriculture, commonly referred to as agribusiness. With the lands of the Midwest and Southeast exhausted, the natural path of expansion is into the northern region, and particularly the states of Rondônia, Tocantins and Acre. These are the exact areas in which the high-level hydro projects are currently under development. Furthermore, these regions (except Tocantins) are still attached to the Brazilian grid. For these reasons, it is expected that the region just northwest of the country will also be interest in the energy issue—and this region, coincidentally, borders Peru.

In Peru the energetic reality is quite different from Brazil. The inhabited regions of the country, the coast and the Andes region, do not take advantage of the potential energy of the jungle's rivers. Peruvian authorities have yet to launch any big projects to bring energy from the Amazon region.

This is where Brazil and Peru can help one another. Brazil has a very sophisticated system of state funding, which is almost unprecedented in the world. It is called the Banco Nacional de Desenvolvimento Econômico e Social (BNDES), and it finances projects that favor the economic and social development of the country. Most recently the bank has acted as a supporter of projects by Brazilian companies in neighboring countries. Such was the case of Odebrecht in Ecuador. The Brazilian construction company was nearly expelled from Ecuador for allegedly disobeying the technical requirements of a hydroelectric plant construction project. The case almost triggered a diplomatic incident.

Brazilian companies have great interest in taking advantage of the virtually untapped hydroelectric potential of Peru, using the available funding credit lines from BNDES. The plants would be assets of Peruvian utilities but would most likely sell more power to the Brazilian side than to the Peruvian side, as the Peruvian market is much less developed and demanding that the Brazilian. The initiative for energy integration between Brazil and Peru is, in theory, a win-win scenario. Both sides would gain. Brazil would have a chance to potentially strengthen its electricity system, and Peru would have access to an unprecedented source of energy—though it would still need to connect this potential Amazon energy source to its own system.

Despite the great potential benefits for all players involved, which is a prototype of the integration of Latin America that we all dream of, there is a detrimental issue that has not been clearly addressed. The Brazil-Peru electrical equation does not factor in environmental issues at stake. We must ask ourselves if we even wish Amazon to initiate these projects in the Amazon. We know that it is technically feasible; the modern construction technology of hydroelectric plants is something close to spectacular. However, deep down, does the desire remain to simply leave the Amazon as a temple, an untouched shrine of nature?

Development is good and is reflected in the quality of life. Brazilians can be proud of this. But is this the type of development that we want—a development of grand projects going above the law of certain principles? Unfortunately, even for those who have this kind of awareness, viable energy projects tend to be large, and it is the large-scale harnessing of hydroelectricity that is on the agenda. This points us in the direction of energy integration between Brazil and Peru.

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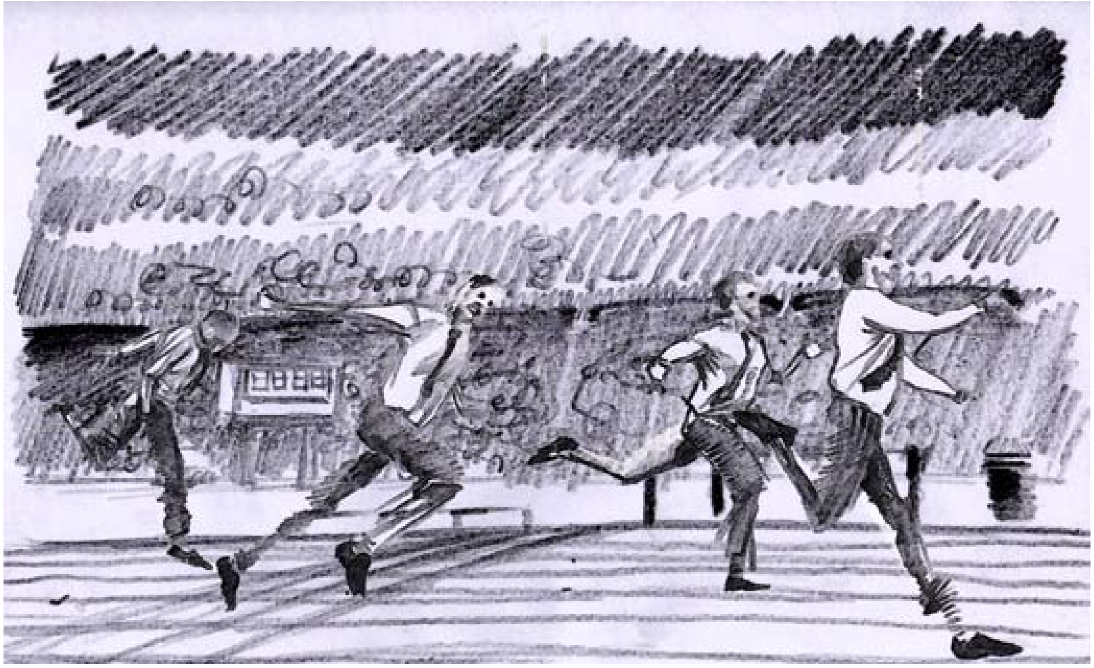
Rio 2016:

Opportunities and Responsibilities

By Tessa Albrecht

Eternally lain on a splendid cradle,
by the sound of the sea and the light of the deep sky,
thou shinest, O Brazil, garland of America,
illuminated by the sun of the New World!

Hino Nacional Brasileiro (Brazilian National Anthem)



Brazil certainly has a lot to boast about in the New Year, not in the least its winning bid to host the 2016 Summer Olympics in the Cidade Maravilhosa of Rio de Janeiro. The decision by the International Olympic Committee (IOC) on October 2, 2009, speaks loudly to the global community, signalling Brazil's arrival on the world stage and showing that a developing nation has the ability to muscle in on both global athletic and economic games.

The real gold medal, however, is not Brazil's winning bid or its recent economic prowess—while a shiny new investment grade rating and a prediction to be the world's fifth largest economy by 2016 are impressive achievements—it's that the Games should enable the country to deliver a more stable, robust investment market in the long term.

Brazil's ability to meet this goal will depend largely on whether its public and private sectors can work together strategically and with purpose and responsibility. This article proposes that Brazil is taking steps in the right direction, with a post-Olympics market expected to be more sophisticated and transparent. Required infrastructure development will have a ripple effect on economic growth, with improvements in civil-society apparatus making the country more attractive to stable long-term investment. Opportunities in commodities, foreign exchange (FX) and the green sector are likely to grow, while consistent improvements to the country's regulatory system will better protect the market.

The Brazilian Model

Key to Brazil's investment approach for the Games is its integration of funding partners and unique mixing of social policy and market economics. Brazil's Administration has allocated $11 billion for infrastructure-related spending, with the mega-event expected to add around $51.1 billion to the economy through to 2027. Funding is split between local and federal levels of Government, private sources, the IOC and multilateral institutions such as The Worldbank. This layering and cross-sectional investment backing is good news for the risk-averse investor. Private sector participation in infrastructure will be essential for Brazil to meet its development targets in time for the Games, as well as the preceding 2013 Confederations Cup and the 2014 World Cup.

Commodities

With China's growth rate barely skipping a beat throughout the global downturn, commodity prices are returning to pre-GFC levels. Key indicators of market stabilization include copper, steel and the Baltic Dry Index returning to levels seen in 2007 before the sub-prime bubble began to burst. With the requirement for raw materials necessary to build up infrastructure, these prices will be crucial in assessing the economic impact on the Host nation. Brazil's wealth of resources will see it source materials locally, and, with such a massive requirement for base metals and an increase in the need for energy, domestic mining and drilling firms look set to enjoy prosperous times. Opportunities abound for investors to ramp up their holdings in local equity. As the government continues to award local firms contracts, there will be a smattering of small domestic firms coming out of the woodwork and requiring foreign dollars for IPOS. Post-Olympics, Brazilian commodities will only become more attractive to the hungry giants of China and India. The insatiable demand of "Chindia" is also likely to hike up prices in the near future.

The ability of Brazil to source its resources internally may reduce the requisite net cost associated with infrastructure development, an important factor in particular if spending exceeds budget, as was the case for China at the 2008 Beijing Olympics. Further, recent discoveries in local pre-salt oil fields will boost Brazil's ability to better finance infrastructure costs.

Infrastructure investment is also likely to lure more sophisticated companies to the market, with Brazil's demand for strategic planning expertise providing opportunities for international consultants, developers and contractors.

Foreign ExchangeThe Brazilian Real has been the strongest appreciating currency against the USD over the past calendar year, gaining 33.67% (31/12/08–07/12/09, Bloomberg). This is in part due to the Brazilian economy being one of the last in and first out of the economic downturn; however the carry trade also has its own part to play. With the interest rate differential between Brazil and America, it is increasingly popular for investors to short the dollar against the Real, as debt is cheaper on the northern side of the Panama Canal and Central bank rates are more than 8% lower. With the FED recently affirming that it plans to keep interest rates low for the foreseeable future, the popularity of this trade doesn't appear to be pending, and the Real is expected to continue to strengthen. The U.S. is showing signs of recovery, and the Central Bank of Brazil (COPOM) unanimously agreed to maintain the current rate of 8.75% at its latest meeting. With COPOM citing the easing of monetary policy and the "benign inflationary scenario," the ideal time to invest in Brazil doesn't appear to be far off. Until the rates reach parity, there will always be the carry-trade buffer to give Brazilian investments that little helping hand.

Alternative Investment

The alternative investment market is likely to become more sophisticated in the near future. This is in part due to Brazil's commitment to an "all-green" Olympics, ramping up spending on technologically savvy environmental programs and the resulting inflow of green dollars into the country. Similarly, as demand for alternative investment increases as a result of the nation's heightened media profile, global financial powerhouses are likely to cash in and augment their product offerings to include more "ethical" options.

Brazil is already using the Olympics as a platform for showcasing its environmental stewardship and has demonstrated its commitment to greening the Games through a number of programs. As part of its bid, Rio allocated a Green Olympic Sustainability Division (OSD) to assist in strategic environmental planning, set goals for greenhouse gas reduction with pre- and post-Game targets, and launched the Carbon Zero 2016 campaign. This campaign will see 3 million trees planted across Rio before 2016. Sustainable investment solutions are still required for the country's problematic water and sewage systems.

Regulatory System

The ability of Brazil to profit from the Olympics will depend on whether the government can maintain its role in overseeing investment while letting private investors actually get things done. Success will further be determined by the strength of these public-private partnerships, and whether the nation can continue to avoid the ideological polarization that has previously disrupted its market. Similarly, Brazil will need to continue to chip away at the layers of bureaucracy hindering international investors.

Brazil certainly has made progress in the regulatory arena over the past few years, and its accomplishments herein should be recognised. The country's conservative tax policy is particularly noteworthy. The tax increases leveraged at foreign investors late 2008, albeit not popular, demonstrated the Government's proactive stance to avoid speculative investment. Tax was implemented in two stages: a 2% tax levied on international stocks and bonds in October, followed by a 1.5% hike on American Depository Receipts (ADRs) a month later. The latter tax was issued to balance out distortions arising from investors attempting to skirt the first levy via the purchase and immediate cancellation of ADRs.

These taxes are unlikely to have a negative impact on the underlying value of the Brazilian market long term. Such measures create a tactical downgrade on the Real, and although it may underperform other emerging currencies in the near future, this will mean Brazil is less likely to overprice assets or experience a Bubble. The nation's booming middle class, strong exports, improving infrastructure and increased domestic spending—the Olympics will augment this by providing close to 120,000 jobs per year up until 2016—will only increase market value. There's a lot to be said for stability, and conservative fiscal policy is a sign of improving corporate governance. The regulatory arena should make for interesting watching come election time in October.

Let the Games begin…

While the Olympic Games will shine light on Brazil as a key investment destination, it will be the country's ability to utilise correct government and corporate coordination to not only avoid the evident overheating dangers of previous boom and bust cycles but further to emerge as a continental and world economic leader. Sport and investment are global languages that know few boundaries, and together they may set the standard for how developing nations can expand their economies and extract significant social value in doing so. If the Brazilian model of public and private cooperation fulfils its possibilities, the gains may not just be short-term economic growth but a farther-reaching shift in business culture and international perception.

Tessa Albrecht is a Sydney-based Risk Analyst at a leading Australian bank. Tessa holds a degree in International Relations from Bond University, with majors in Spanish and International Business, and previously held the position of Business Development and Marketing Manager at the Spanish Official Chamber of Commerce. Fluent in Spanish, Tessa has a keen interest in Latin America, emerging markets and alternative investment. With thanks to contributing author, Paul Ambrose.

Finding your freedom in Latin America

Peter Macfarlane

When checking out investments in Latin America, don't miss intangible benefits that might not contribute directly to the bottom line, but that could make you freer, wealthier and happier as a person. Peter Macfarlane investigates the hidden benefits of Latin Investing such as tax benefits, asset protection and even a new passport...

For most investments, the bottom line is of course the most important. But one of the very attractive advantages of alternative investments is that they are not just digits on a screen. Frequently, they also carry significant fringe benefits that, while not contributing directly to the bottom line, play an important role in the investment itself and in the investor's longer term strategic planning.

These fringe benefits may be pure fun, or perhaps social status - like inviting friends over to sample the latest vintage from your own winery. But as the traditional financial system remains far from predictable, and the outlook for 2010 remains gloomy, you might be surprised to learn that savvy investors are turning in droves to alternative Latin-American investments as a conservative 'safe haven' for serious asset protection purposes.

Longtime international speculator Doug Casey, who authored The International Man back in 1976, recently wrote that "a wise man ... doesn't allow himself to be limited by an accident of birth." Casey predicts that we are "heading into a currency crisis for the record books, and I think you can plan your life around some type of foreign exchange controls. If you don't get significant assets out of your home country now, you may soon find it costly and very difficult to do so."

The USA is the only country in the world that taxes its non-resident citizens. A Brit or Canadian who moves his official residence to Belize or Uruguay won't have to worry about home country taxes any more, but his American cousin will.

Whether you agree with that prediction or not, there are several very good reasons to diversify into hard international assets - things like real estate or physical gold bullion.

For a start, there are the tax benefits. If you are managing an investment portfolio today, chances are your geographic location is not really that important. Day-to-day management of your portfolio can be carried out from anywhere there is a laptop and broadband. So more and more investors and managers have realized that they just don't need to be located in a high tax, high cost country.

The majority of Latin American countries have territorial tax systems – meaning that if you are officially resident there, you are only taxable on your local source income. Anything you do outside the country of residence is tax free as far as they are concerned, so you don't even need to bother declaring it. This contrasts starkly with North America and Europe where the rule of thumb is that your home country taxes you on your worldwide income.

By living - even part time - in one country while overseeing investments in another, you can therefore legally slash your tax bill at a stroke. Some countries, like Uruguay and Panama, are particularly attractive in this regard, having passed business-friendly legislation designed specifically to attract this kind of international investment management business. They recognize that even though it doesn't produce tax revenue directly, it stimulates the local economy and provides work for local professionals, banks and businesses.

Other countries offer 'pensionado' or 'qualified retired person' programs that grant specific tax exemptions to retired foreigners taking up residence. If you don't feel ready to retire yet, bear in mind that some of these 'retirees' are much younger than you might expect - qualifying for the programs simply by proving that they have sufficient regular income from abroad to maintain a quality lifestyle. 'Retirement' to them might mean waking up to the sound of the ocean in their beautiful beachfront properties, logging on to check how much money they made overnight, working on the internet for a few hours a day, and travelling a few days a month to oversee their investments in person.

Ah, I hear you saying, but there is one big problem with this strategy - if you happen to be a US citizen. The USA is the only country in the world that taxes its non-resident citizens. A Brit or Canadian who moves his official residence to Belize or Uruguay won't have to worry about home country taxes any more, but his American cousin will. It's not quite as dire as it sounds, since there are still substantial benefits to Americans living overseas, that a competent international tax lawyer can help you with. But the only way Americans can legally unshackle themselves completely from the IRS is by renouncing US citizenship.

Many are doing just that. But before taking the drastic step of giving up a US passport, another citizenship is required. Millions of US citizens are actually entitled to European or other passports based on ancestry, though the bureaucracy involved can be quite lengthy. That's why the Caribbean states of Saint Kitts and Nevis and the Commonwealth of Dominica both offer 'economic citizenship' programs, effectively 'selling' citizenships and passports for hundreds of thousands of dollars. Years ago most of the takers were Russians, then came the Chinese, and now most of the buyers are Americans.

All this brings me to another big fringe benefit of investing in Latin America: most Latin American countries are relatively liberal when it comes to naturalization – the granting of citizenship based on a period of residence or other 'connection' with the country. 2-5 years is the norm. This already short period can often be speeded up even more based, for example, on marriage or on birth of a child in-country. Frequently the processing time on top of the officially-designated residence period can be a year or more – but one has to consider that citizenship via this method is almost free.

Demonstrating some connection with the country is a necessity, but this requirement can be easily fulfilled by owning real estate or investing in a local business. So smart second citizenship seekers should be looking for attractive business opportunities in Latin America rather than investing hundreds of thousands on small, hurricane-prone islands in the Caribbean.

The biggest benefit of going global for me, however, is intangible. If I had to sum it up in a word, it would have to be 'freedom.' In the same article on expatriation, Doug Casey continued:

"A crisis (and this will be a very real one) always draws exhortations from the authorities to 'unite' and 'pull together' - which usually boils down to following orders and turning in those who don't. People will want, and will get, 'strong leadership.' This does not bode well for libertarians, classical liberals, and free thinkers, in general. . . I suggest you at least consider the possibility of transplanting yourself, or at least start by transplanting some assets. Don't look at it as a negative thing. The world is your oyster. Make the most of it."

Although bureaucracy in Latin America can be overwhelming at times, it is relatively easy to cut through. There is less regulation than in the US in particular, and more reliance on common sense and individual responsibility. People don't sue each other over the least little thing.

Doug is currently involved in developing a community for like-minded individuals in northern Argentina, not too far from Bolivia and Paraguay. The idea being that with the world in constant commotion, it's good to have a 'Plan B' - a place far from the madding crowd that is entirely self-sufficient in terms of food, water and energy – and even wine!

The buyers in such communities, many of whom I have had the pleasure of meeting, are not crazy doomsayers. Most of them are patriotic Americans, serious investors and hard-working entrepreneurs, who hope things will never get that bad – but they sleep sounder at night knowing they have a bolt-hole prepared and assets in place if the worst case scenario plays out. And, lest we forget, they are hoping to pocket a healthy profit on their Latin American real estate investment over the medium to long term.

As with any investment, due diligence in this area is extremely important. But next time you check out an investment, look around for hidden side benefits as well as the cold, hard figures. Treat it not just as a way to increase the number of dollars in the bank, but as a way to diversify, learn and protect the assets of your family by investing in something with a built-in back-up plan.

Further reading: Peter Macfarlane is joint editor of The Q Wealth Report (http://www.qwealthreport.com) a leading privately published newsletter covering how to preserve, create and enhance your freedom, wealth and privacy in a secure international environment. Visit the Q Wealth website to read more articles on this topic or to sign up for their free newsletter.

Global Learning:

A Worthy Cause

By Tiffany Joy Swenson

In our first issue, Alternative Latin Investor profiled the contributing habits of Ultra High Net Worth Philanthropists; in our follow up issue, we would like to take an opportunity to shine a spotlight on one of the many nonprofit organizations that we deem worthy of such philanthropic donations.

Twelve years ago an eager undergrad began a project that has now grown into an organization that helps thousands of children globally each year. Global Learning (GL) is an international not-for-profit organization that is dedicated to promoting education as a means for peace and justice. The organization is funded primarily by individual donors, grassroots fund-raising done by volunteers and generous in-kind donations. Thanks to these donations, GL provides virtually free volunteer opportunities year-round to hundreds of young leaders from around the globe—without a single paid employee. With a mission to alleviate poverty through the transformative power of education, GL has coordinated over 600 volunteers from more than 24 countries to serve on their multicultural teaching teams.

Global Learning Founder and Executive Director Jana Kiser explains her inspiration for starting the organization as twofold. As a first-year student at the University of Montana, Kiser felt fortunate to have access to such a wealth of knowledge and resources, but she realized that the resources that exist at a university level aren't available on a global level. She became determined to find a way to bring art, music and multicultural learning programs into schools globally. Additionally, Kiser was motivated by the fact that her most inspired and talented friends weren't going into community-oriented work, primarily because there weren't many affordable options for volunteer programs abroad. She made it her goal with Global Learning to create an organization that was financially realistic for those wishing to volunteer.

The organization focuses on four primary initiatives to support its mission: School Enrichment, Global Leaders, Global Action Tank and Student-Centered Teacher Training.

The school enrichment programs are located in Nicaragua, Costa Rica, Mexico and the United States. GL volunteers teach and learn with more than 3000 elementary and high school students annually as a part of this program. By introducing empowering, student-centered and democratic teaching methods into economically challenged schools, the students become inspired to learn and move beyond the boundaries of their socio-economic status. The children involved in these programs become fascinated and inspired by their positive, multicultural visitors and the friendship and cooperation between volunteers, students and local community members helps to facilitate a connection that transcends cultural, economic, racial and social barriers.

The Global Leaders program is geared towards college-age volunteers from Nicaragua, Costa Rica and the United States who are interested in education for peace and justice. This professional development program includes the After-School Learning Initiative program hosted in each of the student's individual communities. These after-school programs not only offer local university students an opportunity to serve their community as positive role models, but also expand the GL reach by providing year-round support to uphold the GL standards and facilitate the coordination of projects in local communities. One such program in San Jorge, Nicaragua is focused on both art and nutrition, providing nutritious snacks to the children and

The Global Action Tank is a "meeting of minds."

leading creative art-based projects. The leaders are in charge of everything from budgeting to creating the curriculum. Running these programs from start to finish helps these young professionals develop a mindset that will aid them in their future careers as leaders for social justice.

These after-school programs not only offer local university students an opportunity to serve their community as positive role models, but also expand the GL reach by providing year-round support to uphold the GL standards and facilitate the coordination of projects in local communities.

The Global Action Tank is a "meeting of minds." This year's multi-week session will take place in January 2010 in San Jorge, Nicaragua. Participants will include volunteers from Costa Rica, Nicaragua, Puerto Rico and the United States. In a roundtable discussion, Global Learning team members will be encouraged to discuss and explore the intersection of globalization, inequality and education in order to identify which skills are necessary for students to become active participants in the global social-political community. GL Executive Director Jana Kiser's research on global skills in Uganda, Rwanda, Tanzania, Thailand, Mexico, Peru and Argentina will be integrated into the Global Action Tank. The participating team will create Global Learning's 2010 curricula with the identified global skills in mind.

Lastly, GL offers Student-Centered Teacher Training programs as a response to an outpour of requests from teachers in local communities to have access to teacher-training workshops. GL is unique in that it understands how students learn and uses this knowledge to create effective curricula. The goal: teach people to be proactive global citizens. With a focus on Latin American pedagogical thinking techniques, GL volunteers are trained to teach in a very student-centered and progressive way. Accompanying the Student-Centered Teacher Training is a handbook of field-tested teaching techniques, classroom community-building strategies, and student-to-student conflict resolution methods that educators could use to improve children's learning and life preparation, even with minimal material resources.

According to Global Learning Founder Janna Kiser, part of what makes GL so special is the diversity of its volunteers. GL is very locally guided, with at least half of every volunteer team consisting of locals from that particular country. The other half of volunteers is extremely diverse. Due to the fact that the GL programs are so affordable, those who have been traditionally under-represented or come from a low social economic class have an opportunity to be involved in the program. Surprisingly, 70% of GL's global volunteers are people of color, many of which are the first in their family to go to college or have a passport. The GL programs are 100% free for Latin American volunteers, inciting a fair amount of volunteer exchange within Latin America. Participants traveling from the U.S. and Europe are asked to purchase their own airplane tickets and fundraise approximately $600—everything else is covered as a part of the program.

In January of 2010, Global Learning will enter its thirteenth year of service. With its impressive track record, Global Learning has proven itself to be a worthy global cause. Working from a grassroots platform, GL has managed to do outstanding work on a very small budget. With such a large number of volunteers, there are little overhead costs, so donors can rest assured that their donations will make a tremendous impact as they are put directly towards the GL initiatives.

For more information on donor or volunteer opportunities, please visit www.globallearninginternational.com

Torrontés: The Next Malbec

By Dan Karlin

Since 2004 no other country has seen the meteoric rise in volume, value and market share figures that Argentina has in the import segment of fine wine to the U.S. Over the last two years, while all other segments of imported wine have been down in both value and volume—except for Argentina's across the Andes rival—Argentina has seen value increase in 2008 by 26.6% (U$ 500m) and volume by 15.6% (18.1m 9L cases), and through 3Q 09 value was up 8.8% and volume 8.9%. (It's important to note that over 50% of all wine sales in the U.S. are done in 4Q of any year due to the Holidays.)

The majority of the reason for this growth during a recessed world economy is due to the great value that is Malbec. But of recent, Argentina's ace in the hole has been its little known white wine called Torrontés. Torrontés, a grape variety of Spanish origin, has found a home in the arid high altitudes of Salta, La Rioja and San Juan. The dryness and altitude factors enable Torrontés to achieve its best expression while maintaining its acidity, something that it loses at lower altitudes and with too much rain. When achieving its fullest personality, a Salteño Torrontés—from Salta, widely considered to be the best region—such as one from Carinae Vinos, will have an exuberant nose of honeyed orange blossom, jasmine and citrus while the mouth remains dry and crisp with flavors of pineapple, grapefruit, apricot and tropical fruits. Carinae Vinos was started by Philippe and Brigitte Subra, a French couple who relocated to Mendoza in 1998. They have a passion for astronomy and have named their winery and all their vineyards after constellations, beginning with the southern sky, which was not visible for them before in France. They now make several wines that have received high ratings from both Wine Spectator and Wine Advocate.

This Salteño version of Torrontés is contrasted only slightly by its Riojano (see Aguijón de Abeja) and San Juanino (see Serrera Torrontés) counterparts, which exhibit more delicacy and elegance. The Aguijón de Abeja ("Bee Stinger") Torrontés comes from Familia Durigutti, a winery started by Pablo and

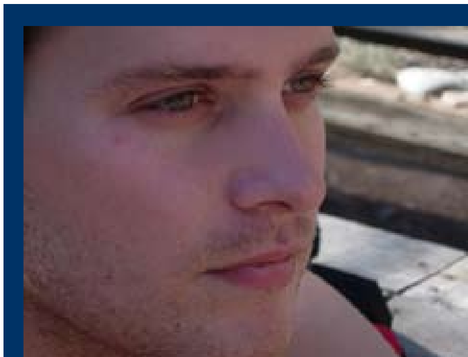
Hector Durigutti. The two brothers had made wine for 10 years in differing styles for different-sized wineries—Pablo for the now Catena Zapata–absorbed La Rural (an enormous conglomerate), and Hector for the acclaimed once-boutique Alto Las Hormigas—and recently they partnered on this project to make their first family wine. Both winemakers have been featured all over the wine press with articles and high ratings alike.

Serrera Torrontés comes from a fairly unknown, very new winery that maintains vineyards in four separate and distinct regions of Mendoza to make its vast array of high quality wines. Only recently gaining international ratings, Serrera has an incredibly bright future with their ability to make Malbec at all price points, high quality yet affordable Torrontés, and a great Bonarda (more on that later). All Torrontés pair extremely well with light pastas, fish and salads. For specific pairings, try a nice apricot or fig jam over triple cream Brie; prosciutto wrapped honeydew or cantaloupe; or peach, raspberry or mango sorbet with lightly flavored biscotti.

It is this author's opinion that this unique flavor profile of Torrontés combined with the newness factor that will ultimately be responsible for its growth in the U.S. and world markets over the next decade. Compared with the ubiquity of Chardonnay, which has led to an ABC ("Anything But Chardonnay") philosophy amongst many an aficionado, slightly fatty Viognier or off-dry Gewürztraminer—the three varieties that Torrontés is most often likened to—Torrontés has the sweet floral nose of the latter two that Chard lacks, better acidity that Viognier, and is dryer and more food friendly than Gewürztraminer, while generally being a better bang for your buck than any of the three. This flavor profile and price point translate to sales potential. Howard Goldberg of The New York Times, upon first tasting the varietal in 2001, wrote, "Bring home half a case, and then think of your corkscrew as a faucet handle." http://www.nytimes.com/2001/01/14/nyregion/wine-under-20-a-kaleidoscope-from-argentina.html

In the first nine months of 2009, exports for this varietal grew 42% in value and 40% in volume. At Anuva's own wine tastings in the U.S. and in Buenos Aires, our wines that most frequently get an "I've never tried anything like that" response are Torrontés. Interestingly, the next most likely wine to get a response like that is our Bonardas.

What is Bonarda? Where Malbec is peaking and Torrontés is on its way up, Bonarda is still completely off the map. Think a nice smokey-chocolate nose with hints of raisin and fig. In the mouth, juicy blueberries and hints of pepper with an aggressive mouthfeel. This is the varietal that most often gets "wows" from wine professionals at our wine tastings. It blows away the normal flavor profile of a deep colored, full-bodied red. Mairena Bonarda has been one that gets great reviews from critics and neophytes alike. Look for Bonarda to start selling well in the next 2–3 years.



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Latin American Art Museum of Amersfoort (LAKMA):

ALI speaks with founders

LAKMA started with a foundation dedicated to the Spanish artist José Gausachs. Gausachs was an artist who emigrated from Spain during the Spanish Civil War, before the Second World War. For many, Gausachs is an unknown name; however, he is of great importance to Latin America's art history. He was the disciple of great masters such as Isidre Nonell and Felix Mestre. He cultivated friendships in Paris with other famous painters of his time, such as Amadeo Modigliani, Georges Braque and Pablo Picasso. He was appreciated by intellectuals like Tristan Tzara, whose friendship and support made a great difference for Gausachs during the exile. Furthermore, he was praised by great writers of that time: Hemingway acquired one of his paintings, and the poet Carles Ribas dedicated a poem to the remarkable painter after the inauguration of Gausach's last exposition in Barcelona.

The Gausach Art Foundation has undertaken the project of creating the first museum in The Netherlands dedicated to Spanish, Mexican, Caribbean, and Central and South American contemporary art. The museum's collection will serve as a cross-cultural exchange gateway between Latin America and the diverse population of the Netherlands. The museum will offer numerous research and study possibilities with its cultural center Casa Latina through various exhibitions and programs.

ALI: What inspired you to start a museum for Latin American Art in the Netherlands?

LAKMA: We saw that there was a need for a macro institution to support on a nonprofit basis the promotion of Latin American culture and arts. We had a good collection but not a lot of support—when we had a proposal for an exhibition it always would come out of the Latin American embassies here. The embassies, however, they don't have a multi-year budget—they are working with a one-year budget. They aren't interested in something that might take place in three years, as they don't know if they will even be established still in the country. The museums on the other hand have full exhibition schedules for years in advance and need to have a long perspective of the programming for their sponsorship. Therein lay the problem—so in order to create movement and interest in Latin American art, whose effects can be felt in commerce, politics, dialogue, education, one macro organization needed to be in place to solidify all of the smaller foundations and culture departments of the embassies. We had a concept of "united we stand." We started just under three years ago—there were a number of stakeholders needing networking with the embassies and with the artists, and we finally got enough momentum going to start the projection of a museum. They thought of which city would be best—wanted a big and prestigious museum. They considered Amsterdam and The Hague; however, they settled on The Hague as that is where the embassies are and there is a higher status of inhabitants. It is a politically charged, cultural city. There is a new train system under development there currently, which will bring travelers directly from Paris. There is a drive for big corporations to settle their corporate headquarters there. This way people can see that there is a potential market for Latin American art.

ALI: How, over the past 5-10 years, has Latin American art been received in Europe?

LAKMA: It is regarded very highly. That is undisputed in the sense that Latin America is seeking an audience in Europe.

When the work of Latin American artists travels to Europe, it increases in value and becomes more interesting. Europeans are investors and explorers and are interested in emerging new artists and stories. We have had exhibitions of Frida Kahlo, Javier Marin, the art history of Cuba; they have all been a huge success. The industry is definitely growing. This will be the first Latin American art museum in Europe. There is an exhibition hall in Zurich, but it's not a museum. This being the first is an indication that the interest is growing and a lot of large companies are establishing themselves in the region.

ALI: What was the exposure of Latin American art in the big European museums before LAKMA?

LAKMA: There were fewer activities. In the past three years there has been more movement, there has been a synergy that happened simultaneously—it has been the right moment. Europe always looks at North America; there is a lot of interest in Latin American Art and business in North America, and Europe always tends to arrive late to these conclusions. Now is the right time for Europe.

ALI: Where would you say are the hot spots for Latin American art at the moment?

LAKMA: Spain and Italy—but of course this can be seen as an opportunity to expand the market to Germany, the Netherlands and Belgium. There is an interest but lack of the presence of a strong organization in order to bring impressive exhibitions that will secure endorsement from the government and large corporations who would like their brands to be seen. That is the economic structure that this idea is based upon at the moment.

ALI: In terms of European interest in Latin American art, what is most popular at the moment?

LAKMA: That is really yet to be discovered—we are opening a new chapter. There are many different installations—modern art, Brazilian graffiti. The municipality of Rotterdam even made space available for graffiti to take place in the streets. The Netherlands invests a lot in its art and culture. There is a large population of Latin Americans and there is a large population of Latinos in the Netherlands. That should give an indication of how things are going to be growing.

ALI: What are you looking to do in 2010? Have you been affected by the current economy?

LAKMA: In the coming year we are excited to have an exhibition from Cuba and the Dominican Republic, and some very impressive artists from Spain and Latin America.

Of course the economic downturn did have an effect; at the same time it also gave cohesiveness to the community to make this happen. All of the cultural departments were feeling the effects of the downturn and a meeting was held, sponsored by the Venezuelan embassy, to discuss how to subsidize cultural affairs in a downturn such as this. Many economic advisors offered their services for free. We met to look at this straight in the face as a community.

fundacion@gausachs.net

"Special FX":

2010 opens with a dose of risk aversion accompanied by cautious optimism-USD strengthens:

Our last article reviewed the roller coaster that was 2009 and many of the core themes that influenced FX market pricing and movements throughout the year. Based on further observations our analysis to date indicates that thematic overtones such as liquidity, behavioral unpredictability of the 'human element' and over-reaction to basic fundamentals are likely to keep FX market participants firmly entrenched and involved in what could be another dynamic yet unpredictable year ahead.

January was reasonably quiet although did show the unwinding of one major recent trend as many currencies came under selling pressure, resulting in a generally unexpected bout of USD strength against most currencies, especially towards the end of the month. Interestingly, the Dollar strengthened on risk-aversion in some cases and on generally better-than-expected US data in others, as employment deterioration showed signs of slowing drastically.

The Euro in particular came to a sticky end (at least during this one-month time frame) leaving many participants wondering how the EUR could have fallen so relatively precipitously; from 1.50 in December to 1.38 in January, around 8 percent in just over a month and quite a significant move given unchanged interest rates at close to zero in both regions. 1.3500 should provide support, if indeed the Dollar manages to rise that far.

This kind of move illustrates perfectly how extreme levels of sentiment & positioning can dictate play over and above fundamentals in Forex.

In our last article we commented that although the USD with zero interest rates enables the $ to become the carry trade currency, we remained mindful that this vehicle is not always the best means with which to express a view should the trade become crowded. The markets love to hate the Dollar and quite simply it seems that in typical FX-style, the speculative positions did in fact become crowded into the end of 2009 from a short Dollar perspective, resulting in a currency sell-off. In this case, the worsening Greek debt situation during January greatly assisted the Euro's weaker stance and quite simply served to highlight that the US is not the only economic region with a 300 million population to encounter fiscal difficulties. Talk of a break-up in the Euro now seems almost inevitable but the event itself probably unlikely.

Naturally this phenomenon of Dollar strength may yet prove to be an excessive correction in itself as time goes by as questions continue to arise over the fiscal position of the United States-as we go to press various newswires from the Davos summit report that President Obama renewed his pledge to make job creation his number one priority in 2010 but that it was also critical to rein in a record budget deficit that threatened economic recovery. Bottom-line, the USD is still potentially under threat and therefore may quickly revert to being perceived as relatively overvalued, at least until such time as policy decisions become vindicated by a return to higher employment rates, meantime the positive $ move in December and January may be seen as corrective in nature.

Future projections for LatAm currencies and the USD.

ARS (Argentinean Peso) - last 12 months trading range			3.44 / 3.89
		Forecast average	
Current	Q2 2010	Q3 2010	Q4 2010
3.8400	3.400	3.3	3.2
BRL (Brazilian Real) - last 12 months trading range			**1.69 / 2.45**
		Forecast average	
Current	Q2 2010	Q3 2010	Q4 2010
1.86	1.64	1.54	1.60
MXN (Mexican Peso) - last 12 months trading range			**12.48 / 15.58**
		Forecast average	
Current	Q2 2010	Q3 2010	Q4 2010
13.08	11.9	11.6	10.8

Much like the currencies of Europe and the Anglo-Saxon regions in December & January, Latin American currencies also gave up many of their recent gains, despite what could arguably be described as unchanged governing fundamentals with the exception of Argentina whose currency, equity markets and bonds all fell amidst market perceptions of discord between its Central Bankers, resulting in the resignation of Central Bank chief Redrado at the end of January. In a “flight-to-quality” situation, ARS-denominated bonds fell, with yields rising to some 7.5% percentage points over US Treasury bonds, quite a gap.

From the standpoint of unchanged fundamentals though, behavioral unpredictability comes into focus in such instances because markets are reacting somewhat counter-intuitively to news and economic events. As a portfolio manager, this particular facet of trading remains one of the most challenging, both during analysis & research but particularly when making allocation decisions.

Consequently we find that retaining a focus on macro or “top-down” issues is best, rather than micro or “bottom-up”. We feel this is relevant as this approach in the long run allows positions to be held albeit with a smaller allocation, but importantly reducing downside, thus often being able to ride out the negative fluctuations of the market for the most part until profit-targets are reached. We talked last issue a little bit about analysis of actual and latent portfolio risks and we remain advocates of helping discover the many advantages to be gained via optimum management of FX exposure.

Credit markets were a main driver of pricing and liquidity in 2009 and recent reports of announcements (again from the Davos summit) by the Brazilian Central Bank chief Henrique Meirelles are indicative of Brazil’s economic conditions being perceived by officials as returning to normal. Of course if this is true we can expect some phasing out of tax cuts/breaks that were originally implemented to stave off recessionary forces as the crisis hit last year. Naturally such measures could be further tweaked by reserve tightening in the region that would serve to increase interest rates, much as China did in January 2010, causing Yuan strength. Brazil’s official interest rates at 8.75% are remarkably higher than the zero interest rates of the US and the UK, yet remain at record lows domestically speaking.

Backed by Brazil’s budget surplus of around 65bio BRL in 2009 (1.25% of GDP) this situation is almost a textbook carry-trade and if it were not for the perceived risk in LatAm markets we remain convinced that the BRL would be trading much more

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Kevin's market longevity is due to an entrepreneurial nature & the ability to provide innovative currency strategies. These are complemented by an impressive network of financial market professionals that result in a comprehensive, contemporary grasp on world currency markets.

forcefully than its current 1.86, therefore we still look for a potential move to the low 1.50s, especially given the budget deficits being run by more established economies.

We have focused more on Brazil specifically this month not only because the Argentinean situation may be on the way to resolution but also as it is the region's biggest economy and because the Real also suffered a significant downturn over the past few weeks. These recent news reports underscore our belief & reasons for remaining bullish on LatAm and if the BRL is about to resume its upward trend against the Greenback it's almost a sure bet that whatever happens in Brazil will have a significant and similar impact on Argentina, Chile & Mexico, the other major traded currencies.

Aside from Brazil's potential measures in the future, Chile's supervisory authorities announced changes to its pension fund hedging rules at the end of January that effectively allow the very large players in the market to buy back currency hedges which immediately resulted in some downward pressure on the CLP to around 524, some 5 percent below its best levels in December 2009. Once the 90-day adjustment period comes to be recognized by the market (previously 10 days) we would expect some smoothing to occur, pushing the CLP stronger once again.

So to reiterate our macro perspective and particularly with the diametrically opposing initial viewpoints emanating from Davos when comparing the US with Brazil, our projections for a more bullish currency environment for LatAm remain intact.

In conclusion we foresee an initial bearish USD outlook with rising LatAm currencies over the next few months, at least until the Fed raises US interest rates which we believe will occur sometime late in H2 2010 leaving some room for USD appreciation. Even at that point LatAm currencies may ultimately continue further appreciation due to growing demand from its Northern neighbors.

In summary, January may have given us a taste then of things to come with a resumption to financial normality in the US and therefore the whole system, but we think the risk is that it's a false dawn for the USD given the extremity of the situation in 2009 and the likelihood that the market's focus will again turn to its preferred approach of USD bearishness in the short-term, underscored by the probability of continued reserve asset diversification and the Fed on hold, for now.