



ALTERNATIVE EmergingInvestor

Issue 7 - June / July



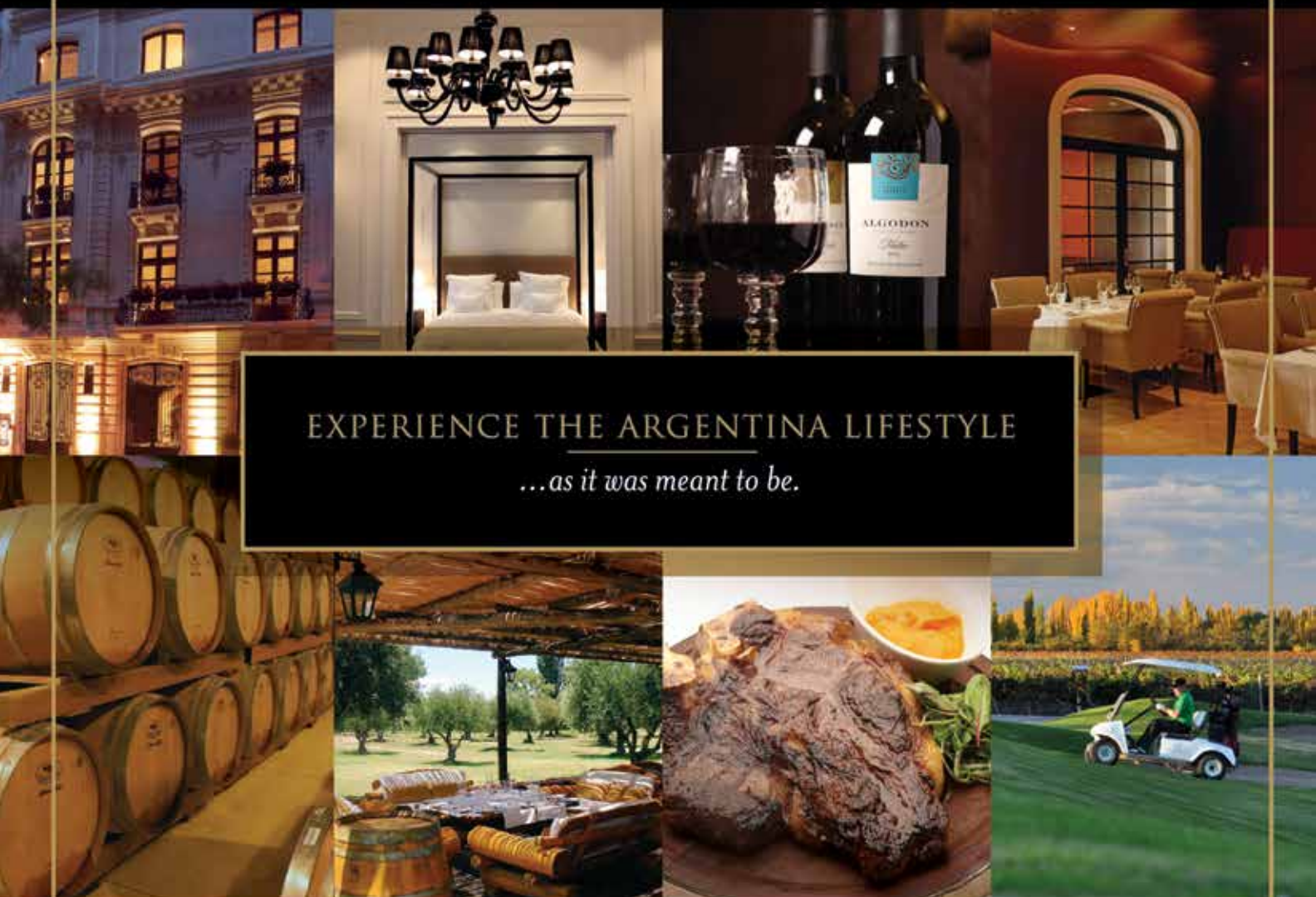
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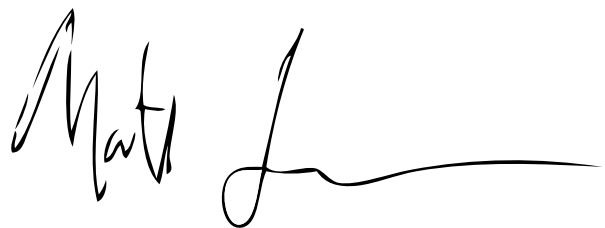
Traditionally, emerging markets have been considered almost an “alternative” asset class, with small portfolio allocations and misperceived risks, with a small segment of die hard proponents – until the later part of 2008. When developed markets felt the global collapse of banking and equity markets, good investor returns were those with the smallest loss. At the same time, emerging and frontier markets with little to no credit/debt remained mostly unscathed and were showing excellent returns. High volatility has always been a facet of these markets, and this alone, historically, has not been enough to entice investors. What has changed? A fundamental shift in emerging markets toward greater transparency, strong anti-corruption moves, and adoption of investor friendly policies – these are all game changers.

With emerging and frontier markets becoming a mainstay in investors’ vernacular as well as their portfolios, it seems odd that as participants in these markets rapidly increase, resources and information regarding EMs have remained, primarily, the same. In the so-called “information age” the lack of a centralized institution for the promotion and analysis of emerging market investment is shocking. As necessity is the mother of invention, it is with great pride and pleasure I would like to introduce the Emerging Market Investors Association, EMIA.

EMIA connects investors with reputable investment professionals, research, education and news, increasing confidence and transparency within emerging markets. For investment professionals, we create enhanced brand awareness that delivers tangible opportunities for business growth. For investors EMIA is an objective, comprehensive and unbiased source of expert, on-the-ground information, daily news and in-depth analysis. In short, EMIA is the world’s first and only not-for-profit emerging market organization, dedicated to advancing the industry as a whole, representing the combined interests of investors and investment professionals, across asset classes.

If you have any questions regarding EMIA please feel free to contact me at the email below, and everyone have an excellent World Cup!

Saludos,



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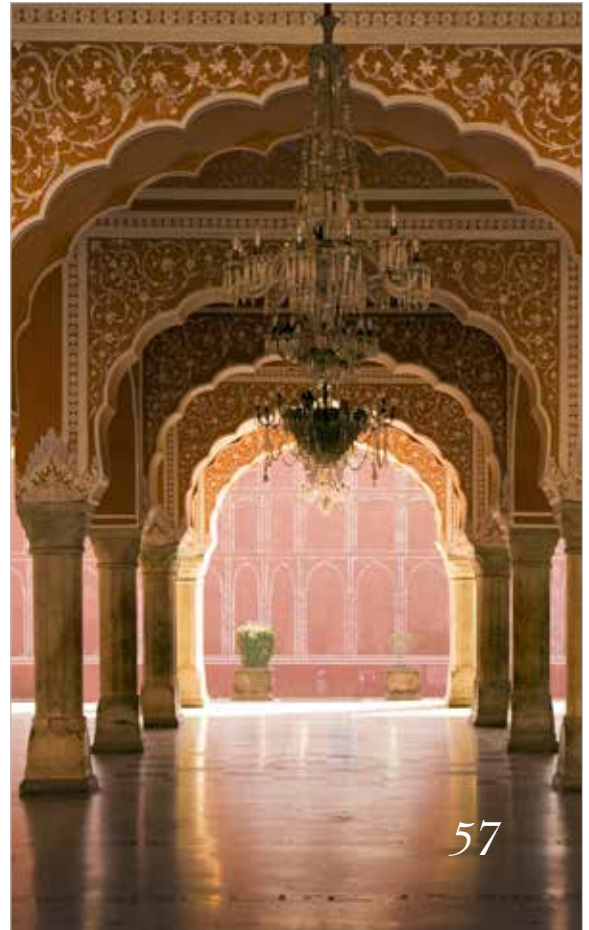
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BRICS and South-South Cooperation: Which Way Forward?

■ Susana Carrillo & Any Freitas

In the last decade, BRICS countries have made significant contributions to strengthening the “Southern dimension” of international flows on finance, trade and knowledge. China and Brazil in particular played an important role in the emergence of South-South finance flows. In 2009 and 2010 two Chinese banks lent more money than the World Bank, which has traditionally been seen as one of the most important global development finance institutions.

Brazil invested in the past few years US\$10 billion in IMF bonds, transforming its position from that of a debtor into one of a creditor. Projections show that by 2020 China will be the number one economy in the world in terms of GDP growth, while India will climb from fourth in 2010 to third place in 2020, Russia from sixth to fifth place, and Brazil from ninth to seventh place for the same period.

More and more, BRICS countries are seen not only as economic powers but as key providers of knowledge and innovation. They have risen as key players in development cooperation. BRICS countries contribute 75% of global annual population growth. In 2010, Brazil, India and China were among the top five countries with higher percentages of working-age population. There is an untapped demographic potential that could in the near future accelerate BRICS global influence.

The (re)emergence of the BRICS as “development partners” has become even more visible in places like Af-





rica, where they have significantly expanded their presence through foreign direct investment, trade and knowledge transfers. Brazil is now present in 22 countries through mining, construction, hydrocarbon production, energy generation and through knowledge transfer on tropical agriculture, tropical health, vocational training and skills development. China is present in 36 countries mainly through mining, oil extraction, construction, energy and agricultural development. India is present in 25 countries mainly through knowledge transfer in telemedicine, ICT, mechanical engineering, metallurgy, hydrocarbon production, agricultural development and energy generation. Russia is present in 25 countries mainly through hydrocarbon production, mining and construction. South Africa is present in 31 countries mainly through banking, finance, retail and telecommunications.

In the last decades, BRICS-Africa trade has grown exponentially, in parallel to the number of technical assistance partnerships established with countries in the continent. According to UNCTAD, BRICS countries are significant investors in Africa. The BRICS' share in the continent's FDI stock and flows reached 14% and 25%, respectively, in 2010.

Although African countries are not yet a major destination of BRICS FDI, this situation has been changing quickly in the last few years, and the group has recently joined the rank of "top investing countries" in the continent. BRICS shares in inflows to Africa reached 25% of total flows in 2010. More importantly, BRICS direct investment in Africa is mostly in the manufacturing and services, sectors which directly contributes to job creation. This aspect of the BRICS-Africa agenda could have significant positive impacts on this South-South relationship.

Despite this greater engagement, BRICS countries have been mostly acting alone, designing and implementing bilateral initiatives without any systematic and coherent coordination on development cooperation initiatives. BRICS countries could be better off showing a degree of coordination and coherence when transferring knowledge and partnering for development.

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BRICS' own experiences and growing interest in development cooperation could open the door for coherent and collaborative action-oriented approaches. As practitioners, they are well positioned to share their success stories in several areas, like agricultural development, health, social protection and poverty eradication, technology and innovation, community development, and oil and gas exploration, among others.

From this perspective, the African continent presents a unique opportunity for

them to act as a bloc and reinforce their role in development cooperation. BRICS achievements in addressing their own development challenges through innovative approaches on social protection, agricultural development, science and technology, for example, have become a focus of attention from other developing countries, including African peers.

As they are still developing countries, these "emergent partners" claim they are also better placed to understand the challenges faced by other developing nations. Tapping into their expertise, techniques and know-how used at the national level, they were able to transfer (policy) solutions – and often also funding – they believe are more adapted to the reality and (institutional) capacity of developing partners. By so doing, they have been disrupting the North-South relations that have traditionally marked the geography and politics of global international relations and development cooperation.

BRICS countries have indeed been quite vocal about the hierarchical ties that have also marked the traditional North-South "donor-recipient" relationship. They have not only rejected the "donor" label, but also eliminated the conditionalities (or "strings attached") from their cooperation initiatives, thus contributing to a shift from a "top down" and "prescriptive" to a more "horizontal" and "collaborative" approach to development cooperation.

Analysts agree that these "new partners" have been introducing some positive changes to the way development cooperation was structured, financed and implemented in the past. Again, BRICS' capacity to produce effective results in development cooperation, in particular in the African continent, could be considerably strengthened if its members were able to set up a common policy framework based

on shared goals and institutional arrangement.

BRICS engagement in development cooperation goes back to the very origins of the bloc as a political group. Indeed, development cooperation has been on the BRICS agenda since the 2009 meeting in Russia. In the group's first political joint declaration, in addition to pleas for achieving greater voice and participation in international institutions, social and economic development was recognized as a major common challenge that required common (global) responses. Since then, global development issues have been included in other summits and informal meetings, even if no concrete joint (policy) outcomes have clearly emerged.

In 2010 South Africa officially became a member of the bloc. This strategic addition carried important geopolitical implications, established an anchor in Africa and partially responded to the increasing demand from African countries for BRICS investments, knowledge and technology transfer.

However, efforts to boost joint cooperation and move it up to another level (i.e. beyond grand summits and joint declarations) have had meager results so far. There are different reasons for that, from domestic and political economic difficulties to a more basic lack of understanding of how to pursue a common policy and political action.

Recently, though, there have been signs indicating that this could change. In March 2013, the Fifth BRICS Summit, for the first time hosted by the bloc's African member, raised development cooperation as a key agenda for action. During the summit, held under the heading "Partnerships for Development, Integration and Industrialization," the "eThekweni Decla-

ration and Action Plan" was signed. The Declaration reinforced the commitment of the BRICS to the creation of a coordination and support mechanism for issues related to world economics and politics. The Declaration also confirmed (i) the creation of a "Contingent Reserve Arrangement (estimated at US\$100 billion) to help BRICS countries strengthen their financial stability; (ii) a commitment to decrease the infrastructure gap in Africa;

In fact, apart from the economic dynamism displayed at that time, finding overlapping features between Brazil, Russia, India and China has been a tricky task.

(iii) a commitment to promote capacity development and knowledge exchanges, stimulate FDI to the region and diversify African exports to BRICS countries; (iv) establishment of the BRICS Think Tanks Council, a network that will focus on policy issues, such as the evaluation of the upcoming BRICS bank short- and long-term strategies; (v) establishment of the BRICS Business Council, which will group business associations from BRICS to promote engagement with the private sector from each country.

During the summit, the creation of the BRICS bank was also confirmed. It is not

yet clear how this bank will operate, where it will be physically located and why this could be the most appropriate approach for institutionalizing the BRICS group as a global actor. There is still skepticism among analysts about the creation of such a bank as the most appropriate approach. Some propose more immediate solutions such as the establishment of a small intergovernmental committee from BRICS countries to address global issues on geopolitics, security, and development.

Others believe that the group has not been able to overcome its initial significance. Coined in 2001 by Goldman Sachs economist Jim O'Neill, the term BRIC was probably not intended to become more than a new investment label, assembling a group of fast-growing, newly industrialized economies. In fact, apart from the economic dynamism displayed at that time, finding overlapping features between Brazil, Russia, India and China has been a tricky task.

On the other hand, one could argue that development cooperation could represent one of the few policy areas on which most BRICS members can effectively converge. Less controversial and disruptive than other issues, development cooperation could be seen as a sort of "minimum (political) denominator," creating spaces for practical collaboration and joint policy action.

A more recent step in this direction was the proposed agreement during the recent BRICS Think Tanks Forum (held in May 2014 in Rio de Janeiro, Brazil) of five pillars for common action. These are cooperation for economic growth, peace and security, political and economic governance and sharing of knowledge and innovation. These five pillars will be presented to the heads of the BRICS countries during the upcoming BRICS Summit in July 2014. These pillars are well aligned with the de-

development cooperation agenda from each of the BRICS countries.

Should the BRICS have the (political) will and (economic) capacity to boost their cooperation to this new level, they could make an important contribution to global efforts for improving development cooperation. The emergence of the BRICS as a

new actor in this field, with its own principles, goals and institutions, could moreover reinforce the political relevance and internal cohesion of the group. Showing that they are able to act together on an issue of global concern matters not only in terms of the group's image, but also its political credibility, influence in global governance and knowledge flows.

What will be required in the future is moving toward a common framework and practical institutional arrangements to facilitate the role of the BRICS as an influential development cooperation actor at a global level.

About the Authors



Susana Carrillo is an international development executive, working on South-South cooperation and partnerships with emerging economies. She has worked extensively in Latin America and Africa. She is presently working as a Senior Specialist with the World Bank. She holds an Executive Degree on BRICS Economies from Fundação Dom Cabral (Brazil), the Moscow School of Management, SKOLKOVO (Russia), the Indian Institute of Management Ahmedabad, and the Cheung Kong Graduate School of Business (China); a Master's Degree in Socio Economic Development Studies from the Graduate Institute for International and Development Studies, Geneva; a Global Master's in International Development and Public Policy from the Fletcher School of Law and Diplomacy, Tufts University (USA).

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Vale's African Adventure Throws Spotlight on Corruption and Deal Risk

■ Ana Mano

More than a century may have passed since Joseph Conrad's *Heart of Darkness* vividly portrayed the perils of doing business in Africa, but risks still abound for those looking to strike it rich in the mineral-rich continent. Just ask the Brazilian mining giant Vale.

After agreeing to pay US\$2.5 billion in 2010 to the Israeli billionaire Beny Steinmetz for a 51% stake in a mining concession in the West African nation of Guinea, Vale appeared to have won the race to secure access to one of the world's largest deposits of iron ore.

There was one problem: the Guinean government wanted it back, and it has since alleged that Vale's partner – Steinmetz's

BSG Resources (BSGR) – had originally acquired the concession through bribery. These corruption claims have subsequently led to a US Department of Justice (DoJ) investigation and Guinean government review of all mining tenders.

The DoJ investigation has focused on whether bribes were paid “to officials of a former governmental regime of the Republic of Guinea to win valuable mining concessions in the mountainous Simandou region of Guinea.”

In March 2014, Frenchman Frederic Cillins, believed to be linked to BSGR, pleaded guilty in a US court to allegations that he “agreed to pay money to induce a witness to destroy, or provide to him for destruction, documents sought by the FBI.”

According to the DoJ, those documents related to the payment of bribes to obtain mining concessions in Guinea. All of these chickens finally came home to roost in recent months when a Guinea government



committee stripped VBG – Vale/BSGR joint venture – of the mining rights. And now the government in the capital Conakry is “ready” to re-tender the concession, according to an industry source.

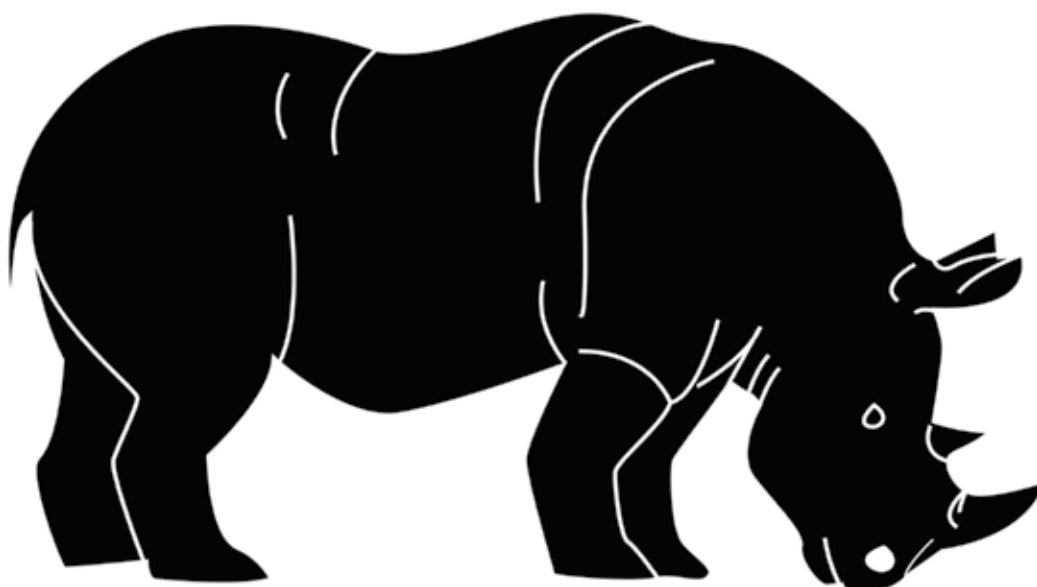
BSGR was banned from the new bidding process after the committee said it

paid bribes to win the original concession rights.

So what’s next for Vale? So far it is still in the game, as it has not been accused of any wrongdoing by either the US or Guinean authorities and can (as recommended by the Guinean government committee) rebid

for the concessions. However, Vale does face the possibility of “successor liability” charges under US anti-bribery laws – in particular the Foreign Corrupt Practices Act – for insufficient due diligence prior to its acquisition, according to a Washington-based attorney specializing in corruption affairs.

WARNING



Although BSGR plans to seek international arbitration as it contests the decision, the Guinean government is not inclined to wait. Arbitration proceedings between a company and a government can last from five to 10 years.

“The government knows the arbitration will be long and wants to re-tender the license as quickly as possible,” the industry source said. “It will be hard to attract investors to Simandou if legal uncertainties linger.”

If and when the rights are re-tendered, it will require a large company with access to financing due to the complexity of the project. Although estimates vary, a person familiar with the situation said it will likely cost around US\$20 billion to develop the concession.

The Guinean government had considered giving Vale first refusal to rebid for the concession – a move that has to be confirmed by the country’s National Assembly – as the company retains strong support in the country, the person familiar with the situation said.

But according to the industry source, giving Vale such “preemptive rights” could reduce competition for, and thus the value of, the country’s mining assets.

Vale has refused to comment publicly on the matter but has announced a potential loss of over US\$500 million in relation to the Simandou project.

However, it is understood that this figure may be a severe underestimation as Vale could have invested up to US\$1.7 billion in Guinea so far.

This higher figure takes into account a US\$500 million down payment made to BSGR when the joint venture was cre-

ated, as well as related operating and administrative expenses, the person familiar with the situation added. The figure also includes “significant” damage to Vale’s property in the town of Zogota by rioters in August 2012 during a period of civil unrest, this person added.

According to the Guinean government committee, the VBG joint venture claims to have invested US\$700 million in the project, including the US\$500 million “advance” to BSGR. Meanwhile, press reports in Switzerland say Vale is suing BSGR for US\$1.1 billion in damages, but neither company would confirm that information.

Vale’s CEO Murilo Ferreira told reporters in Brazil any decision to reinvest in Guinea will have to be approved by the company’s board of directors, but did not discuss the matter in detail. But the company’s losses could rise even further as Rio Tinto – which previously owned the rights to the VBG concession – is suing both Vale and BSGR in a US court.

Rio Tinto’s original agreement was canceled in 2008 but the company subsequently acquired the rights to develop different blocks of the Simandou region.

In a court filing, Rio Tinto accuses the defendants of conspiring with Guinean government officials to defraud it of its original concession.

“This is a case about the theft of Rio Tinto’s valuable mining rights by the defendants through a scheme in violation of the Racketeer Influence and Corrupt Organizations Act,” Rio Tinto alleges in the filing.

However, BSGR has denied the allegations. “Rio Tinto chose to do nothing with

its mining rights so the mining rights were taken away,” a spokesperson for BSGR said.



About the Author

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How Technology Is Changing the Face of Due Diligence



At a time when virtually any type of information is just a click away, due diligence companies are facing unexpected challenges.

Attorney Mark Johnson used to work as an NCIS Special Agent, and he recently decided to use his investigative expertise to help companies make sound business decisions. He defines his company, Sovereign Intelligence, as a global risk consultancy providing strategic counsel to equity, legal and accounting firms, and explains that its competitive advantage comes from the fact that it combines online and personal information.

“The service that I am offering is a dual service: cyber intelligence and human-derived information. As an intelligence officer, I combined the two services in order to answer pivotal questions about national security. Now, when I receive a problem set or request for information, I conduct deep dive internet searches within the deep web and peer-2-peer worlds and corroborate the results with human-derived information. Many corporate intelligence firms may be great at one collection platform or the other, but very few combine them both. I do, and I bring the added benefit of addressing the legal analysis as needed.”

Mr. Johnson adds that there are two important elements of the internet: the worldwide web, which includes the surface web and the deep web, and peer-to-peer network. He notes that the surface web represents 5% of the world-wide web and is categorized and indexed by Google. The deep web is 95% of the world-wide web and contains a lot of information that can be accessed with the help of an anonymizer. Peer-to-peer networks represent approximately 70% of the volume of the internet. “Most of the larger cyber intelligence groups are only looking at the 30% that is the world-wide web – they are not looking in the peer-to-peer world. Where we can distinguish ourselves from other cyber intelligence groups is that we use our capa-

bilities to do research on a vast part of the internet that is relatively untapped.”

The importance of the peer-to-peer world is often underestimated: even though it is the place where movies and music are exchanged, many groups use it for nefarious purposes. Unfortunately, most people and corporations tend to overlook it when it comes to their cyber security. “When you think of what the deep web and peer-to-peer web means, it really only hits home when people start losing money. For ex-

“...the surface web represents 5% of the worldwide web and is categorized and indexed by Google. The deep web is 95% of the worldwide web and contains a lot of information that can be accessed with the help of an anonymizer.”

ample, somebody fraudulently bought a motorcycle with my credit card one day and three days later a jet ski. My credit card company called me and notified me of what had already happened. I had the assurance that they recovered the value of it through their insurance carrier. But what about the insurance company? Until they wake up to the cost of identity theft and

realize that that starts with cyber exploitation from the deep web, they will always be left holding the bag,” he notes.

Sovereign Intelligence gets approached by different types of clients, who tend to approach M&A due diligence from different angles. High net worth individuals, equity groups and hedge funds look at due diligence in terms of whether the financials are sound. If the financials are good, they move forward. Meanwhile, large accounting firms look for information to support a decision that their clients may have already underway.

“If those are the premises for conducting due diligence on, then there maybe a tendency to overlook some red flags because the ROI is sufficient. Many firms don’t take the additional steps to mitigate the risks since they don’t fit the proscribed client driven answer. I’m trying to get ahead of this game by partnering with firms who need answers on target acquisitions and intend to mitigate their risk before they close the final deal. By coming along side an equity partner or hedge fund manager, I can help them approach their next project from the perspective of an attorney, intelligence officer, and federal agent. And because I use specialized databases for research, I’m able to provide decision-making intelligence.” says Mr. Johnson.

“Let’s say it’s a political risk type of issue and the company I have been looking at has questionable connections with a government official. Before the client goes any further they want to make sure that there are no foreign corruption issues. In supporting international law firms concerned with addressing the UK Anti-Bribery statutes as well as Foreign Corrupt Practice Act matters, we provide discrete cyber and human intelligence service as well as a cyber monitoring of persons and their relationships.”



This is particularly helpful for emerging market investors. According to Mr. Johnson, “As the saying goes, you don’t know what you don’t know. Sovereign Intelligence is strategically designed to remove the ‘what you don’t know’ side of the equation. We are able to say at the end of our deep dive research that we have literally scoured the entire internet for our results. This allows our clients to satisfy their due diligence requirements and get a good night’s sleep.”

■ Social media: A double-edged sword

With the rise of Facebook, Twitter and other social media platforms, one would think due diligence companies have it easy, but this abundance of information has generated a massive selection issue, as Mr. Johnson points out.

“Within the last couple of years cyber intelligence companies have been developing sophisticated algorithms claiming to predict your consumer behavior by monitoring ‘big data’ sources including social media. Many use Google monitoring capabilities and other traffic and email advertising techniques thinking that if they get all this information something magically is going to pop out at the other end that a decision-maker can use. That’s not going to happen. What we are missing if we follow the expensive social media bells and whistles company is the original question: What is the actual question I need answered and what is the best method for getting the answer? If the corporate intelligence world and the supporting cast of the equity community poised themselves to address the real questions, equity folks would have what they need more efficiently and economically.” Although sometimes too much information is bad, many firms refuse to even address the use of engaging social media tools and other

deep web, and P2P for their own benefit. According to Mr. Johnson, “It’s better to partner with a professional intelligence firm from the start and do the right thinking and internet searching early and often. At least become educated on the best tools available.”

Another problem is authentication: it’s always hard to know with certainty who you are doing business with on the other line. Solely relying on the popular venues of

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Facebook and even LinkedIn won’t guarantee the soundness of the engagement. Aside from internet verification questions, many firms skip past even the simplest of due diligence measures, such as traveling to the manufacturing plant to determine its existence. Simply relying on what you find on a quick scan of the world wide web to determine someone’s social media profile for verification purposes is insufficient.

With his background and expertise, Mr. Johnson is familiar with just how much information about a person is accessible online, and therefore recommends investing in strong cyber security and intelligence—something that is not always affordable for companies in emerging markets.

“While information flows in globally every day from computer to computer, the most vulnerable networks will be exploited. This simple fact places those doing business in emerging markets at a disadvantage. Cyber security is expensive and establishing variable secure communications is difficult. However, there are simple steps the emerging market community can take to address these problems,” he says. Sovereign Intelligence offers an 80% solution for leveling the playing field for global investors with their risk assessments, penetration testing, and monitoring system.

One way is to map out one’s extended enterprise and research whether each layer of the supply chain of information has basic cyber security measures in place. Achieving good cyber security beyond the citadel of your own firm may not be possible, but Sovereign Intelligence can help. Another measure is to determine what you are taking back and forth from home and work. “BYOD or Bring Your Own Device is a recipe for failure. Since most folks bring their own device into work, the separate home/work paradigms collide, raising exponentially the risk of proprietary intellectual property leaking beyond established Virtual Private Networks or VPNs,” Mr. Johnson warns.

“Hopefully,” according to Mr. Johnson, “with what may be coined the ‘Snowden Effect,’ people are starting to take responsibility for their information and safeguard the layers of their online footprint. Per-

sonal privacy is becoming critical, not simply due to the skepticism toward the alleged overreaching of the NSA, but because identity theft is widespread and surging in every country. There is no silver bullet but with the help of innovative technology companies, the trend is toward personal and corporate responsibility.”

Sovereign Intelligence aims to do its part by providing a comprehensive cyber risk assessment and monitoring service. Mr. Johnson notes that “everyone is reacting to these systemic problems instead of getting out in front of them. We have some ideas on how to change the game a bit. This involves primarily harnessing the right tools in order to answer the right questions. Since we are global and yet small, we can cover a lot of ground efficiently.”

The rise of social media and cyber intelligence technologies has leveled the playing field between developed and developing markets, as practically everyone has access to the same information online. This has also led to alternative and innovative ways to start, fund and operate businesses.

But reaching a balance between over-sharing personal information and protecting professional data while monitoring other companies’ footprint for M&A purposes will remain challenging for some time.

“Now you can go on the internet, get really good information, piece it together, get crowd-funding, talk to other people across the world, share ideas and all of a sudden you have this massive global economy where anybody can enter at any time from any place. Folks in the middle of Malaysia and folks in Washington, DC, can be on an equal footing to do business with each other. The other side of that, though, is the exploitation that causes and the vulnerabilities and risks associated. On one side people want a lot of information about what is going on to make better decisions, but on the other side we really want to keep our information private, so you have this push and pull situation. The result is that the emerging markets are ripe for those willing to be smart by addressing risk in a timely and comprehensive manner. We can help firms do just that today,” adds Mr. Johnson.



About the Author

Mark Johnson, CEO of Sovereign Intelligence LLC, former Special Agent for the Naval Criminal Investigative Service since 2003, represents domestic and international law firms, accounting and equity groups, providing strategic counsel on foreign investment, complex FCPA investigations, M&A due diligence, emerging technology acquisitions, and competitive intelligence.

Prior to joining NCIS, Mr. Johnson practiced law for six years as a criminal defense attorney, handling federal and state crimes for an AV rated firm, and managed his own firm advising small business owners in real estate transactions, corporate law, bankruptcy and estate planning.



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performances in a
volatile market.

Alternative Emerging Investor catches up with Peter Douglas CAIA, Principal, GFIA Singapore and a judge on the panel, on the current state of the Asian hedge fund industry.

“Flows into Asian hedge funds have actually been healthy recently, but not all of it is for Asian markets. Furthermore we are seeing a fairly volatile range of fund performances alongside those increasing inflows. I have been working in Asia off and on since the late 80s; often I’ve seen that when you have the combination of global money coming into Asian securities markets, and increasing volatility, my bones tell me we are closer to the top than the bottom,” he says.

But this healthy performance is not even across all fund categories, and some smaller boutique funds are still struggling. “It is a tale of two cities, really. If you look at the larger funds in Asia, the more asset-gathering focused managers are generally doing well in terms of attracting assets, maybe at lower margins than they would have got five or six years ago, but there is capital coming into Asia and it is generally going to the big guys (those with a billion it if not more under management). That is not really our world as we focus on the skill-driven managers, but it’s nevertheless a very real business. At the boutique end it is much harder. There are some inflows but they are going into a small number of managers, slowly and almost invariably in segregated accounts, at fine margins, and the majority of managers are running very hard to stand still,” Mr. Douglas adds.

■ Awards

GFIA has monitored the “sweet spot” of size for good performance in Asian equity hedge funds for more than ten years. “It moves around a bit depending on market liquidity but usually the center point is

about four hundred million. However, this is hard for many global institutions, as this asset level is only where they are prepared to start to do the work in anticipation of allocating, when the manager gets closer to a billion – at which point performance may be muted” Mr. Douglas says.

He feels that global institutions should be looking for higher returns to compensate for emerging market risk; seeking low volatility, institutional infrastructure, and the ability to take reasonably large tickets is unlikely to result in a satisfactory experience over time.

In order to select and judge funds for the awards, EurekaHedge produces a spreadsheet with fund performances, which looks at the money made by funds over the previous twelve months, and gives judges numbers on longer-term performance in terms of Sharpe ratio and drawdowns, assets size, location, and a range of other measurable parameters. Each of the judges is free to look at the data in whatever way they feel is most relevant, and to overlay their qualitative experience if they know the manager of that fund.

“There are six judges and each of us approach the process differently according to our professional experience, which I think is very healthy, so you have got a lot of different kind of cuts on the funds. Often one judge may favor a manager that another judge wouldn’t touch, and vice versa!



My personal prejudice, developed from looking at Asian hedge funds since 1998, is that I really try to disassociate myself from recent performance and focus on the potential of the manager and the strategy, which is incredibly hard. You really have to work hard on digging yourself out of that hole and sometimes I still fail and am swayed by current performance,” he recalls.

In order to express fair judgment, Mr. Douglas looked at the longer-term performance – four or five years – at a fairly granular level, month after month, to determine trends, patterns and performance in different markets. “You absolutely cannot look at performance as one number; it’s almost the most complicated question and certainly not the simplest,” he adds.

As the competition also includes a few funds that started in the past year, judging sometimes had to be more qualitative – which Mr. Douglas believes to be more important anyway.

“The qualitative side is actually what matters,” he says. “If you can measure something, it has happened already, and that is great if you are a historian, but if you are investing, you have the impossible task of trying to look forward, and while history may be entertaining and sometimes thought provoking, it doesn’t do the job. What will give you some measure of forward-looking insight are pointers such as the relevant experience of the people in the organization, how the organization is structured, what the organization is trying

to achieve, what is going on in the portfolio, and in particular the DNA of the manager of the fund – how do they typically react when the world gets difficult. Everybody can construct a portfolio that works when it pans out according to their world view; but what a manager does when their world view doesn’t work is a key component of a good longer term performance. You are looking not for risk management in terms of clever software but real risk management in terms of what is the manager going to do when stuff doesn’t work out. Understanding a manager’s risk management is a supremely qualitative process.”

However, that type of judging is difficult to achieve in a process as fast as the one

in place for the Eurekahedge awards, and without the ability to go into the type of detail mentioned above Mr. Douglas decided to look back over the past 12- to 18-month performance of the funds, and to talk to managers to determine the quality of their funds and their ability to cope with unexpected crises. This qualitative evaluation combined with hard numbers constituted a good base for him to express judgment.

Fourteen awards were given at the ceremony on May 23 in Singapore, providing the winning funds not only with recognition, but also with a reputation to build on for future business. “Most may pretend not to be too excited, but actually they are really chuffed if they get one,” concludes Mr. Douglas.

About the Author

GFIA was founded in 1998 by Singaporebased Peter Douglas CAIA, a pioneer of the Asian hedge fund industry. He is a Distinguished Singapore Financial Industry Certified Professional. He was an Alternative Investment Management Association (AIMA) Council member for 10 years, was the inaugural Chairman of the Singapore National Group and the inaugural AsiaPacific regional representative of the Association, responsible for AIMA National Groups in Australia, Hong Kong, Japan, and Singapore. GFIA has researched and allocated to specialist managers based in Bangkok, Beijing, Buenos Aires, Cape Town, Dubai, Johannesburg, Moscow, Rio de Janeiro, Santiago, Sao Paulo, Shanghai, and Tel Aviv, as well as emerging market managers based in developed jurisdictions.

How Do You Solve a Problem Like Nigeria?

■ James Knight

While the politicians declare war on insurgents in the troubled African country, what can the private sector offer Nigeria?

In April Nigeria “rebalanced” its economy. By changing the base year for calculating the country’s GDP, it jumped, literally overnight, from 42.4 trillion naira to 80.2 trillion naira (US\$510 billion), making it the largest economy in Africa by some distance. From May 4 to May 6 the country hosted the World Economic Forum’s Africa

Summit in Abuja, which brought together world leaders to discuss how the continent can continue its impressive progress in poverty eradication, economic development and institutional strengthening of the past ten years.

However, you could be forgiven for having missed both these events entirely, as

terrorism and security issues took over the headlines. The kidnapping of schoolgirls from Chibok, in the troubled northern state of Borno, by the extremist group Boko Haram, and subsequent bombings, have caused indignation around the world, and thrown Nigeria into the spotlight for all the wrong reasons. They are the latest indignities in an insurgency that



has claimed almost 1,500 lives in the last three months.

The situation would be challenging for any government, let alone the cash-strapped, crisis-pummeled administration in Abuja. The military are stretched, underpaid and undergunned; porous borders with Cameroon and Niger enable guerrillas to come and go at will; conflicts elsewhere in the region have led to an influx of fighters and guns from Mali and southern Libya. But the root causes of the problem go far beyond radical Islamic ideology.

■ **Economic incentives, good governance required**

Irrespective of how the immediate crisis plays out, a long-term solution needs to address two chronic root causes of the

conflict: a lack of economic development and decades of poor governance. These have created a fertile terroir of instability, in which any seeds of discontent can blossom.

Out of the security spotlight, the private sector has a vital role to play in job and wealth creation in the north that will leech grassroots support from the organization. And parts of the Nigerian government know that, even if the current rhetoric is more belligerent. Africa's richest man, Aliko Dangote, a northerner himself, promised at the WEF meeting US\$2.3 billion of investments in rice and sugar in the northeast, generating an estimated 180,000 new jobs. Local private equity firm Sahel Capital Partners is spearheading agricultural initiatives where others fear to tread, boosted by a disbursement from Nigeria's sovereign wealth fund. South African su-

permarket chain Shoprite continues to expand its services to northern cities like Kano; frontier investment specialists are out on the ground looking at extractives opportunities beneath dusty the soil of the Sahel.

The other piece of the puzzle is better governance. An International Crisis Group report released in April looking at the insecurity in the north stated that "unless issues of bad governance and systemic corruption are addressed vigorously and transparently, all other measures will be nothing but stop-gaps." Easy to write, hard to do. Nigeria's "deep state" reaches far and wide into all kinds of complex power and patronage relationships. Talk of wiping out corruption often fails to recognize the scale of the problem and how hard-wired it has become at every level of society, not simply the government. The challenge will



be to create a system of legitimate incentives to enable parties to transact, economically and politically, without resorting to the crude tools of bribery.

■ Divided country

The strange reality about this diverse, frequently divided yet enormously dynamic country is that in the mainly Christian south, especially around the economic and commercial hub of Lagos, you could be forgiven for thinking that the travails of the north are taking place in another country. And in a way, they are. There is a different side of the Nigerian story, in which the NSE All-Share Index rose 47% last year on the back of strong corporate earnings and a reformed governance structure. This is a country with an internal market of almost 200 million consumers, nearly half of those under the age of 35. Lucrative reform of the power sector provides the first opportunity in a generation to slash energy costs for small and medium-sized enterprises (including in the north).

Optimists see a country with enough raw materials and service opportunities to wean itself off oil and gas dependence in favor of a more mixed economy, harnessing a people who are innately mercantile. No country with the demographic makeup



About the Author

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

and economic fundamentals of Nigeria has not managed to bring a large part of its population out of poverty. But in order to even get close to realizing its potential, the immediate threat of Boko Haram needs to

be thwarted, the reason it exists has to be understood properly, and the private sector needs to step up and offer its own part of a long-term solution.

Asia Catastrophes: the Aftermath

The disappearance of Malaysia Airlines flight MH370 and the fatal capsizing of a passenger ferry in South Korea have had a ripple effect on trade relationships and investor confidence.



Three months after flight MH370 from Kuala Lumpur to Beijing disappeared from radar in the early hours of March 8, investigators are still without tangible clues as to where the plane could be. Search efforts – reportedly the largest in history – have been focused on an area northwest of Perth, Australia, in the southern Indian Ocean, where four acoustic signals were detected in April, although experts were not able to confirm whether they came from the missing plane.

Of the 239 passengers on board, over half (152) were Chinese, but when the Chinese government pushed to take control of the recovery operations it was met by a firm Malaysian hand determined to prove its efficiency in crises of this sort. An investigation team including members from Australia, China, the US, the UK, and France was formed on April 6, and Australia has been coordinating the search in the Indian Ocean, but there are concerns that Malaysia's handling of the catastrophe could have geopolitical consequences.

According to Arvind Ramakrishnan, head of Asia at Maplecroft, "What investors are interested in particularly is the geopolitics of the region, in particular how this affects the very important relationship between Malaysia and China, for example in the South China Sea dispute."

Malaysia is one of the claimants of the oil-rich Spratly Islands, currently shared between China (eight islands), Vietnam (29), the Philippines (eight), Malaysia (five), Brunei (two) and Taiwan (one).

China has been very critical of the Malaysian government in its handling of the MH370 tragedy, increasing tensions in the region and raising concerns of potential trade consequences. "Could this mean a breakdown in relations between China and

Malaysia? The answer is no, but that is the kind of concern that comes to the minds of investors. Lasting damage to the relationship is really unlikely because for all the frustration with the Malaysians that China has expressed in this case, it is really not clear what they could or would have done differently," adds Mr. Ramakrishnan.

Since the disappearance Malaysia Airlines has experienced various other safety incidents, including a burst tire and the emergency return to Kuala Lumpur of a flight to Bangalore. As a result, the company has posted its worst loss in over two years (US\$138 million) in the first quarter of 2014, and rumors have emerged that it could shut down. Consequently, a number of Chinese online travel agents have stopped offering Malaysia Airlines flights, which could have a massive impact on the country's tourism industry.

"There are concerns about security, less about the fact that the flight could not be found, but more about the fact that they allowed people with improper documentation to get on board the flight, for instance, and that the initial radar tracking system failed to detect the unauthorized change in course of the aircraft. These concerns will not really translate into a major travel boycott of Malaysia or damage investor confidence in the country," Mr. Ramakrishnan comments.

Malaysia's refusal to let China take control of the search, and its subsequent failure in recovering the plane before the black boxes stopped emitting pings, has increased the widespread perception in China that Malaysia's political and administrative culture is inferior to its own.

Mr. Ramakrishnan explains, "Malaysia has faced a lot of criticism, quite legitimately about the fact that its handling of the crisis was poor. The main reason for that is that

Malaysia has simply not had a crisis remotely approaching the scale of this flight disappearance for many years. They have had domestic protests over corruption, and on a regional scale there is the South China Sea dispute. Further, in 2013, they had this small-scale invasion of militants from the southern Philippines who came to Borneo and briefly held on to territory. However, this last event was highly localized and did not have a great deal of significance. As a result, Malaysia's preparedness in handling a crisis like MH370's disappearance was lacking."

However, markets have not been highly affected by the crisis, and Malaysian prices, stocks and commodities remained stable. In fact, it seems analysts are more worried about last year's election result, where the ruling coalition held on to power with less than 50% of the votes for the first time, than about the country's security standards. Even at the political level, the MH370 incident is unlikely to have a lasting impact.

"The opposition has tried to capitalize on this to some extent because they were able to point out that the government was really incompetent. First they said that the aircraft had probably crashed into the Andaman Sea, then they said it had crashed in the Gulf of Thailand, and so on and so forth. So they have been able to make some political capital out of it but there is no sign that this has really swung opinion," he concludes.

■ Korea ferry

In South Korea, the ferry accident that left over 300 passengers dead or missing on April 16 has raised concerns about the country's safety norms, particularly in the shipping industry.

Although Prime Minister Jung Hong-won's resignation is unlikely to have a



strong effect on markets in a country that operates on an executive presidency model (meaning political decisions are made primarily by the president), the incident has prompted some questioning of Korea's economy/safety contrast.

"Adherence to safety norms and labor rights is quite poor, so there has been a lot of soul searching internally because the country has an incredibly competitive education system and an incredibly hard work ethic. The Koreans work really long hours, so a lot of questions are being asked about whether in pursuit of economic growth, the country has really lost its moral roots

and its responsibility to safeguard citizens," says Mr. Ramakrishnan.

Furthermore, Korea's huge shipbuilding industry is now being criticized for its inspection system. "One of the things that has caused a lot of public anger is what is perceived as a very cozy relationship between the regulators and the Korea Shipping Association, which is a body of shipbuilders and shipping industry people. The ferry that sank was given a clean bill of health just a few months ago, and inspections have not really happened according to standards. So there we could see tightening of standards and more scrutiny of that industry. I would

keep a watch on this industry as something which could see some fallout as a result of this disaster," he adds.

Although this particular ship was not built in South Korea, meaning the incident is unlikely to lead to a massive overhaul of the industry, Koreans take a lot of pride in their shipping sector, which has a powerful lobby and influence at the national level with the regulators.

"This pretty much allows them to get away with a lot of safety breaches, and I think that is the area where we are likely to see scrutiny," says Mr. Ramakrishnan.



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Thailand

When Will the Chaos Stop?

Having been without a proper government since December 2013, Thailand has become an uncertain place to do business, prompting investors to adopt a wait-and-see attitude.

Anti-corruption protests are not a new thing in Thailand, but they culminated last February, when public demonstrations disrupted national elections, causing them to be ruled invalid under the Constitution. Protesters were demanding that the government be dissolved and that all vestiges of former Prime Minister Thaksin Shinawatra's political power be eliminated. Mr. Shinawatra, a telecommunications tycoon, ruled the country from 2001 to 2006, when he was overthrown by the army based on allegations of corruption, abuse of power and disrespect for the monarchy. But his influence on Thai politics did not stop there, and although he left the country in self-imposed exile, the majority of the prime ministers who have succeeded him have been from his



party – or his family. The latest, his sister Yingluck Shinawatra, was ousted by the Thai Constitutional Court in early May for nepotism, leaving the country once again without a leader.

Chris Larkin, managing director of Thai-based corporate advisory firm CLC Asia, warns that the reasons behind the overthrow were complex. “The actual decision was a technical one based on the Prime Minister transferring one of the members of the government [national security Chief Thawil Pliensri, to make way for Thaksin’s

former brother-in-law Pol Gen Priewpan Damapong]. It was based on events that happened long before protests started, and the protests themselves did not have much directly to do with eventually getting rid of the Prime Minister, but they certainly provided an interesting backdrop for the court to rule against.”

Although it is clear that the opposition wants to deprive Mr. Shinawatra and his followers of their power in Thai politics, and they are regularly asked to step down from office, none of them has yet

been banned from running again in future elections – but this might change with Yingluck. The National Anti-Corruption Commission (NACC) has said it holds enough evidence to ban her from politics for five years if three-fifth of the Senate votes in favor of that decision.

“Previously they were just disqualified and had to step down but they haven’t been banned from running again in the next election, so this could be an interesting twist. Whether that’s enough for pro-government protestors who are now mobilizing, we are not sure; everyone is kind of waiting to see at the moment,” says Mr. Larkin.



“Prior to the coup, what you had was government paralysis, which is created delays and some uncertainty, but there were mechanisms for things to continue working anyway while the government was in caretaker mode. Without these the country would have ground to halt. With the coup, many are waiting to see what happens.”

Following the ouster of Yingluck Shinawatra, the military declared martial law on May 20, summoned political rivals to meet face to face with no effective results on the following day, and ended up seizing power in a coup, suspending the Constitution and declaring a curfew on May 22 in an effort to restore order. At the time of

writing, Yingluck Shinawatra was being detained by the army in a move to consolidate its grip on the country.

■ Economic consequences

Thailand's economy as a whole has suffered greatly from the months of protests, registering a 2.1% drop in Q1 2014, with year-on-year decreases in public sector investment (19.3%) and private investment (7.3%) and a fall in exports and domestic activity.

The Thai baht fell to its lowest level since March 27 one day after the overthrow, reaching 32.547 per dollar, and Standard and Poor's called the development "credit-negative," as it could prolong uncertainty in the political and economic climate, although it did not directly affect the country's sovereign rating.

Another consequence of the political turmoil has been the stalling of approval for foreign investments due to the inability to appoint a board of investment (BOI) while the government was in caretaker mode – since December 2011. The BOI expired in October 2013 and the new board was only appointed in April 2014. According to Reuters, a backlog of around 200 foreign investment projects worth around US\$12.3 billion was still waiting to be approved at the end of May. At the time a government official said he expected the projects to be cleared by August, but that was before the military coup.

"I think in some respect there has been a government paralysis," Mr. Larkin explains, "as when they dissolved parliament and called the election, that stopped the

government from being able to make appointments because it was in a caretaker mode. Because of that the Board of Investment (BOI) doesn't actually have a board because they couldn't be appointed. So decisions couldn't be made, and even though that has since been resolved, we have had six months of no leadership there."

However, he points out that a bigger issue is the lack of new government investment in infrastructure due to its inability to come up with a budget strategy. "Prior to the coup, without an effective government, what was likely to happen, as I understand, is that the Ministry of Finance would have just used last year's budget framework to disburse money, so the government would have still functioned. Now we have had the coup, the interim military government will be able to set some financial priorities, but I doubt whether they will be major investment priorities, given the shortened lead up to the release of the budget, which traditionally begins on the first of October."

Mr. Larkin adds that the now-ousted government "talked a lot about rail investment and high speed trains and freeways, but there were capacity issues in terms of getting the budget to disburse it as well as suspicions about potential corruption surrounding these projects and the ability of government agencies to actually implement them, so it wasn't anywhere near concrete yet. Toward the end of last year the government passed a new public-private partnership (PPP) law, but that is still in gestation, and the actual mechanisms for it are still being drafted. So the lack of political leadership will delay PPPs further."

■ Military coup

Despite the chaos, there were signs of improved investor confidence after the military coup of May 22, which was seen by some as a positive step toward stability. The day after the coup the country's stock market fell less than 1% – a rather tame reaction to such an important political upheaval. Bank analysts started talking about the endgame of the political crisis, and Reuters reported normal activity for domestic investment firms, saying it was "business as usual."

But while domestic investors are seeing a price drop opportunity in the crisis, foreign money remains scarce. According to BNP Paribas, nearly US\$3 billion of foreign money has left the stock market since November. There is hope that restored order will reassure investors, as Thailand's overall growing economy presents undeniable potential, but fears that violence could resume despite the curfew mean the market might remain cautious for some time to come.

"Prior to the coup, what you had was government paralysis, which created delays and some uncertainty, but there were mechanisms for things to continue working anyway while the government was in caretaker mode. Without these the country would have ground to halt. With the coup, many are waiting to see what happens. The coup government is certainly concentrating its energies on rooting out those linked to Thaksin throughout the civil service. But beyond that there is a sort of pessimistic outlook in terms of overall Thai growth anyway," Mr. Larkin says.

Current Developments in the Relationship Between the US and Argentina

■ Javier Canosa

The long history of relations between the US and Argentina have oscillated between “carnal” relations – as it was so colorfully put by former Argentine Foreign Minister Guido Di Tella – to the distant relationship that currently prevails between these countries.

To make a long story short, the modern history of these relationships has gone from one side to the other. In the 90s, the Argentine and US government enhanced their relationship under the presidencies of Bill Clinton and Carlos Menem. During this period, the Uruguay 1995 round of GATT was successfully developed and US investment expanded dramatically in Argentina.

In the early 2000s, the relationship continued to develop until the failed Fourth Summit of the Americas in the Argentine city of Mar del Plata in 2005, where an agreement for a Free Trade Agreement of the Americas could not be reached, and a “counter summit” was also developed by Venezuelan President Hugo Chávez.

Now, these “cold” relationships seem to have turned to “lukewarm,” basically because of US support for Argentina in a court case related to the Argentine debt defaulted in 2002. Recall that the US has supported Argentina in the *pari passu* case in the lower courts and has done the same – and quite vehemently – in a recent hearing before the US Supreme Court on another ancillary case.

But has the US government done this out of sympathy for Argentina and its politics, or for its own political need to resolve the Argentine case in a manner that is also amicable to US interests?

■ Summary

First, let us quickly summarize the cases pending in the US relating to Argentina’s 2002 default.

In the wake of the repudiation of Argentine debt, 92% of the defaulted US\$82 billion of private debt has been swapped for a mix of new bonds with a substantial haircut in net present value. These swaps took place in 2005 and 2009 and bondholders agreed to receive 25 and 29 cents on the dollar.

Political Risk

Some bondholders, known as the “hold-outs,” have not participated in the swaps and continue to fight Argentina in the courts to settle the outstanding debt for the actual amount they are owed plus interest.

Since the early years of the default, these unpaid bondholders have created a special task force – called American Task Force Argentina (<http://www.atfa.org/>) – that pursues a “fair reconciliation of the Argentine Debt Default.”

The main case is led by hedge funds NML Capital Ltd., a fund of Paul Singer’s Elliott Management Corp, and Aurelius Capital Management. This case concerns Argentina’s challenge to a court judgment ordering it to pay US\$1.33 billion to the hold-outs or face a potential default if it refuses to do so. The US Supreme Court could decide in June whether to take it or not; in any event, this case would not be decided until the Supreme Court’s next term beginning in October and ending in June 2015.

This case was already supported by the US government. The crux of the matter here is the *pari passu* clause normally included in contracts that govern the issuance of debt, and require equal treatment of investors. This case could have implications for other issuers of debt.

The “smaller” case, in which the hearing with the US support took place, concerns whether the investors can force banks in New York with which Argentina does



business to disclose information about Argentina's non-US assets as these funds seek repayment. The argument of the holdouts is that when Argentina services its debt on the restructured bonds, it must also pay a proportion of that money to the holdout bond investors. In August 2013 the appeals court in New York endorsed that argument. The ruling was suspended pending Supreme Court review.

The US government has vehemently supported Argentina in the Supreme Court hearing arguing that the lower court rulings undermined sovereign immunity.

Although the two cases present different legal questions, both deal with the scope of sovereign immunity, a legal principle that sets limitations on when a state can be sued. The bond investors have embraced a litigation strategy that aims to circumvent those limits.

The bondholders have said they are willing to negotiate, while Argentina responded to the ruling by proposing a voluntary swap of foreign debt in exchange for bonds issued under Argentina law.

■ Some preliminary conclusions

Does this mean that we are facing a new era in the American-Argentine relationship? We think not. The US has a special interest in resolving this matter amicably, not because of Argentina but because of what the precedent may mean in general to the investor community.

On top of the various macroeconomic distortions in Argentina – high inflation,



About the Author

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

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exchange controls, restrictions on imports, taxes on exports, curbs on remittance of profits abroad – there are other issues clearly affecting the US and US investment in Argentina that render the

support given by the US government to Argentina as a measure aimed exclusively at protecting the US as a financial center for the international issuance of public debt.

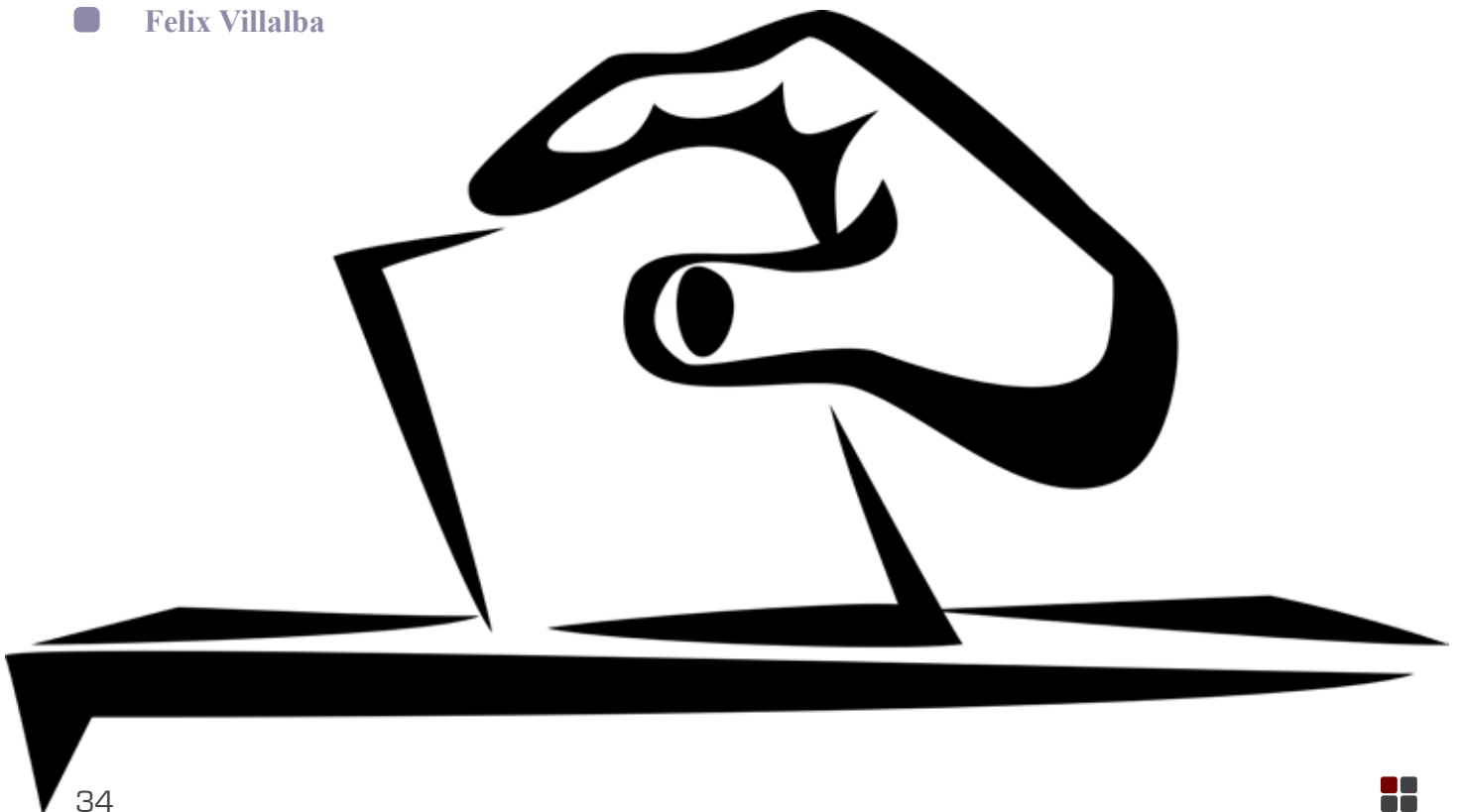
What to Expect:

Colombia's Upcoming Presidential Election

■ Felix Villalba

What should investors expect from the results of the presidential election in Colombia? What will it mean if current President Santos is re-elected? Or if one of the other two candidates becomes the new president?

Possibly the simple answer in the short term is that not much will change that rattles the cage of foreign investors in Colombia. This is the good news. The bad news is that there is a left-leaning group, and to the surprise of many of us that group is the current president's camp. How much to the left, that is anyone's guess. Here's why: with Santos what we know for sure is that we don't know what is in his mind. Here is a list of the candidates along with a label for them that you will come to understand:



- President Juan Manuel Santos – Expect the unexpected. Or, unreliable.
- Enrique Peñalosa – The Manager.
- Zuluaga – Security and rule of law to guarantee investment. Or, continuation of ex-President Uribe’s “Seguridad Democrática.”

Ex-President Uribe is without a doubt the president who changed Colombia for the better after the country was in such a difficult state of affairs that some even went as far as calling it a failed state. That label was unfair, however understandable from the perspective of developed countries. Today, thanks to President Uribe, Colombia is a country that boasts investment grade ratings from Moody’s, Fitch and the like. Uribe’s first four-year term was such a dramatic improvement that Colombians changed the Constitution in order to allow for a president, specifically Uribe, to run for re-election. Uribe was Colombia’s first president to run two consecutive terms under free elections. Juan Manuel Santos was Uribe’s Defense Minister and so he was, in fact, front and center in Uribe’s presidency. As a result, Santos was a natural to run for the presidency given that he had been successful in Uribe’s cabinet.

So President Santos surprised all of us once he took office. We expected him to follow the same line of governance. One of the main tenets was “Seguridad Democrática” or Democratic Security – the idea that without citizens that feel secure, there is no investor confidence. Investor security was the most important tenet of the new party, “Partido de la U,” named after Uribe. Santos ran on that platform, but he did not come through on his main promise. It is important to understand a little recent Colombian history to know how significant a departure this was. This was not just another politician breaking a promise. This was a very serious departure from the expected. In fact, one of his first acts as

president was to have a summit with Venezuela’s President Chávez on Colombian soil declaring Chávez his new best friend. Chávez, a staunch socialist who, unfortunately for Venezuela, understood little of the failure of central planning and socialism, was now the best friend of President Santos. Santos had, only months before, promised to run a capitalistic democracy very different and far from the errors of socialism.

The truth is now clear to all: Santos is simply an astute politician who goes in the direction he perceives is best for his agenda. He believes that making peace with the long-time terrorists, FARC, is what is needed in Colombia, for some odd reason. This after FARC had been reduced, under Uribe, to a group relegated to the deepest parts of unknown jungles and far away from the citizenry. For all intents and purposes, FARC was defeated. So why would Santos do this? Only he knows. Some believe that Santos is pursuing this strategy as a means to earn a Nobel Peace Prize. Experience tells us that the FARC will, as on previous occasions, use these peace talks as an excuse to continue their agenda, and many believe that Santos is kidding himself. But what does this all mean for business?

Let us look at the different candidates and what they promise.

■ Short bios

Santos – On the Santos website you will find a series of YouTube videos. These videos lack substance and include some relatively vague promises like lowering unemployment. These are possibly good to attract votes but contain little in the way of real policy ideas. Education: Santos attended the University of Kansas and graduated with a Bachelor in Economics and Business Administration. He later at-

tended the London School of Economics and Political Science, graduating with a Master of Science in Economic Development, and the John F. Kennedy School of Government at Harvard University, graduating with a Mid-Career Master in Public Administration in 1981. A Fulbright visiting fellow at the Fletcher School of Law and Diplomacy at Tufts University in 1981 and a Nieman visiting fellow at the Harvard Business School at Harvard University in 1988, Santos also holds an honorary Doctor of Laws degree.

Peñalosa – On the Peñalosa website you will find a clear description of the key items his administration would focus on, mainly healthcare & education, rural development, environment, justice and security, and special items broken down by region. Within each of these focus points he addresses the reasons why they are key items for the country along with proposals for change and specific solutions. Perhaps much of the population will not review all this detail, but it shows the type of government he could run. He is a manager, a problem solver. Peñalosa’s claim to fame was his successful term as mayor of Bogotá from 1998 to 2001. During this period he significantly improved the city. Peñalosa is a Duke University graduate (History and Economics major). He also holds an MBA from the University of Paris.

Zuluaga – On Zuluaga’s website you will also find a series of YouTube videos, and they do contain substance. His focus is on security to guarantee the rule of law under which investment can thrive and an economy can be healthy. This makes sense. Zuluaga was Finance Minister under Uribe so he also knows what it takes to push the economy. For example, a major investment area in Colombia during and after Uribe’s presidency was the hotel industry. Given that Colombia suffered from bad public relations, it was important to get

SANTOS (Current Colombian President running for re-election)	PEÑALOSA (Green Party)	ZULUAGA (Center Party – Backed by Colombia’s ex-president Uribe)
Promises to be best educated country in Latin America by 2025	Build/lease 3000 schools serving 350 kids each. Increase public schooling to 1.5 million children from the 1 million currently served. Decrease college turnover.	Colombia was ranked as 62nd among 65 countries in verbal scores. Solution: increase public education (usually for lower income citizens/80% of the population) to 8 hours daily including lunch for these children. Increase teacher salaries and training. All high school graduates to get a technical degree from SENA. Access to higher education.
Free housing for 85,000 poor families. Continuation of mortgage interest subsidies.	Creation of the Ministry for Rural Well-Being. Build roads. Creation of programs to help meet international sanitary standards like those of the US in order to increase exports. Expand rural production beyond cattle and agriculture to include tourism, etc.	Rural areas need loan refinancings and lower interest rates. Lower fertilizer costs. Eliminate sales tax for farming equipment. Access to technology. Healthcare: Increase hospital infrastructure to reduce waiting times. Include prescription drugs in insurance coverage. Improved medical industry salaries. 1.5 million families do not own or inhabit a home. The solution is not giving away homes, but rather building 800,000 homes without need for downpayment and with monthly mortgage payments equal to rental payments. 200,000 middle income homes will have interest subsidies. These are similar programs to those done by President Lula da Silva in Brazil.
Reduce unemployment to 7.8% by 2018	Decrease mining subsidies. Declare a moratorium on mega mining projects if they are non-renewable. Drummond will not get an extension on its coal mining agreement (up to 50% of Colombian coal extraction). Reduce unemployment by reducing taxes to employers, not by increasing subsidies.	
COP\$4 billion for small business entrepreneurs.	Specific programs for the four distinct regions of the country that address the significant income inequality in Colombia. Improved local tax systems. Improve redistribution of central government funds to regions. Diversify the economy to improve other sectors, not just mining. The economy in the last four years has focused on mining at the expense of other sectors.	
Lowest homicide rate in 20 years will continue to decrease. Substantial increase in the police force.	Colombia’s worst citizen security concern is homicides. Colombia’s worst public security concern is organized crime, including the guerrilla group FARC. Solutions: fight corruption; reform the justice system; stimulate cultural changes that place higher value on life and liberty and respect for the law.	Fight the criminal elements to provide security for investment. Overhaul the successful program started by President Uribe “Security Councils” and citizen collaborators. Fight micro-narcotraffic. Increase police and military force salaries. Closed circuit cameras throughout city streets. Peace agreements with terror groups (FARC) must include fairness and justice for the victims of such terror.

the international community to visit the country in order to increase investor confidence. It is very difficult to understand the reality of positive change unless you see it for yourself. For this and other reasons, the country needed to improve its hotel industry. The Uribe government, along with Zuluaga as Finance Minister, instituted a 30-year income tax holiday for new hotels. This created a boom in new hotels and created thousands of jobs, and now Colombia has adequate facilities to tend to its international guests.

■ Conclusions

If Santos is re-elected we simply do not know what will happen. Maybe more of the same? Maybe he will complete a “peace process,” no matter the consequences, simply so he can get a Nobel prize? We just do not know. We do know that if he continues with the same strategy,

Colombia is leaning toward leftist tendencies that do not make for the best investment environment. At best, we can expect “muddy waters,” to use a marketing term. Let me give you an example. In 2012, under Santos, there was a major tax reform due in part to the trade agreement with the US. The Santos government now claims that Colombia’s corporate tax on profits is only 25%. That is far from the truth: it is muddy waters. When you look closely you see that they simultaneously introduced a new tax and called it something else: CREE. This is also a tax on corporate profits of 9%. Total corporate tax on profits: 34%. The net result a 100 basis point increase! Such is life under President Santos for investors in Colombia.

If Zuluaga, the candidate who has Uribe’s backing, is elected, we will likely go back to a Colombia that is open for business. And, for those of you interested in the

peace talks, yes, although not very likely, Zuluaga may talk, but he will likely only listen if there is a clear path to a just resolution.

If Peñalosa, the former Bogotá mayor, is elected president, we can expect good management and perhaps a continuation of the peace talks, but under better terms than with Santos.

About the Author



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

Mr. Villalba is a graduate of the University of Notre Dame with three degrees, a Masters in Business Administration, a B.S. in Civil Engineering, and a B.A. in Economics. He successfully completed the Harvard Business School’s Executive Management Development Program.

Repercussions of Brazilian Internet Law on International Agreements with Brazilian Users

■ Adler Martins



The new Brazilian internet law (Marco Civil da Internet), which is set to enter into force at the end of June 2014, is a complex regulation encompassing public policies, technical standards and consumer rights. The bill also has some very worrying provisions that allow the state to closely monitor internet users and internet content.

In this article, I will focus on the provisions dealing with private international law and regulation of international agreements related to the internet.

■ General approach

Brazilian conflict of law rules have historically been based on the domicile of the contracting parties. That is, generally Brazilian law will apply over agreements entered into in Brazil and not apply when agreements have been executed abroad. The nationality of the parties is not important.

In the case of agreements between parties who happen to be physically distant, Brazilian law determines that the law of the country of residence of the one making the proposal shall be the applicable law.

Since internet agreements don't have a physical place where they are signed, and since most providers of software, applications and other internet services are not located in Brazil, the application of Brazilian rules will generally bend toward the law of the country of the provider (considering that the provider is typically the one who proposes the terms).

The Brazilian government seems to have resented this situation. The new internet law reflects this disturbance and has adopted a legal shortcut to allow the use of Brazilian law in agreements entered into through virtual environments. The Marco Civil determines that whenever a terminal is located in Brazil, the legal residence of the party using the terminal should also be Brazil; and that any internet transaction (or exchange of information) performed through a terminal located in Brazil should be subject to Brazilian law.

Terminal, under the legal definition, is any device capable of accessing the internet – from cell phones to heavy processors and servers.

■ Limits to the application of Brazilian law over terminals located in Brazil

The application of Brazilian law to terminals located in Brazil is, in theory, restricted to the acts of collection, keeping and using user data. Brazilian law should be applied specifically with regard to privacy and protection against unauthorized use (including sale of information for advertising agencies, espionage and data mining by foreign governments).

If the scope of the use of Brazilian law were limited to the topics above, the commercial terms of the agreements should be subject

to usual conflict of law rules, meaning that the use of foreign law would be allowed.

This conclusion, however, is not certain.

For one thing, another part of the law mentions that the application of Brazilian consumer protection rules is also mandatory. Also, the law may be used by the government to justify the taxation of software sales and licensing in Brazil.

In addition, several principles established by the bill are phrased to sound like “collective interest and national security” issues. This means that some dominant clauses in standard terms of use, such as a clause allowing the seller to automatically charge the buyer's credit card, may be ruled illegal in Brazil because Brazilian law is very protective of consumers' credit, and because the application of Brazilian consumer law may be seen as a matter of national security and public interest.

■ Limitations on the choice of forum and arbitration

The bill also establishes that mass agreements entered into via the internet cannot exclude Brazil as a forum for disputes. In other words, the law prohibits foreign providers from insisting on the resolution of disputes in their home countries. (Facebook would not be allowed to choose the US as the preferred forum for dispute resolution, for instance.)

It is not clear if this provision will prevent the use of arbitration or if the use of arbitration in those cases must follow some special provisions that are already applicable to domestic consumer agreements (basically, the need for a very distinctive clause, in bold letters).

■ Consequences: Shutdown of websites and prosecution of subsidiaries in Brazil

The consequences of noncompliance with the privacy rules described in the bill are dire: a fine of up to 10% of the gross revenue of the economic group responsible for the application. (Think 10% of the worldwide revenues from Angry Birds, or, again, Facebook.)

The bill provides, clearly, that the fines may be charged against local subsidiaries of the companies, and even against any assets or related companies and distributors in Brazil. The law does not mention it clearly, but the shutdown of a website is also a possibility. (It is important to note that even well known

sites have been shut down in Brazil, as YouTube was a few years ago.)

■ **Conflicts with international conventions, possible unconstitutionality**

Some aspects of the Marco Civil violate international privacy protection agreements. Many of those agreements have not been ratified by Brazil, but are applicable in the countries where the application provider is located. Specifically, the Marco Civil determines that the sellers of internet servers or applications must cooperate with Brazilian authorities and share information about their customers with the Brazilian police and courts.

Moreover, the application of penalties to local subsidiaries that have not performed any illegal activities per se may be ruled unconstitutional, since the Brazilian Constitution prohibits the penalization of innocent parties.

The Brazilian internet law is bound to create controversy and, possibly, battles in court regarding its validity under international conventions, as well as its constitutionality. We will watch carefully how the principles and rules described in the law are applied.

About the Author



Adler Martins is a law graduate from The Federal University of Minas Gerais (UFMG). He holds an MBA from Fundação Getúlio Vargas. Mr. Martins is pursuing a Masters (LLM) at Pontifical Catholic University of Minas Gerais and a postgraduate course in Financial Planning at São Paulo City University. He can speak English, Spanish, Portuguese, German and some Chinese (Mandarin). Mr. Martins has working experience in Argentina, Mexico, India, England, China and Dubai, aside from extensive experience in Brazil.

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

Mr. Martins has lectured on foreign investment regulation in Brazil to audiences in Brazil and India. Recently, he lectured about Brazilian import regulations at the Ecommerce expo 2011, in London, as a guest speaker. Currently, he works advising companies and entrepreneurs on how to do business in Brazil.

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Sunshine Daydream?

Wake Up – Now Is the Time for Solar Energy in Latin America

■ Ben Moody

Often, the most promising opportunities are those that become visible when the sun shines on a dark space. One such dark space is the wealth of untapped energy sources throughout Latin America; and of those energy alternatives, perhaps none is as promising as the sunlight itself.

The rate of adoption for solar energy throughout Latin America is shockingly low when compared with the rest of the world. With up to 100 gigawatts of solar energy expected to be deployed globally each year, less than 500 megawatts – or about one-half of one percent – is expected in Latin America.

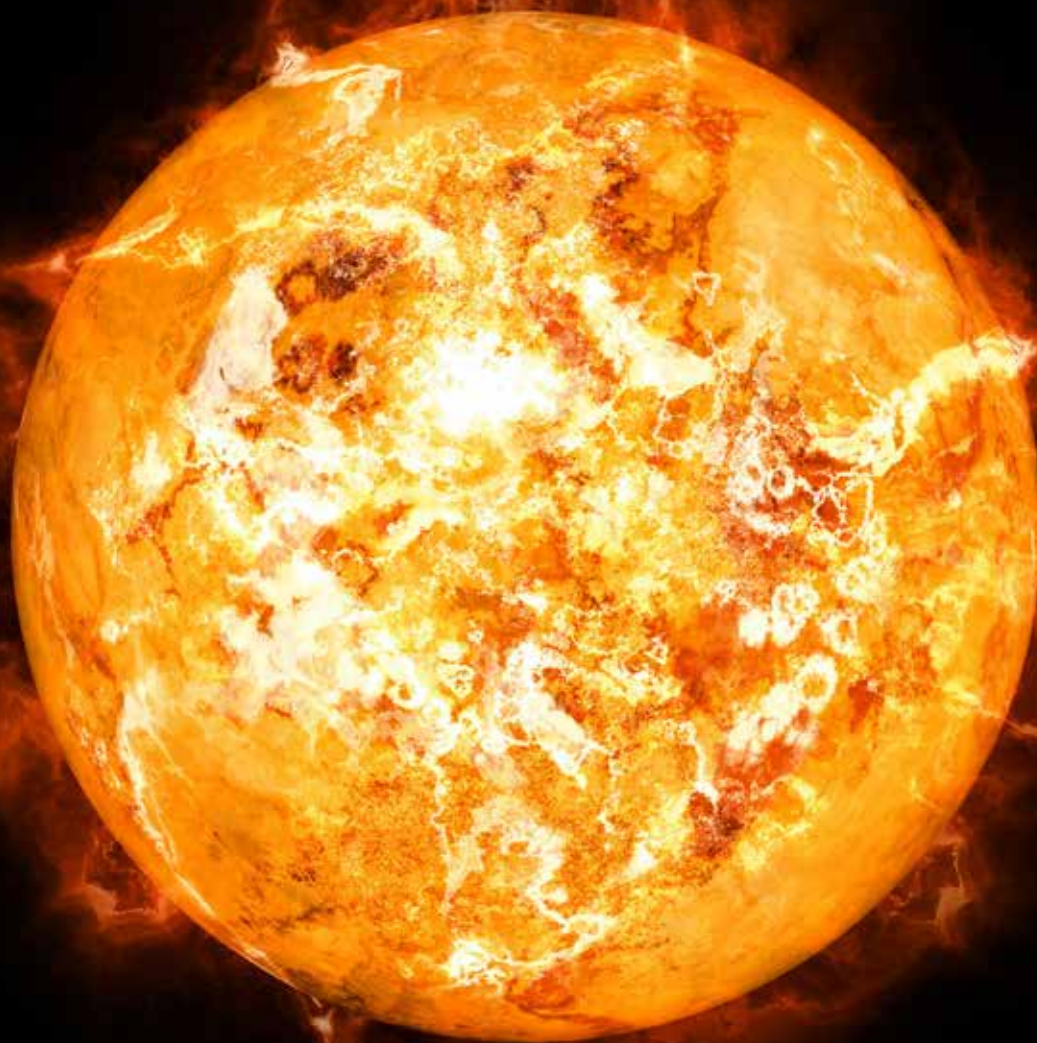
While other regions have already deployed considerable resources in solar as part of larger sustainable energy programs, solar photovoltaic technology is largely non-ex-

istent in Latin America. The Inter-American Development Bank released a report last year indicating that Latin America and Caribbean countries could, in theory, meet 100 percent of their energy needs from renewables. For instance, the Chilean desert offers an economic potential for solar similar to Arizona or Nevada, two leaders in the US. Other regions – like South Africa – are making rapid headway; the time for solar power in Latin America is now.

First, let's dispel some of the myths about the viability of solar energy.

There is a big distinction to be made between making solar panels and producing solar power. For instance, the US solar panel manufacturer Solyndra, a favorite target of critics of solar power, was in fact not a producer of solar power, but a maker of solar panels. Its demise was the consequence of a Darwinian shift in market forces: panel prices, driven down sharply by cheaper alternatives from China, made the business model of Solyndra – and many other manufacturers globally – untenable. That these companies were unable to compete in a burgeoning market is not evidence that the market does not exist, or that others won't succeed in it. Solyndra is gone, but the demand for solar panels is growing rapidly. Supplying that demand today are fewer but stronger manufacturers, who have a brighter future ahead.

Where government assistance and intervention was once required for solar power



plants to work economically, subsidies are no longer a requirement for solvency in the space. In the past five years, the cost of solar panels and other plant components has fallen so dramatically that solar is reaching parity with conventional power sources like coal and natural gas. The solar power model now stands on its own – a sustainable energy source supporting a viable business.

Latin America, as a potential market, has a competitive advantage in not being first. With new technologies, much can be learned from the mistakes of others. The average cost of an installed watt of solar energy has dropped nearly 25 percent in the past couple of years, and most projections indicate that the improvement will continue. More dramatically, consider that a watt of solar energy cost US\$1,785 to produce in 1953, whereas today it costs about one dollar. The underlying costs associated with deployed solar photovoltaic power are expected to continue to decline.

For all the criticism it's faced, solar energy has the biggest upside of all renewables. This is equally true when viewed through the lens of an investment opportunity. The time required to build a solar power project is less than or comparable to wind, significantly less than for hydroelectric or biomass, and a fraction of what's required for coal or geothermal. Financing is readily available from both commercial and development banks, even without the need for a long-term power purchase agreement. Operators can start to produce power on a merchant basis, providing flexibility – and higher short-term profitability – in the more expensive power markets in Latin America. In addition, environmental impacts are often far less than other renewable alternatives. Residential and commercial rooftop installations require even lower investment, and power can be turned on very quickly.

Solar energy is fast becoming the most productive natural resource in the world. Over the next 20 years, cumulative investment in solar power is expected to be close to US\$3 trillion – as much as US\$100 billion per year globally looking for investments.

With some of the best solar resources in the world, Latin America is a vastly untapped potential source. It doesn't take a flashlight the size of the sun to see the opportunity.

About the Author



Ben Moody is President and CEO of Pan American Finance, which he co-founded in 2003 in Miami, Florida, and of PAF Securities, our broker-dealer subsidiary.

Mr. Moody has over 30 years of M&A advisory, project finance, debt & equity capital raising, and restructuring experience, including 25 years in commercial and investment banking and 5 years of private equity & operating experience. For over 20 years, he worked with businesses and their owners including family offices, fund managers and institutional investors in Latin America, the Caribbean and the US markets.

Mr. Moody has extensive in the media, tech and telecom sector. From 1998 to 2001, he served as Managing Director and Chief Financial Officer of Ibero American Media Partners ("IAMP"), a US\$500 million private equity platform jointly owned by the Cisneros Group of Companies and Hicks, Muse, Tate & Furst. IAMP made investments in the pay television, broadcast TV, radio and internet sectors: in 1998 acquiring the Cisneros Television Group ("CTG"), where Mr. Moody was Vice Chairman, and in 2001 merging with El Sitio to form Claxson Interactive Group (NASDAQ: XSON). Throughout his tenure at IAMP & CTG, he was responsible for negotiating, executing and integrating 15 acquisitions and investments, and for raising the debt and equity capital to finance them, along with performing his duties as CFO.

Prior to IAMP & CTG, Mr. Moody served as Managing Director at Violy, Byorum & Partners in New York, an investment banking firm focused on Latin America, and held prior positions with Citicorp Securities and Continental Bank, living and working in New York, Los Angeles, Chicago and London.

Mr. Moody is a director of various private companies and is advisor to the ALS Recovery Fund. He is a graduate of the University of Oxford.

Frontier Markets:

More profitable, safer and less volatile

■ **Tomás Guerrero Blanco**

In recent months some isolated events such as the suspension of Nigerian Central Bank Governor Lamido Sanusi and the outbreak of the Ukrainian conflict have set alarm bells ringing. Frontier markets could be a bubble about to explode.

However, these events are at odds with the forecasts some analysts have hurriedly worked up. In the case of Ukraine, whose weight in the MSCI FM is negligible (0.1%), the stress prompted by the Russian occupation has not weakened the confidence of investors. The PFTS Index, the stock index that registers the performance of the main companies listed in the Ukrainian stock exchange, has gained 36.3%

since the beginning of the year, and 39.1% since May 2013. With regard to Nigeria, whose weight in the MSCI FM is close to 15%, the story is pretty much the same. Despite Sanusi's suspension, corruption, and certain decisions like the recent move to increase cash reserve requirements on public sector deposits from 50% to 75%, the benchmark Nigerian Stock Exchange All-Share Index (NSE ASI) has risen an impressive 11.7% since May 2013.

The truth is that frontier markets are more profitable, safer and less volatile than the "almighty" emerging markets.

During 2013 the performance of frontier markets was well above that of emerging

markets. The reference index for emerging economies, the MSCI EM, ended 2013 falling 2.6%, while the benchmark of funds operating in the frontier markets, the MSCI FM, gained 26.3%. The BRICS stock markets experienced significant declines, with the Chinese stock market the exception. Meanwhile, frontier markets became the most profitable on the planet. In the cases of Bulgaria, UAE, Argentina and Kenya the profits were above 50%. And the trend continues; so far this year the MSCI FM has increased 12.3%, exceeding the MSCI EM's 0.43%.

The frontier markets have become a haven for major investors. Although it might seem counterintuitive, these economies

display a number of features that make them less vulnerable than the emerging economies.

First, they show lower correlation with developed economies than the emerging markets (0.3 vs. 0.9), as well as a lower correlation with each other. This means they are less susceptible than emerging markets are to shocks that can be originated in advanced economies. Meanwhile, this makes them strongly dependent on the behavior of their domestic economies. In addition, the low correlation with developed economies allows large portfolios to diversify their holdings.

Second, frontier markets' low liquidity, cited frequently as one of the risks of these markets, has significantly contributed to ensure stability. The US Fed's announcement of the imminent end of Quantitative Easing, which indicates a future rise in the performance of Treasuries, is taking a bigger hit on emerging markets than on frontier markets. Under situations of uncertainty or stress like the ones generated by the Fed's announcement, fund managers have serious difficulties liquidating their positions in frontier markets, which are usually small and difficult to sell due to the

low liquidity of these markets. Therefore, they often focus on liquidating the bigger and more liquid positions from their portfolios – like those linked to the emerging markets or the mature markets.

These features – low correlation between their own frontier economies and with advanced and emerging economies along with scarce liquidity – have protected frontier markets from capital flight, which has hit emerging markets since the Fed's announcement. However, they are also behind the low volatility shown by these markets. Low liquidity translates into a limited intake and output of inversion flows as a consequence of the absence of counter-partners to sell and buy assets. Added to the scarce dependence on developed and emerging economies' behavior, this has led frontier markets to be less volatile than the emerging ones. In 2013, the MSCI FM's volatility was 18.5%, compared with 22.6% for the MSCI EM and 15.3% for the S&P 500.

At the moment, frontier markets shine brighter than emerging markets, and rumors of their impending collapse will have to wait. Do not panic.



About the Author

Tomás Guerrero Blanco is a researcher at ESADEgeo-Center for Global Economy and Geopolitics of ESADE Business School and SovereignNET research affiliate at Tufts University's Fletcher School. Mr. Guerrero specializes in frontier markets, sovereign wealth funds, halal industry and entrepreneurship. <http://www.esadegeo.com/>

Red Obsession:

Foreign conglomerates battle over Chinese wine

■ Pierre Ly, Cynthia Howson and Jeff Begun



China is one of the largest and fastest-growing wine markets in the world, and the battle for market share is fierce. For wine multinationals, building an identity as a local producer is part of the bigger battle over market share, and with local governments so eager to promote the industry, opportunities seem to abound. Foreign investors build partnerships to distribute their own wines, to establish vineyards and produce wines under their own names, to cement their control of the high-end market and, increasingly, to compete with Chinese producers for the growing middle price point.

■ Manufacturing in China: Wine versus cars

With the lucrative prospects brought by the Chinese wine boom, wine multinationals have been investing heavily in China. They are following the steps of producers in many other sectors, all attracted to the country's market size and stunning growth. When car manufacturers like Volkswagen or GM want to increase their market share in China, they invest in new local plants. Find a local partner, build a new factory, bring the technology and know-how, hire Chinese workers, and off you go; you can make the same cars you would make anywhere else. It's good for brand image, you avoid import hassles, and you have more control than by outsourcing to independent local contractors.

In this regard, wine shares some similarities with cars. First, you can "assemble" foreign wines at the destination by investing in a bottling line business to process your own imports shipped in bulk. Second, you can focus on selling foreign wines by investing in partnerships in the import and distribution business. The Spanish wine firm Torres has been enormously successful in distribution in China, through partnerships with many clients and by offering diverse services such as public relations, transport and storage, even running its own branded retail outlets.

But of course, wine is different from cars in an important way. You can't make

Bordeaux wine in China, or anywhere other than Bordeaux for that matter. One of the most important ideas of wine is the sense of place it conveys; it's all about where the grapes are grown. So several wine multinationals, notably French ones, have become Chinese wine producers. They make wines that will showcase the Chinese terroir, not foreign wine merely assembled in China. Production usually takes the form of a joint venture with a well-established Chinese winery. For the foreign company, it means easier access to land and grapes, good relationships with local governments, and opportunities to build their brand image. For Chinese wineries, partnerships bring capital, technology, expertise, and the legitimacy of a global brand name. In fact, such partnerships are common in many industries, and it is worth noting

that auto manufacturers also enter joint ventures to make new Chinese cars, in addition to their existing models.

■ Fortifying brands with Chinese wine

Investing in Chinese wine production not only allows global wine firms to be at the forefront of upgrading in the booming local industry, it also helps them promote their brand and strengthen distribution networks for the products they import to China.

The large French luxury conglomerate Louis Vuitton Moët Hennessy (LVMH) has long been attracted to wealthy Chinese consumers in search of luxury. With its broad portfolio of brands, LVMH is well placed to offer the whole package of a luxury lifestyle. So it makes sense that the giant has partnered with a state-owned company in Ningxia to expand their successful Chandon brand and make a traditional method sparkling wine in China for the domestic market. Of course, many observers point out that sparkling wine is not an easy sale in China. But thanks to the LVMH presence on many luxury product lines, Chandon China may help bring more Chinese consumers toward sparkling wine, and in turn put the group's very own Champagne brands on a pedestal. LVMH already owns the high-end Wenjun brand of Chinese baijiu (white spirit), and a grand cru red wine project is in the works thanks to another local partnership in Yunnan province.

In Shandong province, Domaine Baron de Rothschild (DBR), owner of Lafite, has partnered with the state-owned Chinese investment company Citic. The project has a very clear focus on quality, with a lot of attention devoted to understanding the challenges of local viticulture.

In Shandong province, Domaine Baron de Rothschild (DBR), owner of Lafite, has partnered with the state-owned Chinese investment company Citic. The project has a very clear focus on quality, with a lot of attention devoted to understanding the challenges of local viticulture. Beyond the potential for a new successful DBR wine (like its popular labels in Chile and Argentina), the venture may help counter the negative publicity due to the widespread counterfeiting of Château Lafite in China.

■ A fight for the middle?

With Chinese wine being far cheaper on average than imported wine, the battle over market share is not viable at the high end



alone. Scholars Loren Brandt and Eric Thun argue that in China, upgrading in various industries is driven by a “fight for the middle.” Local producers seek to move upmarket to escape cut-throat competition and paper-thin margins at the low end. Meanwhile, foreign producers coming from the high end try to expand their market toward the middle, and often avoid the low end where they would have a hard time competing on price. It looks like this may be true for wine as well, despite wine’s traditional position as a status good in China. The wines produced in Ningxia

by French company Pernod Ricard are competitively priced, with entry level wines starting under 100 yuan (about US\$16). Will Chandon China market some of its sparkling wine in the mid-range, as Chandon does in the US?

In any case, foreign investments in Chinese wine are likely to continue. It will be interesting to see how both collaboration and competition with local producers shapes the future of Chinese wine.

About the Authors

Pierre Ly is Assistant Professor of International Political Economy at the University of Puget Sound in Tacoma, WA. Cynthia Howson and Jeff Begun are Lecturers in Politics, Philosophy and Economics at the University of Washington Tacoma. Their current research explores the emerging Chinese wine industry.

To follow the latest trends in China’s wine market, the best sources include Jim Boyce’s Grape Wall of China Blog (<http://www.grapewallofchina.com/>) and Winechina.com (<http://www.winechina.com/en/>)



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The temptations of extrapolation are hard to resist. The trend exerts a powerful influence on markets, policymakers, households, and businesses. But discerning observers understand the limits of linear thinking, because they know that lines bend, or sometimes even break. That is the case today in assessing two key factors shaping the global economy: the risks associated with America's policy gambit and the state of the Chinese economy.

Quantitative easing, or QE (the Federal Reserve's program of monthly purchases of long-term assets), began as a noble endeavor – well timed and well articulated as the Fed's desperate antidote to a wrenching crisis. Counterfactuals are always tricky, but it is hard to argue that the liquidity injections of late 2008 and early 2009 did not play an important role in saving the world from something far worse than the Great Recession.

China Sets America's Mental Trap

■ **Stephen S. Roach**



The combination of product-specific funding facilities and the first round of quantitative easing sent the Fed's balance sheet soaring to US\$2.3 trillion by March 2009, from its pre-crisis level of US\$900 billion in the summer of 2008. And the deep freeze in crisis-ravaged markets thawed.

The Fed's mistake was to extrapolate – that is, to believe that shock therapy could not only save the patient but also foster sustained recovery. Two further rounds of QE expanded the Fed's balance sheet by another US\$2.1 trillion between late 2009 and today, but yielded little in terms of jump-starting the real economy.

This becomes clear when the Fed's liquidity injections are compared with increases in nominal GDP. From late 2008 to May 2014, the Fed's balance sheet increased by a total of US\$3.4 trillion, well in excess of the US\$2.6 trillion increase in nominal GDP over the same period. This is hardly "Mission accomplished," as QE supporters claim. Every dollar of QE generated only 76 cents of nominal GDP.

Unlike the United States, which relied largely on its central bank's efforts to cushion the crisis and foster recovery, China deployed a CN¥4 trillion fiscal stimulus (about 12% of its 2008 GDP) to jump-start

its sagging economy in the depths of the crisis. Whereas the US fiscal stimulus of US\$787 billion (5.5% of its 2009 GDP) gained limited traction, at best, on the real economy, the Chinese effort produced an immediate and sharp increase in "shovel-ready" infrastructure projects that boosted the fixed-investment share of GDP from 44% in 2008 to 47% in 2009.

To be sure, China also eased monetary policy. But such efforts fell well short of those of the Fed, with no zero-interest-rate or quantitative-easing gambits – only standard reductions in policy rates (five cuts in late 2008) and reserve requirements (four adjustments).



The most important thing to note is that there was no extrapolation mania in Beijing. Chinese officials viewed their actions in 2008-2009 as one-off measures, and they have been much quicker than their US counterparts to face up to the perils of policies initiated in the depths of the crisis. In America, denial runs deep.

Unlike the Fed, which continues to dismiss the potential negative repercussions of QE on asset markets and the real economy – both at home and abroad – China’s authorities have been far more cognizant of new risks incurred during and after the crisis. They have moved swiftly to address many of them, especially those posed by excess leverage, shadow banking, and property markets.

The jury is out on whether Chinese officials have done enough. I think that they have, though I concede that mine is a minority view today. In the face of the current growth slowdown, China might well have reverted to its earlier, crisis-tested approach; that it did not is another example of the willingness of its leaders to resist extrapolation and chart a different course.

China has already delivered on that front by abandoning a growth model that had successfully guided the country’s economic development for more than 30 years. It recognized the need to switch from a

model that focused mainly on export- and investment-led production (via manufacturing) to one led by private consumption (via services). That change will give China a much better chance of avoiding the dreaded “middle-income trap,” which ensnares most developing economies, precisely because their policymakers mistakenly believe that the recipe for early-stage takeoff growth is sufficient to achieve developed-country status.

The US and Chinese cases do not exist in a vacuum. As I stress in my new book, the codependency of China and America ties them together inextricably. The question then arises as to the consequences of two different policy strategies – American stasis and Chinese rebalancing.

The outcome is likely to be an “asymmetrical rebalancing.” As China changes its economic model, it will shift from surplus saving to saving absorption – deploying its assets to fund a social safety net and thereby temper fear-driven precautionary household saving. Conversely, America seems intent on maintaining its current course – believing that the low-saving, excess-consumption model that worked so well in the past will continue to operate smoothly in the future.

There will be consequences in reconciling these two approaches. As China redirects

its surplus saving to support its own citizens, it will have less left over to support saving-short Americans. And that is likely to affect the terms on which the US attracts foreign funding, leading to a weaker dollar, higher interest rates, rising inflation, or some combination of all three. In response, America’s economic headwinds will stiffen all the more.

It is often said that a crisis should never be wasted: Politicians, policymakers, and regulators should embrace the moment of deep distress and take on the heavy burden of structural repair. China seems to be doing that; America is not. Codependency points to an unavoidable conclusion: The US is about to become trapped in the perils of linear thinking.

About the Author

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



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King The Dollar Is Still

■ Eswar Prasad

Scarcely a week passes without news about the ascendance of China's currency, the renminbi. But China has a long way to go before its currency can rival – let alone displace – the US dollar as the dominant global reserve currency.

To be sure, China already plays a significant role in international trade and finance, with major financial centers like London and Frankfurt eagerly lining up for renminbi business. Recent speculation that China's economy may soon be as large as America's has boosted this interest further, causing many to believe – whether

ruefully or gleefully – that the renminbi will soon dominate.

Moreover, the Chinese authorities have launched a raft of reforms aimed at opening the economy and making it more market-oriented, and have announced plans to liberalize interest and exchange rates and continue to ease restrictions on

cross-border capital flows. All of this will strengthen the renminbi's claim to reserve-currency status.

But China is missing one crucial ingredient: the world's trust. To achieve currency dominance, China needs more than economic and military might. It requires a broader and more credible set of public

and political institutions. And it is here that the US shines – at least relatively speaking.

This was never more apparent than in the aftermath of the global financial crisis. Even though America's financial markets nearly collapsed, its public debt levels rose sharply, and the Federal Reserve was forced to undertake massive monetary expansion to support the economy, the dollar strengthened relative to most other currencies.

That is because global investors seeking a safe haven automatically turn to US Treasury securities in times of global financial turmoil. Foreign investors now hold more than US\$5.7 trillion of these low-yielding securities, not to mention large quantities of other dollar assets. And the dollar's share in global foreign-exchange reserves has held steady since the crisis.

This can be explained partly by the fact that the United States boasts the world's

deepest and most liquid financial markets. But the most important factor supporting America's currency dominance is the institutionalized system of checks and balances that operates among the executive, legislative, and judicial branches of its government.

Trust in US public institutions is rooted in the open and transparent democratic process that underpins them. Freedom of expression and unfettered media bolster



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this confidence, not by highlighting the system's strengths, but by exposing its weaknesses, which can subsequently be corrected through responsive, rule-based mechanisms.

With the US government forced to answer to its citizens, it is unlikely to resort to inflationary debt financing. In fact, about US\$4.5 trillion of US federal debt is held by domestic investors, including retirees, pension funds, financial institutions, and insurance companies – groups whose considerable political clout ensures that no administration would risk allowing inflation to spin out of control.

The US legal system – independent from the executive and legislative branches of government – further supports the dollar's global role. While one might quibble about the complexity of US laws and regulations, it cannot be said that they are not applied relatively consistently.

This contrasts sharply with China's single-party system, in which the level of govern-

ment accountability is much lower. Official corruption, for example, has become so entrenched that President Xi Jinping has made an anti-graft campaign a central objective.

The reality is that, despite China's economic heft and low central-government public debt, foreign investors are unlikely to trust China with large sums of money. Capital inflows – which will undoubtedly increase in the coming years – are driven largely by investors' interest in diversification and high yield, rather than the country's image as a refuge from troubled financial markets elsewhere, especially given that China's financial markets are relatively underdeveloped and beset by considerable risks.

Of course, some foreign central banks have signed currency-swap agreements with China and even hold small amounts of its currency in their reserve portfolios. But these actions may be less a sign of the renminbi's inevitable march toward global dominance than a low-cost bet on its likely

emergence as a widely accepted international currency. And countries' desire to maintain good relations with China, owing to its rising economic power, cannot be discounted.

Depending on how soon China opens up its capital account and develops its financial markets, the renminbi could become a significant reserve currency in the near future. But it will not contest the dollar's supremacy unless China's leaders align the country's political and legal institutions with its economic reforms.

About the Author

Eswar Prasad, former head of the IMF's Financial Studies Division, is Professor of Economics at Cornell University and a senior fellow at the Brookings Institution. He is the author of *The Dollar Trap*.

A New Vision for India

■ Jaswant Singh

India's Bharatiya Janata Party, led by Narendra Modi, has stormed into office, winning its first absolute majority and reducing the formerly dominant Congress party to a rump, with just 44 of 543 seats in the lower house. Although India's sputtering economy was the dominant issue in the campaign, Modi's victory implies a significant transformation ahead for India's foreign policy as well. In short, an era of timidity and hesitation, bordering on paralysis, under the Congress-led United Progressive Alliance (UPA) has ended.

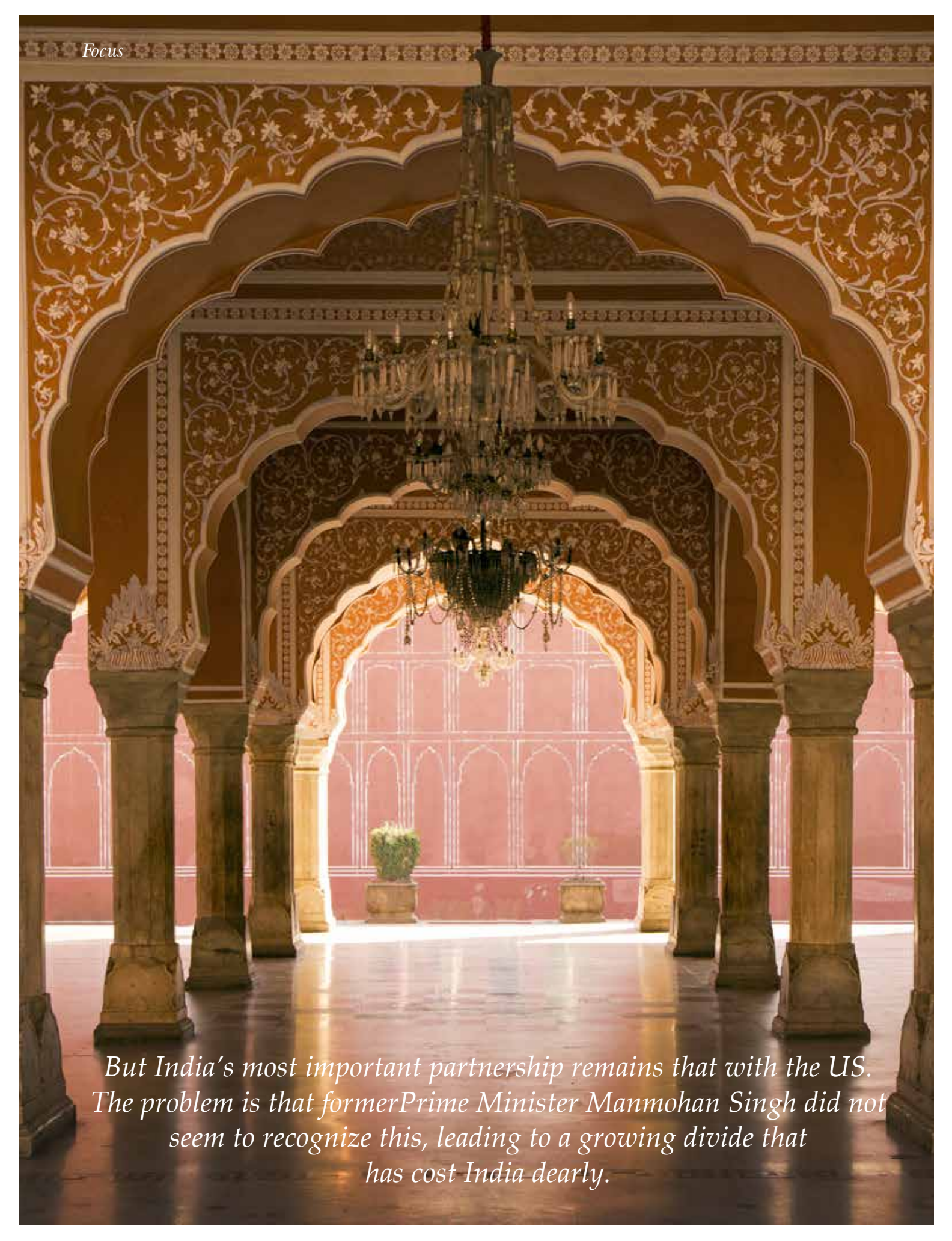
There is no shortage of external challenges facing India's new government. Upon assuming office in 2004, the UPA frittered away the positive national-security and foreign-policy position that the previous BJP government had achieved, neglecting key partnerships as it struggled to work effectively in the face of chronic infighting.

For example, the Communist-led Left Front, part of the UPA, foiled the implementation of the momentous civil nuclear deal with the United States, and consistently undermined the creation of a balanced nuclear-liability bill. Indeed, that bill is still languishing – a situation that Modi should rectify soon.

With its decisive parliamentary majority (282 seats, plus another 50 or so held by its allies), the BJP has the mandate that Modi needs to pursue a bold and creative foreign-policy agenda. The question is whether he will use his political capital effectively to advance India's interests.

Even while it adopts a more emphatic international posture, Modi's government must guard against regression to non-aligned posturing and overzealous assertion of "strategic autonomy." Instead, it must follow the global trend toward economic and security alliances.

Economic diplomacy will undoubtedly play a central role in Modi's efforts. After all, India's international prominence is based largely on its economic potential. Among India's top priorities should be measures to strengthen its relationships in its immediate neighborhood. Modi has already highlighted the imperative of

A photograph of an ornate Indian interior, likely a palace or a historical building. The scene is characterized by a series of nested arches (iwans) and pillars. The walls are decorated with intricate floral and geometric patterns in gold and brown tones. A large, multi-tiered chandelier hangs from the ceiling, casting a warm glow. The floor is polished and reflects the light. In the background, a red wall with white arched niches is visible, and two potted plants sit on the floor. The overall atmosphere is one of grandeur and historical significance.

But India's most important partnership remains that with the US. The problem is that former Prime Minister Manmohan Singh did not seem to recognize this, leading to a growing divide that has cost India dearly.

making the South Asian Association for Regional Cooperation (SAARC) a “living body,” instead of the moribund group that it was under Congress.

To this end, the relevant parties must abandon the usual saber rattling, and implement confidence-building measures. This logic likely drove Modi’s decision to invite SAA-RC leaders – including Pakistan’s Nawaz Sharif – to witness his swearing in as Prime Minister. To build on this, Modi should work to expand intra-regional trade linkages and foster person-to-person connections.

Of course, economic cooperation and development will be impossible without sustained peace – and that will not be easy to achieve in a region beset by deep-rooted tensions, including between India and Pakistan, and the threat of state-sponsored terrorism. Making matters worse, India and China are locked in a longstanding border dispute. Add to that the turmoil in the nearby Middle East – exacerbated by America’s withdrawal from Iraq and Afghanistan – and India’s security situation is not immediately conducive to harmony and cooperation.

A more peaceful and prosperous future will demand a clear and credible strategic vision from Modi, including a zero tolerance approach to terrorists and their sponsors. At the same time, with the US retreating from the Middle East, India must take responsibility for the security of its interests in the region, such as by developing a blue-water naval capacity to secure its maritime energy-trade routes.

This imperative is one of the factors linking India and Japan. As many Indian strategists have noted, Japanese Prime Minister Shinzo Abe may embody the kind of self-confident and decisive leader that Modi aspires to become. Increased investment and defense cooperation with Japan will add

much-needed substance to India’s “Look East” policy, which could be advanced further by implementing long-planned projects with Bangladesh, Myanmar, and Thailand, as well as by building road and maritime infrastructure and strengthening trade links.

Engagement with the Association of South-east Asian Nations – something that the Congress government was always reluctant to pursue – must also become a priority, if only to ensure regional stability. India’s membership in the ASEAN+6-led Regional Comprehensive Economic Partnership was a step in the right direction, but much more needs to be done.

But India’s most important partnership remains that with the US. The problem is that former Prime Minister Manmohan Singh did not seem to recognize this, leading to a growing divide that has cost India dearly. And Modi’s relationship with the US has not been entirely positive, either, owing to American officials’ decision to deny him a visa following the deaths of many Muslims during riots a decade ago in Gujarat, where he was Chief Minister.

Given the bilateral relationship’s economic and strategic importance, Modi must reinvigorate ties, and quickly. For starters, he must work with the US to address commercial and economic issues, including American concerns over India’s weak intellectual-property protections and fears within India’s information-technology industry regarding proposed US immigration reform.

Success will require both sides’ patience and willingness to compromise, bolstered by confidence-building measures. For its part, India could initiate realistic tax reforms, like eliminating transfer-pricing and retroactive taxation.

Modi’s final foreign-policy challenge is Russia – another country that the Congress-led

government neglected. Modi must now assess what kind of relationship can reasonably be expected with President Vladimir Putin’s increasingly assertive administration, while recognizing that it is not in India’s interests to have Putin view China as Russia’s only potential strategic partner in Asia.

One way to gauge India’s relationship with Russia – as well as with the US and even Israel – is to allow for increased foreign investment in domestic defense industries, including more co-production initiatives. Indeed, according to former US Under-Secretary of Defense Ashton Carter, stronger military cooperation and increased technology transfer is the most effective approach to deepening US-India ties. Why not adopt the same approach to strengthen India’s relationships with Germany, France, the United Kingdom, and Japan? Modi undoubtedly faces major foreign-policy challenges. But, with a clear, confident vision and credibility-enhancing policies, he has a rare opportunity to put India firmly on the path toward peace and prosperity.

About the Author

Jaswant Singh was the first person to have served as India’s finance minister (1996, 2002-2004), foreign minister (1998-2004), and defense minister (2000-2001). While in office, he launched the first free-trade agreement (with Sri Lanka) in South Asia’s history, initiated India’s most daring diplomatic opening to Pakistan, revitalized relations with the US, and reoriented the Indian military, abandoning its Soviet-inspired doctrines and weaponry for close ties with the West. His most recent book is *India at Risk: Mistakes, Misconceptions and Misadventures of Security Policy*.

Global Flows and Global Growth

■ Laura Tyson & Susan Lund

A growing share of the world's economic activity involves cross-border flows. But just how interconnected is the global economy? How are cross-border flows among activities, sectors, and countries changing? How do national economies rank in terms of their cross-border flows or “interconnectedness”? And what are the implications for business and policymakers?

A new report from McKinsey Global Institute addresses these questions by analyzing the inflows and outflows of goods, services, finance, people, and data and communications for 195 countries over the past 20 years.

Both aggregate data and micro examples confirm that the world has become more tightly linked, with cross-border flows increasing in scope and complexity – and



embracing a larger number of countries and participants within them. Despite a significant contraction from 2007 to 2009 resulting from the deep global recession, the combined value of financial flows and trade in goods and services was 36% of global GDP in 2012 – 1.5 times higher than in 1980.

The report also confirms that greater openness to global flows has been a significant source of economic growth for individual countries and worldwide. Overall, the research estimates that global flows have contributed 15-25% of global growth each year, with more interconnected countries receiving 40% more of the growth benefits than less interconnected ones. This is consistent with economic theory: interconnectedness fosters growth via productivity gains from specialization, scale, competition, and innovation.

Cross-border flows of goods, including commodities, remain the largest category, growing at 11% per year during the last decade and surpassing their pre-recession peak in 2012. Today, more than 35% of goods cross national borders.

Cross-border flows of services have also recovered to pre-recession levels and have been growing rapidly at 10% per year since 2002. Nonetheless, although services account for roughly two-thirds of world GDP, cross-border flows of services are less than one-quarter those of goods.

Cross-border flows of finance are still 70% off their pre-recession peak, yet even at today's depressed levels they account for more than one-third of all global financing. By contrast, the cross-border flow of people (measured by the percentage of people living outside their country of birth) is small, hovering around 2.7% since 1980. But cross-border movements of people for short-term purposes – tourism, work-related travel, and

education, for example – have been growing by 3.5-4.8% annually during the last decade.

And cross-border flows of data and communications have exploded, expanding by more than 50% per year since 2005. International telephone minutes have doubled, and cross-border Internet traffic has increased by 1,800%. Migration flows may not be gaining as a share of the world's population, but as a result of digitization, people are more interconnected than ever before.

Digitization is also transforming cross-border trade flows in three ways: the creation

Traditional measures of an individual country's global interconnectedness compare the size of its global flows to its GDP. According to these measures, smaller countries with smaller domestic markets appear to be more interconnected than larger ones.

of digital goods and services, such as entertainment and products manufactured by 3D printers; so-called “digital wrappers,” including tracking devices for physical flows; and digital sales platforms, such as eBay and Alibaba.

On eBay, for example, more than 90% of commercial sellers export products to other countries, compared to less than 25% of traditional small firms. Digital technologies are boosting global flows and competition, enabling even the smallest companies – and even individual entrepreneurs – to be “micro-multinationals.”

Knowledge-intensive flows requiring relatively high levels of human capital and research and development are now larger than labor-intensive, capital-intensive, and resource-intensive flows and are growing faster than all three. Flows of low-value, labor-intensive goods like apparel are declining as a share of global flows, while flows of R&D-intensive products, such as pharmaceuticals and business services, are gaining share.

By 2012, knowledge-intensive flows accounted for nearly half of the combined total value of flows of goods, services, and finance. This trend is an advantage for developed countries, which account for two-thirds of knowledge-intensive flows. China is the exception, claiming the second-largest share of flows (after the United States).

Traditional measures of an individual country's global interconnectedness compare the size of its global flows to its GDP. According to these measures, smaller countries with smaller domestic markets appear to be more interconnected than larger ones. But this approach is misleading, because it does not consider a country's share of global flows. The McKinsey report's index of global connectedness remedies this shortcoming by considering both the size of a country's global flows relative to GDP and its overall share of global flows.

The MGI Connectedness Index shows Germany, Hong Kong, and the US ranking first, second, and third, respectively. But some major economies fall well behind. Despite strong exports, South Korea and Japan rank 20th and 21st out of 85 countries, because they lag on immigration and cross-border Internet traffic. China, which ranks 25th, has a strong export engine and large capital inflows but ranks low on people and data flows.

On average, emerging market economies rank lower than advanced economies, but



several emerging market economies – including Morocco, India, Brazil, Saudi Arabia, and China – have improved their ranking significantly since the mid-1990s. Today, emerging markets account for about 38% of global flows, triple their share in 1990.

Yet a “digital divide” between developed and emerging economies persists in both data and communication flows and knowledge-intensive flows – and that gap does not appear to be closing. Emerging economies produce 40% of global output and are home to 80% of the world’s population, yet they account for only 24% of cross-border Internet traffic.

The economic gains of interconnectedness are significant, but so are the challenges. To capitalize on the opportunities of digitization and the shift to knowledge-intensive trade, countries must invest in talent and infrastructure; reduce barriers to cross-border flows of people and information, without jeopardizing their citizens’ privacy and security; and expose their producers to robust foreign competition while ameliorating the resulting costs of disruption for their communities and workers. If the gains from globalization are not widely shared, political support for greater openness to global flows will decline – as will the economic benefits that such flows create.

About the Authors

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Exhibit E3

MGI Connectedness Index

Country connectedness index and overall flows data, 2012¹

Rank of participation by flow as measured by flow intensity and share of world total

Economy			Connectivity Index Rank					Flow intensity ²		
Developed Emerging			1–10	11–25	26–50	51+		100+	70–99	<70
Rank	Country	Change in rank, 1995–2012 ³	Goods	Services	Financial	People (2010)	Data and communication (2013)	Flows value ⁴ \$ billion	Flow intensity %	Change in flow intensity, 1995–2012 %
1	Germany	1	3	5	7	5	2	3,770	110	+53
2	Hong Kong, China		1	4	3	14		1,437	546	
3	United States	-1	8	9	5	1	7	5,622	35	+2
4	Singapore	1	2	3	4	18	5	1,198	436	+8
5	United Kingdom	-1	13	6	9	7	3	1,471	60	-26
6	Netherlands	2	6	7	15	29	1	1,213	157	+39
7	France	-1	9	10	36	15	4	1,581	60	+8
8	Canada	-1	16	22	13	9	18	1,381	76	-3
9	Russia		19	30	16	2	21	1,277	63	
9	Italy	0	11	20	31	16	10	1,187	59	+4
11	Belgium		4	8	30	39	11	937	194	
12	Spain	0	21	12	35	12	12	932	70	+14
13	Switzerland	-1	23	16	11	28	17	851	135	+64
14	Ireland	2	29	1	23	23	24	476	226	+32
15	Sweden	0	28	15	17	45	6	573	123	+17
16	Saudi Arabia	19	20	29	19	8	44	729	103	+40
17	Australia	-1	32	34	14	11	30	813	53	+5
18	Malaysia	1	10	23	34	26	32	528	173	-29
19	Poland	5	22	31	28	34	22	478	98	+41
20	South Korea		7	14	25	58	34	1,393	123	
21	Japan	-1	14	24	10	82	15	2,652	44	+18
21	Austria	-10	24	17	62	33	9	424	107	+22
24	Luxembourg		63	2	1	69	16	1,432	2,594	
25	China	5	5	21	6	93	33	5,124	62	+8
27	Mexico	-6	17	67	22	13	48	921	78	+17
27	Turkey	-1	30	43	32	31	31	524	66	+14
30	India	16	27	13	26	47	64	1,131	61	+37
35	Greece	-2	59	27	44	27	41	265	106	+65
36	Thailand	-3	12	19	27	94	56	630	172	+55
41	Chile	9	42	54	20	95	36	261	97	+38
43	Brazil	15	39	40	18	115	38	757	34	+11
43	New Zealand	-3	61	59	58	25	47	106	63	0
47	Argentina	-6	55	60	53	59	40	200	42	+9
49	South Africa	4	43	50	49	56	73	242	63	+12
50	Estonia	3	54	46	74	76	26	54	241	+72
53	Morocco	26	57	42	79	41	63	91	95	+46
54	Latvia	1	66	69	77	54	27	41	143	53
56	Indonesia	-3	31	49	39	113	65	494	56	-2
63	Nigeria		36	57	33	114	90	267	102	
63	Egypt	-12	60	41	115	53	61	139	53	+2
78	Tunisia	-19	58	66	93	102	62	53	116	11
85	Pakistan	-30	68	81	117	61	79	78	35	-8

1 Index calculations use migrants data for people flows and cross-border Internet traffic for data and communication flows.

2 Flow intensity represents the total value of goods, services, and financial flows as a share of the country’s GDP.

3 Change in rank calculations do not include data and communication flows, for which data are not available for 1995.

4 Flows value represents total goods, services, and financial inflows and outflows.

NOTE: Blank cells indicate unavailable data.

SOURCE: Comtrade; IHS Economics & Country Risk; World Trade Organization; Telegeography; World Development Indicators; World Bank; McKinsey Global Institute analysis

Europe's Ukrainian Lifeline

■ George Soros

Last weekend's European Parliament election and presidential election in Ukraine produced sharply contrasting results. Europe's voters expressed their dissatisfaction with the way that the European Union currently functions, while Ukraine's people demonstrated their desire for association with the EU. European leaders and citizens should take this opportunity to consider what that means – and how helping Ukraine can also help Europe.

The EU was originally conceived to be an ever-closer association of sovereign states willing to pool a gradually increasing share of their sovereignty for the common good. It was a bold experiment in international governance and the rule of law, aimed at replacing nationalism and the use of force.

Unfortunately the euro crisis transformed the EU into something radically different: a relationship of creditors and debtors in which the creditor countries impose conditions that perpetuate their dominance. Given low turnout for the European Parliament

election, and if support for Italian Prime Minister Matteo Renzi were added to the anti-EU vote on the left and the right, it could be argued that the majority of citizens are opposed to current conditions.

Meanwhile, just as Europe's bold experiment in international governance is faltering, Russia is emerging as a dangerous rival to the EU, one that has global geopolitical ambitions and is willing to use force. Putin is exploiting an ethnic national ideology (and support from the Orthodox Church) to bolster his regime. Indeed, speaking on the Russian radio program *Direct Line* last month, he extolled the genetic virtues of the Russian people. The annexation of Crimea has made him popular at home, and his effort to weaken America's global dominance, in part by seeking an alliance with China, has resonated favorably in the rest of the world.

But the Putin regime's self-interest is at odds with Russia's strategic interests; Russia would benefit more from closer cooperation





with the EU and the United States. And resorting to repression in Russia and Ukraine is directly counterproductive. The Russian economy is weakening, despite the high price of oil, owing to the flight of capital and talent. Using violence in Kyiv's Maidan has led to the birth of a new Ukraine that is determined not to become part of a new Russian empire.

The success of the new Ukraine would constitute an existential threat to Putin's rule in Russia. That is why he has tried so hard to destabilize Ukraine by fostering self-declared separatist republics in eastern Ukraine.

With the Donbas region's largest employer mobilizing protests against the separatists, Putin's plan may not work, and he is now likely to accept the results of the presidential election, thereby avoiding additional sanctions. But Russia is likely to seek other avenues to destabilize the new Ukraine, which should not be too difficult, given that the security forces, having served the corrupt regime of former President Viktor Yanukovych, are demoralized and not necessarily loyal to the new leadership.

All of this has happened very fast and very recently. Both the EU and the US are preoccupied with their internal problems and remain largely unaware of the geopolitical and ideological threat that Putin's Russia poses. How should they respond?

The first task is to counteract Russia's efforts to destabilize Ukraine. With the EU's "fiscal compact" and other rules limiting the scope of government assistance, innovative thinking is needed. The single most effective measure would be to offer free political risk insurance to those who invest in or do business with Ukraine. This would keep the economy running, despite the political turmoil, and it would signal to Ukrainians that the EU and the US – governments and private investors alike – are committed to them. Businesses would flock to a newly open and promising market if they were fully compensated for losses caused by political events beyond their control.

Political risk insurance may sound too complex to deploy quickly. In fact, insurance of this type already exists. Private insurers and reinsurers like Germany's Euler Hermes have offered it for years. So have government institutions, like the World Bank's Multilateral Investment Guarantee Agency and the US government's Overseas Private Investment Corporation. They must, however, charge substantial premiums to cover the cost of reinsurance.

Faced with high premiums, most businesses would simply opt to wait on the sidelines until the storm passed. That is why the

governments concerned must take over the reinsurance function and use their agencies only to administer the insurance policies. They could guarantee the losses in the same way as they underwrite the World Bank: each government would provide a modest pro-rata capital infusion and commit the rest in the form of callable capital that would be available if and when losses are actually paid out. The EU would have to modify the fiscal compact to exempt the callable capital and allow actual losses to be amortized over a number of years. Guarantees of this kind have a peculiar feature: the more convincing they are, the less likely they are to be invoked; the reinsurance is likely to turn out to be largely costless. The World Bank is a living example.

By acting promptly and convincingly, the EU could save Ukraine – and itself. What I propose for Ukraine could also be implemented at home. As long as there are so many productive resources lying idle, it would make sense to exempt from the fiscal compact investments that would eventually pay for themselves. Renzi, for one, is advocating precisely this course of action.

Putin plans to turn Crimea into a showcase by lavishing more than €50 billion on it in the next few years. With European support, Ukraine could compare favorably. And, if such an initiative marks the beginning of a growth policy that Europe so badly needs, by saving Ukraine Europe would also be saving itself.

About the Author

George Soros is Chairman of Soros Fund Management and Chairman of the Open Society Foundations. A pioneer of the hedge-fund industry, he is the author of many books, including *The Alchemy of Finance*, *The New Paradigm for Financial Markets: The Credit Crisis of 2008* and *What it Means* and *The Tragedy of the European Union*.



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Los puntos clave que formarán parte de la discusión son:

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Que Trabajan En Campos Maduros, Incluyendo:**

• **TÉCNICAS DE ELEVACIÓN ARTIFICIAL – PETRÓLEO LIGERO:**

Seleccionar las técnicas de elevación artificial óptimas en base a la vida útil, costo, durabilidad, consumo de energía y efectividad para optimizar la producción en reservorios de baja presión

• **PRODUCCIÓN DE PETRÓLEO VISCOSO:** Definir el diseño óptimo del pozo para asegurar la producción efectiva de los campos con propiedades de petróleo viscoso

• **PRODUCCIÓN DE GAS:** Examinar las tecnologías más recientes para desfluidificar los pozos de gas y mejorar la vida útil de la producción de la elevación de gas

• **VIGILANCIA Y MONITOREO:** Identificar las tecnologías de monitoreo, automatización y de indicadores químicos de la producción para optimizar la inyección y minimizar las fallas

• **MITIGACIÓN DE FALLAS:** Prevenir las fallas del pozo mediante metodologías, tratamientos y tecnologías de control de arena, parafina y corrosión

• **INYECCIÓN DE AGUA Y POLÍMEROS:** Proporcionar las mejores prácticas de inyección de agua y polímeros, tratamiento químico e inundación artificial (waterflooding) para maximizar la recuperación de petróleo y gas



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CEO
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Damian Ramallo
Lider de Producción
Gran Tierra Energy



Victor Perusini
Gerente de Producción
San Jorge Petroleum



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