

ALTERNATIVE EmergingInvestor

Issue 8 - August / September

WHY THE WORLD NEEDS EMIA

INDIA:
OPPORTUNITY
IN THE AIR

FRONTIER
ASIA GAINING
GROUND

Join 17,000+ Members to

- Establish relationships
- Source opportunities
- Execute private company financial transactions

Members connect 90,000 times every month around live transactions.



www.axial.net
+1 800 860-4519

45 East 20TH Street
New York City

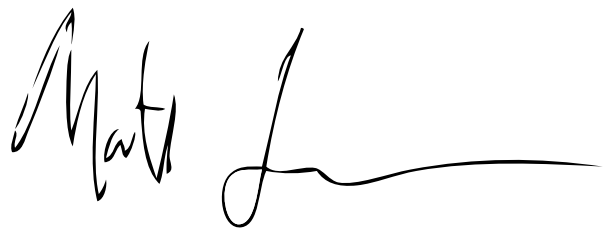
One of the main reasons I've always been fascinated by developing markets is their unpredictability. The beautiful mix of cheap labor, commodity driven economies, corruption, high fluctuations in FDI, lack of political stability, underdeveloped infrastructure and lax regulation have all served to keep me on my toes, paying attention, as prepared for the unexpected as possible. However (and feel free to disagree with me), it seems the world has gone a bit bonkers, as developed markets are behaving irrationally while logic seems to be driving the less developed.

George Soros recently doubled down, betting that the US will collapse and becoming the 4th largest shareholder of Argentina's YPF. Fortress Investment Group's Mike Novogratz and investor Nick Loeb have also expressed their positive outlook for Argentina.

Between March and April Russia saw US\$2.9 billion flee the country as the Ukrainian crisis began to unfold; due to speculation and high yields, by mid-July US\$2.3 billion of that had returned. Even the perpetually troubled Iraq has seen Korea Gas Corp slated to invest US\$4.9 billion in the country's Zubair oil project.

While this topic requires analysis by minds far sharper than mine, it seems the US market is being propped up by a trading frenzy fueled by the desire for continued gains and as a way to stave off the impending bear market, while emerging and frontier market growth and returns are based on tangible opportunities in both the short and long term.

Saludos,



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

ALTERNATIVE EmergingInvestor

Managing Editor	Nate Suppaiah
Public Relations Director	Tiffany Joy Swenson
Head Writer	Melodie Michel
Copy Editor	Sean O'Brien
Contributors	Kenneth Rogoff
	Tom Kadala
	Roberto Laserna
	Bárbara Fernandes Vaz
	Nouriel Roubini
	James Knight
	Mark Johnson
	Jeffrey Frankel
	Tomás Guerrero
	Adrián Blanco
	Federico Chirico
	Andrew Sheng
	Xiao Geng
	Heather West
	Adriana Curiel
	Nadiya Satyamurthy
	Doug Midland
	Javier Canosa
	Cynthia Howson
	Pierre Ly
	Jeff Begun

Articles on Pages 6, 15, 22, 50, 76, 79

Provided by Project Syndicate © 2014

Editorial Partners	Eurekahedge
	EMPEA
Design	Arman Srsa
Consultants:	Adam Berkowitz
	Andrew Forbes

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

2014 Alternative Emerging Investor, No statement in this magazine is to be construed as a recommendation for or against any particular investments. Neither this publication nor any part of it may be reproduced in any form or by any means without prior consent of Alternative Emerging Investor.



Contents

Issue 8 - August / September



15



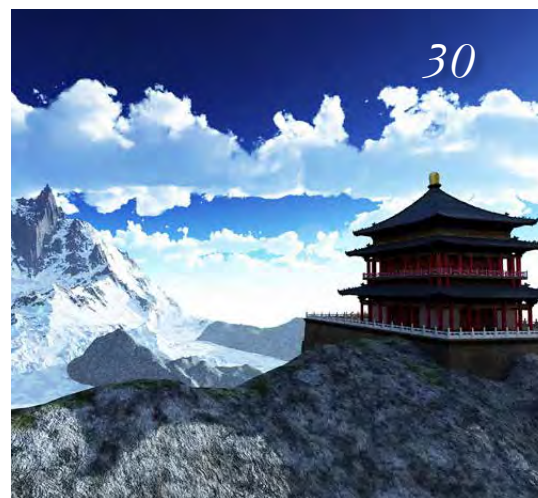
22



26



6



30

Political Risk

06 A Tear for Argentina

10 How to Introduce Entrepreneurship Within a Young Democracy

15 Latin America's Populist Cycles

18 New Brazilian Rules on Taxation of Foreign Subsidiaries

22 Russia's Eurasian Vision

26 World Cup Aftermath Effects on Brazil's Presidential Race

EMIA

30 Asia Frontier Fund: Capitalizing on Asia's Fast Growing Markets

35 The Importance of Liquidity

38 EMIA Offers Informative Hub for Emerging Market Investors

42 India: Opportunity in the Air





46



76



40

Wealth Management

48 Protecting your Assets in the Electronics Wild West

74 China's Subprime Risks

77 Mexican Telecom Sector Aligned for Consolidation Wave

80 Mezzanine Finance in Emerging Markets Deserves a Closer Look

86 Investing in Emerging Markets, North America

Focus

52 Emerging Market Target Practice

84 Argentina Will Start Bidding Process for 4G Cell Phone Band

Funds

55 Smart Public Policies for Development: The Case of Two Strategic SWFs

58 2014 Key Trends in Latin American Hedge Funds

Commodities

70 Nigeria: What's Behind the Oil Story?

Wine

88 Chinese Wine Tourism: Not Just About Wine

A Tear for Argentina

■ Kenneth Rogoff

Argentina's latest default poses unsettling questions for policymakers. True, the country's periodic debt crises are often the result of self-destructive macroeconomic policies. But this time the default has been triggered by a significant shift in the international sovereign debt regime.

The shift favors hard-line creditors in bond issuances governed by US law. With emerging market growth slowing, and external debt rising, new legal interpretations that make future write-downs and reschedulings more difficult do not augur well for global financial stability.

There are no heroes in this story, certainly not Argentina's policymakers, who a decade ago attempted unilaterally to force a massive generalized write-down on foreign bondholders. Economists who trumpeted the "Buenos Aires

consensus" as the new way to run economies also look foolish in hindsight. The International Monetary Fund has long recognized that it made one too many loans to try to save Argentina's unsustainable dollar peg as it collapsed back in 2001.

This is not the first time that an Argentine default has upended international capital markets. According to the tabulation that Carmen Reinhart and I compiled in our 2009 book *This Time is Different*, Argentina has defaulted on seven previous occasions – in 1827, 1890, 1951, 1956, 1982, 1989, and 2001.



Argentina may be almost as famous for its defaults as it is for its soccer teams, but it is hardly alone. Virtually every emerging-market country has experienced recurrent sovereign debt problems. Venezuela is the modern-day record holder, with 11 defaults since 1826 and possibly more to come.

Back in 2003, partly in response to the Argentine crisis, the IMF proposed a new framework for adjudicating sovereign debts. But the proposal faced sharp opposition not only from creditors who feared that the IMF would be too friendly to problem debtors, but also from emerging

markets that foresaw no near-term risk to their perceived creditworthiness. The healthy borrowers worried that creditors would demand higher rates if the penalties for default softened.



Recently, as an outgrowth of a reconsideration of the IMF's lending to the periphery of Europe (and Greece in particular), the Fund has advanced another approach to debt rescheduling, one that might be easier to implement. The IMF now recognizes that the bulk of its financing was effectively being used to allow short-term creditors to exit loss-free. As a result, there was not enough money left over to help soften budget cuts necessitated by the sudden stop in foreign funding.

The experience of the recent eurozone crisis stands in sharp contrast to the Latin American debt crisis in the 1980s, when banks were not allowed to exit precipitously from their loans. If the new proposal is adopted, the IMF would conditionally refuse funds to countries carrying debt burdens that Fund staff determine are most likely unsustainable; creditors would first have to agree to a "reprofiling" of debt.

Reprofiling is a euphemism for debt restructuring, which allows countries to borrow from existing creditors for longer periods and at lower interest rates than they would be able to do on the open market. Although it is far from clear how easily the IMF could hold the line against hard-bargaining creditors, the new policy, if adopted, would toughen the Fund's approach to cases where it finds itself repeatedly throwing good money after bad.

At present, the United States seems reluctant to go along with the IMF's proposal. Evidently, US authorities believe that in some situations geopolitics trump economics (reflected, for example, in the IMF's recent re-entry into Ukraine after a string of failed programs).

This American resistance is unfortunate. It would be far better if the US found ways

Given the recurring complications of adjudicating sovereign-debt contracts in foreign courts, and the world's inability to organize a credible and fair procedure for foreign bankruptcies, perhaps the best idea is to steer the bulk of international debt flows through debtor-country courts. Jeremy Bulow and I made a proposal along these lines 25 years ago; it is still the right approach.

In this scenario, countries interested in borrowing large amounts from abroad would need to develop institutions that made the promise to repay credible. By and large, experience supports this method. Indeed, the huge expansion in emerging market domestic debt issuance in recent years has helped reduce market tensions (although continuing reliance by corporates on foreign debt still leaves many countries vulnerable).

But domestic borrowing is not a panacea. To believe that any country issuing debt in its own currency is risk-free as long as the exchange rate is flexible is astonishingly naive. For one thing, there is still inflation risk, particularly for countries with weak fiscal institutions and heavy debt burdens.

Nonetheless, Argentina's latest debt trauma shows that the global system for sovereign-debt workouts remains badly in need of repair. Deepening domestic debt markets – and perhaps change along the lines proposed by the IMF – is sorely needed.

But domestic borrowing is not a panacea. To believe that any country issuing debt in its own currency is risk-free as long as the exchange rate is flexible is astonishingly naive.

to organize outright grants in exceptional cases like Ukraine, rather than design the international financial system around them.

About the Author

Kenneth Rogoff, Professor of Economics and Public Policy at Harvard University and recipient of the 2011 Deutsche Bank Prize in Financial Economics, was the chief economist of the International Monetary Fund from 2001 to 2003. His most recent book, co-authored with Carmen M. Reinhart, is *This Time is Different: Eight Centuries of Financial Folly*.





HEDGE FUND *Rocktober Fest*

A Leg To Stand On's ("ALTSO's") Hedge Fund Rocktoberfest unites over 1,400 leaders in New York and 500 leaders in Chicago from the hedge fund and finance industries for a night of rock & roll and acoustic music performed by key players in the hedge fund industry.

ALTSO is a non-profit that transforms the lives of children with limb disabilities in developing countries by providing them with free prosthetic legs and orthotic devices. In the last 10 years, Hedge Fund Rocktoberfest has been recognized as one of the most unique, highly anticipated, and effective events in the charitable and finance sectors. This year's 11th anniversary in New York and 3rd anniversary in Chicago will celebrate the 11,000 children who have been treated as a result of this iconic event.

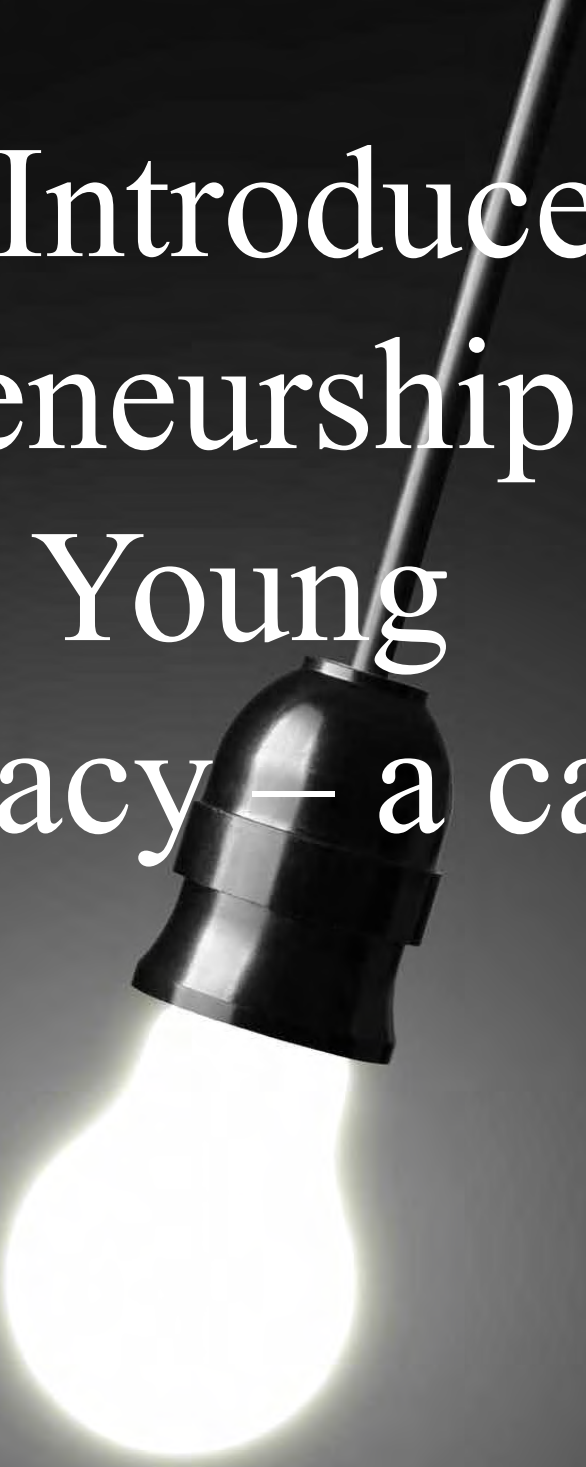
10.22.14 | New York

ALTSO
A LEG TO STAND ON

10.8.14 | Chicago

altso.org/hfr

How to Introduce Entrepreneurship within a Young Democracy – a case study



■ Tom Kadala

During a recent Charlie Rose interview, International Monetary Fund President Christine Lagarde shared her views with a packed audience of international economists in Washington on how young democracies such as South Africa or Malaysia commonly have fragile dual economies operating in parallel, one run by the wealthy and the other by the impoverished. The wider the gap between the two, the greater the likelihood that social unrest will develop, such as what happened in Egypt with the Arab Spring in 2011 and most recently in Brazil last year.



To further explore new insights with countries operating within dual economies, I recently led a facilitated discussion with 38 university students at the Universidad del Caribe (UNICARIBE) in Santo Domingo, Dominican Republic. This island is a foothold for over 10 million inhabitants and a micro version of a typical young democracy. My goal was to hear how young Dominicans felt about their dual economy and to collect a list of recommendations to pass along to political leaders and international creditors. I also hoped their ideas might offer new insights for leaders in other countries.

Universidad del Caribe is not your typical university. With over 19,000 enrolled students and 330 instructors, the university covers an ambitious range of degrees and disciplines at its two-building complex. Students work by day and attend classes one to two days per week. Campus spirit is notably strong, fueled by an enthusiastic faculty comprised of volunteers, many of whom hold other jobs.

Life for a young impoverished Dominican is a daily challenge. Most will spend their lives operating beyond the range of government scrutiny in an underground economy where basic financial stop-gaps such as access to credit for emergencies or a reasonably priced business loan are rarely accessible. Their greatest asset is their ingenuity and vibrant personality, which shines in much of what they do. Job security does not exist. They earn what they can from odd jobs, pay no taxes, and cut corners wherever and whenever – by, for example, stealing electricity off the national grid. Providing for family needs consumes their meager incomes, leaving little to no savings. In short, they have few options within reach to improve their livelihood.

On the other side of the economic spectrum, members of the Dominican middle class have their own set of problems. As avid consumers they buy beyond their means and spend much of their time fighting frivolous lawsuits or fulfilling new government requirements. Aside from

Dominicans see little value in advancing their own education or training, since the better paying jobs can be won with less effort through political connections.

having to pay income taxes, they are also saddled with higher utility bills required to offset the electricity stolen by freeloaders. Surprisingly, the number one aspiration for a young Dominican adult is not to earn a college degree or to own their own business but rather to align himself or herself

with a political party early on in life. In their minds, the only way to obtain job security is by serving a well-connected political group. Competition for these positions can be fierce, not because of an over-supply of skilled workers, who are scarce to begin with, but more for the oversubscribed pool of politically connected job seekers.

Open positions require a minimum of three years working experience, which leaves first-time entrants with no alternative aside from joining a political party. This type of politically motivated workforce, one based on connections rather than qualifications, tends to create a vicious circle. Managers and leaders, also mentors, will send the wrong message to younger Dominicans who will see little value in advancing their own education or training, since the better paying jobs can be won with less effort through political connections. Meanwhile, less qualified government officials are less inclined to require professional certifications from contractors to ensure that state-of-the-art services are rendered. The end result is a less competitive workforce.

The upkeep of a politically motivated workforce can become prohibitively expensive for any government. Venezuela and Cuba are two good examples where individuals are forced into political alliances for fear of being denied even basic services. Over time the workforce becomes lazy, and their leaders complacent. To please their international creditors, government officials devalue their local currency, which only makes matters worse with higher inflation rates. Eventually, both public and private sectors become trapped by the weight of their own unwillingness to progress. Adding to the malaise are party leaders who fail to recognize the immense value their informal sector could otherwise render with existing resources. Instead they would rather keep a tight lid on their potentially vibrant young work-



force – who, due to their discouragement, will enter a life of crime, making matters even worse for their government and the rest of society.

With these facts on hand, I asked the discussion group what they thought was the root cause for their dysfunctional dual economy. Some cited a lack of women's rights affecting the welfare of the family unit. Others pointed to the criminal justice system for sending hardened criminals back out on the streets without offering them a job or alternative forms of income. After a lively exchange, the unanimous vote for the root cause focused on the country's weak judicial system.

According to the participants, on paper the justice system appears formidable, while in practice it is virtually spineless. Laws are readily legislated, approved, and published to please voters; however, in the courtroom these same laws are rarely enforced as written, or at all. For the right price, a political leader or powerful investor can influence a judge's decision to their advantage.

Despite their impoverished status, these 38 student/workers recognized the importance of an independent legal system. Participants noted that whenever politicians or influencers are allowed to operate above the law, trust between the government and its people erodes. This same feeling of distrust infiltrates society and its family units, creating a wider gap in the dual economy. This raised an important question. In a dual economy governed by a biased legal system, what can the government and international financial institutions such as the IMF do differently to create a brighter future for the Dominican Republic?

To counter the gap-widening effects of a weak judicial system, the group suggested the formation of a student entrepreneur as-

sociation based out of the University del Caribe. Members would join the association and then be matched through an interview process according to skills, experience, and interest to a cluster of no more than ten students each. Each cluster would be guided and arbitrated by a university-appointed mentor. At least one member of a cluster would have a specific entrepreneurial venture in mind or a startup in its initial stages. Members of a cluster would become the new startup's board of advi-

On an interesting side note, one individual admitted that if a cluster were to help him launch his dream construction business, he would most likely leave the cluster and not return the favor.

sors and help in their varying capacities to further the entrepreneur's venture. As the venture grows, members of the board of advisors could opt to work for the new entity or start their own venture within their same cluster. The University would act as an independent arbitrator to ensure

members adhere to a clear set of rules and contracts.

On an interesting side note, one individual admitted that if a cluster were to help him launch his dream construction business, he would most likely leave the cluster and not return the favor. His revealing comment confirmed the inherent distrust among his peers, which our facilitated discussion found to be primarily caused by the lack of an independent judicial system. His comment reinforces the university's role as the cluster's so called "mini judicial system," one that is independently operated. Initially the process would most likely be an uphill battle, but after a few success stories it could convince others of the many benefits that can be gained from trusting each other.

Although our time ran out, other questions remained unanswered that could fuel future facilitated discussions. For example, how should the contract among members be drafted and how should the spoils and liabilities of a successful launch be structured to ensure a sustainable business? Of course, securing funding for mentors, garnering support from government officials, attracting outside investors, and designing an ecosystem for future entrepreneurs are important topics too. After the discussion ended, the enthusiasm from both the students and faculty was evident by the clusters that began to form immediately among them.

As I listened to their animated voices, I could not help but think how this two-hour discussion with a sample of prospective local entrepreneurs could potentially change the course of a nation. Hopefully, members of the IMF and other international financial institutions can learn from this case study and consider including a similar cluster program as a funding requirement for young democracies.

About the Author



Tom Kadala is an internationally recognized writer, speaker, and facilitator on topics that concern CEOs and political leaders. He is well versed in economics, engineering, technology, finance, and marketing. His views are regularly published by prominent industry publications and also distributed to an exclusive list of contacts, some of whom he has met personally during his 20+ year tenure as the founder & CEO of Alternative Technology Corporation (ATC, Inc.). At ATC, Inc. Mr. Kadala was the inventor of a fax-on-demand technology called MarketFAX®. His company offered innovative fax marketing solutions and strategic business consulting services to senior management of many corporations including Fortune 500 companies. Long-time relationships include American Express, State Farm Insurance, Unilever, and the US Department of Commerce to name a few.

Mr. Kadala's ability to communicate complex issues to a wide range of audiences in writing or in person has won him a favorable reputation among his peers as someone who is "not afraid to tackle tough issues." Most recently, Mr. Kadala developed a facilitated discussion format called Business Model Innovations or BMIs that was implemented successfully at the United Nations on renewable energy investments strategies for developing countries. Currently Mr. Kadala is seeking a prominent university or "think-tank" type organization that would be interested in promoting/teaching the

BMI process for solving complex problems globally. (For more details on the BMI process, please visit us at ResearchPAYS.net.) Fluent in English, Spanish and Italian, Mr. Kadala earned a B.S. (CEE) degree from Cornell University and an MBA from the Harvard Business School.

Political Risk

Latin America's Populist Cycles

■ Roberto Laserna

Populism in Latin America is at a low point. But, though mounting economic problems facing Venezuela and Argentina might presage a return to market-based economic policies in the short term, this will not end the familiar cycle of populism, profligacy, pain, and pragmatism that has long characterized the region.

Populist parties' rise to power in recent decades benefited from soaring commodity prices, which generated an export windfall that allowed political leaders to spend generously on the poor. However, with prices now softening, revenues can no longer cover the social subsidies that have underpinned populist rule. Furthermore, ineptitude and corruption in redistributing wealth have become more apparent as the region's economies deteriorate, weakening governments' legitimacy.

A populist regime can function over the long run only if there are sustainable funds on which to draw. (It also helps when the ruling party has a powerful enough mandate to run roughshod over the rule of law and minority rights.) Simply put, populists seldom build a healthy economy. Instead, they tend to plunder the productive sectors, and when the money is gone they are either devoured by the crises they created or forced to change course to survive.

Argentina provides a valuable example. Periods of failed populism – featuring state controls over prices, exchange rates, and businesses to redistribute wealth – have been followed by economic reform and liberalization (often by the very same ruling Peronist party). But memories of easy money and frustrated expectations tend to leave voters susceptible to new spending promises. As soon as the economic crisis recedes, the populist cycle begins again. The Argentine and Venezuelan governments are at similar points in this cycle. Their popularity – resulting largely from substantial income

transfers to the poor – is now waning, at a time when severe budgetary pressures rule out further large-scale spending.

Indeed, Argentina recently faced a particularly acute dilemma, following a US court ruling requiring it to repay US\$1.3 billion to US hedge funds that rejected an earlier sovereign-debt rescheduling deal. Argentina's President Cristina Fernández de Kirchner was forced to choose between digging into the country's dwindling reserves or defaulting on all loans – resulting, most likely, in international isolation and a new financial crisis.

Fernández chose the latter, which will only serve to deepen her unpopularity. Her absence from Argentina's World Cup final match against Germany was not surprising; boos directed at her by the Argentine fans would have been the tournament's only certainty.

Venezuela's economic position is also dire. Essential goods are in short supply. President Nicolás Maduro is at a loss to deal with growing political and social discontent, as street protests, which have already claimed 43 lives, continue. For the first time since Hugo Chávez assumed power almost two decades ago, Chavista officials are battling out their differences in public. Like most states that depend on non-renewable resources, Venezuela tends to suffer deeper crises. These countries' subsequent liberalization is usually limited to the few wealth-generating sectors. In this way, populist politicians can retain some economic control while negotiating with investors for new funds. But this approach makes a crisis harder to handle when it finally arrives.

Similar problems are apparent, if less pronounced, in Ecuador and Bolivia under their respective presidents, Rafael Correa and Evo Morales. Both administrations have pursued some pragmatic policies.

Market competition is tolerated among small entrepreneurs. Ecuador's use of the US dollar provides some monetary discipline, and obliges the government to maintain a more open economy.

Likewise, Bolivia's automatic allocation of a fixed portion of tax revenue to local government has created a *de facto* stabilization fund, while cash bond payments to senior citizens have spread some of the wealth. These measures, initiated prior to Morales's election, have reduced the temptation for further economic meddling. But, though the Ecuadoran and Bolivian economies are growing, the more productive sectors that would support sustainable expansion are not. Indeed, both countries have become more exposed to global economic volatility, despite their leaders' vows to reduce dependence on the global capitalist order.

The extent of a country's natural wealth determines the degree and duration of support for populist policies. The crisis for populist governments arises when those vital resources are depleted or demand for them falls. Either way, as the resources boom diminishes, populist regimes lose their legitimacy, because voters still expect to receive handouts.

But the underlying dynamic will not disappear overnight, and no one should be fooled by waning support for populist governments in Argentina and Venezuela. As new political and economic challenges emerge at home and abroad, the populist cycle may well begin again.

About the Author

Roberto Laserna is an economist at CERES, a private research center in Cochabamba, Bolivia, and President of Fundacion Milenio, a think tank in La Paz.

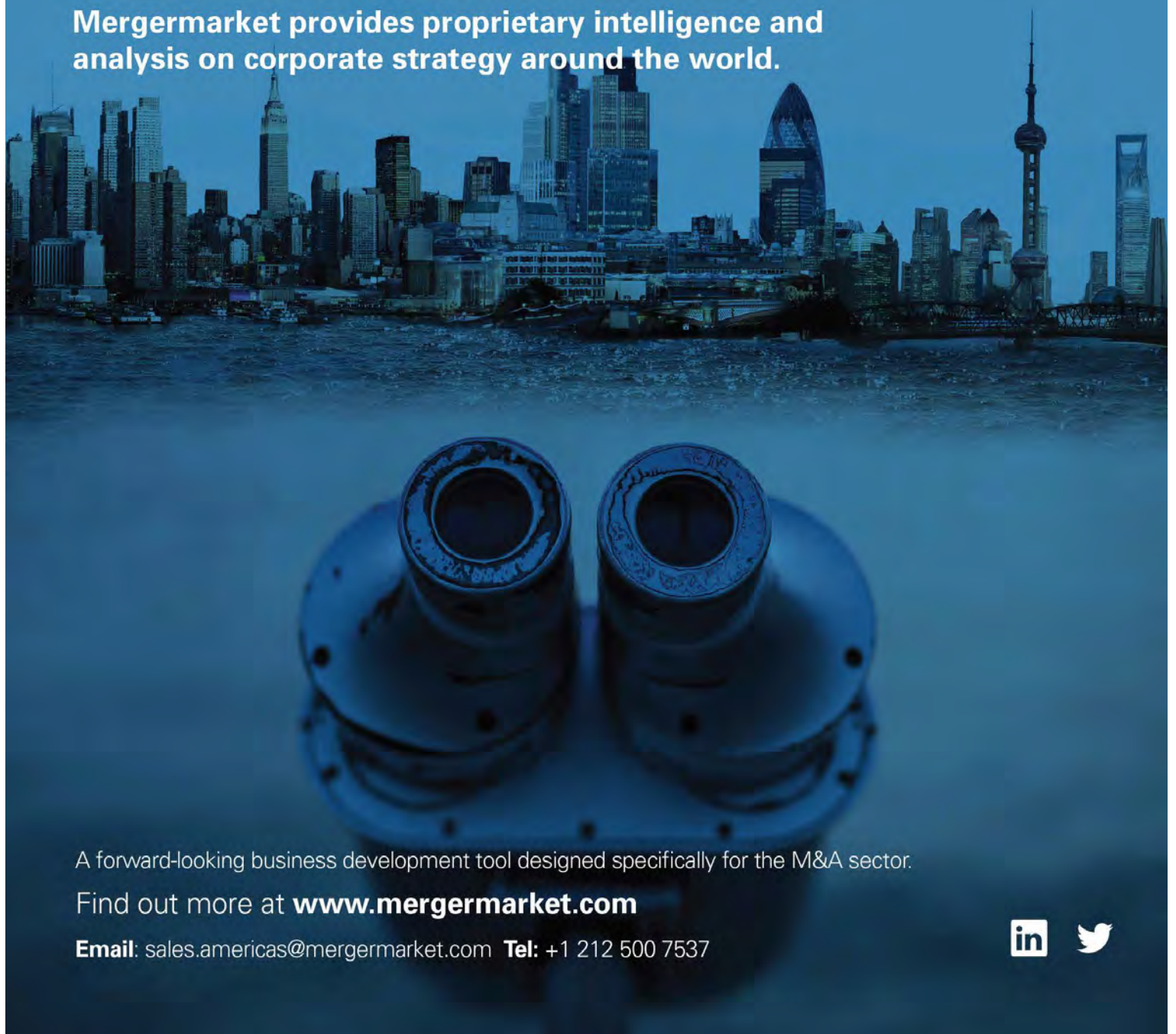




MERGERMARKET

Giving you a window of opportunity.

Mergermarket provides proprietary intelligence and analysis on corporate strategy around the world.



A forward-looking business development tool designed specifically for the M&A sector.

Find out more at **www.mergermarket.com**

Email: sales.americas@mergermarket.com **Tel:** +1 212 500 7537



New Brazilian Rules on Taxation of Foreign Subsidiaries

■ Bárbara Fernandes Vaz

Brazilian Act n. 12.973/2014 recently introduced amendments to profit rules covering foreign controlled companies – rules that seem certain to discourage investors.

The new law establishes universal taxation for foreign companies controlled directly and indirectly by Brazilian entities, which means that every valuation of investments made by the Brazilian company must be registered in its accounting books annually and, therefore, taxed even though the associated profits are not available in Brazil yet. Appreciation in the investment's value will be the basis for the calculation of income tax and contribution on profits related to the Brazilian controlling company.

Moreover, the new rules significantly increase the complexity of profit control. Appreciation and depreciation on an investment must be registered individually in a subaccount of the investment account. This method will probably increase taxation, given that previously taxes were due only when the sum of profits and losses of a directly controlled company was positive. Now, if an indirectly controlled company profits, the gain must be taxed automatically.

Despite resulting from the conversion of Provisional Measure n. 627, Act n. 12.973 has some nuances that may go unnoticed by observers who analyzed the Provisional Measure previously. Not to sound an overly optimistic note, the Act is considerably softer when it comes to controlling individuals. Provisional Measure n. 627 originally instituted the same rules outlined above for Brazilian individuals who control or are owners of foreign companies. This caused a commotion among the investor community because it would impair many small businesses and investments, such as foreign retirement plans, foreign pensions or real estate management. Foreign associated companies may enjoy better treatment in this regard, as the new law requires that profits gained by associated companies will only be computed when

TAKES



available to the Brazilian company, and they will fall into the rules of controlled companies if they are located in tax havens or countries with favorable taxation.

It is important to highlight that this “new” set of rules is, in fact, a rewrite of art. 74 of Provisional Measure n. 2.158-35/2001, which was ruled unconstitutional by the Brazilian Supreme Court (Adin 2.588). The justification for maintaining this rule is justified by some significant lawsuits in-

volving Brazilian companies that did not include in their calculation basis profits of foreign controlled companies, based on agreements for the avoidance of double taxation signed by the countries where those companies are located.

It seems that the government’s motivation is purely to maximize tax collection, as we are unable to glean from the Act any consistency regarding the economic policy the federal government intends to adopt.

This measure will certainly be detrimental to the competitiveness of Brazilian companies abroad, as they will be subjected to more taxation than other companies located in the same places. However, there is hope for Brazilian investors, since it may still be possible to get around the rules with several layers of companies or foreign trusts – at least until the next set of rules are introduced.

About the Author

Bárbara Fernandes Vaz (Barbara@adler.net.br)

Practice Areas: Contract and corporate law, Brazilian taxation over import and export operations, International Commercial Arbitration.

Background: Bachelor of Laws, Federal University of Minas Gerais. Graduate student in International Law, Centro de Estudos de Direito Internacional (CEDIN).

Other Activities: Lecturer on VALE S.A. covering International Arbitration and the Vis Arbitration Moot. Honorable mention when represented UFMG at the Vis Arbitration Moot, Austria (best 32 teams in the oral rounds).

Publications: Article in the special Edition of “Revista de Arbitragem” – New York Convention [Article V(1)], v. 3. Article in “Revista de Arbitragem – GEARB” - The General Procedural Power of the arbitrator and its limits.

Sources:

<http://www.valor.com.br/legislacao/3587204/tributacao-de-lucro-e-tratados-internacionais>

<http://www.valor.com.br/legislacao/fio-da-meada/3572502/lucro-no-exterior-como-politica-economica>

<http://www.valor.com.br/legislacao/3549902/revolucao-do-imposto-sobre-renda>

<http://www.valor.com.br/politica/3548208/tributacao-de-coligadas-pode-virar-embate-judicial>





SAVOY HOTEL • LONDON • UK
20 - 21 OCTOBER 2014

Building Africa's Future through Private Sector Investment

The Global African Investment Summit (TGAIS) taking place on 20 - 21 October 2014 represents your opportunity to discover guaranteed major projects seeking finance across high growth markets in Africa.

Covering the natural resources, agribusiness, power and critical infrastructure sectors, TGAIS already has **five confirmed heads of state** and ministers from African countries including Ghana, Rwanda, Uganda, Tanzania and Togo in attendance.

Don't miss your opportunity to discuss large scale bankable projects and investment opportunities with the industry's key players including board level representatives from organisations including:

African Union Commission • Amatheon Agri Holding • Associated British Foods • Atlas Mara • China-Africa Development Fund • Citigroup • DEG • Denham Capital Management LP • DLA Piper • Duet Group • Ghana Gas Company • Ghana Investment and Promotion Centre • Ghana National Petroleum Corporation (GNPC) • Goldman Sachs • Hermes EOS • Invest in Africa • National Pension Scheme Authority (NAPSA) Zambia • Nigerian Content Development & Monitoring Board (NCDMB) • Nigerian Sovereign Wealth Fund • Nubuke Investment LLP • NEPAD • OECD • PwC • Rwanda Development Board • Standard Chartered Africa • Tanzania Petroleum Development Company • UN Economic Commission for Africa • Volta River Authority (VRA) and many more.

Apply to Attend - Register today and save with our early booking discount.

For further details email christinaadesina@dmgevents.com or call +44 (0) 203 615 1368

www.tgais.com

PLATINUM SPONSORS



GOLD SPONSORS



SILVER SPONSORS



BRONZE SPONSOR



ASSOCIATE SPONSOR



Russia's Eurasian Vision

■ Nouriel Roubini

The escalating conflict in Ukraine between the Western-backed government and Russian-backed separatists has focused attention on a fundamental question: What are the Kremlin's long-term objectives? Though Russian President Vladimir Putin's immediate goal may have been limited to regaining control of Crimea and retaining some influence in Ukrainian affairs, his longer-term ambition is much bolder.

That ambition is not difficult to discern. Putin once famously observed that the Soviet Union's collapse was the greatest catastrophe of the twentieth century. Thus, his long-term objective has been to rebuild it in some form, perhaps as a supra-national union of member states like the European Union.

This goal is not surprising: declining or not, Russia has always seen itself as a great power that should be surrounded by buffer states. Under the czars, Imperial Russia extended its reach over time. Under the Bolsheviks, Russia built the Soviet Union and a sphere of influence that encompassed most of Central and Eastern Europe. And now, under Putin's similarly

autocratic regime, Russia plans to create, over time, a vast Eurasian Union.

While the EAU is still only a customs union, the European Union's experience suggests that a successful free-trade area leads over time to broader economic, monetary, and eventually political integration. Russia's goal is not to create another North American Free Trade Agreement; it is to create another EU, with the Kremlin holding all of the real levers of power. The plan has been clear: Start with a customs union – initially Russia, Belarus, and Kazakhstan – and add most of the other former Soviet republics. Indeed, now Armenia and Kyrgyzstan are in play.

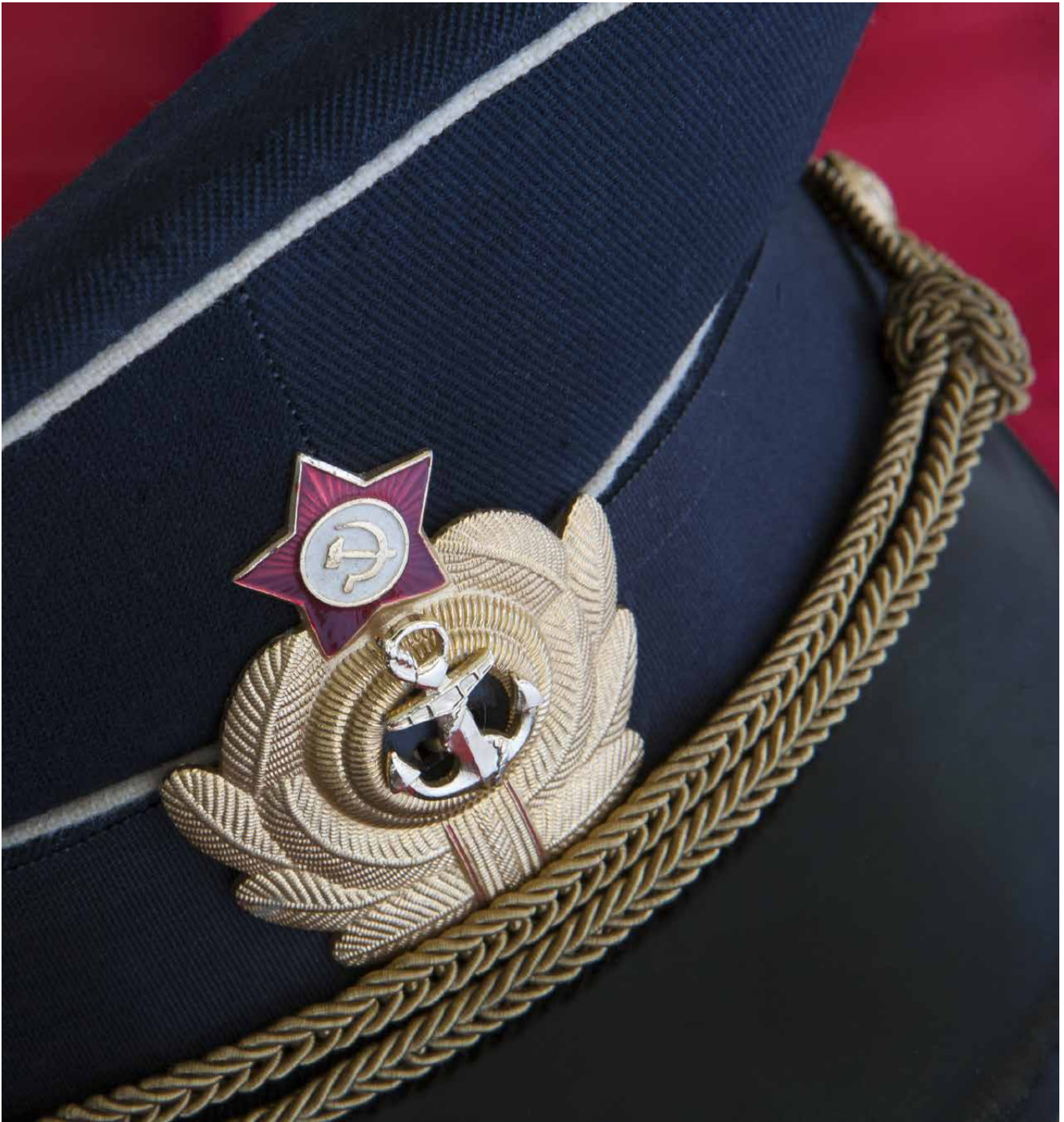
Once a broad customs union is established, trade, financial, and investment links within

it grow to the point that its members stabilize their exchange rates vis-à-vis one another. Then, perhaps a couple of decades after the customs union is formed, its members consider creating a true monetary union with a common currency (the Eurasian ruble?) that can be used as a unit of account, means of payment, and store of value.

As the eurozone experience proves, sustaining a monetary union requires banking, fiscal, and full economic union. And once members give up their sovereignty over fiscal, banking, and economic affairs, they may eventually need a partial political union to ensure democratic legitimacy.

Realizing such a plan may require overcoming serious challenges and the com-





mitment of large financial resources over a period of many decades. But the first step is a customs union, and in the case of the Eurasian Union it had to include Ukraine, Russia's largest neighbor to the west. That is why Putin put so much pressure on former President Viktor Yanukovich to abandon an association agreement with the EU.

It is also why Putin reacted to the ouster of Yanukovich's government by taking over Crimea and destabilizing eastern Ukraine. Recent events have further weakened market-oriented, Western-leaning factions in Russia and strengthened the state-capitalist, nationalist factions, who are now pushing for faster establishment of the EAU.

In particular, the tension with Europe and the United States over Ukraine will shift Russia's energy and raw-material exports – and the related pipelines – toward Asia and China.

Likewise, Russia and its BRICS partners (Brazil, India, China, and South Africa)

are creating a development bank that is to serve as an alternative to the Western-controlled International Monetary Fund and the World Bank. Revelations of electronic surveillance by the US may lead Russia – and other illiberal states – to restrict Internet access and create their own nationally controlled data networks. There is even talk of Russia and China creating an alternative international payment system to replace the SWIFT system, which the US and Europe can use to impose financial sanctions against Russia.

Creating a full EAU – one that is gradually less tied to the West by trade, financial, economic, payments, communications, and political links – may be a pipe dream. Russia's lack of reform and adverse demographic trends imply low potential growth and insufficient financial resources to create the fiscal and transfer union that is needed to bring other countries in.

But Putin is ambitious, and – like other autocrats in Central Asian nations – he may

remain in power for decades to come. And, like it or not, even a Russia that lacks the dynamism needed to succeed in manufacturing and the industries of the future will remain a commodity-producing superpower.

Revisionist powers like Russia, China, and Iran appear ready to confront the global economic and political order that the US and the West built after the collapse of the Soviet Union. But now one of these revisionist powers – Russia – is pushing ahead aggressively to recreate a near-empire and a sphere of influence.

Unfortunately, the sanctions that the US and Europe are imposing on Russia, though necessary, may merely reinforce the conviction among Putin and his nationalist slavophile advisers that Russia's future lies not in the West, but in a separate integration project in the East. US President Barack Obama says that this is not the beginning of a new Cold War; current trends may soon suggest otherwise.

About the Author

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





The World's Premier
Agriculture Investment Conference Series

MARINA BAY SANDS SINGAPORE

23 - 25 SEPTEMBER 2014

**Register now
and save 10%!**
Use code: AEIASIA-14

GLOBAL AGINVESTING SERIES

Global AgInvesting Europe 2014
1-3 December | London

Global AgInvesting Middle East 2015
23-25 February | Dubai

Global AgInvesting 2015
27-30 April | New York

Singapore • London • Dubai • New York
www.globalaginvesting.com/conferences

"I enjoyed all aspects of the conference and especially the singular opportunity to meet some really great people in agriculture. I have to say that I have never been so busy meeting people in such a concentrated period of time."

Robert Cowan, Utah Retirement Systems

Since 2009, GAI has hosted nearly 6,000 attendees worldwide to discuss agriculture as an asset class, including investment opportunities in global farmland and agribusiness operations, ag private equity and agriculture technology.

ANTICIPATED HIGHLIGHTS:

- Over 350 projected attendees, making Global AgInvesting Asia 2014 the largest agriculture investment event in the region
- Industry-specific opportunities, case studies, and discussions, including dairy, permanent crops, and transportation & logistics
- Added networking opportunities with the preeminent gathering of like-minded institutional investors, farm and fund managers and industry stakeholders

WHO ATTENDS GLOBAL AGINVESTING?

- Pension funds
- Endowments
- Foundations
- Sovereign wealth funds
- Family offices
- High net-worth individuals
- Private Equity/Venture Capital investors
- Commodities & futures traders
- Pension fund advisors
- Asset managers
- Farmland managers
- Agribusiness industry executives
- Service providers to the financial and agribusiness communities

Hosted by:



World Cup Aftermath – Effects on Brazil's Presidential Race

■ James Knight

Could a sports game really lose a president an election? Football fans were quick to grasp the seismic significance of Brazil's 7-1 humbling by Germany in the recent World Cup, and in sporting terms it ranks as one of the most unexpected results of recent times, but just how far reaching could the effects of the encounter be on Brazil's political playing field?

A little more than a week after that crushing defeat, polling firm Datafolha released its latest assessment of voter intentions ahead of the October election. President Dilma Rousseff's support slid a further two points from the beginning of July, to 36% – not low enough to lose an election, but not high enough to win it outright either. And this is significant, because Brazil has a second-round run-off between

the two highest-placed candidates in the event of no clear winner in the first round, which tends to consolidate opposition support around the main challenger. While she has a healthy lead on her closest rival (the Senator Aécio Neves, at 20%), when asked about second-round intentions voters put the two neck-and-neck. This is a remarkable decline for a leader who had approval ratings above 70% for much of her first year in office.

■ **Events, dear boy, events**

"Events, dear boy, events." The statement famously attributed to Harold Macmillan about what is most likely to affect the fortunes of governments is as applicable now as ever. The death of Nestor Kirchner was arguably the single most important factor in sealing an election victory for his wife in Argentine elections in 2011; the

train bombings in Madrid in March 2004 three days before polling, and the government's response to them, handed a mandate to challenger José Zapatero; the UK's Sun newspaper still claims that a headline released on the eve of elections in 1992 swung the vote decisively in favor of the Conservative Party.

But can a sporting result really have the same effect, and so long before polling

dal of political favors and kickbacks that exploded earlier in the year. Not because Dilma has been touched by the most serious allegations of corruption, but because she was on the Board of Directors of what is now the world's most indebted company, and signed off deals that were commercially questionable, including the almost US\$1 billion acquisition of a refinery in Pasadena, Texas, that had been bought two years earlier for only US\$50 million.

nect with voters (even during the World Cup she looked ill at ease, in stark contrast to German premier Angela Merkel, whose obvious love for and knowledge of football and familiarity with the players connected her to her people), technocratic competence was Dilma's main calling card. Without it, she is more vulnerable to attacks over the poor delivery of public services, woeful transport infrastructure that has not kept pace with Brazil's devel-



takes place? Most political analysts are downplaying the game's significance, and certainly Rousseff is still in the best position with two months to go, and has time, cash and media opportunities to rebalance her campaign now that the tournament is finished.

It is also true to say that her declining popularity predates the World Cup. For me, the real damage began with the Petrobras scan-

■ Dilma's tarnished halo

This has tarnished the halo of good stewardship and capable administration under which Rousseff was able to win in 2010 (with the not-insignificant backing of much-loved predecessor and mentor President Lula). It was this that enabled her to weather the storm of disappointing economic results for the majority of her term. In the absence of much charisma to con-

opment, indiscriminate public spending that is fueling inflation, and an inefficient business environment.

But don't underestimate the power of football, especially in Brazil, to reflect and intensify feelings of dissatisfaction and insecurity. Ironically, local fears ahead of the World Cup centered on infrastructure failures and widespread demonstrations that could interfere with the schedule of

games, neither of which materialized. What had not been anticipated was such a chronic failure of the players on the pitch, and the effect it could have on the national psyche. Many contacts in Sao Paulo, Rio and Brasilia see the event as symptomatic not simply of the state of Brazilian soccer, but of the country as a whole, which has been papering over the cracks of much of the last administration. An election so soon afterward offers the chance to publicly register this frustration and dissatisfaction, greatly enhancing the prospect that voters will look for something different after 12 years of PT government.

■ **What would change look like?**

It is difficult to tell what a change of Brazilian president would mean for the business environment. Neves belongs to the notionally more business-friendly social democrat PSDB party; he is a congressman with a consummate knowledge of Brazil's notoriously complex and fragmented political system, and as a former governor of Minas Gerais state, Brazil's second most populous, he too has a reputation as an able administrator and technocrat who turned the

state's public sector around. However, at the federal level he will need every ounce of his *savoir faire*, pragmatism and drive in

But don't underestimate the power of football, especially in Brazil, to reflect and intensify feelings of dissatisfaction and insecurity.

order to face down powerful vested interests and push through the reforms to Brazil's business environment that the country

needs to continue building on its economic growth of the last 20 years. The reality is that in Brazil many of the easy gains have already been made, and whoever takes on the next four-year mandate will face tough choices: dealing with the national fuel subsidy, outdated labor laws, and overly complex fiscal regime to improve business efficiency and stimulate private-sector-led growth and poverty reduction.

For all her faults, and her reputation as a tinkerer and control freak (perhaps an effort to compensate for the more laissez-faire culture of decision-making at Petrobras), President Rousseff has a clear vision of the kind of infrastructure reforms the country needs, and as a PT stalwart she is arguably better placed to solve issues with the unions and civil society when it comes to enacting difficult reforms. Despite a thinning lead in the polls, she is still the most likely candidate to win in October. But the sure thing that we were expecting even a few months ago is now the dogfight of the President's life. One hopes, whatever the outcome, that she puts up a better showing than the *seleção* did in Belo Horizonte.



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.



ALTERNATIVE INVESTMENT FORUM

30 SEPTEMBER - 1 OCTOBER 2014 LONDON



Join us for this year's must attend **Alternative Investment Forum** which will take place on **30th September – 1st October 2014** in London.

The highly anticipated **Alternative Investment Forum**, featuring two highly specialized tracks: **Timber Invest and Global Agro Invest**, promises to be an engaging and memorable event, delivering global updates with important takeaways on regulations and attractive opportunities.

Key topics at this year's forum include:

- **Around the world in the real asset universe** - highlighting status and the opportunities in Timber and Agriculture
- **Timber investment** as a growing asset - why you should and why you should not; making it attractive for today's investors
- **Land grabbing** - agricultural land as a profitable asset class ensuring responsible and sustainable investments
- **Asia and impact investment** - realising the needs of this market and its residents for a successful long term investment
- **Investor Only Power Hour -Negotiation** - discuss with your peers solutions and best practices in successful negotiation practices and overall managing strategies of your asset manager
- **Biomass** and its impact on timber prices - short, medium and long term status

High profile speakers include:

- **Adrian Whiteman**, FAO Forest Economics Team Leader, **UN**
- **Andrew Hilton**, Senior Land Tenure Officer, **FAO**
- **Marc Sadler**, Head of the Risk Management and Practice Leader for Climate-Smart-Agriculture, **WORLD BANK**
- **Kim Carstensen**, Director General, **FSC**
- **Mads Asprem**, CEO, **GREEN RESOURCES**

This is the only opportunity for today's investor looking to place or cash in investments in the timber and agriculture assets classes to meet, network and learn about the best opportunities.

Book your place now using reference code **MK-SRAD**

<http://www.arena-international.com/alternativeinvest>

For more information please contact us at event@arena-international.com



AFC Asia Frontier Fund: Capitalizing on Asia's Fast-Growing Frontier Markets

Launched in March 2012, AFC Asia Frontier Fund currently invests in 11 frontier countries in Asia, including Bangladesh, Pakistan, Sri Lanka, Vietnam, Cambodia, Iraq, Laos, Maldives, Mongolia, Myanmar and Papua New Guinea.

We caught up with fund manager Thomas Hugger, who explains what it's like to work in frontier markets, why the benefits outweigh the risks, and what investors need to know before taking the leap.

■ Uncorrelated markets

Mr. Hugger is one of the few fund managers pioneering investments in frontier markets and may be the only one in the world managing a fund with a specialized focus on frontier Asia. The AFC Asia Frontier Fund invests exclusively in listed stocks from Asia frontier markets where foreigners are allowed to buy stocks. Whilst other similar funds invest in some parts of

frontier Asia they also have exposure to emerging markets like China, Indonesia, the Philippines and India in their portfolio which are at a much later stage of development and have a higher correlation with global markets. In Hugger's opinion one of the greatest strengths of frontier markets specifically is that they do not move in lock step with the rest of the world or each other.

"All these countries we invest in are growing incredibly fast from a very low base. Their economies are domestically driven and their stock markets are very uncorrelated to the rest of the world. Moreover, these markets have a young and cheap workforce which makes these countries very competitive compared with the rest of Asia and other parts of the world."

Very bullish about future prospects, he explains that foreign investors make up only 5 to 10% of the daily stock market volumes of Vietnam and Bangladesh, which

represent some of the more developed frontier markets in Asia. Typically fund investment is done as part of a large global portfolio that buys large cap stocks across the board, which means there is plenty of low hanging fruit for niche strategy funds such as his.

"If you are trying to allocate billions of dollars to these markets you are faced with an issue where you need to actively manage your liquidity risk. To get portfolio exposure to individual markets these funds are forced to buy the large cap stocks which are more actively traded but that means you can't necessarily buy stocks that are undervalued. Larger funds can push up the valuations in the large-caps names and these funds end up paying a liquidity premium. My strategy takes this into account and our ability to also look below the large caps which have been bid up is what gives AFC an edge over the less flexible larger funds."

■ Consumer stocks

The AFC Asia Frontier Fund focuses largely on consumer stocks, which in frontier markets cost half the price of the same stocks in more developed Asian Markets.

“You can invest in a fast growing market at a cheap valuation. Forty years ago when you bought a product in North America or Europe and looked at the label, it was made in Hong Kong. Twenty years ago it was made in Taiwan. And five years ago, it was made in China. But that is changing now or has already changed to places like Bangladesh, Cambodia, Pakistan and Vietnam.”

“You need to buy the stocks now whilst this is shifting. The monthly salaries in China have now gone up a lot, at an average of US\$260, whereas in Bangladesh it’s around US\$100 or even less than that. That’s the big competitive advantage of those countries capturing global manufacturing market share such as Bangladesh, Vietnam, Cambodia, Myanmar and Pakistan,” Mr. Hugger says.

And while China’s economy develops, its manufacturing is shifting from low-tech to high-tech, which has a dramatic impact in the consumer space.

Meanwhile, some Asian frontier markets are focusing on production for export, for example in the textile sector. And although the growth of a middle class is undeniable, Mr. Hugger believes domestic consumers are still not enough of a market for this model to shift in the near future.

■ Risk

Like all frontier markets, the Asian countries AFC Asia Frontier Fund operates in tend to be perceived as risky. But the annualized volatility of the fund’s portfolio is actually slightly lower than the MSCI world index.





“There are different reasons for it; first of all, because the correlation is low and the second thing is our investment style. We invest in undervalued stocks and in stocks which have a very defensive nature, like consumer staples.”

He adds that the risk the fund does experience is mostly political, but the stocks are more stable than in developed markets because of fewer investors, who all tend to be very cautious.

As for China’s so-called “slowdown” – often perceived as a risk by foreign investors

– Mr. Hugger puts things in perspective. “China’s economy grew by about 8.25% over the last decade on average, and now it’s slowing down to 7%. Greece, Spain or Italy would love to have 7%.”

“Also, the slowdown is partly due to the fact that more and more manufacturing is shifting into other countries like Vietnam, Bangladesh, Indonesia, the Philippines, Mexico or even Africa.”

While a lot of companies are shifting away from China, the country itself has started to invest more in places like Pakistan and

Iraq, which are not hugely popular with Western investors.

“As a friend told me, if you’re flying to Myanmar, which is one of the hottest spots for investment, the planes are full of Thais and Koreans and Japanese, but you hardly see a caucasian face. I think Asians are really, really ahead of investing into this new frontier like Myanmar, Iraq and Pakistan,” adds Mr. Hugger.

However, investors should be aware of regulations in the region, as the ease of “getting out” should things go wrong var-



ies widely from country to country. “In Vietnam and Pakistan, it’s okay, but in Bangladesh it takes about two to three weeks until you can use the sales proceeds. In many countries, especially Bangladesh, the government officials and bureaucrats are very worried about foreigners manipulating stock markets.”

■ Top to bottom

The AFC Asia Frontier Fund uses a top-down approach to allocate funds, which helps it mitigate corporate and currency risk.

“All these countries are in different economic stages, for example Vietnam is far ahead of Cambodia and Cambodia is ahead of Laos, even though they are neighbors. Or we have countries like Papua New Guinea or Iraq, which benefit from high oil prices, whereas Bangladesh and Sri Lanka will suffer from a high oil price.”

“They’re all very different and also, at the moment, we cannot hedge the currency risk, so we use a top-down approach to manage the risk, especially the foreign currency risk,” Mr. Hugger says.

According to Hugger, currency exposure is different in each country, and since launching the fund, some of the countries’ currencies have even slightly appreciated against the US dollar, even when the perception is that the currency is depreciating.

For example in Bangladesh and Sri Lanka the currency has remained fairly level. In Cambodia and Laos, the currency is as stable as the Hong Kong dollar, but in Vietnam, for example, the dong loses 2 to 3% of its value almost every year.

As for Mongolia, the recent FDI issues have seen the value of the currency drop roughly 30% over the past 18 months. The currency situation could turn around rapidly, however, if the government does more to attract international mining investment.

■ Type of investors

Asia Frontier Capital is a boutique company that runs two funds. The AFC Asia Frontier Fund is their multi-country fund which has approximately US\$10 million under management whereas their Vietnam dedicated AFC Asia Frontier Fund, which launched in December 2013, has approximately US\$7 million under management.

“Around one-third of the investors in AFC Asia Frontier Fund are from the US with the remaining two-thirds coming from Europe – mainly Switzerland and the UK. As the AFC Vietnam Fund isn’t open to US investors most of our clients are from Europe. Typically our investors are either high net-worth individuals or family offices, but there has been a great deal more interest from wealth managers, funds of funds and endowments in 2014,” he notes.

“We are now also seeing some Asian-domiciled investors coming on board, but without exception they are expats living in Asia for some time, who saw the development in Thailand in the 1970s, India and China in the 1990s and now see this opportunity in Vietnam and Bangladesh. It is surprising that we have so few investors who grew up in Asia in our fund as they have seen the incredible regional development first hand. Given how much of the wealth controlled in Asia today was accumulated from the increase in economic activity due to FDI from outsourcing, and the rise in consumption that followed, why

they do not yet have exposure to the next wave in Asia’s frontier markets is beyond me,” Mr. Hugger explains.

■ Investment tips

According to Mr. Hugger, the perfect investor for an Asian frontier market has a

“Asian Frontier Markets have very similar growth potential to China 20 years ago and at the moment investors can get in ahead of the crowd before stock markets are pushed up.”

time horizon of around three to five years, as they are able to then wait and maximize their potential upside. Having this time horizon also helps to minimize the short-term market noise, as while the economies in

these countries are definitely on an upward trend, there will no doubt be pullbacks in the bull market.

For that reason, Mr. Hugger recommends allocating only a proportion of what the investor actually wants to put in the region, and keeping the rest to invest more when setbacks occur. “If that pullback appears, investors should have ammunition to buy more. Don’t leave; instead use these opportunities to invest more,” he says.

He also stresses the importance of investing with an active fund manager. While in developed markets it is possible to buy an ETF or index fund, as the stock market is the most important thing and returns are in high correlation with the underlying GDP growth, in emerging markets it is crucial to invest in the right companies. Active doesn’t mean that he trades your stock every day; it just means investing in good companies and absolutely not mirroring an index.

“Just because large companies get put in an index doesn’t necessarily mean that they are good companies. Investors should look out for that. For example,” he continues, “in China the index has gone down a lot, and the reason for that is that when the Chinese indexes were launched a few years ago, about 60-70% of the index is made of large badly managed state-owned companies. The Chinese government still has a lot of shares, and whenever a stock is going up, they sell more shares, because they want to diversify. But if you have been investing in consumer stocks or IT stocks or distribution, for example, you were able to make a fortune in China. And you have similar examples in other countries. So investors should not invest in an index in emerging and frontier markets, but in an active fund manager instead.” Mr. Hugger points out.

The Importance of Liquidity

Monitoring liquidity is something that goes in and out of fashion, and after an era of popularity in the 1980s, investors started to base their judgment on interest rates alone - which cost them dearly in the global financial crisis.

Now central banks are injecting more liquidity into the markets, and analyzing its levels is back on investors' list of priorities.

"Basically the modern monetary system is really a re-financing system and it needs liquidity as a lubricant, and that is basically what was missing in 2007/08. It's now back again," says Michael Howell, managing director of research and investment firm CrossBorder Capital.

He explains that liquidity is the first link in the investment chain, giving investors and other market participants funds to "go out and pressure things", which usually leads to faster economic activity, and is reflected in asset prices.

"I think the clearest example of how liquidity works is to look at the quantitative easing (QE) exercises with the Federal Reserve and to note the fact that ever since the Federal Reserve turned the money tap on, US asset prices are considerably higher while when it turns the money tap off asset prices can come down again," he adds.

■ US situation

In order to gauge the health of a financial system, it is important to look at what the economy considers "safe" assets, i.e. domestic cash. According to Howell, there was a shortage of US dollars in 2007/08, and Federal Reserve has since injected a lot of liquidity back into the market, bringing refinancing risk down.



In global terms, the US dollar remains the paramount currency, despite what a lot of economists, who claim China and India have taken over based on GDP growth numbers, say.

“That may be true in terms of GDP numbers, in terms of currency, the US is even more dominant than ever, was used to finance about 70% of international flows. Ever since the fall of the Berlin Wall emerging economies have used dollars; the world needs dollars.”

“During periods where the US economy is very strong and therefore the supply of international dollars is lower, tightening by the federal reserve, or when the US cur-

rent account deficit is shrinking, the world economy becomes starved of dollars and there are insufficient safe assets for the international economy to operate,” he says.

For that reason, the US makes a lot of efforts to keep dollars within its boundaries, which is currently causing an issue on a global scale. “What we are getting is that Federal Reserve tapering, alongside a strong US economy, alongside a closing of the current account deficit because of shale oil, which is making the US move toward current account surplus. That means that the conduit for international dollars is basically shrinking, and the dollar is becoming a scarce currency,” Mr. Howell adds.

■ Renminbi threat

When it comes to the much-hyped rise of the Chinese renminbi, Mr. Howell doesn’t believe that is a threat to the US dollar in global financial markets.

“It may be high on the wish list but in terms of reality it is not there; the Chinese would like it to be used more but unless they force people to do it there is no way it will happen,” he says.

Even in the long term, he doesn’t think the renminbi has the potential to overtake the dollar. “It may be more important than it is now – that will clearly be an aspiration of

the Chinese with a faster growing economy, but if you look at the Chinese economic model it basically mirrors what I call the Soviet growth model that the USSR used to follow; embarking on massive capital expenditure in a context that does not create economic growth. We are not seeing a reality in China, and the economy is starting to see a much slower trend growth rate, which has been one of the warnings for much of the last four or five years.”

■ Liquidity movements

According to Mr Howell’s analysis, over the last five years money started avoiding emerging markets and returning to Anglo-American markets.

The reason for that is that emerging markets faced the tightening of China’s monetary stands in trying to slow the economy down, which caused investors to shun the market, and the complacency of corporates, which did not tackle the issue of cost restructuring and consequently damaged margins.

In contrast, the US is experiencing higher return on capital, growth recovery and strong profitability, making it a magnet for foreign funds.

“Generally speaking the world has shifted from the absolute honeymoon with emerging economies that was much of the last ten 15 years to the current reality of the stronger US economy,” he says.

In the short term, the big issue has been political unrest, particularly in Thailand, Ukraine and now Iraq.

“Thailand has lost around seven billion net of funds certified this year. If you look at Russia there has been a huge export in money over the course of the last 12 months – it didn’t just begin with the inva-

sion of Ukraine; it started to occur in May of last year, but the trend has been mostly a clear outflow of money.”

As a result, Mr. Howell believes there is a short-term buying opportunity in Thailand and Ukraine, as a big exodus of funds tends to be followed by a very strong rebound.

■ Market projections

While the developed world cycle is largely driven by US monetary policy and the US economy, emerging markets are much more affected by the Chinese economic cycle monetary policies. Judging from that, CrossBorder Capital expects what Mr. Howell calls “the worst of both worlds”.

He explains that China’s current monetary stance is not dissimilar to what happened in Japan through the 1990s. “You have got to measure that not in terms of the depths of monetary timing but the duration of monetary timing. In other words, this monetary tightening could go on for several quarters of economic years.”

The US on the other end is removing excess bank reserves in the system. “Every time a quantitative easing (QE) has ended in the US, such as QE1 and then QE2, the bond markets have rallied strongly and the equity markets have basically flatlined, and you are looking at exactly the same situation right now,” Mr. Howell points out.

CrossBorder Capital monitors the amount of money that physically gets into the markets very closely, and based on that the firm predicts that the US will continue to taper monetary conditions, which will take US liquidity down from the heights it has been at and put the financial system on a firmer footing.

The company also expects China to continue its “soviet stance” of operating well into 2015. “I don’t think anything is going to be in great movement in the Chinese market, so from an investment standpoint, given the fact that the market looks forward, it may be an opportunity to buy into these markets at low levels, anticipating some better news next year,” Mr. Howell says. In Japan, a weak economy combined with growing inflation makes it difficult to engage in quick easing of the monetary policy, no matter how needed it is.

“Meanwhile, the Europeans are talking a good game. I am not sure they have the fire power, the ability to actually push a lot of liquidity back into their system very quickly, but the real risk for Europe in the near term is past deflation in the high street. If that is the case look at the analogy for Japan: markets fell, equity markets fell in Japan as soon as deflation appeared in the headlines,” he adds.

As for Argentina, it will follow the trend of a region dominated by commodity prices, and therefore affected by both China and the US. An acceleration of the Chinese economy – which is unlikely to happen before 2015 – would create an uplift in commodity prices. And when the US starts to ease its federal reserve policy, the result is a drop in commodity prices.

Mr. Howell defines four phases of a market cycle: rebound, calm, speculation and turbulent. He believes 2012 was a rebound year, 2013 was the calm year, with equity performing well and high yields. “This year is more of a speculation year, with the risk-return trade looking favorable. We are favoring things like US treasury and investment growth debt: of the major equity market our favorite one has been the US. And if you are looking at 2015 that is a phase we think of as turbulent, when volatility is definitely going to pick up, there is a lot less liquidity around and the economy starts to

EMIA Offers Informative Hub for Emerging Market Investors

The growing importance of emerging and frontier markets in global investors' portfolios means the need for reliable insight about these markets is greater than ever before.

But for most investors, it remains difficult to find. Mainstream media sources, for all the added attention they've given to the subject, largely fail to deliver accurate and timely information pertaining to real opportunities, while the on-the-ground, actionable expertise of seasoned investment professionals remains obscure or inaccessible to many investors.

Now, a new not-for-profit organization is trying to close this knowledge gap. The Emerging Market Investors Association (EMIA) launched last May to educate global investors about developing market investment and to connect them with the right investment professional.

Through its website and a variety of media, EMIA publishes free information on

developing market investment and related topics, while providing developing-market-focused investment professionals crucial exposure and a platform for delivering their expertise and actionable advice to a global audience.

The association is the first of its kind devoted exclusively to developing markets across asset classes, already garnering high-profile members such as Sturgeon Capital, Greylock Capital, Asia Frontier Capital, and others.

"Emerging and frontier markets have grown enormously in importance precisely during the so-called information age," said Nate Suppaiah, EMIA's founder and director, in a recent interview. "And that makes the paucity of reliable information about these markets and the investment

professionals working there all the more shocking."

He says mass media coverage of developing markets usually gives partial accounts of geopolitical dramas, ephemeral investment trends, and the oft-misleading performance of equities markets. Meanwhile, strong investment stories are missed (particularly in alternative asset classes), and knowledgeable, on-the-ground investment professionals are ignored.

"The idea behind EMIA is that emerging and frontier markets are here to stay and they'll be increasingly relevant over time. But the purpose is not to say, 'Invest in emerging markets now!' We're not marketing a trend. We're marketing actionable investment expertise and helping to educate investors."



Dedicated to education

Mr. Suppaiah has spent much of the last decade educating investors about emerging markets, largely as a publisher. A former broker at Oppenheimer, he founded the magazine *Alternative Latin Investor* in Buenos Aires in 2009, focusing on alternative asset class investing in Latin America. The magazine's thesis remains true today: While Latin American markets offer excellent opportunities to sophisticated investors, it's difficult to get exposure to these markets through conventional investment vehicles. Instead, alternative asset classes are often the best way to get exposure to the region.

Mr. Suppaiah published ALI from 2009 to 2012, during a veritable golden age of alternative asset class investment in Brazil, Colombia, Mexico, Peru, and elsewhere.

As he saw investor interest expand to other emerging markets – and saw increasingly

strong ties forming between developing market economies – Mr. Suppaiah reconceived and rebranded his magazine venture in 2012, launching Alternative Emerging Investor. AEI added Africa and Asia to its coverage of alternative asset class investment, while incorporating other relevant though frequently overlooked topics such as corruption and cyber-security. The focus remains on delivering actionable insight from top investment professionals.

Knowledge sharing

EMIA builds on Mr. Suppaiah's publishing pursuits, delivering analysis and opinion from expert contributors on its website along with proprietary material from partner media outlets including Roubini, the World Bank and Barron's. AEI is now EMIA's official magazine.

But it also represents Mr. Suppaiah's move from merely covering emerging market investment to working with in-

vestors and investment professionals directly.

“I see it as the final piece of the puzzle, personally. I want to continue publishing valuable information, but I also want to start taking what we’ve learned over the years to make the right connections for people in the industry.”

One of the most important developments he's witnessed in covering these markets, Mr. Suppaiah says, is that the quantity and quality of sophisticated, local investment professionals continues to rise.

“Investors need information from the right human resources on the ground, particularly with alternative asset classes. I know first-hand that those resources are there. EMIA is an effort to connect them with investors.”

A recent report sponsored by Principal Global Investors emphasizes the impor-



tance of local expertise in emerging market investing. Investors are becoming increasingly discerning when it comes to developing market investment as a whole, the report found, attuned to the diversity and inconsistency of opportunity and the prevalence of volatility. Increasingly, these investors are making tactical, opportunistic investments, requiring “high-conviction specialists” to help them navigate these markets and make deals.

Likewise, Mr. Suppaiah says his years of interviewing hundreds of investors and investment professionals from around the world taught him that local, sophisticated, on-the-ground expertise is crucial.

“The new age of emerging market investment isn’t just about new opportunities or new versions of the same opportunities. It’s about harnessing sophisticated knowledge of these markets from people who really understand the dynamics at play.”

■ **Marketing for investment professionals**

Another issue Mr. Suppaiah has witnessed over the years, and which EMIA aims to remedy, is the lack of marketing resources among developing market investment professionals, particularly in boutique firms.

“Many of the great boutique firms don’t have the time, budget, or skills to market themselves effectively to global investors,” he explains. “We help them by providing exposure and a platform.”

Each EMIA member is given a profile page on the website. Profiles are published in AEI magazine and on a rotating basis on the EMIA homepage and in its newsletter.

Members are also invited to share their expertise in the magazine or via webinars hosted by Mr. Suppaiah himself, which are made freely available as podcasts on the website.

“We’re trying to bring 21st-century-style marketing, knowledge exchange, and networking to an industry that sorely needs it,” he says.

*The association
is the first of its
kind devoted
exclusively
to developing
markets across
asset classes*

■ **The changing landscape of global investing**

Investor perception of emerging markets has completed a full cycle since Mr. Suppaiah launched Alternative Latin Investor in 2009. The aftermath of the global financial crisis saw an unprecedented influx of capital into emerging markets, only for the tide to change in 2012 and 2013 as growth statistics and the effects of quantitative easing in the US, among other factors, sent many global investors back to developed markets.

Now, EMIA has appeared with a new wave of investor optimism regarding developing

markets in general and frontier markets in particular.

“These cycles are a reality of developing markets,” he says. “In fact, they account for many of the best opportunities, as well as for the savvy of the investment professionals working there. The best managers know how to weather these cycles and use them to their advantage.”

He says the recent optimism reflects a broad awareness that the long-term growth story is still valid in many developing markets, while transparency and policies continue to improve. He emphasizes, however, that the concept of “emerging markets” is changing – and goes well beyond the BRICS of yesteryear.

“The BRICS are no longer the only game in town. Five or ten years ago, they were obviously the main story among developing markets, and we can be thankful to Jim O’Neil for coining and marketing the term – he really captured a certain zeitgeist.”

“But they were sort of like a door that investors could pass through. They were easy to understand, they had big economies that mirrored other big economies that people knew about, they had transparency relative to frontier markets. But as people got accustomed to them, they began looking elsewhere. You could say investors have become more familiar with the unfamiliar. The BRICS remain massively important to the global economy, but investors are willing to look elsewhere to find what’s right for their portfolios,” he says.

“But again, that requires education and the right people. EMIA exists so that investors can find both.”





Bonds & Loans MEXICO

7th October 2014, Four Seasons, Mexico City

SAVE 20% with
promo code **AE20**

Mexico's largest credit markets event



2014 Sponsors

Platinum sponsor

BBVA Bancomer

Gold sponsors



BNP PARIBAS
CORPORATE & INVESTMENT BANKING



MUFG



Santander

Cocktail sponsor

HSBC
Global Banking and Markets

Silver sponsors

FitchRatings

Bronze sponsors

Bloomberg

**CHADBOURNE
& PARKES**

**RITCH
MUELLER**

Milbank

**Moody's
ANALYTICS**

**STANDARD & POOR'S
RATINGS SERVICES**
McGraw Hill Financial

UNIFIN

Supporting Organisation

EMIA

www.bondsloansmexico.com

INDIA

Opportunity in the Air

India's May 2014 general election saw the victory of the business-friendly Bharatiya Janata Party, led by Narendra Modi – and raised hope that more foreign investment would come flooding into the country as a result.





Since the election, India's new commerce minister Nirmala Sitharaman announced that the government would stay tough in trade talks and keep India's retail market closed, but also try to attract more foreign investment by lowering barriers to

business and clarifying tax laws – a move that should be welcomed by international investors.

Gaurav Aggarwal, CFA, co-founder and portfolio manager of Mauritius-based Indian listed equity investment firm Metis

Capital Management Ltd., explains: "From a macro perspective it's definitely a step in the right direction for the country as well as for the overall fund flow and sentiment. Even without the 'Modi effect' the Indian economy was poised to improve a bit this year from 4.7% to 5%+ GDP growth this

coming fiscal year, so we will see higher growth, which will lead to more cyclical sectors continue to perform well.”

He adds that from late 2010 to the end of 2013 foreign investors were the ones that kept the market going when confidence was faltering as a result of a growth slowdown. “Domestic people have sold and foreigners have propped up the market; they’ve had more faith in the Indian story generally than the Indians themselves.”

Trust in the government has always been an issue for Indian investment, and Indian citizens tend to either keep their savings or invest them in hard assets like gold and real estate. Though motivated by cultural reasons, this also proved to be a wise business decision, as Indian real estate and gold has provided investors with double-digit returns in the past four years, while the stock market underperformed. But now that the government is starting to execute its announced vision, domestic investors are slowly coming into the market.

“You can see the domestics starting to come into the picture and foreigners are even increasing their allocations, but we feel there’s still a long way to go especially on the domestic institution and retail side so that’s what will be the next leg up in terms of the technical driver of the market,” says Mr. Aggarwal.

■ International investment

Though gauging where international money is coming from is tough as a lot of investors use Mauritius or Singapore as intermediaries between their country of origin and their investments in India, US and European mutual funds (including ETFs) form the biggest percentage of foreign institutional investors in the Indian market.

“One fifth of the Indian market is foreign and half of that is mutual funds,” says Mr. Aggarwal.

He points out that now is a good time to invest in the country, as both the cyclical and structural factors are improving due to the political changes and economic climate.

“The thing to remember is that India has times of extreme optimism and pessimism while underlying growth continues at 5% plus – very high relative to the rest of the world. There’s huge amount of micro work to be done in India so one has to keep it long-term focused; at least two to three years. Large multinational companies are even starting to increase their exposure and priority ranking of India so there will be better FDI flows, not just foreign institutional flows.

“In every sector of the economy I could talk to you about there are so many issues and constraints, and how they will tackle these is quite mind-boggling, but decisions have to be made and the vision has been clearly laid out. If Modi doesn’t deliver the same thing will continue to happen and he’s very well aware of that – expectations are extremely high. The whole world is watching and I think he’s the kind of a leader who has the best chance to deliver, the only one in Indian history who has come from the ground up, has a clear free market vision and has a verifiable track record.”

■ Unique market

India is very different from other emerging markets both in terms of sector mix



– with its developed technology segment – and pace of development. Moreover, its structure and politics make it an extremely complex market that potential investors need to be prepared for.

Metis co-founder and portfolio manager Piyush Sharma explains that in order to successfully invest in India, prospective investors must “unlearn” some of the things developed markets taught them. “For many businesses you may have to throw metrics such as returns on invested capital and free cash flow out of the window when you’re evaluating Indian businesses, and for good reason. Those metrics were designed for geographies where most of the capital expenditure would be for maintenance and inflation remains structurally muted. When I look at an economy

like India most of the cap ex would be expansion capital.”

“Similarly, something like return on invested capital: I can show you several relatively new businesses in India where marginal returns on invested capital would be higher than some of the other legacy peers, but the conventional calculation of returns on invested capital might be lower. You’re looking at an economy where there’s an average 7-8% inflation in the last decade. Legacy businesses that have been here for 30-40 years have an artificially deflated invested capital denominator base. In comparison, some of the newer smaller businesses that have started in the last 15 years would have more attractive marginal metrics, but their typical return on invested capital metric would look worse.”

Focusing on absolute value and doing due diligence on the ground are also paramount.

According to Sharma, the perfect investor in India needs two critical things. One, they need to recognize that price discovery is extremely poor, in a market where half of all volume is retail, with liquid derivatives on only a handful of names. “However, going back 30–40 years, over any three-year rolling periods, India is as efficient a market as any developed market. Its earnings and asset prices disconnect during periods of panic and euphoria, but unless you see one of those two, you’ll typically see earnings and stock prices generally tracking each other. So when investing in India, look three years out because dislocations can occur over shorter periods,” he says.

The two cofounders chose India not because of their origins, but because of the market’s macro and micro structure. They believe that the country suffers from extreme skepticism when it comes to small and mid cap names, and these are names where they can selectively pick clean assets at attractive valuations.



Second, they should aim for a superior up-down capture: Though highly correlated with the market, they can grab more and more of the upside, and as little of the downside as possible. “If you believe that you will be immune to the asset price downside in the short run, then you shouldn’t be investing in India. Even though you might be invested within a business that’s perfectly clean and not decelerating in a broader downturn, its valuation is likely going to fall during periods of panic when broader stock prices drop 20%+, but you would see lot of our holdings drop much less. So it’s critical that investors appreciate those two things.”

■ About Metis Opportunity Fund

Although the fund launched in March 2014, the strategies that the fund employs, namely India Undervalued and India Underserved, have an audited track record since late 2010. From the start, the managers have been investing in “clean” businesses run by managers with a proven ethical track record, deploying an exten-

sive forensic approach to their evaluation process.

The two co-founders chose India not because of their origins, but because of the market’s macro and micro structure. They believe that the country suffers from extreme skepticism when it comes to small and mid cap names, and these are names where they can selectively pick clean assets at attractive valuations. They point out how the sell side “concierge service” isn’t required, as they screen and dive deeper into most of these names themselves.

Mr. Aggarwal points out that the firm started at the previous cycle market peak time, and that shortly after, economic growth started slowing down. As a result Metis adopted a rather conservative approach, digging into the mid and small-cap sector and putting consistency on top of its priorities. “You want consistency of growth in the past ten years; even through the down cycle and falling earnings you want to see management who have withstood the pressures (and indeed prospered/invested for future growth) of the last four years of sharp slowdown.”

“We are value investors in a very high-growth economy. The cost of capital is high so our hurdle rates are high and we are looking for very clean businesses with high growth and very clean management in terms of ethics and capability. Valuation has to make sense in the long run and in the short run – these are some of the reasons why we’ve delivered over the short and long run versus our peers and benchmarks.”

Mr. Sharma adds that although the firm is capitalization agnostic, its current book includes only a single large cap name. “Small and mid caps: that’s where we continue to currently see the biggest opportunity. Over eight-hundred million people (more than 1/10 of humanity living under \$2/day) must have their standard of living catch up with the rest of the world—we humbly feel this is the world’s greatest challenge and opportunity.”



NORTH AMERICAN INVESTORS summit

September 8-9, 2014
The Ritz-Carlton Buckhead | Atlanta, GA

<http://nainvestors.marcusevans-summits.com>

REACH CIOs FROM AMERICA'S INSTITUTIONAL INVESTORS:

Participation from

- Economical Mutual Insurance
- AZ Public Safety Personnel Retirement System
- Northern Trust Co

Your sponsor package at the **North American Investors Summit** includes all the essentials needed for a productive and rewarding event. Each of your representatives at the summit will receive:

- A two-day agenda of 10-15 pre-scheduled meetings in advance of the summit
- A directory of delegates attending the summit
- All meals and networking activities
- Access to premium event content, exclusive presentations, interactive panels and all summit proceedings
- Accommodation at a luxury five star venue

A wonderful
experience! High
caliber participants
and presentations.
An extremely
well-organized
experience throughout.

Chief Endowment Office
Jewish Community Federation and
Endowment Fund

CONTACT:

Jenny Keane, 312 540 3000 ext 6515 j.keane@marcusevansch.com


marcusevans

Protecting Your Assets in the Electronic Wild West

■ **Mark Johnson, CEO, Sovereign Intelligence, LLC**

The headlines say it all. “Breach Involved 3 Million Customers.” “Data breaches targeting retailers affect millions of customers.” These headlines are hardly anomalous. Every day, stories of data breaches, identity theft, and credit card fraud can be found littered in newspapers across the globe. As technology continues to digitize every aspect of life, the threat to electronic information is expected to grow significantly in the years ahead. For businesses, cyber threats pose a particularly acute challenge. Insider threats, corporate espionage, organized criminal syndicates, freelance hackers, and state-sponsored actors are among the most notable threats every business must be prepared to counter. Protecting a business

from cyber threats is a 24 hour a day, 365 days a year task. With much of cyber space operating as a proverbial wild west, businesses must adopt a cyber-strategy focused on proactive defense meant to identify, counter, and defeat threats before they have the opportunity to cause irreparable damage.

■ **The macro threat**

Businesses face an acute uphill struggle in the fight against cyber criminals. Unlike traditional crimes, cyber-crimes are proving both highly lucrative and difficult to defeat. Until the digital age, the biggest threat to businesses was the occasional armed rob-





ber, fraudster, or rogue insider. Today, cyber criminals operating thousands of miles away can potentially gain access to and divert millions of dollars from a business, steal proprietary information, or cause crippling infrastructure attacks that can disrupt operations. This new dimension in security has fundamentally altered how businesses must approach the handling of proprietary or otherwise sensitive information.

The cost of cyber crimes can be immense. Estimates have placed the cost of cyber crimes on the global economy from hundreds of billions of dollars to upwards of one trillion dollars annually. Management is not immune from the fallout of such crimes. The CEO of Target Corporation was fired only months after the company fell victim to a serious attack. The signs are clear: the costs of cyber crimes are immense and growing. Businesses must be prepared to identify and counter cyber threats.

■ The actors

The actors involved in cyber crimes range from state-sponsored hackers to organized crime syndicates. Organized crime syndicates are becoming particularly active in such crimes. According to one study, in 2011 Russian organized crime syndicates stole more than US\$4 billion in assets. This figure was roughly one-third of the total cyber fraud committed during the year. State-sponsored actors pose an even greater challenge. In mid-May, the Department of Justice indicted five Chinese government employees for their role in pilfering trade secrets from US industries. The indictment alleges that the Chinese government employees carried out cyber attacks against US corporations in order to pilfer sensitive and proprietary information and technology. The goal of their economic espionage, the indictment claims, was to provide Chinese state-sponsored industries competitive advantage.

Often, the most prolific threats to US businesses are its employees. Deliberate corporate espionage carried out by trusted insiders is a constant threat to any business. In today's digitized age, the threat that rogue insiders pose is greater than ever. As Edward Snowden and Chelsea Manning have illustrated, trusted

insiders can walk away with terabytes of highly sensitive information.

Poor cyber hygiene also poses a significant threat to businesses. Whether at the corporate or individual level, poor cyber hygiene can enable hackers and other cyber actors to gain access to and ex-filtrate sensitive and proprietary information. Among the most common breach points are employees' home computers. Typically such breaches occur when employees use peer-to-peer networks (P2P); these networks pose a serious threat to users as they are designed to open a user's shared folder to other P2P users, thereby enabling hackers and other cyber actors to ex-filtrate files.

■ The soft underbelly

Among the most vulnerable targets of cyber-crimes are foreign subsidiaries or partner companies operating in emerging markets. Information technology infrastructure in such markets is often inadequate to meet the near-daily emergence of new cyber threats. In many of these countries, IT security is often incapable of identifying (let alone responding to) cyber threats. This soft underbelly is not only a threat to the subsidiaries but to the parent companies as well. By hijacking a subsidiary, cyber criminals can easily gain access to treasure troves of information regarding the parent company, thereby enabling additional cyber-attacks or diversion schemes.

Examples of notorious cyber-crimes in emerging markets are well documented.

According to a report published in early July, cyber actors in Brazil took aim at more than US\$3.75 billion in transactions by Brazilians. Although it is unclear exactly how much money was diverted, the scope of the theft is among the largest ever identified. The cyber-criminals targeted Brazilians via the popular electronic payment method Boletos, a system akin to PayPal in the United States. According to 2012 statistics, Brazilians lost an estimated US\$1.4 billion in electronic fraud and cyber-crime accounted for 95 percent of losses incurred by Brazilian banks.

Brazil is hardly alone. A study of cyber threats identified the five most vulnerable countries as Brazil, Turkey, China, Russia, and India. The vulnerabilities existing in these and other emerging

*Examples
of notorious
cybercrimes
in emerging
markets are well
documented.
According to a
report published in
early July, cyber
actors in Brazil took
aim at more than
US\$3.75 billion
in transactions by
Brazilians.*

markets are such that they pose a substantial risk to US-based companies.

■ The best defense is a good offense

Given the increasing volume and sophistication of cyber-crimes, businesses are obligated to make cyber defense a key aspect of everyday operations. But how do you defend your business against enemies that can often seem invisible?

Within the last few years, successful cyber security firms have demonstrated flashes of brilliance in warning clients and defending against tier one threats, including Mandiant, now part of FireEye, WebSense and others. However, the systems currently employed fall short in addressing the actual threat. In other words, it is no longer sufficient to shore up your defensive castle. By the time you are aware of an attack on your systems, and the intellectual property is out the door, it's too late.

There is a better way. As the US law enforcement community investigates the culprits behind state-actor initiated attacks against federal system, so too should corporations investigate the perpetrators. Only by following leads and identifying the instigators of these exploitations will your firm have a change to stop the onslaught. This is accomplished through a good offense.

■ P2P cyber trip wire system

In fact, it is established through a cyber trip wire system. The system should monitor key terms, similar to an RSS feed, and pro-

duce intelligence on what is found. However, it's not sufficient to track the nefarious conversations and transmission occurring on the World Wide Web. There is a deep pool of data wherein each known and developing exploiter exists. It is known as P2P. This is a global file sharing network consisting of over 500 million users. Each user, by virtue of the software parameters, voluntarily shares with other users who are sharing within a limited scope. The P2P world is dynamic, anonymous, and full of malware. However, it is a treasure trove of information for those conducting nefarious activities.

Everything from movies, music, confidential patient information, board minutes, login/password information, emails, and even intelligence has been discovered residing on someone's shared folder – all over the world.

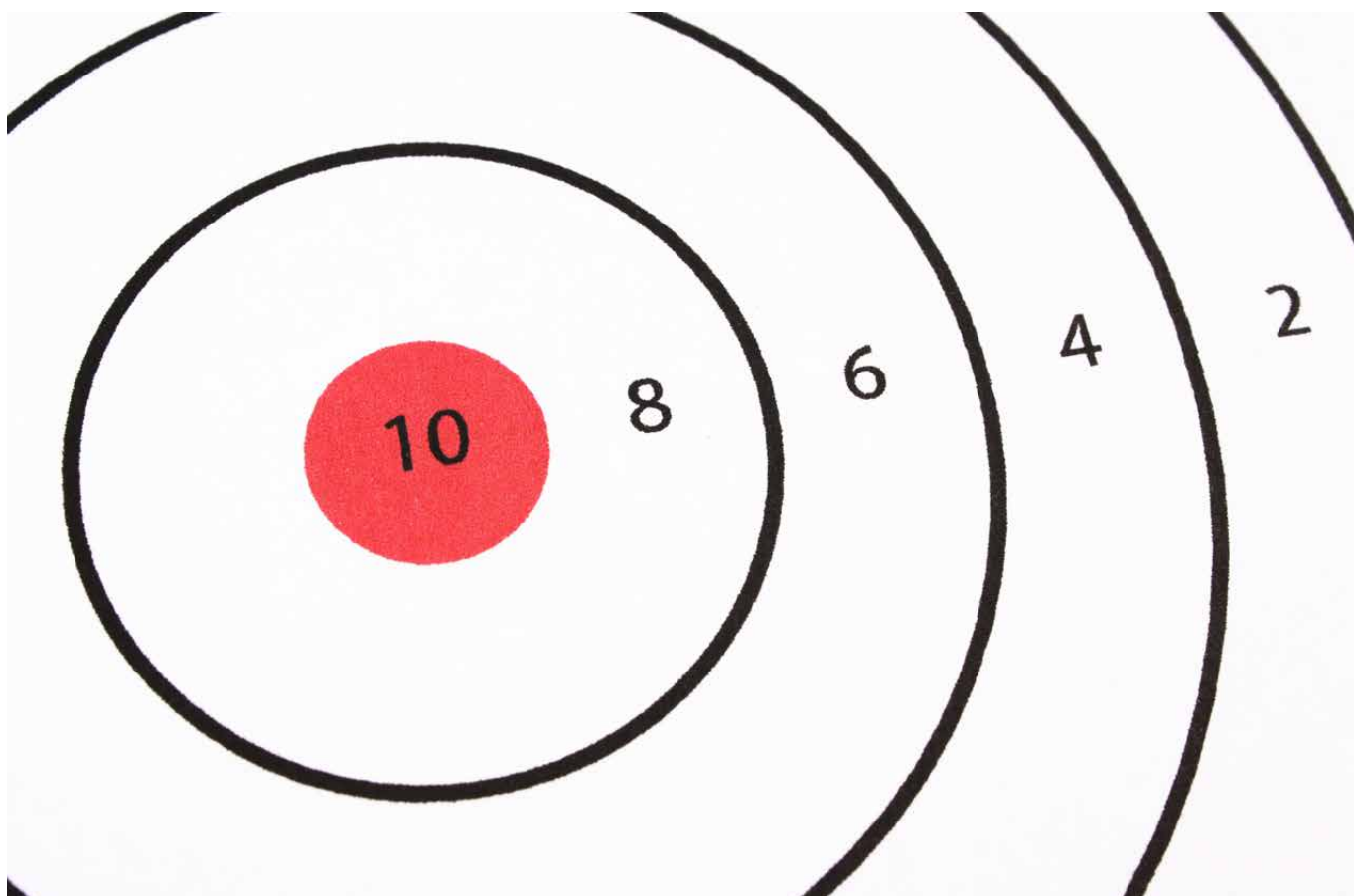
By establishing a cyber trip wire system set to monitor the transmission of files containing the key words of interest, a firm can receive feeds and notifications of who is interested in their information from within the P2P world. Here's the most significant aspect of this system: a corporation can learn about an exploitation before it happens, because the conversations typically associated with future exploitations take place among the users currently using P2P software.

To learn more about establishing your firm's cyber trip wire system for the P2P or receive a cyber risk assessment, please contact info@sovereign-llc.com or call 703-663-6689.

Emerging Market Target Practice

■ Jeffrey Frankel

Central bankers want only a few things. To achieve any of them they usually seek to nudge inflation expectations, demonstrate the transparency of monetary policy, and establish their institutions' credibility. To communicate their intentions simply and clearly, they may set an explicit target range in terms of a particular economic variable, or announce a forecast for the variable, or offer forward guidance by specifying a threshold value for it that must be met before changing interest rates.



But what should that one economic variable be? In the 1980s, major advanced countries tried the money supply. After the monetarist approach failed, some switched to targeting the inflation rate. But they repeatedly missed their targets.

Until the currency crashes of the 1990s, emerging and developing countries tended to target their exchange rates. Many then also switched to inflation targets, but they tend to miss these targets even more often than the advanced countries do.

The problem with these approaches to monetary policy targeting is that even though a particular numerical target may be reasonable when it is set, subsequent unexpected developments often make the target hard to live with. The monetary authorities are then confronted with a harsh choice between violating their announced target, and thus undermining the credibility that was the point of the exercise, or setting policy too tight or too loose, thus doing unnecessary damage to the economy.

Major central banks can generally withstand failure to achieve targets without a fatal loss of credibility. The Bundesbank routinely missed its money supply targets, and yet remained a credible, admired institution. More recently, inflation expectations in the United States and the United Kingdom remained well anchored even when the Federal Reserve and the Bank of England had to walk away from the unemployment thresholds they had announced.

The situation is different in emerging and developing economies. These countries' need to establish policy credibility tends to be more acute, whether as a result of histories of high inflation, an absence of credible institutions, or political pressure to monetize budget deficits. They need targets with which they can really live.

Nothing seems to work. When the International Monetary Fund comes around asking what their nominal anchor is, many declare themselves to be inflation targeters. But they have trouble abiding by their targets. If they are hit by an adverse

*Many
emerging and
developing
countries
need to bring
inflation
down, much
as advanced
countries
needed to do
30 years ago.*

supply shock or terms-of-trade shock in the meantime, the right step would be to loosen monetary policy sufficiently that the currency depreciates. But targeting the consumer price index precludes this, because depreciation would raise the price of imported oil, food, and other tradable commodities.

Indeed, if the shock is an increase in the dollar price of oil, an inflation target in theory dictates tightening monetary policy enough that the currency appreciates. But

such a policy would mean that the adverse shock is reflected in a sharp fall in output. In practice, an inflation-targeting central bank usually abandons the target for price stability in such a case. It tries to explain the failure to the public in terms of “core” inflation: what has happened is only an increase in the cost of filling their gas tank or buying groceries. But this defeats the very purposes – transparency, credibility, and predictability – for which a target was announced in the first place.

Emerging-market countries ought to consider targeting nominal GDP. Relative to inflation targeting, the great virtue of NGDP targeting is that it is robust with respect to supply shocks and terms-of-trade shocks, meaning that the central bank is not faced with a choice between abandoning the target and hurting the economy.

Proposals to target NGDP are familiar in major industrialized countries, first arising in the 1980s. In the wake of sharp price increases in the 1970s, central banks wanted to commit credibly to monetary discipline in order to facilitate disinflation.

The proposal was never adopted. Yet the idea was suddenly revived two or three years ago. The context this time was a desire to achieve expectations of greater monetary stimulus in order to facilitate recovery from the great recession of 2008–2009.

There are good reasons to think that NGDP targeting is better suited to emerging and developing economies than to industrialized countries. These economies are more frequently subject to adverse terms-of-trade shocks, such as increases in world oil prices or declines in prices for their commodity exports. Their economies also tend to suffer larger supply shocks from natural disasters, other weather events, social unrest, and unexpected productivity changes.

The advantage of a nominal GDP target is that adverse shocks of these sorts are reflected equally in output and inflation, rather than imposing the entire burden in the form of a loss in output. This provides the sort of response that one would want anyway, while still retaining the advantages of a rule (communicating the central bank's plans in such a way that it can live with what it has promised to do).

Many emerging and developing countries need to bring inflation down, much as advanced countries needed to do 30 years ago. One example is India, which is currently considering adopting inflation targeting to enhance monetary discipline. But the country is regularly hit by supply shocks such as good or bad monsoons. Statistical estimates suggest that an attempt to set the path of inflation in the face

About the Author

Jeffrey Frankel, a professor at Harvard University's Kennedy School of Government, previously served as a member of President Bill Clinton's Council of Economic Advisers. He directs the Program in International Finance and Macroeconomics at the US National Bureau of Economic Research, where he is a member of the Business Cycle Dating Committee, the official US arbiter of recession and recovery.

of such shocks would lead to undesirably large swings in real GDP, compared to anchoring policy to the path of NGDP.

The target path for nominal GDP can be set at whatever level of monetary discipline is desired. The robustness of NGDP targeting to unknown future shocks is similar whether the objective is to ease money, tighten money, or stay the course,

and whether the central bank wants to announce a forecast, a target range, or a threshold for forward guidance.

If it is worth communicating a plan, it is worth choosing a plan that one can live with. NGDP targeting is that plan.

Family Office & Endowment Forum

A Private Wealth Series Event

September 15-16, 2014

Renaissance Vancouver Harbourside Hotel, Vancouver, BC

This family office conference is Opal's premier event for high net worth individuals and family offices. Private investors and asset managers from around the world will visit this picturesque setting for three days of engaging discussions on the latest investment trends. The conference will explore the challenges and opportunities associated with investing in emerging markets, alternative investments, real estate, global credit & fixed income markets along with numerous other asset types

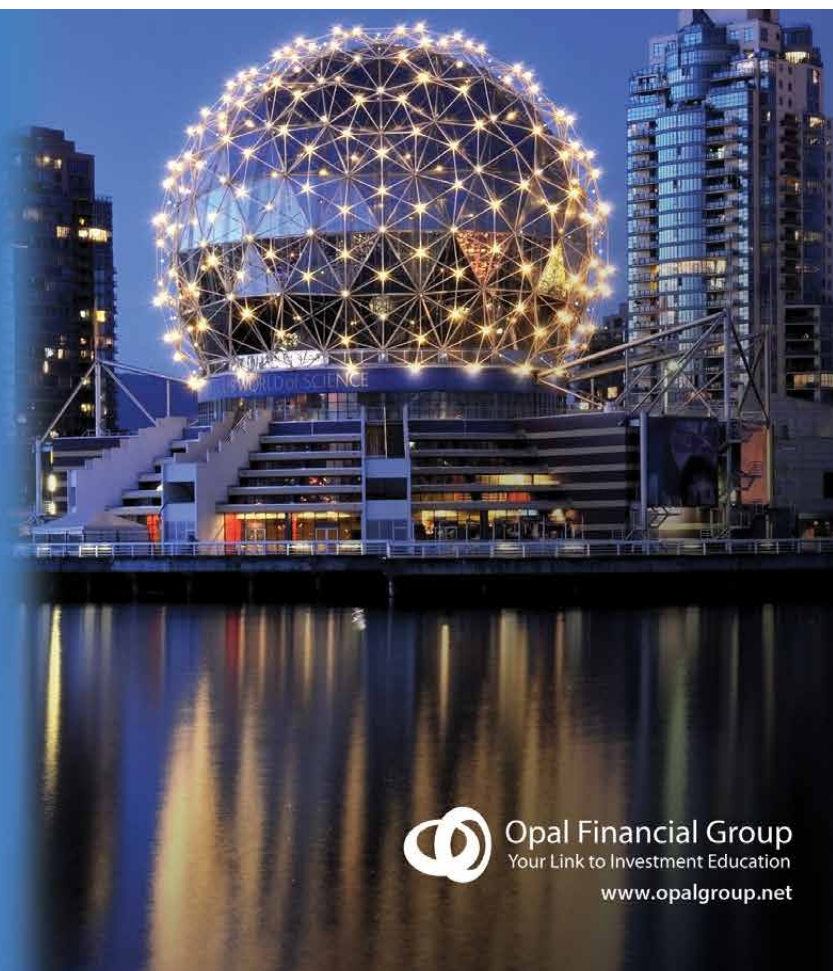
Sponsorship and Exhibiting Opportunities are Available

If you are interested in attending, sponsoring, speaking or exhibiting at this event, please call 212-532-9898 or email info@opalgroup.net

Register

To register, visit us online at www.opalgroup.net or email us at marketing@opalgroup.net

REFCODE: FOCWA1406



Opal Financial Group
Your Link to Investment Education

www.opalgroup.net

Smart Public Policies for Development: The Case of Two Strategic SWFs



■ Tomás Guerrero and Adrián Blanco

Sovereign wealth funds (SWFs) have become, along with state-owned enterprises (SOEs), the ultimate expression of state capitalism. Their role in the rescue of US banks at the beginning of the financial crisis of 2007 cleared away many of the doubts and fears that these giants inspired among developed economies, transforming them into the white knights of capitalism. Today they manage over US\$5.5 trillion, and some of them, like the Norwegian SWF or Alaskan SWF, are synonymous with good corporate governance practices. Emerging in most cases from budget surpluses arising from the exploitation of natural resources, SWFs have become the most effective tool to overcome each and every one of the problems of the “paradox of plenty.” Specifically, with the launch of SWFs states pursue seven objectives:

- Obtaining long-term profits from current account surpluses arising from the exploitation of natural resources.
- Stabilizing the fiscal cycle by applying countercyclical economic policies.
- Diversifying and restructuring the country’s economy, investing in high-tech industry and knowledge-intensive services.
- Reducing inflationary pressure stemming from the budget surplus.
- Avoiding the effects of the so-called “Dutch disease,” the loss of competitiveness of other sectors in the economy (with respect to extractive export industries) as a result of the appreciation of the national currency.
- Developing a model of intergenerational solidarity that allows the generations to come to enjoy the wealth that finite natural resources are bringing to present-day generations.
- Eliminating rent-seeking by implementing recognized professional processes to ensure good practice.

Of the 82 active SWFs that exist today, only the most sophisticated, such as the Norges Bank Investment Management (NBIM) or the China Investment Corporation (CIC), are able to achieve all seven objectives described above. In most cases, states define and delimit the functions of these vehicles to concentrate their efforts on getting one of the three “big” goals (a, b and c). Based on these three objectives, we distinguish three types of SWFs: stabi-

Sovereign wealth funds (SWFs) have become, along with state-owned enterprises (SOEs), the ultimate expression of state capitalism.

lization funds, such as the Ghana Stabilization Fund, which seek to balance the fiscal balances of their home countries using economic countercyclical policies; financial funds, such as ADIA, seeking higher returns from investment in sophisticated assets, such as real estate or new technologies; and strategic or development funds, such as Mubadala or Temasek, which pursue the diversification and modernization of their national economies.

The last two SWFs illustrate how a development strategy fostered by the public sector and channeled through a SWF can be highly successful in promoting economic development in emerging countries. Temasek (Singapore) is the ninth largest SWF with US\$198 billion in assets under management. Its investment strategy has played a crucial role in fostering high-value-added industries in Singapore, diversifying the local economy and its sources of fiscal revenues, triggering the transfer of technology and spillovers and taking advantage of the economic performance of the most vibrant countries in Asia.

Temasek contributes to the high-value-added industry growth in Singapore through economic and financial support to strategic public firms. For example, that is the case of Singtel, the telecommunication and IT SOE owned by the SWF. These SOEs also encourage the transfer of technology and knowledge from the leading tech centers worldwide toward Singapore. For example, Singtel has recently launched a venture investment fund (Singtel Inno8, worth US\$200 million) to promote technological acquisitions, and it has acquired several tech startups in the US, such as Pixable or Amobee. The ultimate goal of these deals is to absorb technological knowledge and replicate its business model in Singapore. Additionally, Temasek takes a piece of the pie of the high economic growth in Asian economies through its direct stakes on Indian operator Bharti Airtel (32% of the capital), Telekom Malaysia (5%) and a significant stake in the Chinese giant Alibaba.

Other notable example is Mubadala, Abu Dhabi’s SWF with US\$65 billion in assets under management. As in the case of Temasek, the fund is one of the main tools used by the government to make strategic investments, diversifying the local economy and reducing the oil dependency of the



Emirate. Dozens of examples can also illustrate the successful investment policies made by Mubadala. One major project is Masdar City, a massive project implemented by Masdar (Mubadala's subsidiary) to create the first smart and 100% sustainable city in the world. Mubadala has been

fundamental in diversifying the Emirate's model of growth, through financing and developing the healthcare, aerospace and renewable energy industries in Abu Dhabi. Also, the SWS leads the main acquisitions of the Emirate overseas, reducing the risk of an excessive concentration of assets in

Abu Dhabi and diversifying the sources of fiscal income. Some of the major stakes include key investments in global leading firms such as General Electric or EMI Music.



About the Authors

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

Adrián Blanco Estévez is Senior Economist at Spanish Institute for Foreign Trade and Investment (ICEX) and Master Policy Management (MPM) candidate at Georgetown University.

Investment Trends Summit

September 8-10, 2014
The Four Seasons, The Biltmore, Santa Barbara, CA

Opal Financial Group's Investment Trends Summit will serve as an educational forum focused on analyzing trends for the future, as well as exploring ways to implement new strategies in particular investment plans. The event is designed to meet the needs of money managers, senior pension fund officers and trustees who prefer smaller, more structured programs. By limiting this event to select managers, participants will be able to more carefully examine a distinct set of topics specifically tailored to their interests.

Sponsorship and Exhibiting Opportunities are Available

If you are interested in attending, sponsoring, speaking or exhibiting at this event, please call 212-532-9898 or email info@opalgroup.net

Register

To register, visit us online at www.opalgroup.net or email us at marketing@opalgroup.net

REFCODE: ITSA1403



Opal Financial Group
Your Link to Investment Education

www.opalgroup.net

2014 Key Trends in Latin American Hedge Funds

The Latin American hedge fund industry has continued to provide remarkable performance and growth for hedge fund investors over the years with the Eureka-hedge Latin America Hedge Fund Index up 14.5% on an annualized basis since December 1999 and total assets under management (AUM) of the industry currently standing at US\$60.8 billion. Since the start of the new millennium the Latin American hedge fund industry has witnessed tremendous growth, both in terms of number of funds and AUM. During this time the total number of funds in the industry has increased from just over 100 to nearly 400, while AUM has witnessed even more impressive growth. At end-2000 total AUM in Latin American hedge funds stood at US\$2.5 billion, while this figure stands at US\$60.8 billion as of the end of April 2014.

The industry witnessed some losses and redemptions during the financial crisis, amid falling equity markets globally and heightened volatility across different asset classes. Total AUM fell below the US\$40 billion mark in 2009 as managers suffered some losses while investors withdrew substantial capital from the funds. Compared with

Figure 1: Industry growth since 2000

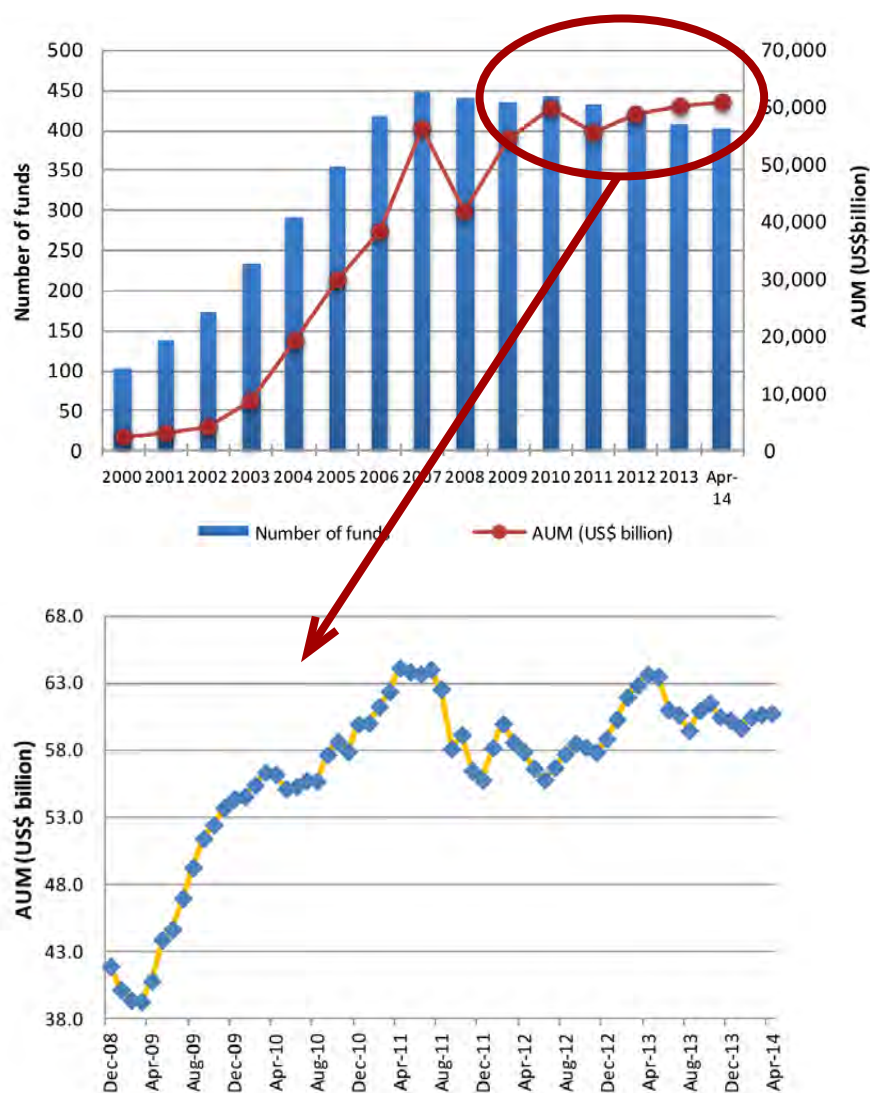


Table 1: Monthly asset flows in Latin American hedge funds since December 2010

Month	Net growth (performance)	Net flows	Assets at end
2010	4.9	0.7	60.0
Jan-11	(0.1)	0.2	60.1
Feb-11	0.4	0.8	61.3
Mar-11	0.5	0.6	62.5
Apr-11	0.8	0.9	64.2
May-11	(0.1)	(0.2)	63.9
Jun-11	(0.3)	0.1	63.7
Jul-11	0.1	0.2	64.1
Aug-11	(0.2)	(1.2)	62.6
Sep-11	(0.8)	(3.6)	58.2
Oct-11	0.6	0.5	59.2
Nov-11	(0.2)	(2.4)	56.5
Dec-11	0.2	(0.9)	55.8
2011	0.8	(5.0)	55.8
Jan-12	0.9	1.6	58.2
Feb-12	0.9	0.9	60.0
Mar-12	0.1	(1.5)	58.7
Apr-12	0.3	(1.1)	57.9
May-12	(0.4)	(0.9)	56.7
Jun-12	(0.1)	(0.7)	55.9
Jul-12	0.7	0.2	56.8
Aug-12	0.3	0.7	57.8
Sep-12	0.3	0.5	58.6
Oct-12	(0.0)	(0.2)	58.3
Nov-12	0.3	(0.7)	57.9
Dec-12	0.7	0.3	58.9
2012	4.0	(0.9)	58.9
Jan-13	0.6	0.9	60.4
Feb-13	(0.0)	1.7	62.0
Mar-13	0.3	0.6	62.9
Apr-13	0.4	0.4	63.7
May-13	(0.1)	(0.1)	63.6
Jun-13	(1.0)	(1.5)	61.1
Jul-13	0.4	(0.7)	60.7
Aug-13	(0.1)	(1.1)	59.5
Sep-13	0.5	1.0	61.0
Oct-13	0.6	(0.0)	61.6
Nov-13	0.2	(1.2)	60.5
Dec-13	0.1	(0.4)	60.3
2013	1.8	(0.4)	60.3
Jan-14	(0.3)	(0.3)	59.7
Feb-14	0.5	0.3	60.5
Mar-14	0.3	(0.1)	60.7
Apr-14	0.2	(0.2)	60.8

other regional hedge funds, the Latin American sector performed admirably through the financial crisis – the Eurekahedge Latin American Hedge Fund Index declined by only 5.87% in 2008 while the average global hedge fund lost 9.66% during the year.

During the global financial crisis, Latin American hedge funds also witnessed some negative returns and redemptions, although not on the same scale as global hedge funds. Assets under management in the industry declined to US\$39.3 billion by March 2009, but have since posted a remarkable recovery. Over the next two years managers posted excellent gains while also attracting capital, and by April 2011 the AUM in Latin American hedge funds had reached a historical high of US\$64.2 billion.

As market sentiment soured toward the latter half of 2011 due to overwhelming concerns about the European debt crisis and the strength of the global economy, assets in Latin American hedge funds also declined, primarily due to net negative asset flows.

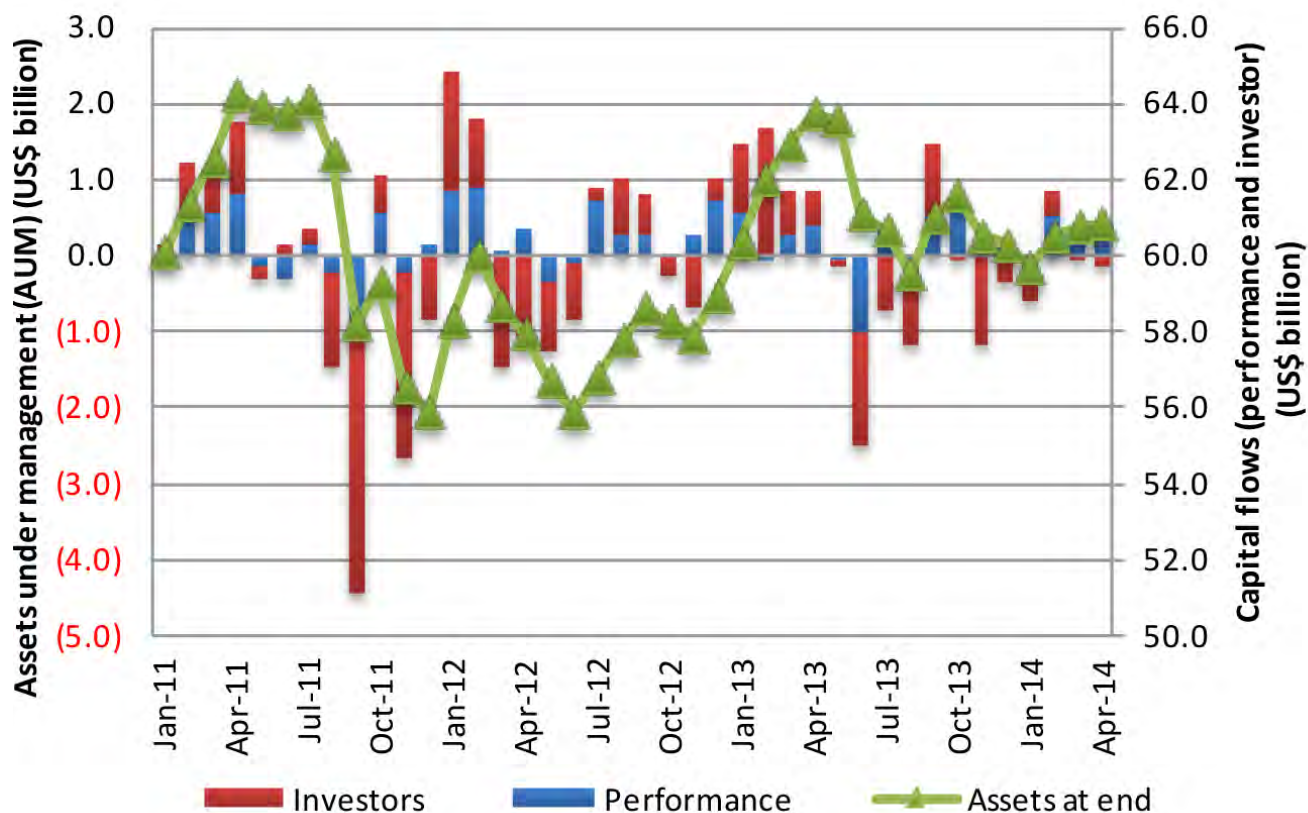
It was a mixed year for Latin American hedge funds in 2013. Although they managed to successfully outperform underlying markets, fund managers have had to contend with net asset outflows of US\$0.4 billion in a year when the global hedge fund industry witnessed record amounts of net capital allocations in the post-2008 period. 2014 appears to be following a similar trajectory, with the Latin American hedge fund industry driving its growth primarily on the back of performance-based gains in a tough market environment for emerging economies.

■ Industry composition and growth trends

Asset flows

Table 1 and Figure 2 show the breakdown of Latin American hedge fund AUM since

Figure 2: Latin America capital inflows/outflows since 2011 (US\$ billion)



December 2010 as well as the monthly asset flows and performance-based growth/decline. It proved to be a difficult year in 2011 for Latin American hedge funds with managers seeing net redemptions of US\$5.0 billion amid a difficult market environment, although managers were able to post some performance-based gains. A rebound came in 2012 and the Eurekahedge Latin America Hedge Fund Index gained 11.61% with fund managers posting performance-based gains of US\$4.0 billion. Latin American hedge funds had an uneventful year in 2013, recording annual performance-based gains of US\$1.8 billion while seeing net asset outflows of US\$0.4 billion. Overall, since the start of 2010 Latin American funds have posted performance based gains of US\$12.1 billion, while recording net asset outflows of US\$5.8 billion.

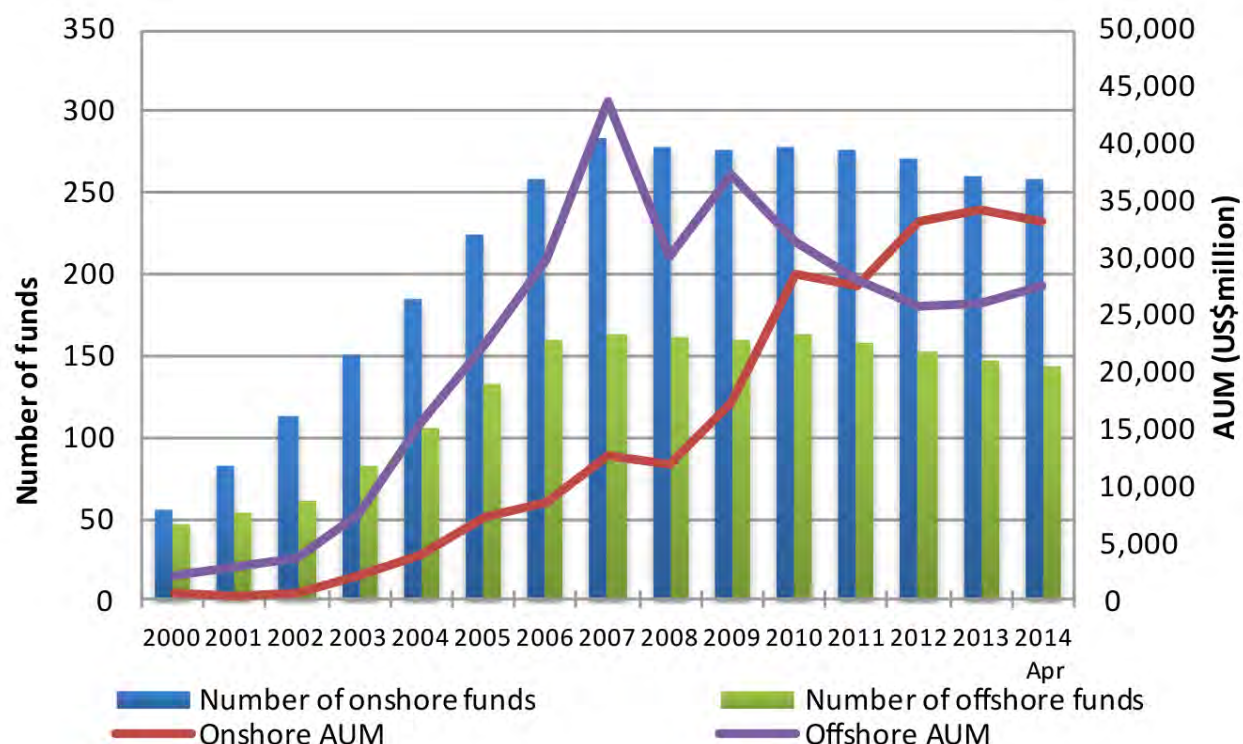
Latin American hedge funds are further split into onshore and offshore vehicles; this distinction is based on the funds' domicile. Between 2000 and 2007, most of the growth in Latin American hedge funds was generated by offshore vehicles – surprising given that onshore vehicles have always performed better than offshore funds. By the end of 2007, offshore Latin American funds managed US\$43.8 billion or 78% of total industry assets, as most onshore Latin American hedge funds are regulated and only open to local investors.

During 2000 to 2007, offshore fund structures were very much in demand, as managers had more flexibility to pursue various investment styles without getting tied down by regulations. Onshore hedge funds, also known as multimercado funds,

are mostly located in Brazil, require registration with the Brazilian authorities and are regulated in the same manner as mutual funds – needing to meet requirements such as providing regular net asset values, transparent pricing policy and a centralized counterparty risk.

In the post-financial crisis environment, these aspects of onshore funds have become quite attractive to investors. Additionally, the increasing prosperity within Brazil (which is home to the bulk of onshore funds) has driven growth in the onshore funds industry because the country boasts strong GDP growth prospects and an increasing number of high net worth individuals (HNWI). As many of the local funds are regulated retail vehicles, they can also be marketed to the burgeon-

Figure 3: Industry growth of onshore and offshore funds



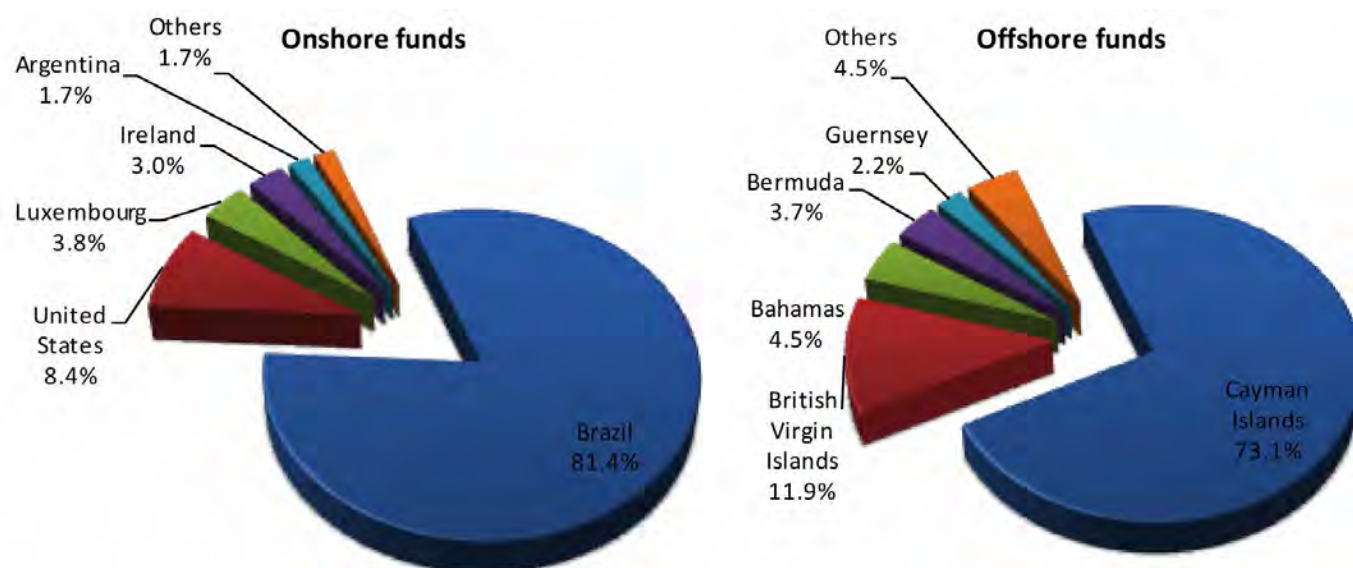
ing middle class retail investor segment. Due to these factors, the AUM of onshore hedge funds has now overtaken that of the offshore industry and currently constitutes 54.6% of the total industry AUM in Latin America.

Fund domiciles

Figure 4a-4b shows the breakdown of fund locations for both onshore and offshore funds as of April 2014. Brazil is the country of domicile for a clear majority of

the onshore funds with 81.4% of the share, followed by the United States with 8.4%. For offshore funds, 73.1% are domiciled in the Cayman Islands, followed by 11.9% in the British Virgin Islands and 4.5% in the Bahamas.

Figure 4a-4b: Fund domiciles by number of funds



Head office locations

Head office locations within Latin American hedge funds can be broken down into two categories: funds located in Latin America and funds located outside of Latin America. The domestic industry is dominated by Brazil, accounting for 93.8% of the funds, most of which are located in either Sao Paulo or Rio de Janeiro. Additionally, an increasing number of international firms are opening their offices in the country to take advantage of the growth opportunities – notable names that have recently made moves in the region include Highbridge, Brevan Howard and FRM. In addition, a number of local hedge funds have indicated their intention to raise capital from outside the region, which would trigger substantial growth in the sector.

In terms of non-domestic Latin American hedge funds, the UK and US hold the top two spots, together accounting for 79.2% of overseas Latin American funds. In the overall picture Brazil once again comes out on top with 69.6% of the funds, and we expect this share to increase further as more firms launch their Latin American funds in the country.

Geographic mandates

In terms of distribution of assets by geographic mandates, there is an observable trend since 2007 with an increasing focus on Brazilian investments. Since April 2007, the share of Latin American hedge fund AUM in Brazil-focused funds has increased by 23.4% while the share of funds investing globally has declined by 23.8%.

This is primarily due to the increased asset flows to local hedge funds and also because of their stronger performance vis-à-vis other regional mandates. Brazil-focused funds have historically delivered better risk-adjusted returns than globally mandated funds (see Table 3).

Going forward we expect the share of AUM in Brazil-investing hedge funds to increase, as the country has one of the largest stock markets in the world, a network of service providers and a strong talent pool of financially trained professionals, while a rapidly increasing middle-class and high-net-worth population will provide further marketing opportunities to local multimercados which can be marketed to retail investors as well as to HNWI's.

Figures 5a-5c: Head office locations by number of funds

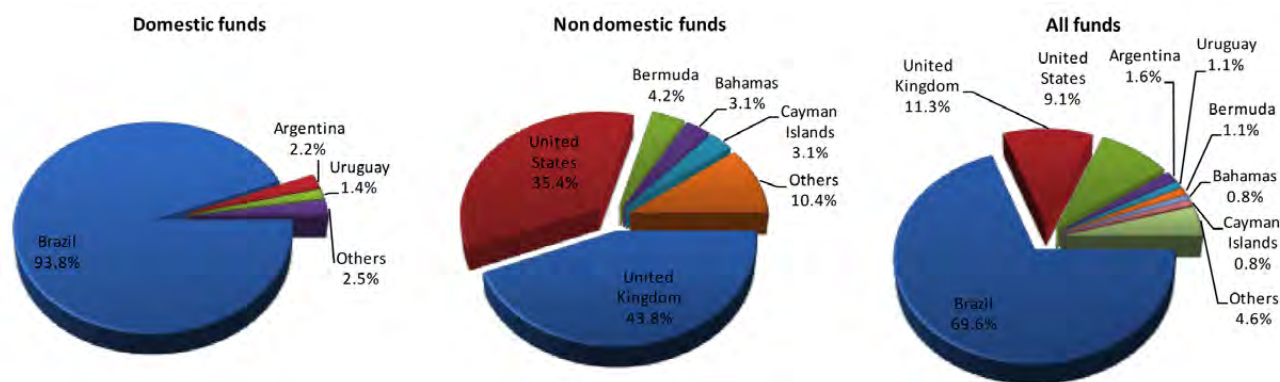
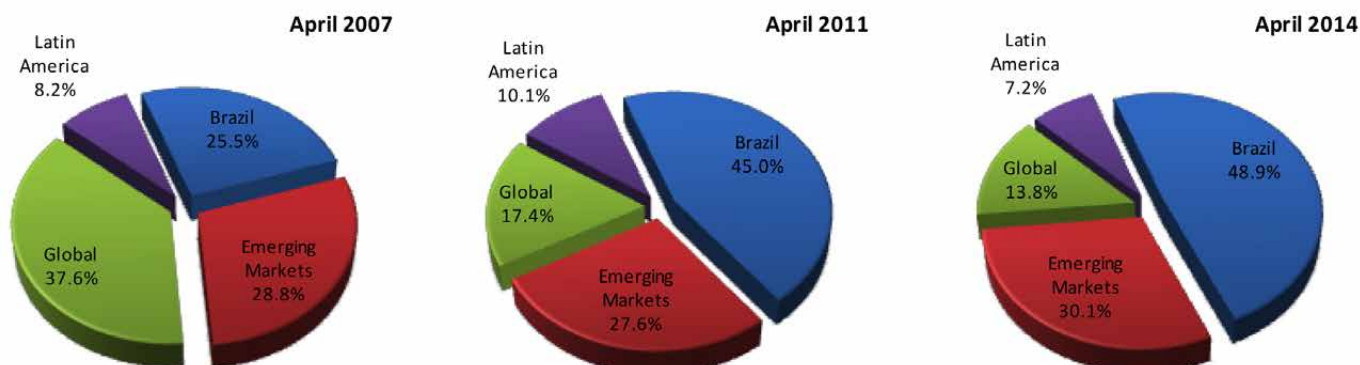


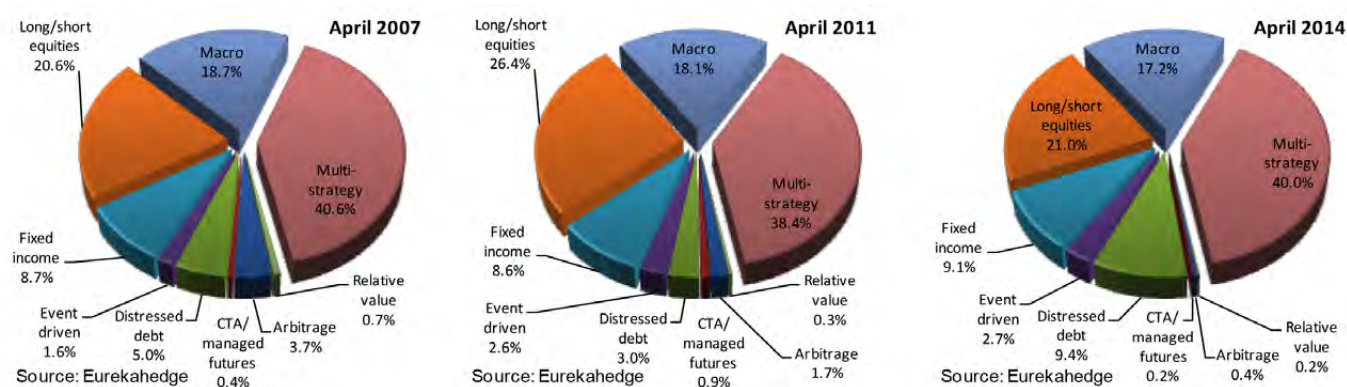
Figure 6a-6c: Geographic mandates by assets under management



Figure 7a-7c: Strategic mandates by assets under management



Figures 8a-8c: Industry breakdown of hedge funds by fund size (US\$ million)



Strategic mandates

The share of assets in Latin American hedge funds across the different strategies has also witnessed some slight changes over the years. Multi-strategy, long/short equities, macro and fixed income strategies account for 87.2% of AUM in the industry as of April 2014. Multi-strategy investing remains the most popular strategy with 40.0% of the assets – hardly surprising since these mostly comprise the local multimercado funds in Brazil. Long/short equities managers are the second largest group (market share of 21.0% as at April 2014) primarily because Brazil is home to one of the largest stock markets in the world. It is also interesting to note that despite the strong dependence

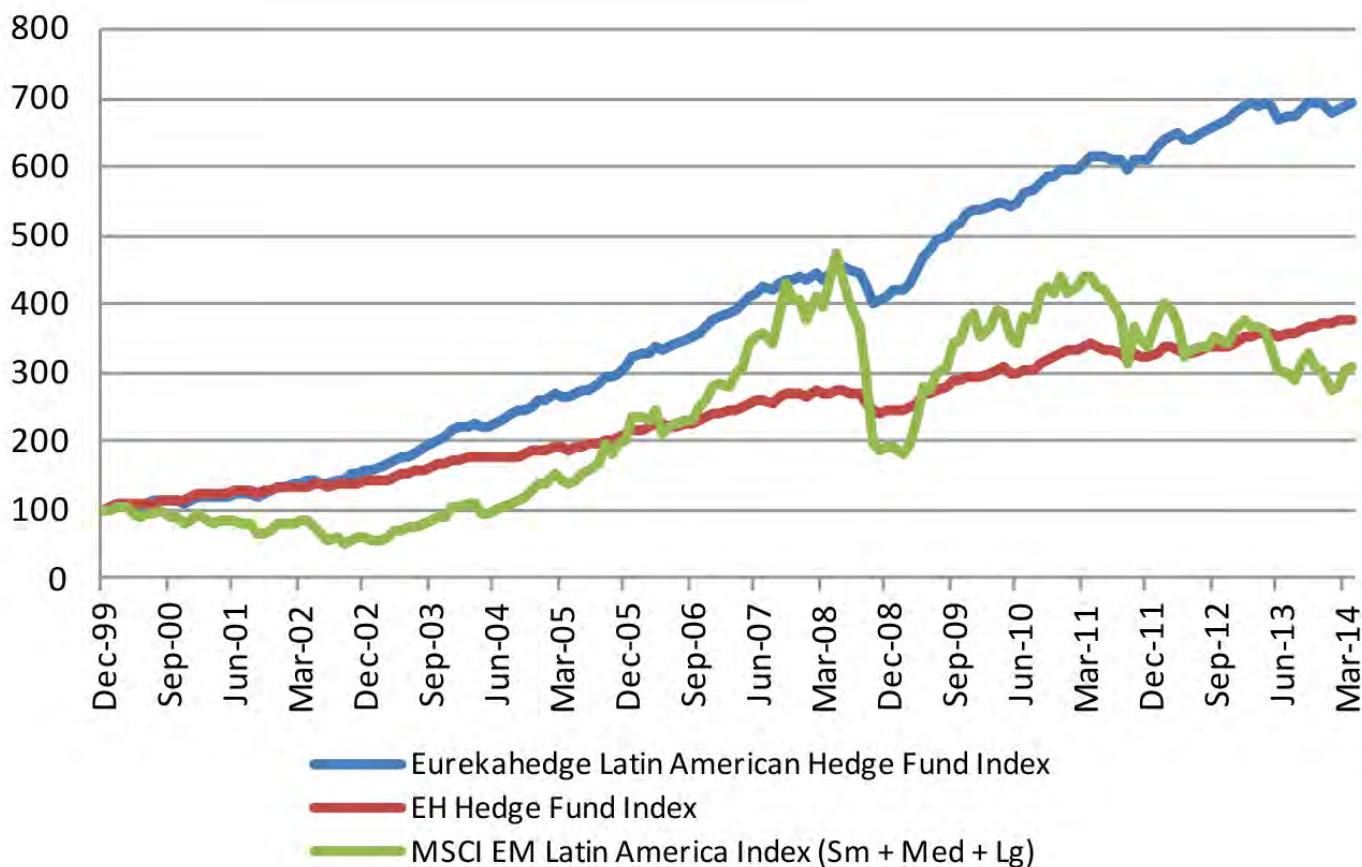
of regional economies on raw material exports, there are very few commodity trading advisors or funds focused entirely on this asset class. Managers looking to gain exposure to commodities either invest in the equities of commodity producers or employ multi-strategy and macro mandates.

Fund size

In terms of fund sizes, the industry has witnessed some significant trends. The percentage of funds with AUM of US\$20 million or less increased from 19.90% in April 2007 and reached 28.40% by April 2011 as the industry resurfaced in the aftermath of the global financial crisis. Net asset outflows and performance-based losses dur-

ing the financial crisis pushed some of the funds from higher AUM categories to the US\$20 million range. Additionally newly launched funds in 2008 and early 2009 struggled to raise assets in the risk-averse environment, and hence remained in the lowest AUM category. As of April 2014, funds with AUM less than US\$20 million constitute 36.95% of the Latin American hedge fund space while overall the share of funds managing less than US\$100 million in assets has increased by 9.73% since April 2007. The share of hedge funds with AUM between US\$500 million and US\$1,000 million has increased by 1.92% since April 2011, which is line with the global trends of net allocations being biased in favor of the larger hedge funds.

Figure 9: Performance of Latin American hedge funds versus underlying markets



Performance review

In this section we compare the performance of the Latin American hedge fund industry against global hedge funds, and with the underlying markets as denoted by the MSCI EM Latin America Index. We further dissect their performance according to geographic and strategic mandates, and conclude with a performance review across various hedge fund sizes in the Latin American hedge fund space.

Figure 9 displays the Eurekahedge Latin American Hedge Fund Index, Eureka-

hedge Hedge Fund Index and the MSCI EM Latin America Index since December 1999. The overall performance of the Eurekahedge Latin American Hedge Fund Index is well ahead of the other two indices due to rapid economic growth in the underlying markets over the last 14 years, the strong development of the Latin American hedge fund industry and the ability of managers to guard against downside risk, which is endemic to the markets. In 2013, fund managers have outperformed the MSCI EM Latin America Index by 18.43% despite a difficult trading environment for emerging market economies.

Table 2 shows that Latin American hedge funds have outperformed both the underlying markets and the broader hedge fund industry on both the three- and five-year time horizon, with the Eurekahedge Latin American Hedge Fund Index up 4.28% and 9.00% over both time periods. Latin American fund managers also boast the best risk-reward profile – Sharpe ratio of 0.54 and 1.58 over the three- and five-year time periods, respectively.

Figure 10 shows the performance of Latin American hedge funds across regional mandates, with emerging markets invest-

Table 2: Performance of Latin American hedge funds versus underlying markets

	EH Latin American Hedge Fund Index	EH Hedge Fund Index	MSCI EM Latin American Index
2014 April year-to-date returns	0.20%	0.75%	1.34%
2013 returns	1.95%	8.18%	(16.48%)
3 year annualized returns	4.28%	3.34%	(11.32%)
3 year annualized volatility	4.24%	4.09%	23.53%
3 year Sharpe ratio (RFR = 2%)	0.54	0.33	(0.57)
5 year annualized returns	9.00%	7.93%	5.72%
5 year annualized volatility	4.44%	4.77%	24.30%
5 year Sharpe ratio (RFR = 2%)	1.58	1.24	0.15
Maximum drawdown (5 years)	(3.22%)	(6.14%)	(37.74%)
% Below HWM (5 years)	0.00%	(0.49%)	(30.27%)

ing funds leading with returns of 1.63% as of 2014 April year-to-date while most other mandates are marginally positive or in the red. 2013 returns show a different picture, where globally mandated funds

delivered the best returns, up 7.20%, while those focused on Latin America ended the year in the red – down 0.49% as equity markets in the developed economies outperformed their emerging counterparts.

On a three-year annualized basis, globally mandated and Brazil-focused hedge funds lead with gains of 6.68% and 5.66%.

Table 3 shows that Brazil investing hedge

Figure 10: Performance of geographic mandates

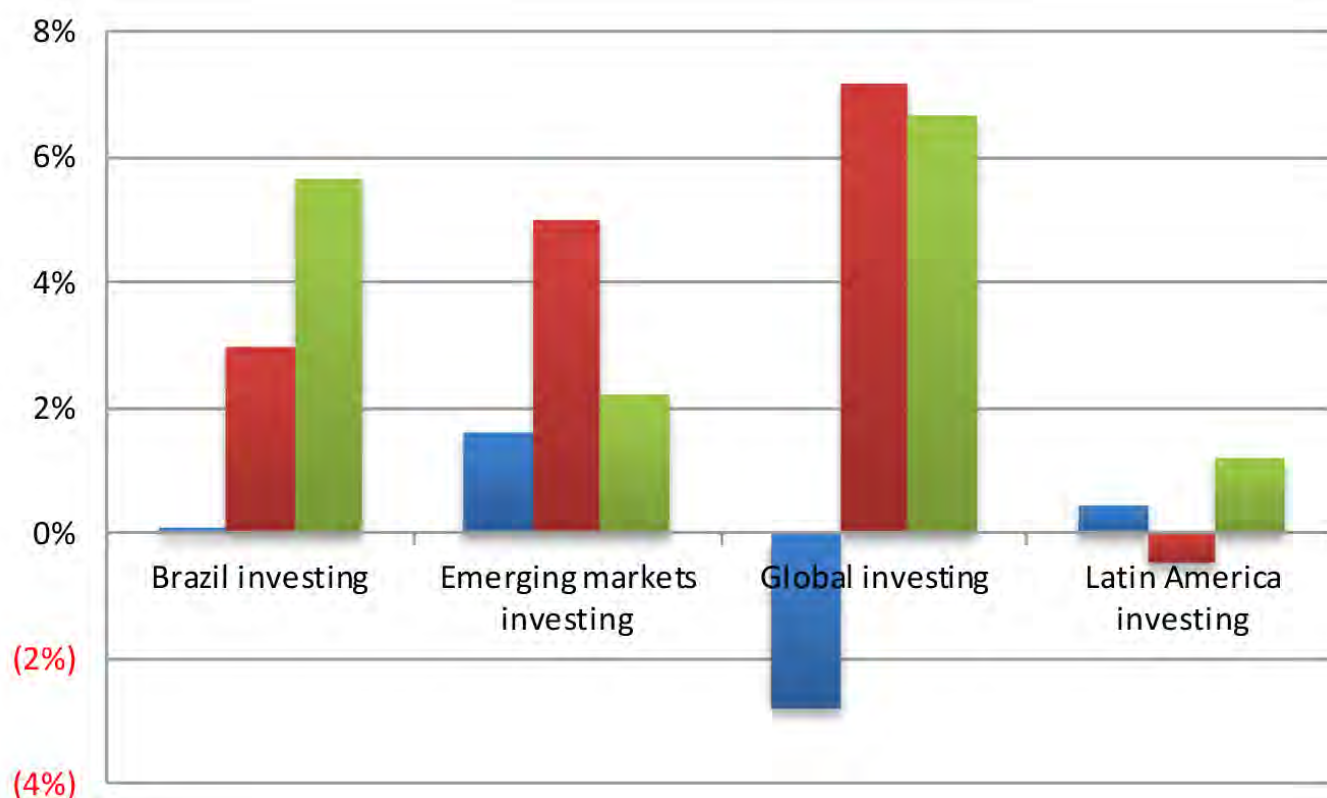


Table 3: Performance of geographic mandates

	Brazil investing	Emerging markets investing	Global investing	Latin America investing
2014 April year-to-date returns	0.11%	1.63%	(2.83%)	0.43%
2013 returns	2.98%	4.99%	7.20%	(0.49%)
3 year annualized returns	5.66%	2.21%	6.68%	1.18%
3 year annualized volatility	3.74%	7.13%	9.59%	5.68%
3 year Sharpe ratio (RFR = 2%)	0.98	0.03	0.49	(0.14)
5 year annualized returns	9.80%	8.06%	8.29%	7.15%
5 year annualized volatility	3.93%	7.24%	8.21%	5.85%
5 year Sharpe ratio (RFR = 2%)	1.99	0.84	0.77	0.88
Maximum drawdown (5 years)	(2.61%)	(12.25%)	(8.28%)	(6.59%)
% Below HWM (5 years)	0.00%	0.00%	(2.83%)	(1.79%)

funds have the best risk/reward profile, posting Sharpe ratios of 0.98 and 1.99 over both the three- and five-year time horizon. Funds investing in the region have also posted the lowest annualized volatility over both time periods under consideration. Brazil investing hedge funds are usually marked by low net exposures, thereby countering some of the negative impact of the market declines. Addition-

ally, these funds are mostly denominated in the Brazilian real, so the effects of currency depreciations do not have a negative impact on their portfolio returns vis-à-vis funds denominated in other currencies and investing in other regions. Their superior risk/reward profile is confirmed once again by their maximum drawdown over the last five years, which stands at -2.61%, the lowest among all geographic mandates.

Figure 11 shows the performance of Latin American fund managers across various strategies employed. In terms of strategic mandates, fixed-income and arbitrage funds are up 3.61% and 1.39% as at April 2014 year-to-date, while macro, multi-strategy and event-driven funds are marginally positive. Long/short equities funds are down 0.90% for the year, as emerging markets got off to a rough start in early

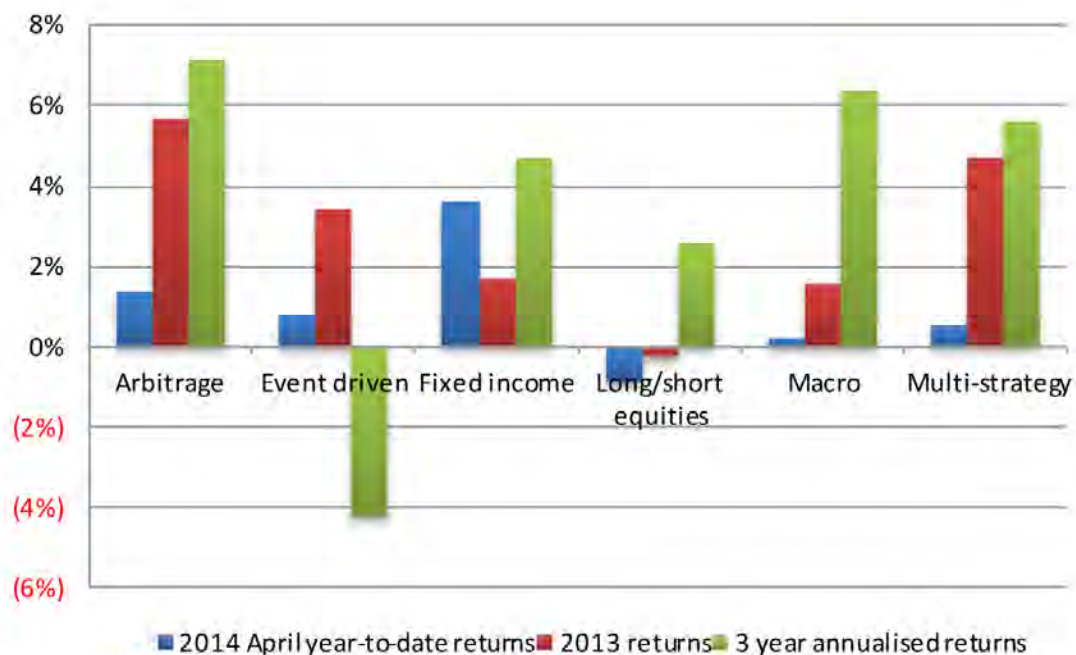
Figure 11: Performance across strategic mandates

Table 4: Performance across strategic mandates

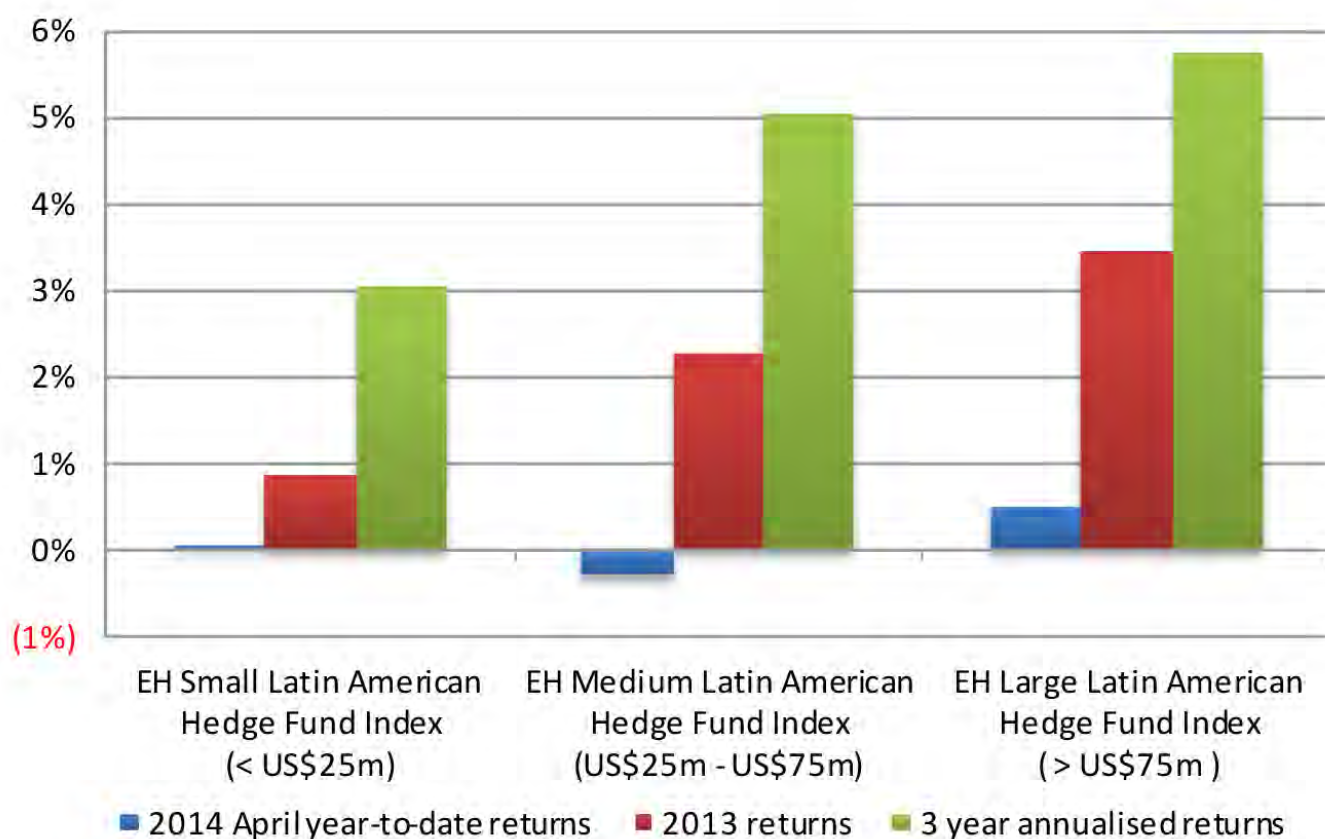
	Arbitrage	Event driven	Fixed income	Long/short equities	Macro	Multi-strategy
2014 April year-to-date returns	1.39%	0.79%	3.61%	(0.90%)	0.22%	0.53%
2013 returns	5.65%	3.41%	1.72%	(0.22%)	1.58%	4.71%
3 year annualized returns	7.18%	(4.19%)	4.74%	2.62%	6.39%	5.63%
3 year annualized volatility	1.70%	10.31%	3.91%	6.41%	3.13%	3.24%
3 year Sharpe ratio (RFR = 2%)	3.04	(0.60)	0.70	0.10	1.40	1.12
5 year annualized returns	8.52%	6.12%	8.00%	9.64%	8.42%	8.92%
5 year annualized volatility	1.45%	10.39%	3.63%	6.71%	3.23%	3.40%
5 year Sharpe ratio (RFR = 2%)	4.49	0.40	1.65	1.14	1.99	2.04
Maximum drawdown (5 years)	(0.82%)	(23.32%)	(3.53%)	(6.44%)	(1.47%)	(1.99%)
% Below HWM (5 years)	0.00%	(12.05%)	0.00%	(3.21%)	0.00%	0.00%

2014, when major emerging market currencies witnessed a sharp selloff as capital outflows picked up the pace as the Fed wound down its QE program.

Table 4 summarizes key performance statistics across strategic mandates, with arbitrage funds posting the best risk/reward profile over both the three- and five-year

time horizon – a Sharpe ratio of 3.04 and 4.49, respectively. The arbitrage space in Latin America is still wide open to new entrants, as there are only a handful of funds

Figure 12: Performance across fund size



	Eurekahedge Small Latin American Hedge Fund Index (< US\$25m)	Eurekahedge Medium Latin American Hedge Fund Index (US\$250m - US\$75m)	Eurekahedge Large Latin American Hedge Fund Index (> US\$75m)
2014 April year-to-date returns	0.06%	(0.29%)	0.51%
2013 returns	0.87%	2.29%	3.46%
3 year annualized returns	3.05%	5.06%	5.77%
3 year annualized volatility	4.25%	4.67%	4.18%
3 year Sharpe ratio (RFR = 2%)	0.25	0.65	0.90
5 year annualized returns	7.82%	8.55%	9.92%
5 year annualized volatility	4.35%	4.39%	4.23%
5 year Sharpe ratio (RFR = 2%)	1.34	1.49	1.87
Maximum drawdown (5 years)	(3.43%)	(3.72%)	(3.11%)
% Below HWM (5 years)	(0.61%)	(0.29%)	0.00%

employing the strategy in the market, with almost all of them focused on Brazil.

Figure 12 shows the performance of Latin American hedge funds according to fund size, with large funds (AUM>US\$75m) clearly outperforming the small funds (AUM<US\$25m) and posting lower annualized volatilities on both the three- and five-year time horizons. On a five-year annualized basis, the Eurekahedge Large Latin American Hedge Fund Index is up 9.92%, followed by medium-sized funds (AUM US\$25m-75m), which are up 8.55%, and small funds (AUM<US\$25m) up 7.82%. Table 5 further confirms the better risk/reward profile of the large Latin American hedge funds, which have posted Sharpe ratios of 0.90 and 1.87 over the three- and five-year time horizons, respectively.



About the Author

Founded in 2001, Eurekahedge is the world's largest independent data provider and research house dedicated to alternative investment funds. Maintaining coverage on over 29,000 funds across all strategies and asset classes, Eurekahedge strives to deliver a complete overview to its clients. Eurekahedge research covers hedge funds, funds of hedge funds, UCITS hedge funds, Islamic funds, insurance-linked securities and long-only absolute return funds.

In addition to fund data Eurekahedge publishes over 100 alternative investment benchmark indices along with the monthly Eurekahedge Report covering asset flows, fund performance, macroeconomic trends, league tables and specific index returns on the hedge fund industry.

Investing in Emerging Markets

A 2 Day Practical Training Programme

23-24 Oct 2014 London, UK



This practical 2 day course will provide you with the necessary tools, concepts and analytical insights to evaluate and decide on emerging market investments.

By the end of this course you will be able to:

- Analyse micro and macro economical conditions
- Assess emerging market country risk
- Understand the performance of the stock markets and listed companies
- Explore the characteristics of investing in goods and services markets
- Assess performance outlook and apply pricing and evaluation strategies
- Understand the trading patterns and opportunities
- Gain tools to assess investment opportunities and explore the best strategies for creating returns on your investments

Taught by an experienced practitioner this course will provide you with the tools to assess investment opportunities and explore the best strategies for creating returns on your investments. The programme includes many case studies from around the world.



Register by 31st of Aug and **save £360!**

For programme details go to:

http://www.eurekafinancial.com/courses/investing_in_emerging_markets.html

For more information and to reserve a place contact us on:
Eureka Financial Ltd • enquiry@eurekafinancial.com
+44 (0) 207 993 8597 • www.eurekafinancial.com

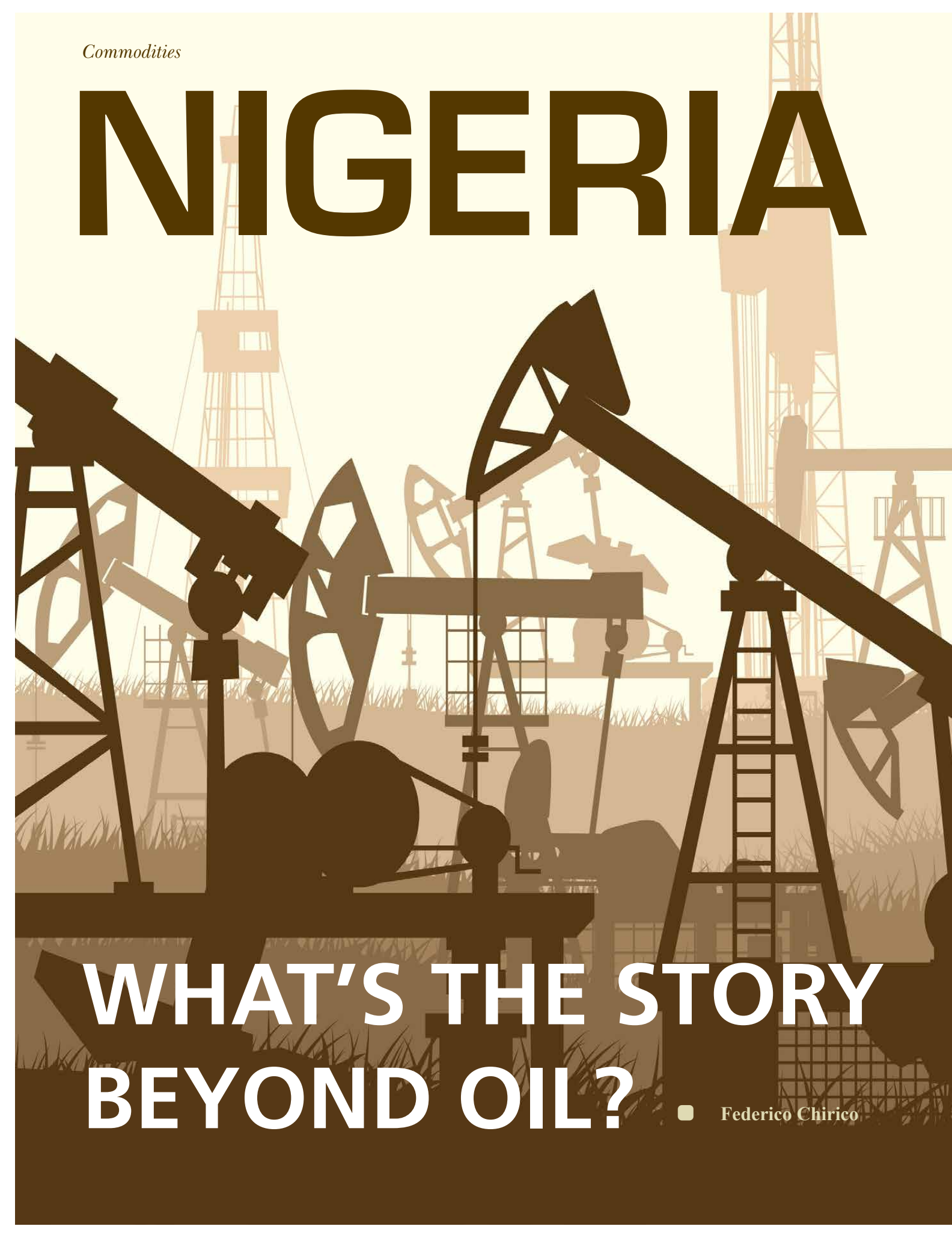
Other upcoming programmes:

Managing Family Office & Wealth – 2-3 Oct 2014 London • Investment Performance Measurement – 29-30 Sep 2014 London
UCITS Funds – 14 Oct 2014 London • Corporate Governance – 24-25 Aug 2014 Dubai & 12-13 Nov 2014 London
International Trade Finance – 1-2 Dec 2014 London • FATCA – 10 Sep 2014 London
Int. Securities Settlements & Custodial Services – 6-7 Oct 2014 London
Wealth Management & Private Banking – 20-21 Oct 2014 London • Repo Market – 18 Nov 2014 London
Operational Risk Management – 10-11 Nov 2014 London • International Payments – 3-4 Dec 2014 London

We offer over 200 specialised programmes on in-company basis in any location worldwide. For more information contact us on:
Eureka Financial Ltd • enquiry@eurekafinancial.com • +44 (0) 207 993 8597 • www.eurekafinancial.com

Commodities

NIGERIA



WHAT'S THE STORY BEYOND OIL?

■ Federico Chirico



Despite the recent challenges faced by the country, investors and analysts do not seem to have lost confidence in Nigeria. Surprisingly, attention is no longer focused exclusively on energy, as an important retail business is growing, driven by strong demographics.

Looking at the latest headlines from major financial journals, it seems that Nigeria has been in the news for all the wrong reasons in the last six months. The suspension of Mr. Sanusi as governor of Nigeria's Central Bank, together with an escalation of corruption scandals, terrorist issues, and the decline in international reserves seemed to mark a turning point for the country.

But despite these challenges, market analysts and investors do not seem to have lost confidence in Nigeria's potential. Rating agency Fitch has confirmed the stability of its outlook due to good economic fundamentals and continued strong GDP growth, while equity index provider MSCI increased the weight of Africa's biggest economy in its frontier market index to 19 percent, triggering a 4-month high on the Nigerian Stock index. So where is this reliance coming from? The fact that the country is a key global player in the oil and gas business does not appear to be enough to explain such a trend.

Demographics seems to be the main underlying factor supporting this confidence, as Nigeria is a very big market to serve

with rising per capita income. According to Oxford Economics, the population is expected to exceed 200 million by 2020, making the country the fifth most populated in the world, and the biggest market in Africa. Its middle class, which reached barely one million individuals up until a few years ago, has grown exponentially to the current 5 million.

The recent rebasing of Nigeria's Gross Domestic Product, with the primary purpose of reflecting more accurately those sectors that were almost non-existent in the early 90s, provided an in-depth look at the country's economy and suggested indeed that investment appetite is not limited to the energy sector.

Telecommunication has been highlighted as one of the most vibrant sectors, with MTN, Airtel and Globacom now well-known retail brands, demonstrating the rapid development of an industry that was negligible just two decades ago. Given the lack of line infrastructure and the still increasing demand for mobile services, mobile operators are expected to grow exponentially and be a potential target for investments in the coming years.

Another element emerging from the rebasing is the greater relevance gained by the entertainment sector, where the local film

industry represents significant export potential for the country in the long run. According to a recent report from Financial Derivatives Company, “Nollywood is now estimated to be worth about N853.9billion (US\$5.1billion), about 1.2 percent of the revised GDP number.” These numbers are impressive if we consider that Nigerian movies are still widely considered semi-professional and are far from comparable to the products of more conventional film industries. But significant demand across the continent and relatively low production costs make this business an ideal entry point for investors.

These positive stories alone do not sweep away the concerns of a country that still needs to find its way to stability, but it is also possible to say that Nigerian growth is no longer oil dependent but is rather more connected to good governance. The challenges posed by terrorism, the condition of the economy and, most importantly, the elections in 2015 are the factors that will determine the long-term investment growth in the country. If Nigeria can manage to address these challenges it will have paved the way to success.



About the Author

Federico Chirico is the founder and editor of “The African Frontier,” a blog dedicated to the discovery of African financial markets. He started his career at UBS Investment Bank in 2007, and he then moved to Ghana for a few years where we worked as business analyst for a Ghana-based financial boutique called Canal Capital. Currently, Mr. Chirico works for a large media and information company as financial markets executive, and he is a CFA level 2 candidate.

[Http://theafricanfrontier.wordpress.com](http://theafricanfrontier.wordpress.com)

HEDGE FUND AMERICAS FORUM 2014

NOVEMBER 4-5 / NEW YORK

The Hedge Fund Americas Forum gathers the brightest minds in the inter-American investor and hedge fund communities to explore the ever-evolving liquid alternatives investment landscape, share experiences, engage in constructive debate and work toward optimizing returns and aligning interests for investors and managers across the region.

LAST CHANCE TO SAVE!

REGISTER BY **AUGUST 29 TO RECEIVE
OUR PRE-REGISTRATION DISCOUNT**

Register at www.latinmarkets.org

For more information, contact:

William Frank

+1-212-696-0848 / william.frank@latinmarkets.org

 **LATIN MARKETS**

It is now widely accepted that the recent global financial crisis was actually a balance-sheet crisis. Long periods of negative interest rates facilitated the unsustainable financing of asset purchases, with high-risk mortgages weakening national balance sheets. When liquidity in the key interbank markets dried up, the fragilities were exposed – with devastating consequences.

China's Subprime Risks

■ Andrew Sheng & Xiao Geng

Today, the rapid expansion of Chinese financial institutions' balance sheets – which grew by 92% from 2007 to 2011, alongside 78% nominal GDP growth – is fueling predictions that the country will soon experience its own subprime meltdown. Is there any merit to such forecasts?

The first step in assessing China's financial vulnerability is to distinguish a solvency crisis, which can occur when firms lack sufficient capital to withstand an asset-price meltdown, from a liquidity crisis. During the Asian financial crisis of the 1990s, some countries suffered foreign-exchange crises, in which devaluation and high real interest rates de-capitalized banks and enterprises owing to the lack of sufficient reserves to repay foreign-exchange debts. In the case of Japan's asset-price collapse in 1989, and again in the United States in 2008, bank recapital-

ization and central-bank liquidity support restored market confidence.

The recently released Chinese Academy of Social Sciences (CASS) National Balance Sheet Report suggests that China is unlikely to undergo a foreign-exchange or national insolvency crisis. At the end of 2011, the central government's net assets amounted to CN¥87 trillion (US\$14 trillion), or 192% of GDP, of which CN¥33 trillion comprised equity in state-owned enterprises (SOEs). Moreover, at the end of last year, China's net foreign-exchange position totaled US\$2 trillion – 21% of GDP – with gross foreign-exchange reserves totaling just under US\$4 trillion.

The concern is China's rapidly increasing domestic debt, which currently stands at 215% of GDP. Since 2008, SOEs and so-called local-government financing platforms have been using loans to fund

massive fixed-asset investments, while private-sector actors have been borrowing – often from the shadow-banking sector – to finance investment in real-estate development.

This excessive dependence on credit stems from the lack of adequate funding and the relative underdevelopment of China's equity markets, with market capitalization amounting to only 37% of GDP, compared to 104% of GDP in the US. The debt held by non-financial enterprises amounts to 113% of GDP in China, compared to 72% in the US and 99% in Japan.

But, given that the largest enterprises are either state-owned or local-government entities, their debts are essentially domestic sovereign obligations. With China's total government debt/GDP ratio amounting to only 53% – much less than America's 80% and Japan's 226%





– there is sufficient space to undertake debt-equity swaps to tackle the internal-debt problem.

Of course, China's leaders will also need to pursue major fiscal reforms, including improved revenue-sharing between central and local governments. In the longer term, the authorities must put in place stricter regulations to ensure that local-government infrastructure investments are sustainable and do not depend excessively on revenue from land sales.

In the interim, the burden of adjustment will fall largely on monetary policy, which will be particularly challenging given the structural “tightness” in liquidity in the more productive sectors. From 2007 to 2011, China's money supply increased by 116%, whereas its foreign-exchange reserves grew by 180%. The excess was mopped up through statutory reserve requirements amounting to as much as 20% of bank deposits.

With the official banking system thus constrained, it allocated the remaining credit to large enterprises and those with sufficient collateral, resulting in an uneven distribution of loans across regions and sectors. As a result, large enterprises – mostly SOEs, which enjoy considerable financial subsidies and liquidity – accounted for 43% of total bank loans in 2011; small and medium-size enterprises (SMEs), which face financial repression, including higher borrowing costs and tight liquidity, accounted for only 27%.

This highlights two fundamental structural imperatives. First, large SOEs and local governments must be discouraged from over-investing, which undermines the rate of return. Second, more capital must be channeled toward SMEs and faster-growing regions, which are more likely to generate jobs and innovation.

In other words, interest-rate reforms must be pursued alongside capital-market reforms that boost access to credit by the more productive sectors. China cannot complete its transformation from an export-led economy to one driven by domestic consumption and services unless value creation through innovation exceeds value destruction from excess capacity.

In short, despite a strong national balance sheet and ample central-bank liquidity, China is confronting a localized subprime problem, owing partly to high reserve requirements. One promising move is the central bank's recent release of CN¥1 trillion in liquidity through direct lending

to the China Development Bank for the reconstruction of shanty towns, fulfilling the need for socially inclusive investment. Unlike the US Federal Reserve, it has not purchased subprime mortgages.

The key to success will be to manage the sequence of liquidity injections and interest-rate reforms so that the effort to address local subprime debts does not trigger asset-price deflation, while reducing financial repression that cuts off funding to more productive sectors and regions. If it manages to get these structural reforms right, China – and the rest of the world – will be able to avoid the consequences of a hard economic landing.

About the Authors

Andrew Sheng, Distinguished Fellow of the Fung Global Institute and a member of the UNEP Advisory Council on Sustainable Finance, is a former chairman of the Hong Kong Securities and Futures Commission, and is currently an adjunct professor at Tsinghua University in Beijing. His latest book is *From Asian to Global Financial Crisis*.

Xiao Geng is Director of Research at the Fung Global Institute.



Mexican Telecom Sector Aligned for Consolidation Wave

■ Heather West and Adriana Curiel

Regulatory changes in Mexico's telecom space, coupled with AT&T's move for DIRECTV, could signal an upcoming consolidation spree in Mexico, industry sources say.

The landscape is a sticky web of longstanding and newly formed relationships, but industry sources point to Nextel and Iusacell as potential targets in the mobile sector, and Axtel, Alestra, Maxcom and Megacable as opportunities in the fixed-line arena.

In addition to AT&T, Telefonica, Verizon and Vodafone are also seen as possible consolidators, and may be evaluating acquisitions or joint ventures.

A handful of deals should be expected in the US\$100 million to US\$300 million range in the next six to 24 months, according to two Mexico-based industry sources.

■ Timing is right

Mexico approved its telecom reform in June last year, but the secondary legislation, which will outline how the reform will be executed, is now expected in July. Mexico's President Enrique Pena Nieto said this month that he is confident secondary laws should be approved no later than July 15.



The reform would allow foreign firms to own up to a 49% stake in radio and broadcast TV companies, and up to 100% in all telecommunications and satellite TV services.

It may also grant foreign and local investors the confidence needed to start consolidation, says Ernesto Piedras, director of the The Competitive Intelligence Unit (CIU), a consulting firm with expertise in the telecommunications industry across Latin America.

■ Strategies for growth

While the billionaire Carlos Slim dominates the Mexican telecom market through his companies America Movil (Telcel), the mobile carrier, and Telmex, the fixed-line carrier, with 70% and 80% market shares, respectively, now may be the time for other players to make an entrance.

Because long-distance calling is now seen as a commodity, strategies to compete against the incumbent leader may include providing these commodity services, but enhanced with cloud-based services and information management for corporations, note two of the industry sources.

■ AT&T's role

On May 18, AT&T announced it would acquire DIRECTV for US\$48.5 billion, and noted that DIRECTV's Latin American business is the leading pay TV provider in the region. "Latin America has an underpenetrated pay TV market (about 40% of households subscribe to pay TV) and a growing middle class, and is DIRECTV's fastest growing customer segment," AT&T said in a press release.

AT&T's next step is not clear, but Mr. Piedras notes that now that the telecom rules

would allow it to take a majority stake in a telecom company in Mexico, it could come back to Alestra or look to acquire another competitor such as Axtel or Maxcom. AT&T was an original partner in the formation of Alestra in 1996, but sold its 49% stake in 2011.

While the billionaire Carlos Slim dominates the Mexican telecom market through his companies America Movil (Telcel), the mobile carrier, and Telmex, the fixed-line carrier, with 70% and 80% market shares, respectively, now may be the time for other players to make an entrance.

A spokesperson for AT&T could not discuss its plans for Latin America, as the company is still working on the approval process.

■ Potential targets

"There are three telecom companies that people are watching carefully," says an

industry source. They are Alestra, which is held by Mexico's Alfa Group; its rival Axtel; and Iusacell, which is jointly owned by Grupo Televisa and Grupo Salinas.

Alestra is "definitely" a target, noted a second industry source. It has become more of an Internet services provider than a fixed telephony company, points out Mr. Piedras. It focuses on corporate and institutional customers in Mexico, and provides Internet-related and value-added services, in addition to its long-distance services.

Axtel, which is highly leveraged with US\$750 million in convertible bonds maturing in 2020, has been the subject of industry chatter as a target for Alestra, noted the industry source. According to Mr. Piedras, Axtel is an interesting target for both local and foreign investors, as it is considered the second-largest fixed-line network behind Telmex.

However, Axtel's value will be impacted by the new regulations, which will affect its interconnection charges and therefore determine its profitability, noted the second industry source.

Iusacell has also been in the news. A June 19 report noted that Iusacell and Telefonica are still discussing a possible combination, after first being reported as possible merger partners in February. But a deal between the two may be difficult to consummate due to questions about control and anti-trust concerns, among other reasons.

Other smaller targets could include Maxcom, which could be a good partner for a cable company that wants to be able to offer triple-play (Internet, fixed-line and cable television) or quadruple play (Internet, fixed-line, mobile-line, cable television), Mr. Piedras says.



Megacable is another possible target, two of the sources report. Meanwhile, three sources cite Nextel as a very likely target. In March, NII Holdings retained UBS and Rothschild to explore strategic and capital structure alternatives. NII Holdings provides mobile services under the Nextel brand in Argentina, Brazil, Chile and Mexico.

Further, on June 24 an Argentine news report said Nextel could be selling its operations in Argentina and Chile.

Nextel has a low valuation but presents a solid opportunity because it has quite a bit of spectrum and a high end customer base, the second source says. It has not been aggressive in upgrading its technology and finds itself in a similar situation as BlackBerry, two of the sources note. Nextel was known for its “push-to-talk” technology.

NII Holdings, Iusacell, Axtel, Alestra, Maxcom and Megacable did not return requests for comment.

■ Potential buyers

Televisa, the Mexican television broadcaster, issued US\$1 billion in 30-year bonds in May. A second industry source noted that the company is the main provider of open and cable television in Mexico and will continue to be a consolidator. Televisa should be considered a “safe bet” as a buyer.

Additionally, its fixed telephony arm, called Bestel, is small compared to those of Alestra and Axtel, which could make it interested in an acquisition or partnership, says Mr. Piedras.

Now that the competition rules are clearer, Vodafone and Verizon could be two foreign competitors interested in returning to Mexico, Mr. Piedras says, and the third industry source concurs. Verizon and Vodafone walked away from their investment

in Mexican wireless Iusacell after spending more than US\$2 billion in one decade, and both companies said at the time that they struggled in Mexico because Mexican regulators favored AmericaMovil.

Other international strategies that could be interested in mergers, partnerships or JVs with Mexican telecoms could include China-based Huawei, Italy-based Telecom Italia Mobile (TIM) as well as the British Telecom Capital, according to Mr. Piedras.

■ Approach with caution

Mexico is a market where certain US carriers do not have a presence, but there are many established players with a lot of clout, notes Rick Gibson with Lape Mansfield Nakasian & Gibson. New entrants should approach carefully, he cautions.

Gibson cites the terminated NII Holdings/Televisa deal in 2010, where the companies had agreed to jointly buy Mexican wireless spectrum in a government auction, and then deploy a 3G network that would allow them to compete with larger players in the market. NII won the spectrum auction but faced a series of legal challenges from wireless rivals questioning the legality of the auction, and the deal with Televisa was never consummated.

Another important issue to consider is the FCPA (Foreign Corrupt Practices Act). US companies need to conduct thorough FCPA diligence to ensure that they do not acquire an FCPA issue, as at least some Mexico companies do not operate in an FCPA compliant manner, Gibson points out.



MERGERMARKET

About the Author

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

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

In August 2006 The Mergermarket Group was acquired by the Financial Times Group, publisher of the Financial Times newspaper and FT.com. FT Group is a division of Pearson plc, the international media group. For further information, please see: www.mergermarket.com

■ Nadiya Satyamurthy and Doug Midland, EMPEA



Mezzanine Finance in Emerging Markets Deserves a Closer Look

Despite what lately seems to be a continuous cycle of negative-chasing-positive headlines, emerging markets have solidified their status as an important component of investor portfolios – and when allocating capital to these countries, investors enjoy a relatively wide array of investment vehicles from which to choose. However, one option that has not received much attention to date is the mezzanine fund.

EMPEA recently released its study *Private Credit Solutions: Mezzanine Financing in Emerging Markets*, which explores the nascent but growing sub-asset class that sits above equity and below senior debt in a firm's capital structure, and is inclusive of instruments such as senior subordinated debt, convertible subordinated debt or preferred shares. Often overlooked or misunderstood, mezzanine

finance offers four key reasons for why it may warrant a closer look from global institutional investors seeking exposure to emerging markets.

■ Mezzanine can fill the financing gap

Access to finance is a major challenge for small and mid-size business owners based in emerging markets. Oftentimes local

banks prefer lending to larger, well-known businesses, which they believe represent "safer" borrowers. Adding to the banking constraints, a number of international financial institutions have pulled back their lending in emerging market regions, in part because of the lasting effects of the global financial crisis on their balance sheets, but also because of more restrictive capital adequacy requirements imposed by regulators. These dynamics have left



Mezzanine funds can offer a financing solution for companies in developing countries as mezzanine specialists typically work with firms to provide longer duration financing for growth and expansion. This characteristic marks a major distinction between mezzanine finance in emerging and developed markets.



small and medium-sized firms relatively unbanked. Moreover, capital markets remain an elusive source of financing for many emerging market companies. While private equity offers a viable alternative, some owners are reluctant to relinquish control over even a small portion of their businesses.

Mezzanine funds can offer a financing solution for companies in developing countries as mezzanine specialists typically work with firms to provide longer duration financing for growth and expansion. This characteristic marks a major distinction between mezzanine finance in emerging and developed markets. Whereas in emerging markets mezzanine lending is normally direct to the company, in developed markets the sub-asset class – used for restructurings, recapitalizations and lever-

aged buyouts in addition to growth capital – has become somewhat commoditized, characterized by “institutional mezzanine” deals where credit institutions underwrite chunks of a transaction and distribute mezzanine tranches to assorted investors. The bespoke nature of emerging market mezzanine financing makes it a suitable plug for the financing gap facing a wide and diverse spectrum of companies operating in these countries.

■ Mezzanine can align interests between entrepreneurs and investors

Many growth opportunities in emerging markets come from owner-managed companies. But, as previously noted, these entrepreneurs are sometimes concerned

about dilution of their equity stakes. Thus, the challenge for fund managers is not only sourcing attractive investment opportunities, but also working with owners and management teams to design a package that aligns the interests of both parties.

Mezzanine can provide an alternative to private equity when the owner is reluctant to cede control of his or her business. For the investee, the advantage in mezzanine is its ability to reduce or avoid altogether the diluting effects that traditional private equity investors may cause (in addition to imposing fewer restrictions than pure debt). Moreover, through extensive negotiations and structuring up front, the investor and investee can tailor a bespoke financing package with terms and instruments aligned with the company’s operations and long-term strategy. The investor

Figure 1: Consideration of Risks for Emerging Market Mezzanine Investors



can thus structure a targeted return ex ante, while the owner retains control.

■ Mezzanine can offer a favorable risk-adjusted return profile

While mezzanine fund managers share many of the risks faced by private equity (see Figure 1), the sub-asset class is designed to offer institutional investors a less risky option than pure equity. Mezzanine transactions can rely on several tools to mitigate risk, including: the ability to employ covenants to exert a level of control or obtain prepayments when the company undertakes a prohibited action; the self-liquidating nature of mezzanine, which gradually reduces risk throughout the life of the investment; the inclusion of resources from a committed strategic or financial investor in sponsored deals; and the strength of the security. The security on mezzanine asset-backed debt is traditionally second or third lien. However, the dearth of senior lenders in many emerging markets has resulted in mezzanine investors sometimes being the only debt providers in a deal, giving them the ability to secure senior rights.

Of these risk-mitigating tools, one that particularly differentiates mezzanine from equity financing options is that of the liquidity profile. Through the receipt of regular interest and principal payments, mezzanine offers the ability to de-risk an investment over the course of its lifecycle, while flattening the J-curve. By having a scheduled amortization of the loan, exit risk is reduced, which can often be a challenge for investors in small and mid-sized companies. Furthermore, decisions on which currency will be used for interest and principal payments are often negotiated up front, reducing exchange rate risk for both parties.

■ Mezzanine can generate competitive returns

Mezzanine fund managers sometimes claim to capture 80% of the returns of private equity while taking 50% of the risk. While these figures are more impressionistic than scientific, the performance of mezzanine funds in emerging markets appears to be on par with that in developed markets. According to performance data collected by EMPEA for its report, the median emerging market mezzanine deal returned a 1.5x gross multiple, while the median fund delivered a gross IRR of 17.2% (between 1999 and 2011). Comparing deal-level returns, the median emerging market return is competitive with the average multiples for realized transactions in the United States and Europe over the same time period, which ac-

cording to data from CEPRES were 1.5x and 1.4x, respectively.

Mezzanine can be a complex investment approach – particularly in emerging markets where the number of dedicated specialists in operation is limited, and the rules of the game in each region are still being developed. Nevertheless, this sub-asset class can present attractive opportunities to discerning investors: mezzanine funds can plug the financing gap in emerging markets, align the interests of the investors and investees, offer flexibility in creating a risk-adjusted return profile, and achieve competitive returns. For more information and detail on this topic, download a copy of EMPEA's May 2014 in-depth report, *Private Credit Solutions: Mezzanine Financing in Emerging Markets*.



Emerging Markets Private Equity Association

About the Author

Nadiya Satyamurthy is a Senior Director and Doug Midland is a Graduate Fellow with EMPEA's Consulting Services team. You can learn more about EMPEA Consulting Services at www.empea.org/research/consulting-services.

Argentina Will Start Bidding Process for 4G Cell Phone Band

■ Javier Canosa



An opportunity for investing in telecommunications in Argentina has been opened by means of Decree 671/2014 (the “Decree”) of the National Executive Power, which orders a bid for 3G and 4G cellular telecommunications bands.

The Decree instructed the Secretary of Communications, an office under the Ministry of Federal Planning, Public Investment and Services (“SECOM”), to proceed with the public auction of both 3G and 4G frequencies. To this end the SECOM will prepare and approve bidding terms and conditions and call for tender for the award of these bands.

The frequencies at stake are (i) the frequencies held by the local state-owned company, “Empresa Argentina de Soluciones Satelitales S.A. or AR-SAT” that relate to the service known as 3G that the company Movistar (a company controlled by Telefonica, a product of the merger between Movicom and Unifón) returned to

the federal government because, as a result of the aforementioned merger, such frequencies exceeded the maximum 50MHz; and (ii) the bands between 698-806MHz,

Although the commencement of the bidding process has not yet been specified, the public officers mentioned that this will happen soon, “between six and eight months.”

1710-1770MHz, and 2110-2170MHz exclusively for land mobile telecommunications services that will be used for the pro-

vision of mobile communications through the 4G system.

During the presentation, the public officers mentioned that after the bidding, the system will double the current allocation of resources, of 170-380 megahertz, and will be above the Latin American regional average of 263 megahertz. Therefore, the government believes a fourth mobile operator can enter the local market.

Although the commencement of the bidding process has not yet been specified, the public officers mentioned that this will happen soon, “between six and eight months.” This opens a new door for investment opportunities in Argentina. The bidding process will be developed under the principles of efficiency, non-discriminatory treatment, promoting competition, ensuring the rights of users and promoting access for people living in areas where mobile communication services are not currently being delivered.



About the Author

Javier Canosa is a partner in the BA firm Canosa Abogados. His practice encompasses 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.

Canosa Abogados – Montevideo 711 4th Floor – C1019ABO – Buenos Aires -Argentina – jc@canosa.com.ar Tel: 54 11 5252 2462 and Fax: 54 11 5252 2463 www.canosa.com.ar

Investing in Emerging Markets, North America

This annual report, brought to you by Clear Path

‘Investing in Emerging Markets, North America’ brings together industry leaders from North American pension plans, insurance and endowment funds, foundations and large private wealth investment to uncover the shift in attitudes to investing in emerging markets, the opportunities and threats in these changing economic times, and what the future holds for this asset class. With such respected contributors expounding on the issues most relevant to your professional practice, it will give

you the opportunity to diversify and update your knowledge with our pick of market-leading experts. Register your interest for your copy of this free e-report at <https://www.clearpathanalysis.com/product/114-iemna-2014/>

Through a series of interviews, whitepapers, panel discussions and expert debates, you will be guided through the pertinent questions surrounding today’s emerging market landscape. The report will address key issues including the impact of quantitative easing in the U.S., the domestic bias

to capitalise on favourable demographics, emerging market managers’ capacity strains, the impact of the BRICs’ inflation conundrum on local debt, strategic vs. tactical investment choices and balancing local currencies with dollar denominated allocations.

At once far-reaching, readable and informative, the six sections of the report begin with an examination of the potential of emerging markets and the effect of the ‘taper tantrum’ and U.S. quantitative easing on emerging market prices. The debate then moves on to discuss; allocation, headline risks and the onslaught of market volatility, and takes a closer look at how the Ontario Pension Board moved from 0-15% allocation in an exclusive interview with their Vice President of Public Markets. Markets outside of the BRIC domain are explored in an expert debate titled ‘How can investors unlock the African potential?’ with confirmed panellists including the Director General of the East African Development Bank and the Senior Investment Officer of the International Finance Corporation. The report wraps up with a case for the alternatives, looking at the opportunities presented by emerging market real estate.

Broaden your knowledge and give your portfolio the edge, with the latest opportunities in the emerging market space, and what the future holds for this asset class.

Clear Path Analysis specialize in the publishing of high quality, free online reports in the financial services and investment sectors; we look forward to sharing our insights with you in ‘Investing in Emerging Markets, North America’, report, available for download from <https://www.clearpathanalysis.com/product/114-iemna-2014/>.

INVESTING IN EMERGING MARKETS, NORTH AMERICA **REPORT**



The annual report bringing together North American institutional investors to examine the growing plethora of opportunities in emerging market investing both in and beyond the BRIC countries.

DOWNLOAD FOR FREE

REGISTER YOUR INTEREST NOW TO BE EMAILED THE REPORT AS SOON AS IT IS RELEASED

Clear Path Analysis specialize in the publishing of high quality, free online reports in the financial services and investment sectors, including:

- BANKING
- FINANCE TECHNOLOGY
- FUND MANAGEMENT OPERATIONS
- INSURANCE
- INVESTMENT STRATEGY
- PENSIONS ADMINISTRATION & OPERATIONS
- PRIVATE & RETAIL INVESTMENT

**DOWNLOAD THIS REPORT & OTHER
FREE FINANCIAL REPORTS FROM
WWW.CLEARPATHANALYSIS.COM**

 **Clear Path Analysis**
Sharing Financial Knowledge
www.clearpathanalysis.com

Chinese Wine Tourism: Not Just About Wine

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

One of the most visible symbols of growth in the Chinese wine industry is the development of wine castles, museums and amusement parks. An intriguing feature of Chinese wine tourism is that the infrastructure is developing with remarkable speed, even before the wines receive widespread recognition. Whether it's a beach resort city in Shandong or an isolated rural region like Ningxia, wine is part of a bigger story, where complementary investments can promote tourism, hospitality, banking, real estate, and more, targeting visitors who may not even be wine drinkers. This is unusual, but there are good reasons to believe it can pay off. First, building a welcoming environment for visitors may help grow the base of wine

consumers by educating them. But more than that, when a wine region develops in conjunction with other complementary businesses and institutions, the benefits can extend far beyond the wine industry. In fact, the importance of industrial clusters has long been apparent in other sectors in China as well as far-reaching wine clusters like Napa, California, so the real question is how to invest in the right places, given each region's distinct strengths.

■ **Building the market:
Something for everyone**

Wine tourism in China has something to offer for everyone. State-owned giant Changyu has wine museums in several provinces where visitors can learn about



wine production and history, and taste wine. The photo ops in Changyu's chateaus are stunning and perfect for weddings. These places offer a great introduction to wine, but that's not necessarily the point. Instead, wine seems to be a vehicle to connect many other things: a mock mini

European town with hotels and restaurants, and activities like tennis, golf, picking your own fruit or horseback riding. The amusement park nature of a place like Chateau Changyu AFIP, close to Beijing, on the way to the Great Wall, makes it a day of fun regardless of one's interest in

wine. Wine helps diversify the local tourism offerings, promoting wine brands and building the wine consumer base.

For a more intimate experience, and one perhaps more focused on the wine itself, wineries like Grace Vineyard in Shanxi or



In Shandong, the birthplace of China's modern wine industry, tourism is already established. Thanks to the location, climate and easy access to markets, the region's agriculture, industry and infrastructure are well developed.

Jade Valley in Shaanxi offer smaller-scale, boutique rural tourism. They are places where visitors connect personally with the story and people behind wines that have been critically acclaimed. But they also promote sustainable rural tourism and attract investment to otherwise ignored villages.

■ Building on regional tourism clusters

In Shandong, the birthplace of China's modern wine industry, tourism is already established. Thanks to the location, climate and easy access to markets, the region's agriculture, industry and infrastructure are well developed. With so many visitors to Yantai in the summer, it is not surprising that Changyu's wine museum is regularly packed with tourists. On the way from the beach to the museum, you may even walk through "wine street," a street dedicated to wine with several wine shops representing different countries. For now, it seems these stores are not (or rarely) open, but that doesn't prevent soon-to-be married couples from coming for pictures. In the nearby Penglai resort, close to a popular water park, Changyu Castel offers the museum experience enhanced with walks around a lavish Chateau and well groomed vineyards.

Further west, in Shaanxi province, tourists also flock to Xi'an for its stunning city walls and day trips to see the terra cotta warriors. In a nearby village, the boutique winery Jade Valley is finishing a few hotel

rooms to welcome visitors, who can have lunch and tour the winery. Their wines have already received good reviews from Jancis Robinson. The location close to major tourist landmarks will help expand the local tourism cluster to a rural area, which can benefit from increased investment and improved infrastructure.

■ Using wine to spur new clusters

Of course, Chinese wine tourism is about much more than growing the market for wine. Wine tourism is part of the bigger trend of domestic rural tourism, which has become very popular in China. It can help the government address the rural-urban divide, while at the same time preserving farmland, two major policy objectives in China. Hundreds of thousands of farmers have, on their own or in partnership with local governments and corporations, diversified their activities to welcome visitors. Many urban residents in need of fresh air engage in rural tourism to enjoy picking their own fruit, spending a few days at a farmer's house to sample farm life and enjoy local home-cooked meals. Local governments have used rural tourism as an economic development tool, because it allows farmers to diversify their income sources, bringing visitors and investors to rural areas otherwise left behind (or even swallowed by) urban development.

All of this makes wine tourism especially promising for more remote and poorer

provinces like Ningxia. Compared to Shandong, it is much further off the beaten path. It is one of the poorest provinces, and while the city of Yinchuan has a number of hotels and restaurants, it is not yet a major tourist destination. On the other hand, the region's climate and soils are seen as promising for wine, and investment has poured into the emerging local wine industry. Close to Yinchuan, state-owned Ningxia Nongken Corporation is leading the development of a stunning wine town. The company is not only promoting the development of new wineries and vineyards, but has also paved roads and decorated them with vines between lanes. Signs to the various local wineries are shaped like wine bottles, making them easy to find, even though some still lead to wineries under construction.

But a successful wine cluster is always part of a larger economic community. Ironically, the most renowned areas for Chinese wine grapes are Ningxia and Xinjiang, regions with significant Muslim minority groups. No problem. Ningxia already has plans to develop tourism around its diverse Muslim cultures to rival the busy Muslim market in Xi'an. Then, the Ningxia tourism industry really will have something to offer everyone.





latin private wealth management

SUMMIT

September 25-26, 2014, Trump Ocean Club, Panama City, Panama

ATTENDEES' TITLES INCLUDE

Delegates will include CIOs, VPs, Directors, Founders and Department Heads responsible for Investment Strategy and Asset Allocation decision-making from the following: Multi-Family Offices, Single Family Offices, Registered Investment Advisors, and Financial Institutions

REASONS TO ATTEND

A two-day agenda of 10-15 pre-scheduled meetings in advance of the summit

A directory of delegates attending the summit

All meals and networking activities

Access to premium event content, exclusive presentations, interactive panels and all summit proceedings

Accommodation at a luxury five star venue

Very productive platform to find out what other companies are doing and to build connections.

**President, Brick Investment
Advisors LLC**

CONTACT US FOR MORE INFORMATION ABOUT SPONSORSHIP OPPORTUNITIES

**If you are interested in attending, sponsoring or speaking at this event please call
312-540-3000 ext. 6592 or email j.keljik@marcusevansch.com**



■ LATIN MARKETS

PRIVATE EQUITY ANDEAN FORUM

October 2, 2014

Cartagena, Colombia

The Private Equity Andean Forum will bring together 300+ local and global institutional investor, funds and advisors for one day of informative discussion and networking that offers local firms access to the global private equity industry and serves as the perfect cornerstone to any international due diligence trip to the region.

SAVE \$500
REGISTER BY AUGUST 31ST
FOR OUR DISCOUNTED PRICE!

2014 Featured Speakers

Herman B. Santos



Chairman - Board of Investments
Los Angeles County Employees Retirement Association (US)

Pablo Medina



Chief Risk Manager
AFP Skandia (Colombia)

Paula Delgadillo



Head of Alternative Investments
Seguros Bolivar (Colombia)

Alfonso Vargas



Strategy Manager
AFP Colfondos (Colombia)

Oscar Rocha



Chief Investment Officer
Metlife Colombia (Colombia)

Renzo Castellano



Chief Investment Officer
AFP Integra (Peru)

Vicente Tuesta



Chief Investment Officer
Profuturo AFP (Peru)

Katherine Downs



Principal Investment Officer
International Finance Corporation (US)

2014 Sponsors



Stand out from the crowd



For more information, contact:

Charles Fathers

T: +1-212-696-0898

charles.fathers@latinmarkets.org

Register at:

www.latinmarkets.org