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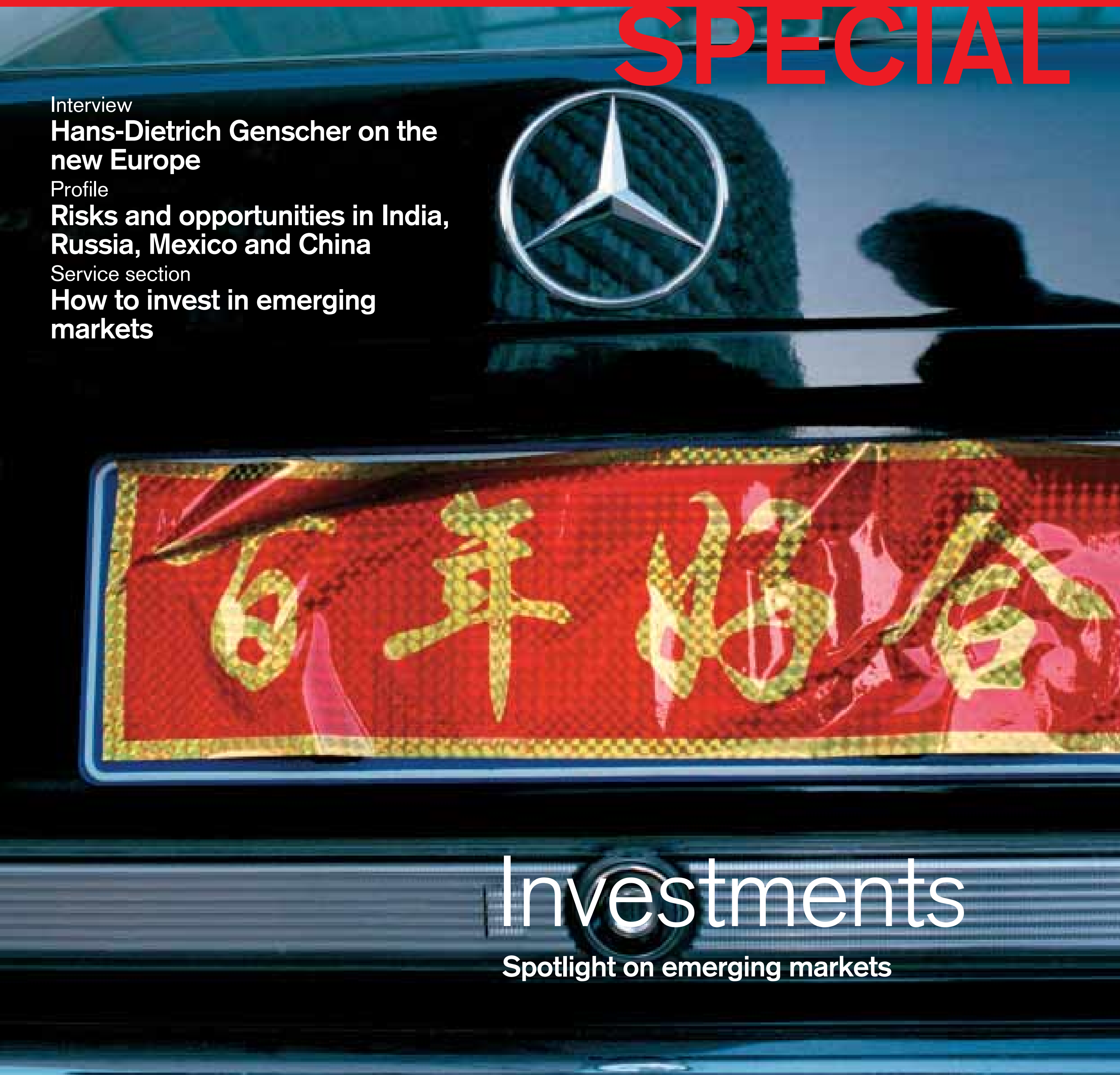
SPECIAL



Interview

Hans-Dietrich Genscher on the new Europe

Profile

Risks and opportunities in India, Russia, Mexico and China

Service section

How to invest in emerging markets

Investments

Spotlight on emerging markets

Why emerging markets?

Emerging markets are countries undergoing a phase of economic transformation. This process generates a range of opportunities and risks that are economic, societal, and political in nature. The sooner investors analyze such developments, the greater the potential returns that can be achieved in these markets. In the current environment marked by relatively modest growth in the large industrialized economies, successful investors will have no alternative in the future to devoting more attention to emerging markets.

The latest group of countries to join the European Union (EU) represents one cluster of emerging markets. Considering the economic progress achieved by previous emerging-market countries such as Ireland, Spain and Greece, one can imagine the potential these new EU member states represent.

Various factors are likely to contribute to above-average economic momentum in these countries in the next few years, and it goes without saying that investors stand to profit from this development. Some examples:

- Salary costs that are up to 80 percent lower and scaled-back capital-transfer controls will stimulate foreign investment and boost profit margins in labor-intensive industries in the foreseeable future.
- If interest rates in these countries continue to fall to EU levels, saving will become an unattractive option and consumer spending will be stimulated.
- Inclusion of local stock exchanges in international indices will automatically result in passive capital flows from indexed funds and institutional investors.
- The Ifo Institute expects growth rates in the new EU member states to be twice as high as growth in the EU overall over the next few years; in view of the lower historical basis for growth, this projection is entirely realistic.

In addition, the price corrections in emerging market investments in the spring represent a welcome remedy to the overheating that had set in during the months before. This correction is a good reason to re-examine emerging markets, hence this special issue of Bulletin dedicated to this exciting topic. We hope you enjoy reading our analyses.

Burkhard Varnholt, Head of Financial Products

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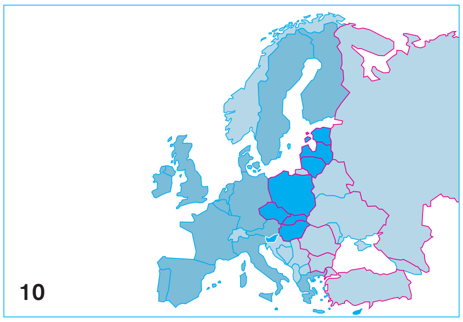
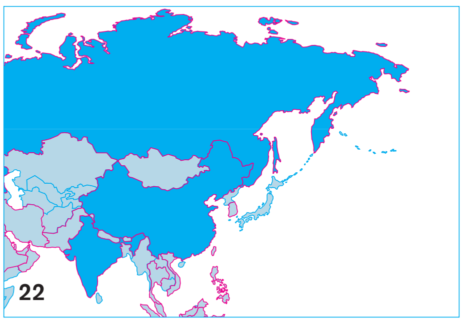




Bulletin Special on Investment

Emerging markets with growth potential

Many investors in emerging markets took a beating during the 1990s. In these markets, however, past performance is not a reliable indicator of the future. **Cedric Spahr**

Emerging markets

Africa/Middle East

1	Egypt	Ba1/BB+
2	Algeria	NR/NR
3	Bahrain	Baa1–/A–
4	Botswana	A2/A
5	Ghana	NR/B+
6	Iran	NR/NR
7	Iraq	NR/NR
8	Jordan	Ba2/BB
9	Qatar	A3/A+
10	Kuwait	A2/A+
11	Lebanon	B2/B–
12	Morocco	Ba1/BB
13	Mauritius	Baa2/NR
14	Oman	Baa2/BBB
15	Saudi Arabia	Baa2/A
16	Senegal	NR/B+
17	South Africa	Baa2/BBB
18	Tunisia	Baa2/BBB
19	U.A. Emirates	A2/NR

Asia/Pacific

20	China	A2/BBB+
21	Hong Kong	A1/A+
22	India	Baa3/BBB–
23	Indonesia	B2/B
24	Malaysia	Baa1/A–
25	Pakistan	B2/B
26	Philippines	Ba2/BB
27	South Korea	A3/A–
28	Taiwan	Aa3/AA–
29	Thailand	Baa1/A–
30	Vietnam	B1/B

Europe

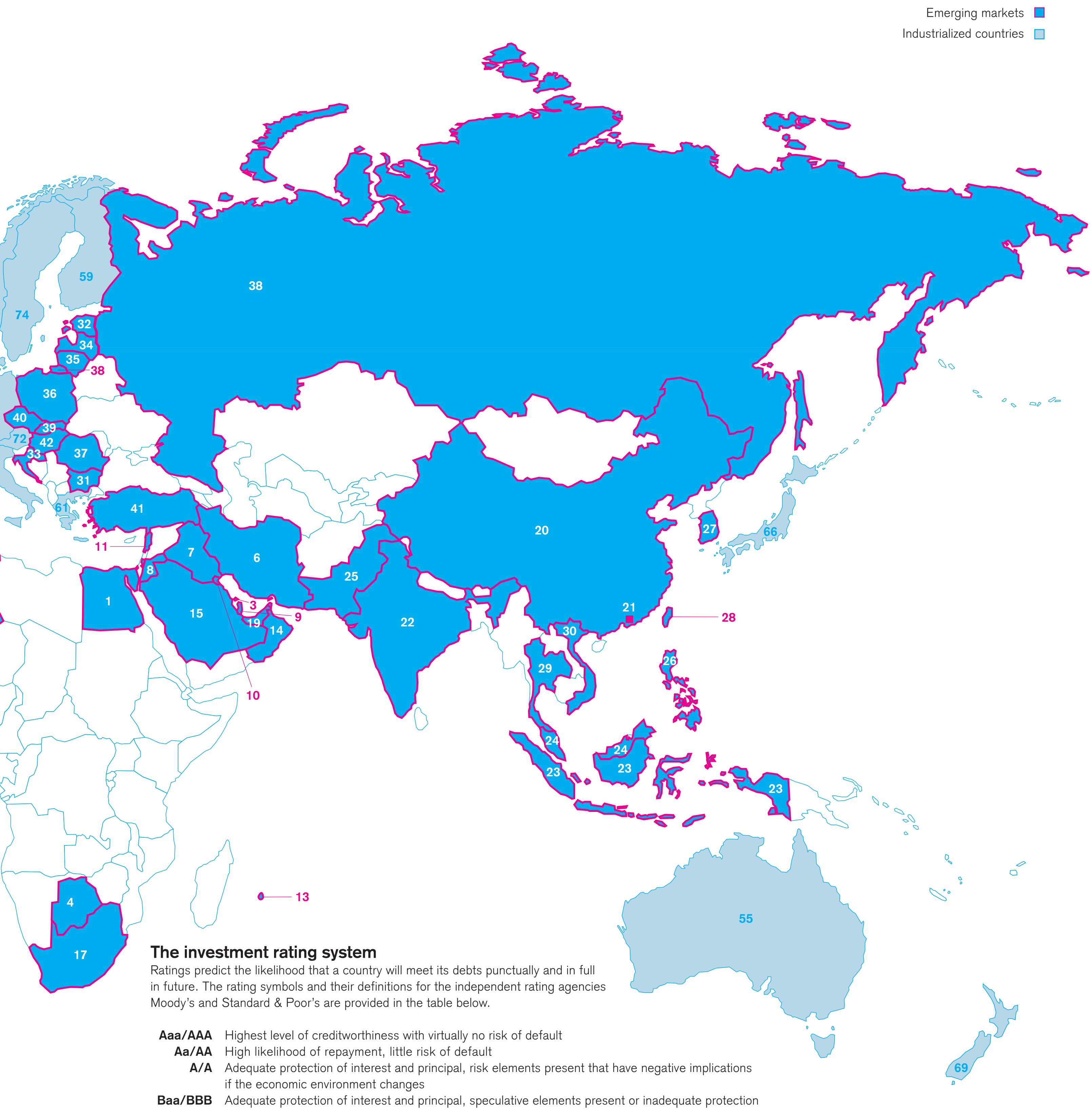
31	Bulgaria	Ba2/BB+
32	Estonia	A1/A–
33	Croatia	Baa3/BBB–
34	Latvia	A2/A–
35	Lithuania	A2/A–
36	Poland	A2/BBB+
37	Romania	Ba3/BB
38	Russia	Baa3/BB+
39	Slovakia	A3/BBB+
40	Czech Rep.	A1/A–
41	Turkey	B1/B+
42	Hungary	A1/A–

Latin America

43	Argentina	Caa1/SD
44	Brazil	B2/B+
45	Chile	Baa1/A
46	Costa Rica	Ba1/BB
47	Ecuador	Caa1/CCC+
48	Colombia	Ba2/BB
49	Mexico	Baa2/BBB–
50	Panama	Ba1/BB
51	Peru	Ba3/BB–
52	Uruguay	B3/B–
53	Venezuela	Caa1/B–

Industrialized countries

54	USA	Aaa/AAA
55	Australia	Aaa/AAA
56	Belgium	Aa1/AA+
57	Denmark	Aaa/AAA
58	Germany	Aaa/AAA
59	Finland	Aaa/AAA
60	France	Aaa/AAA
61	Greece	A1/A+
62	UK	Aaa/AAA
63	Iceland	Aaa/A+
64	Ireland	Aaa/AAA
65	Italy	Aa2/AA
66	Japan	Aaa/AA–
67	Canada	Aaa/AAA
68	Luxembourg	Aaa/AAA
69	New Zealand	Aaa/AAA
70	Netherlands	Aaa/AAA
71	Norway	Aaa/AAA
72	Austria	Aaa/AAA
73	Portugal	Aa2/AA
74	Sweden	Aaa/AAA
75	Switzerland	Aaa/AAA
76	Spain	Aaa/AAA



The investment rating system

Ratings predict the likelihood that a country will meet its debts punctually and in full in future. The rating symbols and their definitions for the independent rating agencies Moody's and Standard & Poor's are provided in the table below.

Aaa/AAA	Highest level of creditworthiness with virtually no risk of default
Aa/AA	High likelihood of repayment, little risk of default
A/A	Adequate protection of interest and principal, risk elements present that have negative implications if the economic environment changes
Baa/BBB	Adequate protection of interest and principal, speculative elements present or inadequate protection if the economic environment changes
Ba/BB	Moderate protection of interest and principal, speculative elements present
B/B	Limited protection of interest and principal
Caa/CCC	Large risk regarding likelihood of repayment
Ca/CC	Already in default or close to default; still some likelihood of repaying interest and principal
C/C	Normally already in default with limited likelihood of repaying interest and principal
SD/DDD	In default
NR	Not rated
+/–/1, 2, 3	The designations +/– and the figures 1, 2, 3 indicate the rating within a category. In this way, 1 represents the upper end of a category (for example Aa1), and 3 the lower end (for example Aa3).

› For many investors, the concept of emerging markets conjures up images of financial and currency crises, unstable political systems and floundering equity prices. Between 1990 and 2002, Swiss equities produced an annual return of 13 percent with market volatility of 23 percent. In the same period, the performance of equities in emerging market countries was just 7 percent with volatility of 29 percent; investors would have been better off with Swiss equities. As is so often the case, however, past performance is not a reliable indicator of the future. Morgan Stanley's MSCI Emerging Markets Index, for example, has risen by more than 40 percent since May 2003 (MSCI Emerging Markets standard annualized historical returns, local currency). Asia in particular has generated spectacular growth: indices in some emerging markets in this region have risen by more than 100 percent, depending on market and period.

Excesses have been corrected

Of course, it would be a mistake to base one's entire portfolio on emerging markets. Under current economic conditions, a certain amount of caution is advisable in this regard. Periods of more restrictive US monetary policy – such as is anticipated over the next six to nine months – are typically associated with below-average performance in emerging markets. Long-term opportunities for good returns, however, remain intact. The financial and economic crises have brought about a fundamental structural correction. Old-boy networks linking politics, financial systems, and industry are no longer as common in many regions, and the banking system has been purged of its debt excesses. This has created an environment for healthier growth. In Korea, for example, the banking system has been restructured and re-capitalized over a period of four years, and Central and Eastern European countries have introduced structural reforms that EU member states such as Germany and France are only now starting to consider after great hesitation.

Foreign lenders and domestic companies and governments in the emerging market regions have learned their lesson. In addition, the increased macroeconomic stability and the cost advantages offered by emerging market countries have secured a steady inflow of foreign direct investment to these regions since about the mid-1990s. These inflows have proven remarkably resilient to crises and currently constitute the largest share of net capital inflows.

Steady inflows of foreign direct investment have proven remarkably resilient to crises.

Another important reason for investing in the equity markets of emerging market countries is the strong economic growth they are experiencing. In addition to foreign direct investment, one of the primary driving forces behind this growth is the rising level of prosperity among the populations of these countries. The demographic component further enhances the attractiveness of emerging markets, as the rapidly deteriorating situation in industrialized countries in general, and Europe in particular, is impairing the growth potential of their equity markets. Populations in emerging market countries are not only generally younger, they are also increasingly well educated. Once stable political conditions are the order of the day and sensible economic policies are pursued, the inherent growth potential will be fully exploitable. This will also promote the emergence of a middle class, which is likely to become a significant growth factor due to rising levels of prosperity.

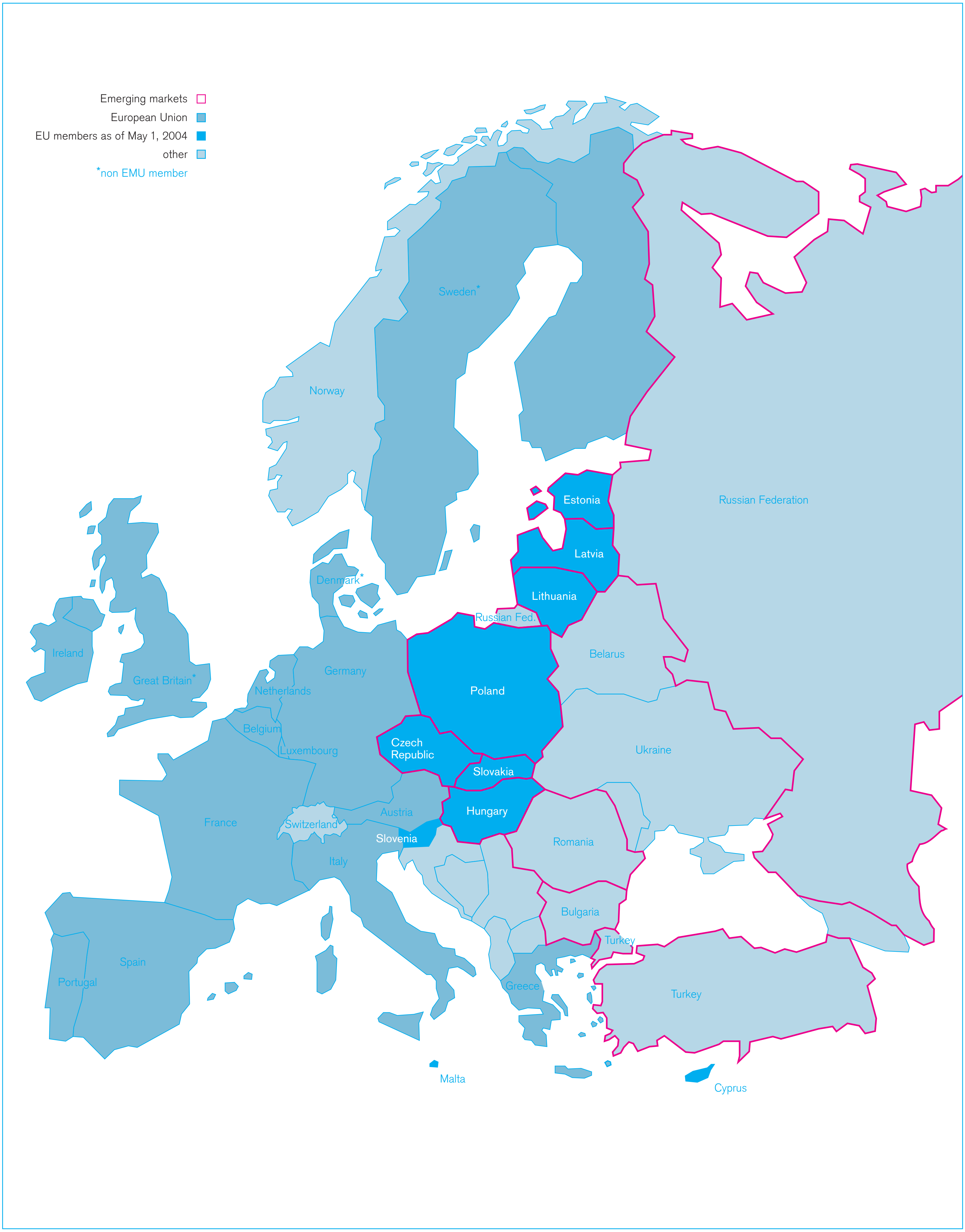
Relapses are unlikely today

The next ten to fifteen years will be characterized by accelerated industrialization in the emerging market regions. This will result in a growing demand for raw materials and energy supplies. Commodity exporting countries such as Canada, Russia, South Africa and Brazil are likely to benefit from this development. The trend towards globalization and growing acceptance of market economy principles in countries such as China and India should also help to prevent a recurrence of the turbulence seen in the 1990s. Local crises are possible, but the runaway fires of the 1990s are much less likely today. ❚

Defining "emerging markets"

There is no "official" definition of what constitutes an emerging market. As a rule, the term refers to countries that have underdeveloped financial infrastructures but the potential for economic growth. The World Bank sets an upper limit of USD 9,656 in annual per capita income. Apart from its gross national product, a country's geographical location and indebtedness are important criteria in defining emerging market status. Finally, one or more of the following descriptions will apply to an emerging market country:

- **Economic liberalization has occurred. This process may include a reduced role of the state in economic affairs, privatization of previously state-owned companies, and an opening up of financial markets to foreign investors.**
- **State debts have already been subject to rescheduling, or the state has reached a point where it can no longer service its debts.**
- **The political system has become more democratic and the population enjoys increasing participation in political processes.**
- **The country is not yet a member of the Organization for Economic Co-operation and Development (OECD).**



Emerging markets
European Union
EU members as of May 1, 2004
other
*non EMU member
Sweden*
Norway
Estonia
Russian Federation
Latvia
Denmark*
Lithuania
Russian Fed.
Ireland
Great Britain*
Germany
Belarus
Netherlands
Poland
Belgium
Luxembourg
Czech Republic
Ukraine
Slovakia
France
Austria
Hungary
Switzerland
Slovenia
Romania
Italy
Bulgaria
Turkey
Spain
Portugal
Greece
Turkey
Malta
Cyprus

The enlargement continues

The biggest enlargement ever of the European Union (EU) has just been completed, but the real work is only just getting under way. The new EU member states must prepare for adopting the euro and fresh candidates are already waiting in the wings. **Hans-Peter Wäfler, Economic & Policy Consulting**

The May Day holiday this year gave special cause for celebration in much of Europe. On May 1, 2004, ten countries joined the EU, most of them former East Block countries. Celebrations at the official enlargement ceremony also marked the reunification of East and West. May 1 was a historic occasion, but the festivities were only a brief intermezzo in the much larger project that is underway. Joschka Fischer, Germany's foreign minister, emphasized this a few days later in his speech on Europe delivered in Zurich: "It will take some time to work through the enlargement process."

No time for a breather, there's work to do. A further step for the new member states will be the introduction of the European single currency, the euro. They are not yet members of European Monetary Union (EMU), but as members of the EU, they are obliged to prepare for adopting the euro. For the new member states, there is no opt-out clause such as that of the UK and Denmark giving them the right to remain outside EMU permanently.

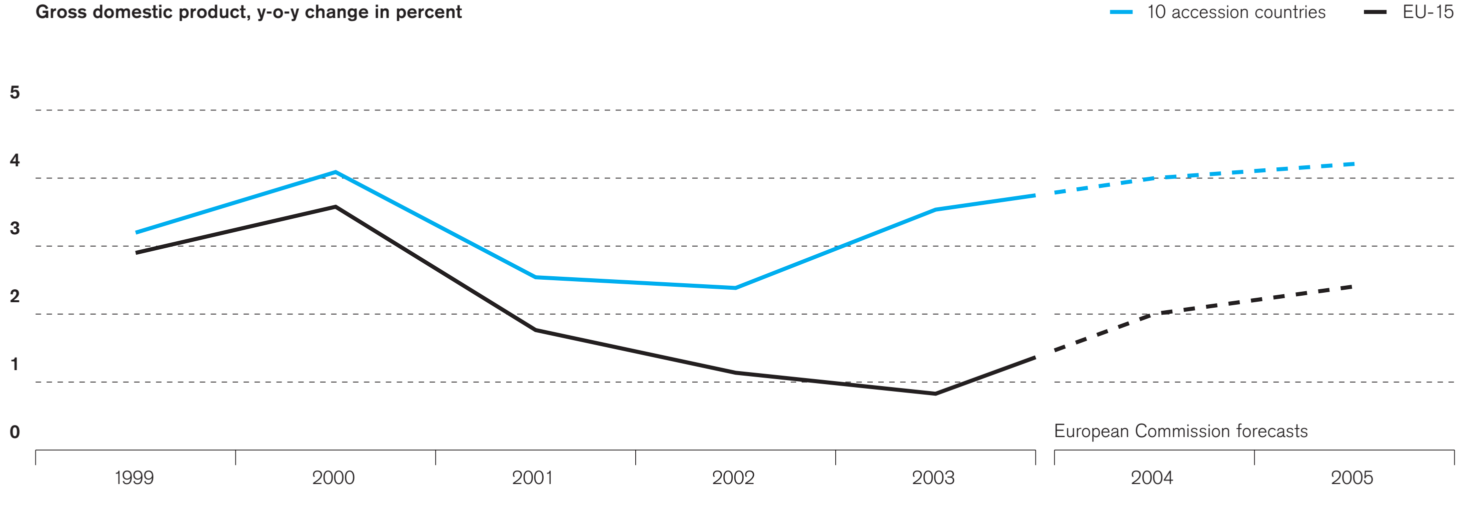
A question of pace

The accession states did not request an opt-out clause anyway. On the contrary. They hope that the euro will provide additional support to their rapidly expanding economies (see graph on page 11). Although all ten countries joined the EU at the same time, they will not reach the finishing line for adopting the euro together. Each country will approach EMU at its own pace, and each will be assessed individually. The basis for this assessment is the Maastricht convergence criteria: solid public finances, low inflation, low interest rates and two years of stable exchange rates versus the euro within the framework of the European Exchange Rate Mechanism (ERM 2). The normal bandwidth tolerance is plus or minus 15 percent; however, a smaller margin may be prescribed for individual countries. The exchange rate criterion requires that at least two years must elapse between accession to the EU and joining EMU. This means that the enlargement of EMU is unlikely to move off the drawing board before 2007 at the earliest.

Not all of the new accession states will be ready this early, and some countries will not

Dynamic economies

The ten accession countries are enjoying faster economic growth than the older EU members. Central and Eastern Europe has developed into Europe's most dynamic economic region. Source: European Commission, Eurostat



want to adopt the euro this soon. Each new EU member state faces the difficulty of finding the right pace for the euro convergence process. Entry into EMU will see a lowering of transaction costs for trade with other EMU members, but at the same time those countries involved must give up their independent monetary policy and flexible exchange rates, and this at a time when their economies are in a phase of catching up. Higher economic growth tends to result in higher inflation, while an ongoing need for substantial investment makes it more difficult to consolidate public finances.

The first countries to be ready for the euro are likely to be the smaller accession states. For example, Lithuania and Estonia meet most of the convergence criteria already (see table below). The euro timetable will be more unpredictable for the three largest new member states in the group: Poland, the Czech Republic and Hungary in particular will face a challenge when it comes to reining in their government deficits. These countries will probably only be ready to join EMU around the end of the decade. The Czech Republic aims to introduce the euro by 2009 or 2010. Against a background of still only partial fulfillment of the convergence criteria, the European Central Bank (ECB) itself has warned against hasty entry to the ERM 2, the anteroom of EMU. Jean-Claude Trichet, President of the ECB, has stated that countries must undergo "greater political adjustment, for example price liberalization and credible plans for consolidating state finances" before they can join the exchange rate mechanism. The first convergence report by the ECB examining preparations for the euro in the accession countries is due to be published in October 2004.

"Our objective is to create a league of friendship stretching from Russia to Morocco."

Romano Prodi, President of the European Commission

Old and new EU aspirants

The end of the year, however, will not only see the release of important news for the euro hopefuls. There is also excitement in the candidate countries that have not yet attained full membership: Bulgaria, Romania and Turkey. In fall 2004, the European Commission will release its annual interim report on the candidate countries. Bulgaria and Romania are hoping for the green light in favor of EU accession in 2007. The report will also serve as the basis for an EU decision on whether or not to begin actual membership negotiations with Turkey. Any negotiations can be expected to drag on for several years.

Other countries may accede to the EU before Turkey makes it over the finishing line. Membership applications have been received from Croatia and Macedonia. In the case of Croatia, the Commission has already recommended opening negotiations. This has been seen as a signal that the future of the Balkans will also lie within the EU.

However, the EU is more hesitant when it comes to countries further east and south. The outgoing President of the European Commission, Romano Prodi, commented as follows during his speech about enlargement on May 1, 2004: "Our objective is to create a league of friendship from Russia to Morocco." To a certain degree, this would represent "a different kind of enlargement concept – enlargement without participation in our institutions", integration that would not necessarily lead to EU membership. A growing EU is trying to find its limits without creating new divisions in Europe.

Conditions for introducing the euro

Like the founding members of European Monetary Union, the new accession states must meet the Maastricht convergence criteria before they can adopt the euro. Source: Eurostat, Credit Suisse

	GDP 2002 in EUR billion	GDP per capita in % of Ø EU 15	Maastricht convergence criteria	State budget Deficit/surplus in % of GDP	State debt In % of GDP	Inflation rate* In %	Interest rates** long term, in %
			benchmark 2003	–3.0	60.0	2.7	6.34
Estonia	6.9	40		2.6	5.8	1.4	4.75
Latvia	8.9	35		–1.8	15.6	2.9	5.07
Lithuania	14.7	39		–1.7	21.9	–1.1	4.81
Malta	4.4	69		–9.7	72.0	2.5	4.71
Poland	202.3	41		–4.1	45.4	0.7	6.76
Slovakia	25.7	47		–3.6	42.8	8.5	5.42
Slovenia	23.3	69		–1.8	27.1	5.7	5.27
Czech Republic	78.2	62		–12.9	37.6	–0.1	4.80
Hungary	68.9	53		–5.9	59.0	4.7	8.24
Cyprus	10.8	77		–6.3	72.2	4.0	4.75

* Annual average inflation rate should be no more than 1.5 percentage points above that of the three member states with the most stable prices.

** Annual average yield on long-term government bonds should be no more than 2 percentage points above the corresponding rate for the three member states with the most stable prices.

The tortuous road to the euro

Currency developments in the new EU member states depend on macroeconomic and political stability, as well as a credible monetary policy. Investors should therefore look beyond the interest rate advantage offered by these currencies. **Marcus Hettinger, Forex Analysis & Strategy**

› In the last few years, hopes for rapid accession to the EU have led to a convergence in interest rate levels. This is because entry to the eurozone and adoption of the euro make it likely that local interest rates will move closer to interest rates in the EU 12. The yield differential between government bonds denominated in local currencies and German government bonds has contracted. Interest rates higher than those in the eurozone increase the attractiveness of local bond markets, but, in considering the total yield, investors should not lose sight of currency fluctuations. The last two years have shown that Eastern European currencies are prone to significant fluctuations which can eliminate the positive yield on bonds entirely.

Over a longer period of five years, the Polish zloty (PLN) and Hungarian forint (HUF) lost about 15 and 5 percent respectively against the euro (see graph). By contrast, the Czech koruna (CZK) and Slovakian koruna (SKK) rose by 7 and 5 percent respectively. In the short term, however, the currencies have been subject to much greater fluctuations. The zloty, forint and Czech koruna have depreciated significantly against the euro since the start of 2002. One reason for the devaluation is probably the euro's strength during this period. However, domestic economic factors also play an important role in the performance of currencies, and investors should not forget this.

Budget and balance of payments deficits

The budget position has worsened over the past few years. Rising deficits in government budgets lead to more government bond issues, which in turn tends to drive interest rates higher. Higher interest rates can be a positive factor for currencies, but if higher rates mean greater risk premiums, then the currency will come under pressure. Political factors, such as the willingness of a government to rein in its spending, are equally important. A factor closely related to government budget deficits is the significant increase in some balance of payments deficits that has also been a feature of recent years. A balance of payments deficit is the result of domestic public and private savings levels being insufficient to finance investments. The deficit must be financed by foreign capital inflows (direct investment or portfolio inflows in the form of bonds and equities). Portfolio inflows in particular respond rapidly to changes in the macroeconomic or political environment and therefore have a greater impact on currencies. The size of the balance of payments deficit and the structure of financing therefore play a decisive role in currency performance.

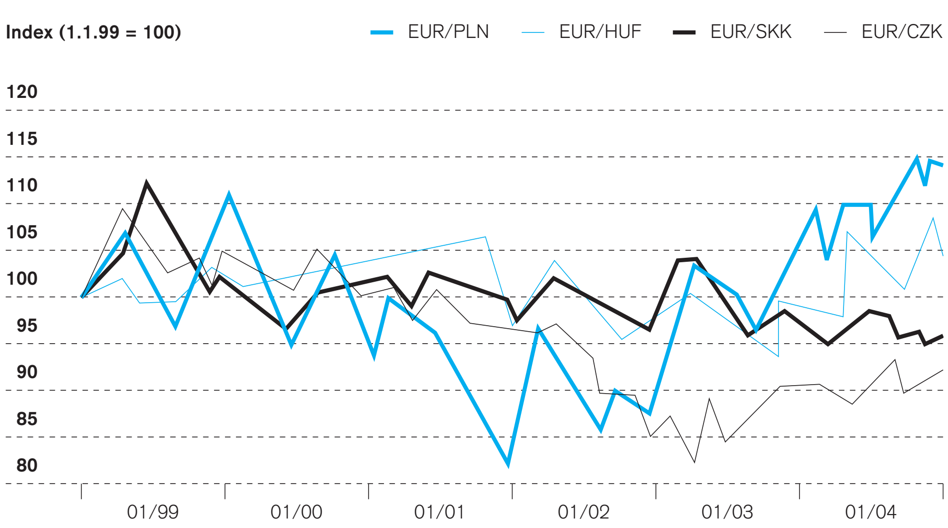
In addition to fiscal policy, the credibility of a country's monetary policy plays a central role. Some countries set inflation targets and accept currency fluctuations as a fact of life (Poland, for example). Once a country joins the European Exchange Rate Mechanism (ERM 2), however, the primary objective of monetary policy becomes the stabilization of the exchange rate within the ERM 2 bandwidths.

Exchange rate policy dominates

The European currency system crises of 1992 (Italy, the UK and Sweden) should serve to remind us that, following entry into ERM 2, domestic economic objectives (fiscal and employment policies, etc.) take second ranking behind exchange rate policy in order to avoid major disruptions in the financial markets. Investors should not overlook the fact that the currencies of the accession states can still experience considerable fluctuations against the euro within the ERM 2 bandwidths. ▌

Large exchange rate fluctuations

While the forint and the zloty have fallen against the euro in recent years, the Czech and Slovakian koruna are stronger today than they were in 1999. Source: Bloomberg, Credit Suisse



Take the market home with you

Direct Net is an important online distribution channel of Credit Suisse. It provides simple and self-explanatory access to various banking and equity market services via the internet. **Daniel Huber**

Modern computer and communication technology has finally made the financial world into a village too. Internet access is all that the browser-based (HTML) version of Direct Net needs. This can be a dial-up connection and PC at home or a wireless hotspot connection and laptop at the swimming pool of the hotel. Direct Net does not require a complicated download or installation of help programs.

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The online service also provides clients with round-the-clock access to the world's major equity markets. The creation of straightforward entry screens makes trading in securities particularly easy.

Clients can buy and sell equities, funds or bonds via Direct Net from a laptop, fully independently. Furthermore, the personal trading platform also offers a wide selection of financial and equity market data with important background information and analysts' forecasts. Various search functions can be used to call up targeted information on individual securities.

Not only is Direct Net quick and flexible, it is also not restricted to office hours. And when effecting payments and equity market transactions, Direct Net users save on fees compared to conventional banking transactions.

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Win a notebook

In association with Littlebit Technology AG, Hünenberg, we are giving away a Razor Z81 notebook to enable you to take an active part – online – in events on the stock markets. The Razor Z81 uses components that represent the latest in mobile computing technology, from processor, graphics, and network card to the wireless LAN module. The computer battery provides up to five hours of mobile power and the weight is only 2.45 kg, making this laptop ideal for travelers.

Competition questions

Question 1 **Which URL provides more information on Direct Net?**
Question 2 **What is the weight of the Littlebit Razor Z81 notebook?**

Write your answers in the fields provided on the enclosed answer form. Closing date: September 30, 2004

Competition prize

Littlebit Razor Z81 notebook

- **Intel Centrino mobile technology**
- **Intel Pentium M processor**
- **15" SXGA + TFT display**
- **ATI Mobility Radeon 9600 graphics**
- **Wireless LAN with 54 Mbps GigaLAN**
- **Windows XP Professional and MS Office**
- **PORT computer bag**

"Even after the eastward expansion, the EU must proceed boldly"

The former German foreign minister, Hans-Dietrich Genscher, is convinced that eastward enlargement of the EU is a historic milestone, not an end in itself. **Interview: Marcus Balogh**

Marcus Balogh The expansion of the EU into Central and Eastern Europe sees the reunification of a formerly divided continent. What are your thoughts on this?

Hans-Dietrich Genscher This is a historic milestone. And not only because the EU has 450 million citizens as of May 1. If one were to speak of a European miracle then this would be it for me – the fact that, after the Second World War and starting with the six founding countries, the people of Europe have managed to come together to decide their future collectively.

Will the eastward expansion be an economic burden for the EU in the next few years?

The enlargement process is not something that was planned in a hurry. Important economic issues were addressed in advance. This is particularly the case for Poland, Slovakia, the Czech Republic, and Hungary. I see major opportunities for new and old members alike.

The EU successfully launched the common market and the euro. Do you think that the challenges of the future will lie in consolidating what has been achieved – or should new initiatives be developed? The EU should not be content with all that it has achieved to date. On the contrary. The EU must proceed boldly – and I am optimistic that this will happen.

What are the challenges facing the EU?

Firstly, the EU must complete the process of European unification that it has embarked upon. We took an important step in this direction on May 1. The second main challenge will lie in making a significant contribution to creating the new world order.

"We should avoid a situation in which the European Union becomes surrounded by a huge moat – be it political, environmental, or economic."
Hans-Dietrich Genscher

What do you mean by new world order?

The world is becoming a smaller place. Increased cooperation also means that we are becoming more dependent on each other. In such an interdependent world, national developments will inevitably have implications for the rest of the world. We cannot be disinterested in events taking place around the world that are disruptive or that upset the order of things – be they economic, environmental, political or, even worse, military events. The question is, what can Europe contribute to this new world order?

What is your opinion in this regard?

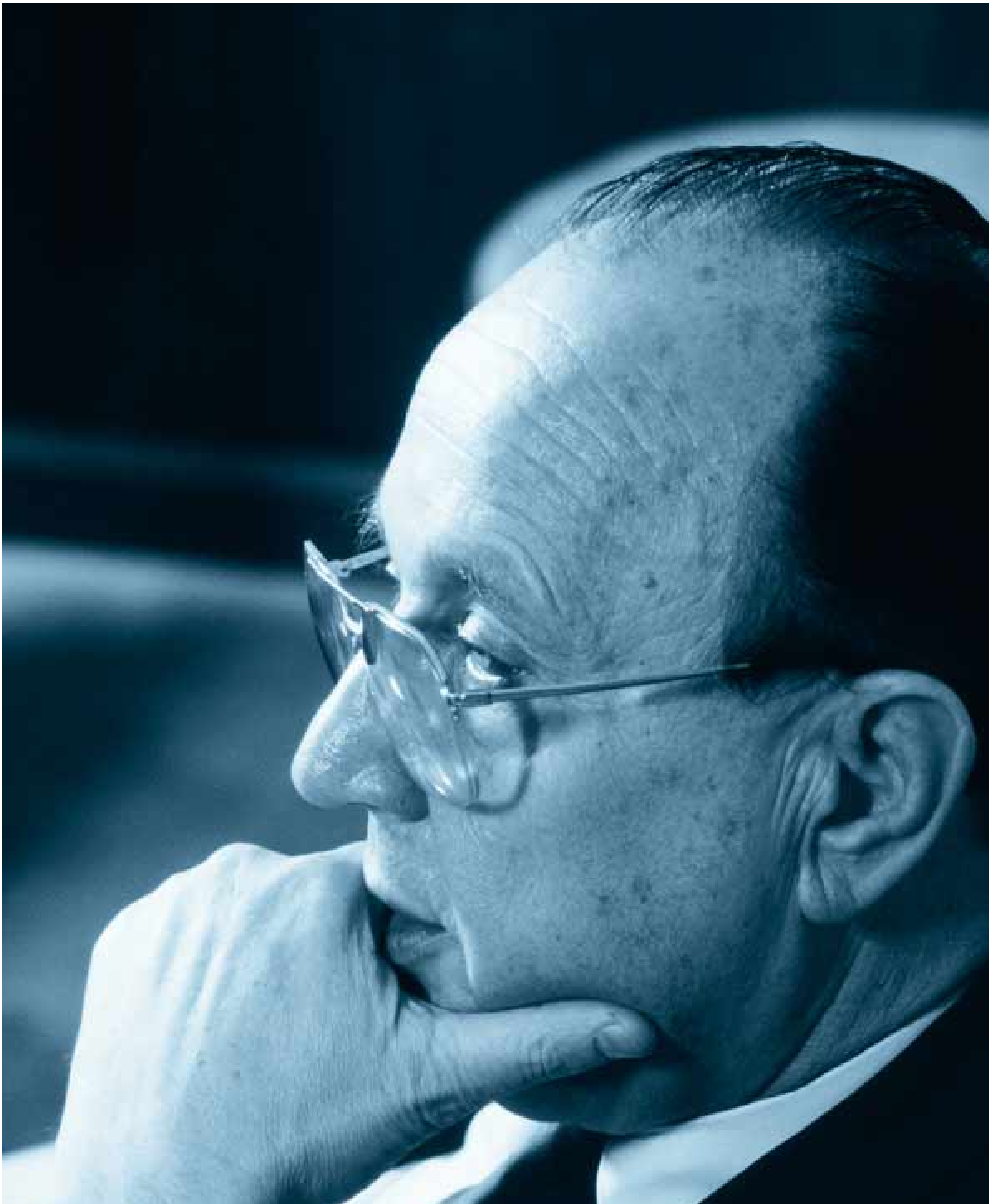
The European Union can serve as an example to the world with its structure, which is based on equal cooperation for small and large countries, on common values, and on collective responsibility. Another important factor is the outlook of the US, the most powerful country in the world. But China, with 1.3 billion citizens, is becoming an economic factor of increasing importance – not only as an exporter of consumer goods but also as an importer of jobs. A country like China cannot be excluded from decision-making bodies that determine the future of the planet. Take the G8 Summit for example: there you have France, the UK, Italy, Germany, Canada, the US, Japan, and Russia. But where is China? And what about India? With a billion people it is the largest democracy in the world.

Should Europe champion these countries?

In the long term, we will only enjoy prosperity if our neighbors prosper. We should therefore avoid a situation in which the European Union becomes surrounded by a huge moat – be it political, environmental, or economic. We should work towards a world order in which we can become comfortable with no longer being the center of the universe and in which the importance of other regions increases. We should also ensure that this world order is not confrontational, but rather based on cooperation. Cooperation offers more opportunities than confrontation.

And how do you perceive Switzerland's role? If I were Swiss, I would ask myself, do I want to co-determine the future or do I want to watch from the sidelines? I have always said that the EU is incomplete without Switzerland. Only Switzerland can decide if it can live without the EU. The country certainly doesn't need anyone from outside telling it the answer.

Photo: Bassu Regis/Corbis Sygma



Romania seeks to build reputation

Over the last few years, Romania was hit repeatedly by widely publicized setbacks. Corruption, trade in children, and the creaking remnants of the old command economy regularly produced strongly negative headlines. Now, for the first time since 1989, the country seems to have found cause for cautious optimism. **Phelim McAleer, an economic journalist in Romania**

› Anyone who pulls up a chair at one of the many international restaurants in Bucharest these days is likely to encounter some familiar faces. Hollywood stars like Andy Garcia, Liz Hurley and Dennis Hopper are descending on the Romanian capital for numerous movie projects. Recent visitors have also included Nicole Kidman and Jude Law who played the main characters in "Cold Mountain", the American Civil War epic shot almost entirely on location here in Romania. The country may be struggling with a negative image abroad, but for Hollywood film producers it is an attractive location that provides unforgettable landscapes and labor that is both skilled and affordable.

"We are highly satisfied with the labor force and the quality of work."
Ueli Forster, CEO, Forster Rohner AG

Since when has Forster Rohner AG been producing in Romania?
Inter-Spitzen AG, an associated company of Forster Rohner AG, has had a subsidiary in Lugoj, a city of 70,000 inhabitants in the west of Romania, since 1996. The company manufactures embroidery and employs approximately 550 people. In general, we are highly satisfied with the labor force and the quality of work in Romania. We are currently completing another phase of expansion.

What is your experience of working with the Romanian authorities?
We haven't had any serious problems. Quite the opposite, in fact. The authorities are helpful and respond quickly, but occasionally are a bit bureaucratic in their approach.

What do foreign companies in Romania need to watch out for?
It is important to maintain good contact with the authorities – which are, after all, interested in creating more jobs. The best region for investment is the western part of the country. Foreign investors should make sure they complete all their transactions correctly.

What is the next hurdle for Romania?
The traditional problem of high inflation finally seems to have been brought under control. It is also important to continue the reforms aimed at EU compatibility. Reduction of the foreign debt is another significant challenge in this regard. We feel that the sooner the country joins the EU the better. Finally, we would like to see a more rigorous approach in fighting corruption. (ba)

Change for the better

After the fall of communism in the wake of the bloody revolution of 1989, Romania's image abroad was tarnished by a number of scandals and the country became known as a place of illegal immigration, abhorrent orphanages, and harsh poverty affecting the majority of its citizens. Even then, this reputation did not match the reality of the country, and the Romania of today is scarcely recognizable. The fact that the producers of the American dream have established a presence here is just one among many little known signs of change over the last few years.

International political recognition

Political stability and a booming economy have delivered a period of sustained growth in Romania for the first time since the fall of the Iron Curtain. In the last few years, growth has averaged 5 percent per year, representing one of the highest growth rates in Europe. The country's economic policy – for many years an issue of concern at international levels – has finally met with the approval of the International Monetary Fund (IMF), and after five embarrassing failures since 1989, Romania finally managed to launch its first IMF program last year. This, in addition to the country's NATO membership, is an important step toward full EU membership, which Romania hopes to achieve by 2007.

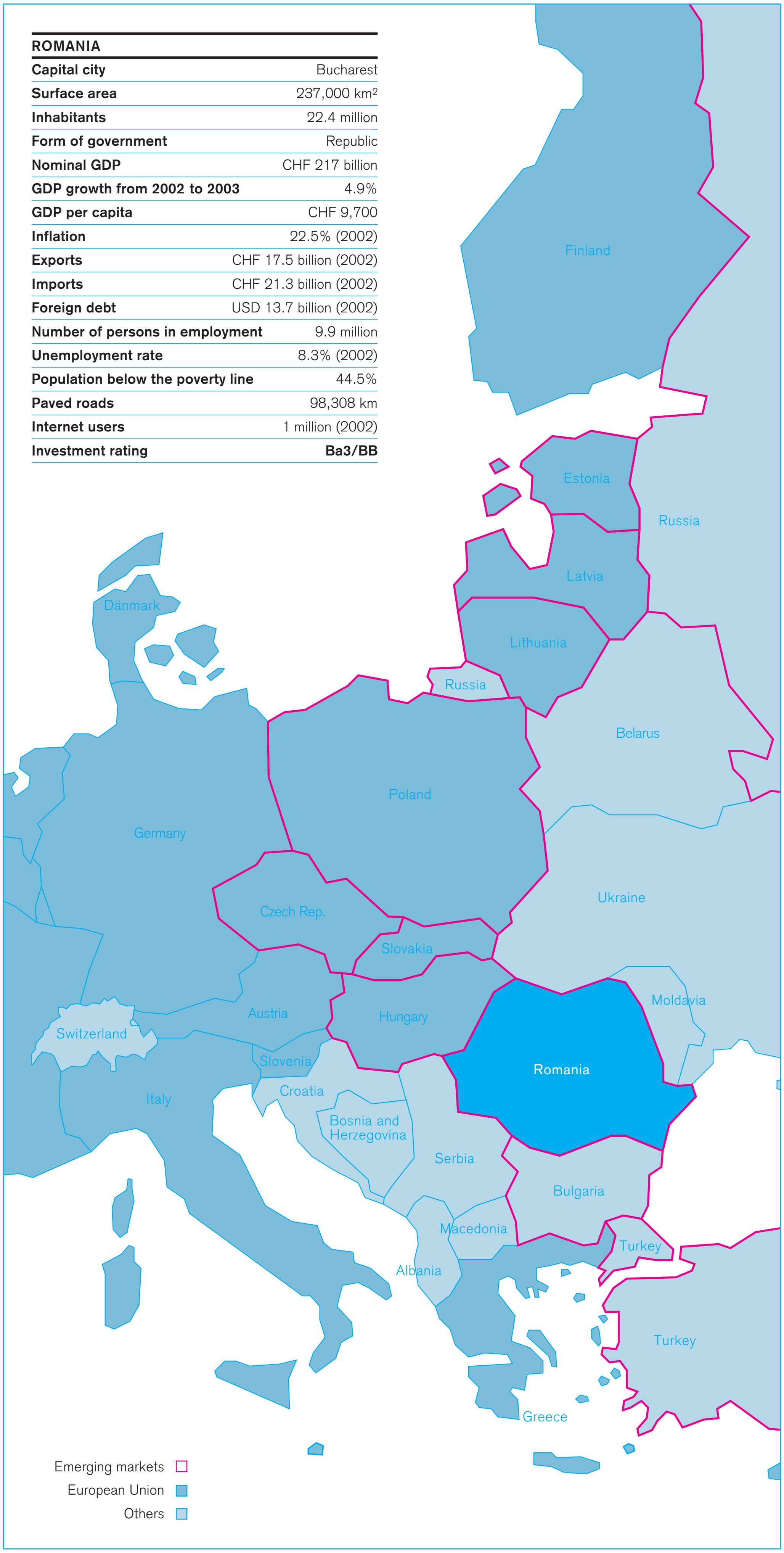
Fear of overheating

Naturally, this growth has brought with it changes to the lifestyle of Romanians. The previous three-digit inflation rate, which stayed at around 50 percent in recent years, is this year likely to be below 10 percent for the first time since 1989, thanks to stringent controls over government expenditures. Romania is currently experiencing a boom in consumer spending, which is shored up by rising salaries and eased credit regulations. This has led to explosive growth in the number of restaurants, new construction projects and renovation of old buildings, plus to a surge in demand for consumer durables due to Romanians' spending spree on refrigerators, washing machines and televisions. For the first time since the end of the communist era, the central bank has voiced concerns about the boom, warned against overheating in the economy, and raised interest rates in an effort to dampen demand. However, this seems to have had little impact on consumer spending.

Despondence and optimism

Many Romanians who endured the pain of earlier reforms are despondent about the lingering poor reputation of their country abroad. Of course, they are aware that there are still problems. The country is still plagued by corruption, and severe poverty continues to afflict those living outside the main cities. As in earlier times, a number of state enterprises continue to produce goods that no one wants to buy. Although they provide jobs in regions with few other employment opportunities, these industrial relics are a drain on the national treasury. Nevertheless, optimism has been rekindled in Romania and a mood is emerging that has rarely been felt since 1989. The Romanians want to see their economy heading into a favorable wind and are prepared to support further necessary reforms. And many Romanians are convinced that, for the first time since 1989, the future for the economy looks bright.

ROMANIA	
Capital city	Bucharest
Surface area	237,000 km²
Inhabitants	22.4 million
Form of government	Republic
Nominal GDP	CHF 217 billion
GDP growth from 2002 to 2003	4.9%
GDP per capita	CHF 9,700
Inflation	22.5% (2002)
Exports	CHF 17.5 billion (2002)
Imports	CHF 21.3 billion (2002)
Foreign debt	USD 13.7 billion (2002)
Number of persons in employment	9.9 million
Unemployment rate	8.3% (2002)
Population below the poverty line	44.5%
Paved roads	98,308 km
Internet users	1 million (2002)
Investment rating	**Ba3/BB**



BULGARIA	
Capital city	Sofia
Surface area	111,000 km²
Inhabitants	7.7 million
Form of government	Republic
Nominal GDP	USD 20.3 billion (2003E)
GDP growth from 2002 to 2003	4.5 % (E)
GDP per capita	USD 2,633
Inflation	2.3 % (2003E)
Exports (in % of GDP)	52.0 (2003E)
Imports (in % of GDP)	61.4 (2003E)
Foreign debt	USD 13.1 billion (2003E)
Number of persons in employment	3.8 million
Unemployment rate	13.5 % (2003E)
Population below the poverty line	12.6 % (2001E)
Paved roads	35,049 km
Internet users	585,000 (2001)
Investment rating	**Ba2/BB+**

A new tiger economy in south-eastern Europe?

Bulgaria happily accedes to the suggestion that it is the south-eastern European tiger economy. When it comes to foreign and economic policies, the country is the most exemplary of the international institutions. However, only a minority enjoys the benefits of the country's economic success. **Urs Fitze, a freelance journalist**

› In the shade of a grove of trees in Bansko, a south-west tourist region in Bulgaria, a group of women hang freshly picked tobacco leaves to dry on a hemp cord. The women work for Ivan Kehajov, former head of the local collective farm and now a commercial tobacco farmer. He complains eloquently about how his business is being ruined by Bulgartabak, a tobacco company still owned by the state, and the complex workings of Bulgarian bureaucracy. The women earn the equivalent of CHF 5 for a working day of 12 hours. His automated drying facility – for which he paid a fortune in the west – was never brought into commission because the production quota, allocated by a state commission, was reduced overnight without warning. The drying facility is not profitable for the 10 hectares he is currently allowed to farm; his remaining 40 hectares lie fallow. This is why he has hired the women, who in turn are pleased for the opportunity to earn what money they can. In many cases, their husbands are unemployed and their families subsist on what they can grow in their small fields. The money from the tobacco farm is an additional source of income that is used to buy the staples: flour, rice, and other foodstuffs that they cannot grow themselves. Very little is left over for anything else. Kehajov retains about CHF 40,000 of the CHF 80,000 a year brought in by his tobacco farm. His 50 seasonal workers combined earn half this amount.

Disillusionment after 13 years

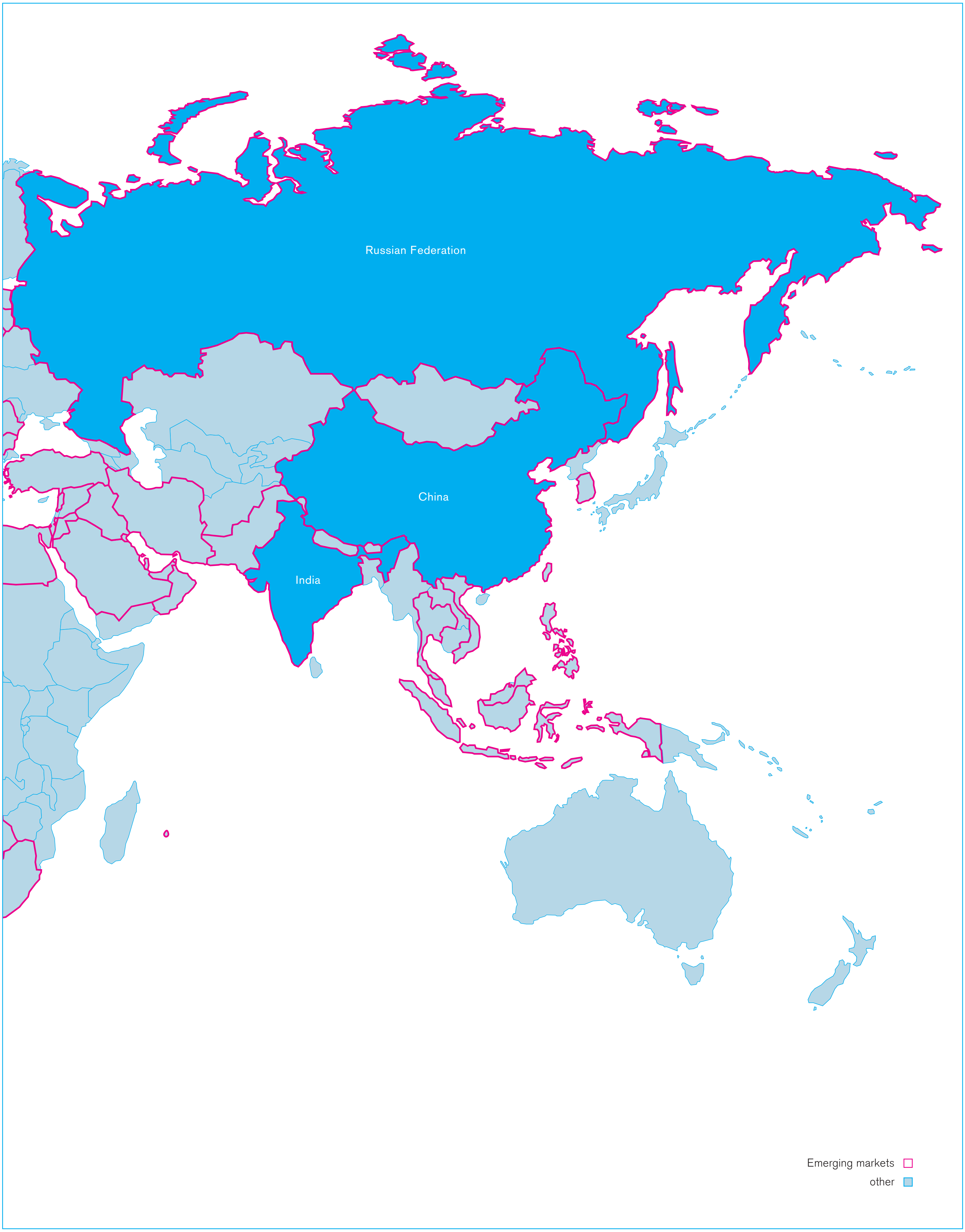
The example illustrates the difficulties facing Bulgaria 13 years after the fall of the communist regime. The initial euphoria has dissipated. Since then, no government has been able to protect the majority of the population from the harsh consequences of economic transformation in the country. Bulgaria has lost most of its traditional trading partners in the east, and has turned to the west. Even the National Movement (elected to power three years ago and led by Simeon II, the former Tsar of Bulgaria who was dethroned as a child and sent into exile by the communists in 1946) has been unable to relieve the distressed situation of the people, especially those living outside the cities. Bulgaria's gross national product is still below the level of the early 1980s. According to statistics from the World Bank, one quarter of the population is living below the poverty line, and the gap between rich and poor has steadily widened over the last few years. Hundreds of thousands of Bulgarians have emigrated. However, the country's economic progress is impressive, despite the enormous social problems. Annual growth since 2000 has been high – at 4 to 5 percent – and has given rise to the suggestion that Bulgaria is the tiger economy of south-eastern Europe. Unemployment has also been falling steadily and currently stands at 13.5 percent. However, the boom has been limited primarily to the major economic centers in the cities of Sofia, Varna, Plovdiv, Burgas, and Sandanski, while large areas of the country in the north and south-west have continued their slide into poverty.

Government claims to have the right answers

Negotiations to join the EU have progressed well and Bulgaria has been recognized as having a "fully functioning market economy". No one now doubts that the country will accede to the EU in 2007. Of the 30 dossiers in the "acquis communautaire", 25 have been finalized. The prospect of soon joining the EU has become a trump card that the Bulgarian government is not willing to relinquish. It claims to have all the right answers for the economy and has been highly praised by international institutions. Although corruption has not been eliminated entirely from daily life, it has been reduced significantly from the levels of recent years. Together with the Czech Republic, Bulgaria is ranked 54 on Transparency International's corruption index, placing it in the upper middle range of the 133 countries included in the study.

Staying the course for EU membership

Despite this progress, the chances of the government being re-elected at next year's elections are minimal. The poorer sections of the population that saw Simeon II as their hope for the future are turning away from his party in disappointment. Surveys show that the National Movement's support has decreased, reducing it to a minor party. However, even this political rejection is unlikely to seriously threaten Bulgaria's course for the future. The next government, which will probably be led by the socialists, will continue to pursue EU accession, while domestic politics will revolve around squabbling over the best positions, in other words, business as usual in Bulgaria. In a country that has become an economic engine in the crises-stricken Balkans, those who can come to terms with the situation there will do pretty well.


Russian Federation
China
India
Emerging markets
other

Emerging markets in the spotlight

With a total population of 2.4 billion, the emerging markets of Russia, China and India hold enormous potential. They could become the most important engines of the world economy. Where are they today, and what about tomorrow?

Svetlana Le Gall, Fund Manager of the Clariden Russia Equity Fund, Andrea Schulzke and Jiannan Wang, Fund Selection Credit Suisse

What makes Russia, China and India attractive compared to other emerging markets?

Russia

In 1998, three years after Russia had emerged from one of its worst economic crises, the country's greatest wish was to be admitted to the league of industrialized nations as an equal partner.

In order to achieve this ambitious goal, economic policy had to be put on a path of sustainable growth if the general standard of living was to be raised, and a stable political climate was essential. The key to this policy was the country's enormous natural resources and its trade surpluses in most manufacturing sectors.

Huge opportunities beckoned to foreign investors because so many economic sectors, notably the banking industry, the services sector and the consumer goods industry, were headed in a new direction. Economic policy increasingly focused on small and medium enterprises in an effort to support economic growth as broadly as possible. A well-educated population was and is an advantage to the Russian economy. And the SME sector, which had previously been neglected, offered tremendous investment opportunities. 1998 thus introduced a fundamental change.

China

Since 1978, the Middle Kingdom has been on a singular path of economic reform and modernization. China's per capita GDP has tripled from USD 352 in 1991 to USD 1,091 in 2003. The population of 1.3 billion makes up almost a quarter of the world's population. The level of education is rising continuously. The country has not only developed into a world manufacturing base, it has also become an important foreign market for goods from all parts of the globe.

India

India, and especially its new middle class, has a rapidly growing consumption potential. In addition, the young generation is well

	RUSSIAN FEDERATION	CHINA	INDIA
Capital city	Moscow	Beijing	New Delhi
Surface area	17,075,200 km^2	9,596,960 km^2	3,287,590 km^2
Inhabitants	142.8 million	1.3 billion	1 billion
Form of government	Presidential republic	Socialist people's republic	Federal republic
Nominal GDP	USD 441 billion (2003E)	USD 1,564.9 billion (2003E)	USD 542.4 billion (2003E)
GDP growth from 2002 to 2003	7.3 % (2003E)	9.1 % (2003E)	4.3 % (2003E)
GDP per capita	USD 3,007 (2003E)	USD 1,091 (2003E)	USD 559.7 (2003E)
Inflation	13.7 % (2003E)	1.2 % (2003E)	4.5 % (2003E)
Exports	USD 139.7 billion (2003E)	USD 548 billion (2003E)	USD 59 billion (2003E)
Imports	USD 95.9 billion (2003E)	USD 527.6 billion (2003E)	USD 76.9 billion (2003E)
Foreign debt	USD 123.5 billion (2003E)	USD 200 billion (2003E)	USD 100 billion (2003E)
Number of persons in employment	71.8 million	744 million	406 million
Unemployment rate	8.6 % (2003E)	10 % (2002)	8.8 % (2002)
Population below the poverty line	25 %	10 % (2001)	25 % (2002)
Paved roads	358,833 km	314,204 km	1,517,077 km
Internet users	18 million (2002)	45.8 million (2002)	7 million (2002)
Investment rating	**Baa3/BB+**	**A2/BBB+**	**Baa3/BB**

educated and has studied at universities that are supported by major state investment. The levels of specialized knowledge in pharmaceutical research, software development, engineering, mathematics, and financial analysis are internationally competitive. Consumption, supported by the national market, and exports are dual drivers for a rapidly growing economy. Where infrastructure is still lacking in efficiency and quality, improvements have been initiated. Last but not least, India has also made clear progress in improving its relations with China and Pakistan.

What has changed the most over recent years?

Russia

In the course of the last three years, the Russian economy has recorded continuing growth of 6.5 percent p.a.

The political and economic environment has also stabilized considerably in the last few years. After the successful implementation of tax reforms, tax discipline has improved significantly and tax receipts have risen. Living conditions have improved markedly and Russia is experiencing a consumption boom. Management skills have increased while, at the same time, capital flight has decreased and the economy has invested in modern technology and operational facilities.

China

Since the opening of the country, China has become increasingly attractive to foreign direct investors. With USD 500 billion, China is globally the country with the largest share of foreign direct investment. China's private sector now makes up over half of total GDP, and there has been a clear separation of state and economy.

India

At the corporate level, there has been a massive reduction in debt and a sharper focus on operational profitability, return on equity, and free cash flows. Significant quality improvements have been achieved in the services and manufacturing sectors. More and more companies are now turning towards export and outsourcing to increase earnings. At the public sector level, privatization of state companies has been pushed, the private sector has been subsidized less, and, at the same time, has become more crucial to economic growth. Finally, the government is working towards reducing bureaucratic hurdles for foreign investors.

How large is economic growth?

Russia

In the last three years, growth was about 6.5 percent p.a. Growth is expected to be at the same level this year, although the government's estimate is a more conservative 4.5 percent. In the first quarter of 2004 it was 8 percent.

China

Growth was 7.5 percent in 2001, 8 percent in 2002, and 9.1 percent last year. In the first quarter of 2004 the growth rate equaled 9.8 percent. The anticipated growth rate for the next three years is approximately 8 percent p.a.

India

Growth in the Indian economy was 4.4 percent in 2001, 5.6 percent in 2002, and 4.3 percent in 2003. We expect growth this year to be about 7.5 percent; it is also likely to be at about this level in 2005 and 2006.

Which sectors are driving growth?

Russia

Growth is especially due to domestic investment, construction, and domestic consumption. Commodities and oil contribute a large share of GDP – oil and gas alone make up one third. Other sectors such as services, banking and consumer goods are also developing fast and will play an increasingly important role in the near future.

China

Foreign direct investment has created jobs and contributed noticeably to economic development (42 percent of GDP). This has significantly raised the income level, which positively impacts domestic consumption. The automobile, oil and gas, commodities and energy sectors are the most important sectors and will retain their position in future due to continuing growth.

India

Domestic consumption is the most important contributor to India's economic development and makes up approximately 77 percent of GDP. The remaining 23 percent is accounted for by foreign direct investment. In 2003, USD 5 billion of foreign direct investment was recorded in India, compared to USD 54 billion in China. The three largest sectors in MSCI India are energy (23 percent), finance (17 percent) and IT (16 percent).

The recent election results could lead to the energy sector, which has profited strongly from privatization, losing in importance over the next few years, and sectors that are less politically influenced increasing in significance, such as IT and pharmaceuticals.

What is the situation with regard to national debt and currency reserves?

Russia

The ratio of debt to GDP has fallen from 90 to 30 percent between 1999 and 2003. The Russian central bank is building up reserves, which currently amount to USD 84 billion. Last year, the government also founded a stabilization fund to which the surplus from the oil industry is channeled. It currently stands at USD 12 billion. The government intends to pay debt liabilities with this money if the oil price should suffer a drastic collapse.

China

China's budget deficit is currently USD 40 billion and is running at 6.8 percent of total state income. Overall national debt is 12.6 percent of GDP. China's foreign exchange reserves, already the second largest in the world, currently amount to USD 440 billion.

India

India's total national debt amounts to 76 percent of GDP and remains a constraint to its economic development. A large share of national debt is cross-held between state agencies. Foreign exchange reserves currently amount to USD 118 billion.

How stable is the political and economic situation?

Russia

When Vladimir Putin was elected president in 2000, his first step was to restructure the Kremlin power base. The Kremlin parties also gained an absolute majority in the parliamentary elections of December 2003. Both these events were needed to stabilize the political environment. The government is now promoting structural reform – even in socially delicate areas. The government is composed of well-known economists and politicians who feel a strong obligation to promote reform. Parliamentary support for the reform process is indispensable if the reform program is to be implemented in a timely manner without interference by economically influential groups or extra-parliamentary political groupings.

China

China's political foundation has remained stable after the seamless transfer of power from Jiang Zeming to Hu Jintao at the start of 2003. The relationship with Taiwan is still tense and uncertainty about future developments has not abated. Since China's accession to the World Trade Organization, implementation of the proposed reform and liberalization steps has accelerated and the equity markets and regulatory authorities are becoming increasingly transparent.

India

Economic development is robust, but the political future remains unclear. It also remains to be seen what the political consequences will be of a possible coalition between the government party and the communists.

What hurdles must be overcome next?

Russia

Economic growth is clearly dependent on the government pushing ahead with the announced reforms. Uneconomic sectors of the economy, such as electricity, gas and transport, must be restructured. In the interest of more stability, the government must protect property rights and create the framework conditions for attracting foreign capital.

China

China's main requirements are reforms to the banking and financial system, solutions for bad debts, and further improvements in the operational efficiency of state enterprises. Tools for macroeconomic management must be improved, and the gap between rich and poor regions must be narrowed.

India

India must continue its political development and introduce further economic reforms. Many Indian companies are still not competitive at an international level. An important factor is the struggle against poverty, which automatically leads to a demand for further large investments in infrastructure. This is a constraint to economic growth.

Investment **Products**

Contents: Emerging Market Products

HSBC GIF Chinese Equity Fund

China joins the global market

The more it grows, the more China takes on the economic stature of an emerging economic superpower. The Chinese economy has the highest growth rate in the world and offers unique opportunities for foreign investors. **Jiannan Wang, Fund Selection**

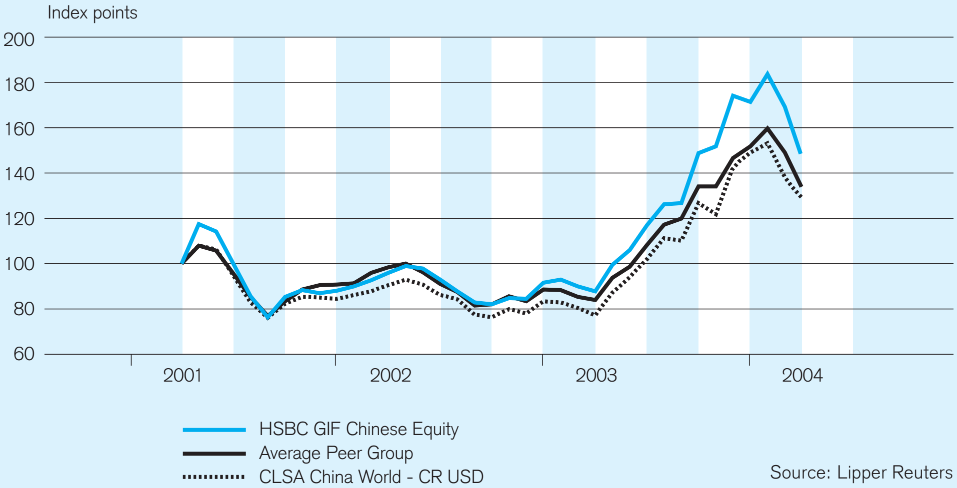
"The Chinese have gained achievements in only 20 years which would take many other countries two centuries to accomplish," commented James Wolfensohn, Chairman of the World Bank, in a recent interview. Direct foreign investment in China has indeed grown at a breathtaking rate since the country joined the World Trade Organization in 2001. The private sector has profited the most from this development, showing a much higher growth rate than that of state enterprises. China's capital markets are also expanding very rapidly. Despite strong state control, China's equity markets have joined the global markets, primarily via what are called "B" and "H" equities. "B" equities were conceived as a vehicle for foreign investors, but they have also been available to domestic investors for the last three years. "H" equities are listed on the Hong Kong Stock Exchange. Even Chinese equity markets, which trade in restricted "A" equities, have gradually been opened to foreign investors in a limited fashion. Chinese equities offer an attractive risk-return profile and a low correlation to other markets. The "H" equities in particular combine growth opportunities with western-style disclosure standards.

The current efforts of the Chinese government to slow the economy are concentrated on capital-intensive sectors that show signs of overheating, such as automobiles, aluminum, steel, cement and real estate. In the short term, the equity markets could be hit strongly by an investor over-reaction, but a hard landing for the Chinese economy is relatively unlikely. China's equity markets are well positioned for further price gains.

Fund performance over three years

Growth opportunities remain intact, even after cooling of the economy

The Chinese government is trying to prevent overheating in certain sectors, but a hard landing is relatively unlikely. The market is well positioned for further price gains and the managers of the HSBC GIF Chinese Equity Fund expect China to deliver long-term growth.



Source: Lipper Reuters

Timing and sector determine profit

The HSBC Group (Hong Kong and Shanghai Banking Corporation Ltd) has been rooted in China for a long time, and the company is focused on long-term Chinese growth. The HSBC GIF Chinese Equity Fund invests predominantly in "H" equities and "red chips" – these are companies based in Hong Kong, whose shares are largely held by organizations on the mainland and whose profits are primarily earned on the mainland.

The fund manager combines top-down analysis of the company's global investment strategy with bottom-up analysis in Hong Kong. The local bundling of HSBC resources under the management of experienced investment teams is reinforced by input and support from other divisions of the strong international group. HSBC believes that at any given stage of the economic cycle, certain sectors and industries offer better returns than others.

The selection of shares focuses on the following aspects: market capitalization, dynamics/quality of profit growth, management quality, interest rate sensitivity and the liquidity and volatility of the share. The management team constantly tracks changes in the Chinese capital markets, as well as new regulatory developments in China and the impact these may have on equity markets in China and Hong Kong.

Security number	**238957**
Fund currency	**USD**
Average annual return (3 years)	**14.8% (in USD)**
Annual volatility (3 years)	**33%**
Fund volume	**USD 1,509 million**
Fund manager	**Richard Wong**

Clariden Russia Equity Fund

Russia waits for growth to take off

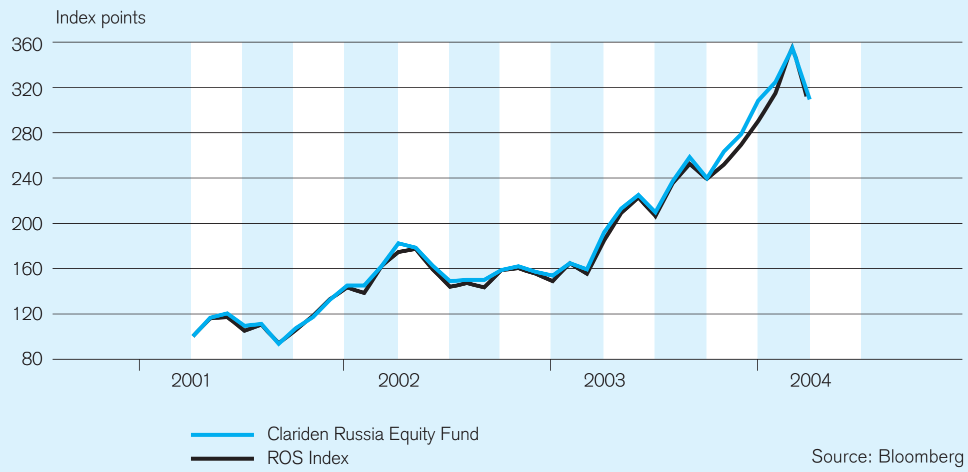
A stable political environment following the re-election of Vladimir Putin as president, improved economic conditions and, in particular, growing consumer spending suggest that the Russian growth story is only just beginning. **Jiannan Wang, Fund Selection**

Recent events have also impacted the Moscow Stock Exchange. Price corrections followed on the heels of increased volatility in global markets, but have also been stoked by the financial situation of the giant oil company Yukos. Although the Russian economy has diversified considerably compared to a few years ago, equity markets are still dominated by the oil industry. Oil companies represent more than 75 percent of market capitalization on the Moscow Stock Exchange. In the short term, this means that general market performance is closely tied to the price movements in the oil and gas sectors. In addition, Russian equity markets suffer from lower-than-average liquidity and are therefore highly susceptible to global equity market sentiment. However, we are convinced that strong economic growth from consumer spending and construction investment will once again have a positive effect on equity markets. Russia has been one of the best-performing emerging markets for many years. Even after considerable price gains, the Russian equity markets still have upside potential. Many of the pending reforms, especially in banking, land and administration, and the restructuring process in the energy sector will have a positive influence on economic structures and equity markets.

Fund performance over three years

International and domestic factors underpin the investment fund

Banking, land and administrative reforms and the restructuring process in the energy sector will have a positive influence on the economy and equity markets. Consumer spending and construction investment will also impact positively. In addition, the fund concentrates on companies that are well positioned in the global market.



Source: Bloomberg

Dominance on world markets is essential

The Clariden Russia Equity Fund invests in a focused portfolio consisting mainly of large, liquid stocks in the energy, telecommunications, life insurance and metal sectors. The quota of oil and gas stocks is currently around 55 percent of the overall portfolio. The fund manager, Svetlana Le Gall-Voronova, believes that the Russian oil industry remains well positioned despite major corrections and increased short-term volatility.

The fund manager pursues an active investment strategy based on her skills and experience in Russian equity markets. She knows the major sectors represented in the portfolio and aims to identify the current driving forces in each sector. The fund invests primarily in sectors where companies have a dominant position on world markets. This includes sectors such as metals, mining, and gas. The fund manager combines a sector-specific, top-down approach with bottom-up analysis of individual shares. The fund focuses on well-positioned companies with significant growth potential in up-and-coming regions. The following factors are the most important for Le Gall-Voronova: management's shareholder value orientation, large and growing markets, competitive products, solid financial figures, and attractive valuations.

Security number	**603364**
Fund currency	**USD**
Ø annual return (3 years)	**45.6% (in USD)**
Annual volatility (3 years)	**31.9%**
Fund volume	**USD 223 million**
Fund manager	**Svetlana Le Gall-Voronova**

JF India Fund and HSBC GIG Indian Equity Fund

India's growth remains dynamic

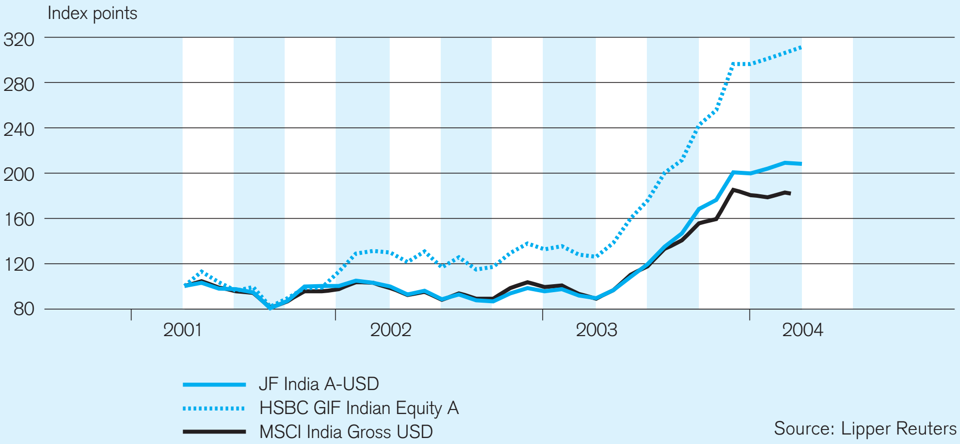
The Indian economy is displaying pronounced vitality. The Mumbai Stock Exchange has a history spanning 128 years and today boasts around 6,000 listed companies. This market offers fund managers a wide selection of investment opportunities in globally competitive companies. **Jiannan Wang, Fund Selection**

After strong performance in 2003, Indian equity markets are currently under pressure. The primary reasons for the volatility are uncertainty following the election results in May and a flood of new issues. The risk of possible disappointment due to lower corporate profits is also dampening spirits. In the light of the inclusion of left-wing parties in the new coalition government, there has been much skepticism since the elections about the future of the existing reform program, especially privatization plans, agricultural reforms, and reform of subsidies, for example in the labor market. However, there is general consensus on the fact that India is the second most dynamic economy in the world (topped only by China) and its growth momentum remains intact. The Congress Party's aim to achieve annual GDP growth of ten percent is remarkable. India remains the Asian software focal point and has also become one of the most important locations for the outsourcing of call centers by international companies.

Fund performance over three years

Current uncertainty does not dampen optimism

The JF India Fund and HSBC GIF Indian Equity Fund have a different focus. JF India is currently strongly overweighted in industrials and commodities, whereas the manager of the HSBC Fund seeks exposure to software, pharmaceuticals, and automobiles.



Source: Lipper Reuters

JF India Fund

The specialized skills of the in-house staff at JPMF in India form the basis for the management of the JF India Fund. The selection of equities is not tied to the benchmark, allowing the fund's portfolio to diverge significantly from the index. The current portfolio, for example, is overweighted in the industrial and commodities sectors, and underweighted in financials and non-cyclical consumer goods. Given the risk factors associated with the Indian equity markets, the fund's strategy is to minimize these risks while at the same time seeking new investment opportunities. The bull market has further increased the fund manager's sensitivity to valuation-based problems. Despite increasing risk aversion, the fund strategy reflects a positive outlook overall. The fund is still fully invested and is holding no particularly defensive equities in its portfolio.

HSBC GIF Indian Equity Fund

The investment process of the HSBC GIF Indian Equity Fund is based on the concept of economic cycles. According to this approach, economic cycles serve to determine the generation of value. The fund manager believes that India has a relatively closed national economy that is being increasingly exposed to global market movements. Reform processes are equally important and often serve as catalysts for equity market movements. The fund manager focuses on companies that are industry leaders with global competitive advantages in terms of their low labor costs and deployment of technology. In particular, the fund is overweighted in the software, pharmaceuticals, and automobile sectors.

Funds	JF India Fund	HSBC GIF Indian Equity Fund
Security number	401 213	417 871
Fund currency	USD	USD
Ø Annual return (3 years)	27.5% (in USD)	45.8% (in USD)
Annual volatility (3 years)	23.6%	28.5%
Fund volume	USD 513 million	USD 1,489 million
Fund manager	Rukhshad Shroff	Sanjiv Duggal

New members play catch-up

The decision to join the EU has previously always resulted in impressive development for candidate countries. This is also likely to be the case with the most recent accession states. The two products discussed here are examples from a wide range of potential structures that enable investors to gain exposure to this development.

Florence Schnydrig and Daniel Shashoua, Structured Derivatives Team, and Lars Kalbreier, Trading Strategy

If one examines the performance of the stock market indices of previous EU accession candidates, one finds that these indices show an average 76 percent outperformance within two years of the decision to join the EU. For our calculations we have used the time period between confirmation of accession by the candidate countries and the official date of their EU integration. The Spanish IBEX Index, for example, outperformed the DAX Index by 40 percent in the almost two-year period after EU acceptance. Portugal, Greece, Sweden and Finland also outperformed strongly in their equivalent periods.

Impetus for investment

At present, the investment world still regards the Eastern European accession countries as emerging markets. Soon, however, they will probably be viewed as Western European investment regions, and their stock markets subsumed into the sectoral allocations for the eurozone – just as was the case for Spain, Portugal and Greece in the 1990s. It can also be assumed that per capita GDP will increase in the accession states, that their equity markets will enjoy increasing liquidity as international investment grows, and that many local laws and restrictions on foreign investment will be overturned in future.

Certificate Plus: Central & Eastern Europe

Investors seeking to invest in the new EU member states are confronted by relatively illiquid markets. The CECE Index is a very good alternative to investing directly in the indices of the individual countries. The CECE was launched in 1999 and is a capitalization-weighted index for Central and Eastern Europe. It is denominated in euros and encompasses all equities included in the Czech Traded Index, Hungarian Traded Index and Polish Traded Index.

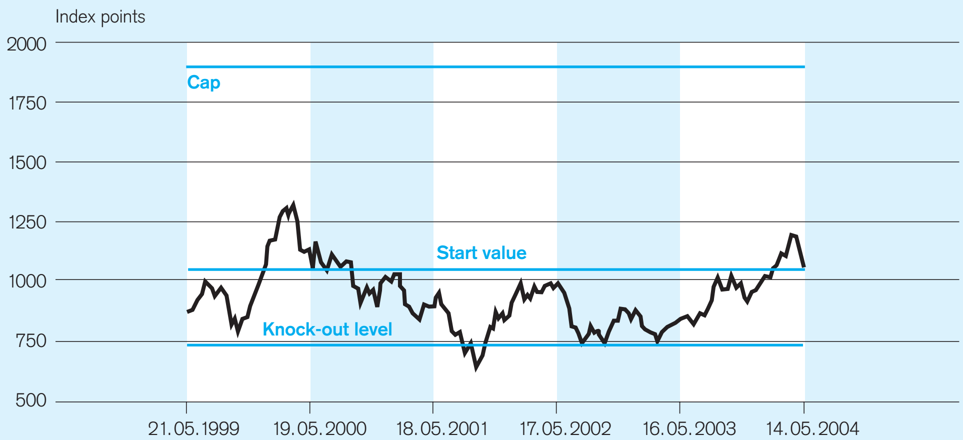
The recently launched Certificate Plus in euros on the CECE Index combines full exposure to the future performance of these markets with "conditional" capital protection. The certificate has a term of five years. Investors enjoy an indicative 100 percent participation in the positive performance of the index upon expiry, although the maximum repayment is limited to 185 percent. Moreover, the repayment will always be at least 100 percent, even if the index does not perform positively. The capital protection is conditional because it will lapse if the underlying index loses more than 40 percent of its start value at any time during the term of the certificate. In the event of this happening, the product is exposed fully to the negative index performance. However, exposure to positive index performance remains at 100 percent, even if the index reaches its knock-out level.

The Certificate Plus is a new type of structured derivative, and its appeal lies in its simplicity. It is particularly attractive for investors who are seeking exposure to rising equity prices in the new EU member states of Poland, the Czech Republic and Hungary. The knock-out conditions are well matched to the positive outlook for economic growth and the anticipated performance of these markets.

Performance of the CECE Index since its launch in 1999

Conditional capital protection for investors

The maximum repayment is 185 percent, the knock-out level is set at 60 percent. Even if the knock-out level is breached, participation in positive performance remains 100 percent.



Source: Credit Suisse

We therefore anticipate that, in the next few years, the equities of the new accession states will be transferred from the MSCI EM Eastern Europe Index to the MSCI EMU Index, and that rating agencies such as Moody's, S&P und Fitch will improve their ratings for the accession states. This will occur because these countries are improving their public finances in order to meet the Maastricht criteria, while at the same time restructuring their economies by doing away with investment restrictions and introducing liberal European trading legislation. The backing of the ECB will also reduce currency risks.

Better growth prospects

For all the reasons listed above, the economies of the accession states will probably grow at about twice the rate of existing EU members. We have been tracking the stock market index performance of the new EU members since October 1, 2002, when the European Commission announced the official list of candidate countries for this round of enlargement. Since that date, Poland has outperformed the Euro Stoxx 50 by 75 percent, the Czech Republic has outperformed by 98 percent and Hungary by 69 percent. We believe that these countries have even more to offer.

Due to their preparations for EU membership, the new Eastern European EU countries are likely to outpace their Western European competitors. We therefore also recommend investing in Eastern European equities. Unfortunately, however, due to current liquidity constraints, there are only three tradable indices: Poland's WIG 20 Index, the Budapest Index in Hungary and the Prague PX 50 Index in the Czech Republic.

Opportunities for new candidates

The new members of the enlarged EU offer significant advantages to investors due to a number of factors:

- **Lower interest rates mean greater international and domestic investment in equities.**
- **Businesses from current EU member states are moving to the accession countries because salary costs in Eastern Europe are two-thirds lower.**
- **The EU provides financial assistance to its new members.**
- **The new members must meet the Maastricht criteria; this will require a range of measures to improve the current situation.**
- **The average corporate tax rates of Hungary, Poland and the Czech Republic are about 50 percent lower than those of Germany.**

CPU Multi Plus: Chinese economic zone

The CPU (Capital Protected Unit) Multi Plus on the Greater China Index Basket is a defensive alternative to investing directly in Asian markets. It is particularly suited to investors who anticipate positive performance in these Asian markets over the next four years.

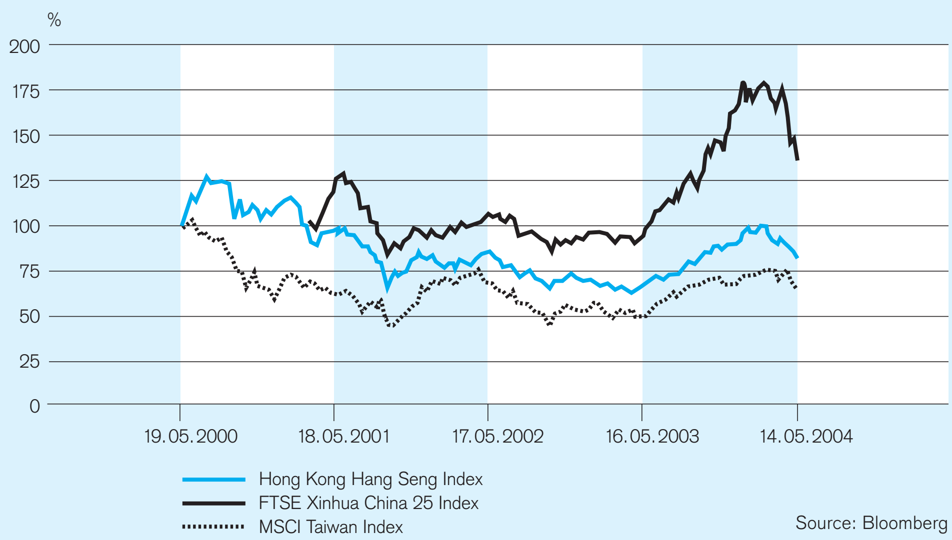
The Greater China Index Basket is an equally weighted index comprising the FTSE Xinhua China 25 Index, the MSCI Taiwan Index, and the Hang Seng Index. The CPU Multi Plus has a term of four years and is denominated in US dollars.

This innovatively structured derivative enjoys capital protection of 106 percent at maturity, i.e. the issuer guarantees a minimum return of six percent over the term as a whole. In addition, the investor enjoys exposure to the performance of the index basket as follows:

Performance of the three underlying indices in the CPU Multi Plus

Guaranteed minimum return at maturity

The Greater China Index Basket is composed of the three indices shown below. Even if the indices perform negatively, the investor is assured of capital repayment at maturity of 106 percent – this represents a minimum return of 1.46 percent per year.



Source: Bloomberg

The term of four years is divided into 16 quarters, with the basket being re-weighted every quarter. Investors participate fully in the performance of the basket except in quarters when all three indices perform positively. For quarters in which this is the case the basket performance is replaced by a fixed value of six percent, even if the average performance of all three indices is lower than six percent.

The overall performance of the CPU Multi Plus is calculated by multiplying the quarterly returns, taking the compound interest effect into consideration.

The CPU Multi Plus is not risk-free. During its term, the price of the derivative may fall significantly below the issue price. At maturity, however, the repayment will always be a minimum of 106 percent.

Currency as a springboard for investors

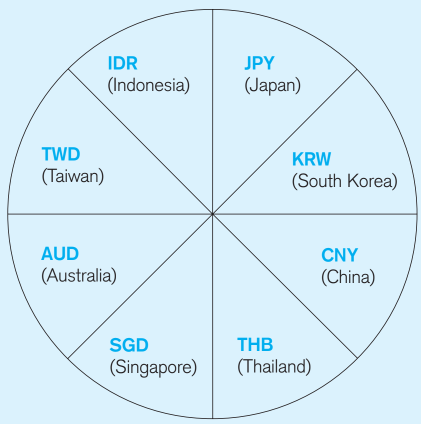
Asia is seen as the growth market par excellence for the next few years. The USD TIMER Note on Asian Currency Basket allows investors to participate in this growth. **Anke Haux, FX Products & Cash Management Solutions**

The Far East continues to impress with its significant economic growth. Despite the impact of SARS, gross domestic product (GDP) growth in 2003 was seven percent. This represents approximately half of global growth. The solid economic outlook and strong domestic demand in Asia are likely to produce another year of high growth in 2004. China is unquestionably the driving force behind this growth; the country has an enormous domestic market and a growing export market. Based on strong structural advances to date and the development of an economic framework that can also offer foreign investors more infrastructure and security, we consider China's prospects for sustained growth to be better now than at any time in the last five years.

USD Timer Note on Asian Currency Basket

Balanced structure represents good prospects for returns

The various currencies underlying the USD Timer Note on Asian Currency Basket each represent one eighth of the total. Seen over the maturity of five years, this should deliver the best prospects for returns.



Source: Credit Suisse

Unequal starting point for countries

China's above-average economic growth shows increasingly that the pegging of the yuan to the US dollar in a fixed exchange rate is disadvantageous for the economy in the long run. In an extreme scenario, it could even bring with it the danger of overheating. On a basis of purchasing power parity, experts consider the yuan to be undervalued against the dollar by between 10 and 25 percent. From a perspective of stable growth and low inflation, it is becoming more and more important that China finds a way to introduce a more flexible exchange rate mechanism, allowing the yuan to increase in value.

Other countries in the region find themselves in a similar situation. Thailand's economy continues to grow with low inflation; the same is true in Malaysia where economic activity is recovering while inflation and unemployment remain low. Consumer demand is supporting moderate growth in Indonesia, inflation has fallen and consolidation of fiscal policy is starting to have a positive effect. Here too, an easing of the rigid exchange rate mechanisms is increasingly desirable, given the reforms in banking, law and the judiciary combined with the stable monetary policy of national banks. Singapore, the star of the ASEAN countries, has shown that a secure financial center and stringent monetary policy create the optimal environment for foreign investment while also promoting sustained domestic growth.

The situation in Japan and South Korea is different. Both countries have suffered many years of economic hardship, but they too are benefiting from the positive regional trend driven by China. The latest figures confirm this: Japan's GDP grew by 5.6 percent during the first quarter of 2004 – significant growth compared to 2003. This points to positive development in Japan's economy.

USD Timer Note offers capital protection

As investment in Asian equity markets continues to be a difficult business and the region's market indices can be unreliable indicators, the USD Timer Note on Asian Currency Basket offers an interesting way of gaining exposure to growth in the entire economic zone via appreciation of Asian currencies. The product has a term of five years, and offers capital protection of 103.25 percent. Investors benefit 100 percent in any revaluation of Asian currencies and, in addition, can lock in profits early on request.

Investment	**USD**
Underlying asset	**Basket of Asian currencies (in USD)**
Term	**5 years**
Strike	**Equal to the spot rate fixed at launch**
Participation	**100%**
Capital protection	**103.25%**
Denomination	**USD 1,000 (minimum investment USD 10,000)**

Equity

Time for a breather

When it comes to performance, emerging markets are usually a step ahead during a recovery phase. Once the zenith has been reached, however, the industrialized countries take over the lead once more. **Cédric Spahr, Equity Strategy**

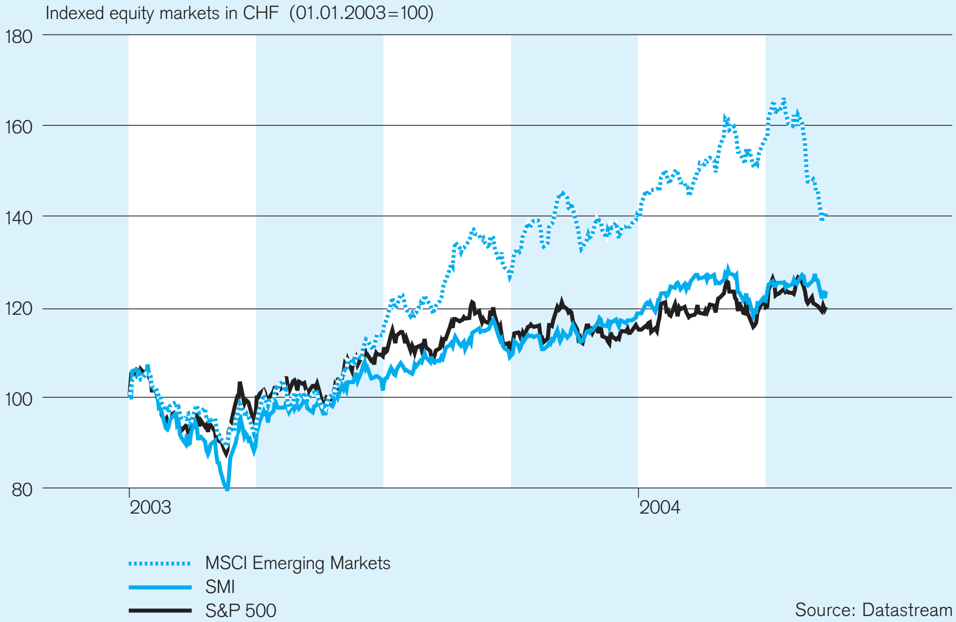
Since the start of 2004, equity markets in the developing world have performed worse than markets in the industrialized countries. The MSCI Emerging Markets index lost 3.9 percent in CHF terms, whereas the SMI (+3.8 percent) and the S&P 500 (+4.0 percent) were able to deliver positive, albeit small, returns. Despite this setback, however, the MSCI Emerging Markets index is still looking good. Between the start of 2003 and the end of April 2004, the index recorded a cumulative gain of 37.9 percent in CHF terms, well ahead of the SMI (23 percent) and the S&P 500 (15.2 percent). This illustrates two well-known empirical facts. Emerging markets outperform the industrialized countries during a recovery phase, but show below-average performance as soon as the economic recovery has peaked. This has clearly been the case since April. The US Purchasing Managers Index (ISM) and leading indicators for the G7 countries show this beyond a doubt.

In addition to this typical cyclical pattern, important structural factors have played a role. For the first time, China has become a cornerstone in the global economy. This has driven prices sky high for many commodities. The process has been fuelled by speculative investors using vehicles such as hedge funds. With the prospect of a change in US fiscal policy and a slowing of growth in China, these investors began to liquidate their positions aggressively in March and April.

Comparison of equity indices: MSCI, SMI, S&P

Emerging markets are in a phase of correction

It can be seen clearly how the MSCI Emerging Markets index has moved ahead of the indices in the industrialized countries during the latest recovery phase. However, its correction since April has also been much more pronounced.



Source: Datastream

Political risks are inevitable

To say that emerging market countries are not known primarily for their political stability and predictability is an understatement, to put it mildly. In Russia, for example, the government has increased pressure on the Yukos oil company, leading to a correction in the Russian equity market. However, a reversal of capitalist principles is unlikely. The latest developments should rather be interpreted against the backdrop of the ongoing power struggle between the Kremlin and the oligarchs who emerged during the Yeltsin era. In South Korea, the impeachment proceedings against President Roh were suspended after his party won a landslide victory in parliamentary elections. These kinds of political risk are inevitable in emerging market countries. But in the medium term they are unlikely to have a major impact on a well-diversified portfolio.

Correction in a bull market

Emerging market equities remain attractively priced despite their strong gains: this somewhat reduces the risk of a setback. We continue to believe there are good reasons (demographics, growth, more stable financial systems) that speak in favor of a long-term bull phase in these markets. At present, we prefer Asian equity markets and would reinvest there from the middle of the year. Latin America is suffering more than Asia from the fall in commodity prices and is unlikely to become interesting again before 2005. As far as central Europe is concerned, convergence with western Europe is largely a fait accompli – we would reduce our positions here.

Prejudices put to the test

Emerging market bonds are a small but popular sector in the field of fixed income investments. In terms of yield and volatility, they are positioned between conventional investment grade fixed income instruments and equities. **Walter Mitchell, Credit Research**

Emerging market bonds make up some seven percent of the global bond market. They include both domestic and foreign bonds issued by governments and corporations in non-industrialized and developing countries. Most foreign bonds are issued in US dollars or euros, but there are also smaller niche markets for bonds in pounds sterling, Swiss francs and Japanese yen.

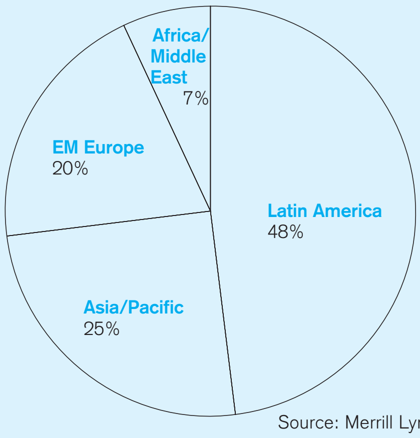
A growing market

The market for bonds in emerging market countries has grown steadily over the last ten years. It has benefited from continuously falling interest rates in the G7 countries (USA, Canada, UK, France, Italy, Japan and Germany) and the resultant growing demand for higher yielding investments. Latin American borrowers make up approximately 50 percent of the total outstanding emerging market bonds; Asia's share of the total is about 25 percent followed by the European emerging market countries with around 20 percent. Historically, most emerging market bonds were rated as speculative bonds, i.e. a rating of less than BB+ in Standard & Poor's rating system. Over the last few years, however, the average credit rating of emerging market countries has improved, and a large majority of the outstanding bonds are now rated BBB or higher.

Regional share of emerging market bonds

Uneven distribution

The graph shows outstanding foreign government and private sector (banks and corporate) debt.



Source: Merrill Lynch

Yields please investors

In the last ten years, emerging market bonds issued in US dollars achieved an annual average return of eleven percent. Yields at this level appear attractive, but of course they are also associated with a higher degree of risk. Due to their higher yields and greater levels of volatility, emerging market bonds form an asset class that is positioned between traditional investment grade fixed income investments and equities. If one uses the Sharpe ratio (see box on page 35) as a basis for comparison, then emerging market bonds in the last ten years have outperformed US equities but slightly underperformed investment grade and high yielding corporate bonds.

Lower yield, better risk profile

The outlook for yields on bonds of emerging market countries is very mixed at present. Fundamental credit data has improved, thereby reducing risk and volatility levels. However, the bonds have become more expensive, both in terms of their absolute yield and their yield differential (spread). Lower yields mean less income in the future, which is acceptable as long as the risk profile of most emerging market borrowers continues to improve. Investors seeking exposure to lower rated or even speculative bonds should supplement their existing fixed income portfolios with some emerging market bonds. In historical terms, emerging market bonds have a low correlation to investment grade bonds (between 20 and 40 percent). Bonds from emerging market countries should thus increase portfolio yields without adding very much risk.

The world from A to C

Independent rating agencies play an important role in the financial services industry. The best-known rating agencies are Standard & Poor's and Moody's. Standard & Poor's was formed in 1941 through the merger of Standard Statistics and Poor's Publishing Company, and Moody's was founded in 1900. Today, both companies provide a range of services to financial companies, including the provision of credit ratings. Ratings are essentially a phenomenon from the USA that only recently jumped the Atlantic to become established in Europe. The rating methods can be applied equally well to a country, a company, or a bond. Ratings reflect future expectations as well as success and risk factors. These factors are examined in a complex model and summarized in a single indicator. The rating expresses the borrower's economic capability, legal status and willingness to repay its debts in full and on time. Ratings of Bbb (Moody's) or BBB– (Standard & Poor's) and higher are considered investment grade, whereas ratings below this threshold are non-investment grade, or speculative grade investments. (Further definitions of the rating categories are provided on page 8).

Credit risks play a key role

As bond yields have contracted over the last few years and margins have narrowed, the best performance has been achieved by investments with the longest maturities and the biggest risks. We believe that this phase has ended. In the current market environment, in which rising US interest rates can be expected, investors should be reducing their maturity risk by focusing on bonds with shorter maturities that expire between 2006 and 2008. Moreover, credit risks will again play a key role in determining the performance of bonds in an environment of rising yields. This is because higher returns are likely to be generated owing to the potential reduction in spreads rather than due to falls in risk-free interest rates. We therefore recommend concentrating on emerging market borrowers with a stable or improved risk profile such as Brazil (B2/B+), Mexico (Baa2/BBB–) and Russia (Baa3/BB+). Bonds from more risk-prone countries with uncertain or worsening credit profiles, such as Ecuador (Caa1/CCC+) and Venezuela (Caa1/B–), should be avoided.

Sharpe ratio

The Sharpe ratio compares the return and risk of an investment. The greater the return and the lower the risk, the higher the Sharpe ratio. Investors who are not averse to risk should make their investments purely on the basis of the return, while risk-averse investors should instead base their decisions on the Sharpe ratio.

King Midas of Mexico

Carlos Slim is the richest man in Latin America. The son of a Lebanese immigrant, the Mexican billionaire speaks hardly any English, doesn't use a computer, and works 14 hours a day. His credo is: buy cheap, grow fast. Whatever he touches turns to gold. **Peter Ruch, an economic journalist in Mexico City**

› The 64-year-old Carlos Slim Helu laid the foundation for his wealth when he was a small boy – by selling sweets to his older brothers on weekends. By the age of 15 he owned 44 shares in Banamex (Mexico's largest bank at the time) and had saved 5,523 pesos. When he began his studies at the Universidad Autónoma de Mexico (Unam) at the age of 17, his bank account had risen to 31,900.26 pesos. Slim has a phenomenal flair for numbers. There is a legendary story of his appearance at the annual general meeting of a company in which he had a minority share. Doing the calculations in his head, he added up the figures in the annual report and his result was only a thousandth of a decimal place off.

The breakthrough deal for Carlos Slim was his takeover with other investors in 1990 of Telmex, at that stage still the state-owned incumbent telephone company. The company held a monopoly on the fixed-line network in Mexico, Latin America's largest economic player. Auditors valued Telmex at USD 10-12 billion. Slim took control of the company for USD 1.7 billion, paying roughly 80 cents per share. At the end of April 2004, Telmex shares were trading at over USD 30.

Taking advantage of good connections

The sensation caused by the takeover of Telmex was not restricted to Mexico. Slim was accused of enjoying more than just a passing acquaintance with the then president of Mexico, Carlos Salinas de Gortari. The fact that Slim nurtures good relations with politicians and is not afraid to use his connections is illustrated by another, more recent example: last year he donated USD 50 million to pay for the restoration of the old town in Mexico City. In exchange, Andres Manuel Lopez Obrador, the mayor of what is probably the largest city in the world, granted Slim the pre-emptive right to purchase a number of buildings in the inner city. Of course, once the renovation of the city center was completed (paid for by Slim's millions), the buildings in question were worth considerably more than Slim's initial investment. Amlo (the popular nickname in Mexico for Mayor Lopez Obrador) is not only a close friend of Slim, he is also currently the front runner to succeed President Vicente Fox in the next presidential election, scheduled for the summer of 2006.

The market capitalization of Carlos Slim's empire amounts to more than USD 60 billion.

Not all business deals made by Carlos Slim leave such an aftertaste. Quite the contrary: he is a brilliant man and has been recognized in various forums as the best manager in Latin America over the last few years. Of course, the takeover of Telmex did open up certain opportunities. He was suddenly worth an amazing fortune, but he was also able to recognize in advance the signs of the times. Telmex was one of the first telecom companies in the world to be able to offer its clients (functioning) ADSL connections. During the WTO ministerial conference in Cancun last summer, the entire venue was fitted with hotspots, making it possible for all those present to enjoy wireless internet access. Slim, who himself does not own a computer, gives away computers with internet connections virtually for free. In particular, younger clients are targeted for Telmex services.

Slim still derives the largest share of his income from traditional fixed-line services, but believes that conventional telephony has poor prospects for the future. The internet is the technology of the future, in the Third World too. Slim believes even more strongly in mobile telecommunication. He is well positioned in this market with his company América Móvil, launched in September 2000, which lags only a few percentage points behind Telefónica, a Spanish company and the largest mobile phone operator in Latin America. Unlike his competitors, América Móvil is not willing to pay high prices per subscriber. Recently the Spanish company Telefónica paid BellSouth well over USD 500 per existing subscriber for the purchase of its Latin American operations – boosting Telefónica's total to 40.6 million users and becoming the number one mobile phone operator in Latin America. América Móvil trails marginally with 40.4 million subscribers.

Cost-effective entry into Brazilian market

The highest price paid by Slim per existing subscriber was USD 368 last year when he took over the Brazilian mobile phone company BCP. However, BCP has an extremely solid base market in the Sao Paulo region – the most lucrative market in Brazil.

Continued on page 39 ►

Photo: Keith Dannemiller/Corbis Saba

Economic recovery despite stagnating reforms

Mexico is one of the most open economies in Latin America. 80 percent of its exports go to the US market. This has allowed Mexico to benefit from the recent recovery north of its border. However, the country has failed to follow through on important reform issues. **Walter Mitchell, Credit Suisse**

After three years of below-average growth, Mexico is at last seeing the start of an economic recovery. GDP is projected to grow by 3.5 percent this year, significantly above the average growth rate of 0.6 percent from 2001 to 2003. Mexico is recognized as having one of the most open economies in Latin America. Exports make up 30 percent of GDP. More than 80 percent of its exports go to the US market, explaining the strong trade networks between the two countries. The upswing in the US is gradually making itself felt across the border and is adding support to the current economic recovery in Mexico. Economic forecasts for 2005 are also positive, although GDP growth could weaken depending on the sustainability of US growth and the impact of rising interest rates (in the US and in Mexico). The Mexican Central Bank has had to apply restrictive monetary measures three times since February to counter inflationary pressures. At the end of 2003, inflation was 4 percent in comparison to the previous year. However, a rise in inflation is forecast for 2004. In addition, oil plays an important role in the Mexican economy. Oil price developments will also have a marked impact on future economic performance.

Another significant factor for medium-term growth prospects in Mexico is the stagnation of the government's reform program. After the first half of his six-year term in office, President Fox has not managed to move ahead with reforms to stimulate the economy.

Up until now, the opposition party PRI has continued to use its veto to stall legislative programs for energy, tax, and labor reforms. This is unlikely to change in the run-up to presidential elections in 2006. The delay in reforms will probably result in moderately slower growth and a weaker exchange rate. In the last two years, the value of the Mexican peso has fallen by about 20 percent in nominal terms.

MEXICO	
Capital city	Mexico City
Surface area	1 972 550 km²
Inhabitants	101.5 million
Form of government	Federal republic
Nominal GDP	USD 603.5 billion (2003E)
GDP growth from 2002 to 2003	1.2 % (E)
GDP per capita	USD 5875
Inflation	4.5 % (2003E)
Exports	USD 190.5 billion
Imports	USD 218.5 billion
Foreign debt	USD 141.4 billion (2003E)
Number of persons in employment	39.8 million
Unemployment rate	3.4 % (2003E)
Population below the poverty line	40 % (2001)
Paved roads	108 087 km
Internet users	3.5 million (2002)
Investment rating	**Baa2/BBB–**

Slim also sets a shining example when it comes to work ethics. He is well known for his 14-hour working day. In stressful situations (and there have been more than just a few of these in his life), he lives almost entirely on thick cigars. A former Swiss employee reports that Slim has no hesitation when it comes to calling a meeting of his key staff at four in the morning if he deems it necessary. Until just recently, his headquarters were located in an unlikely nondescript building and his own office was not much larger than that of a normal office worker. Since then, however, Slim has relocated to offices more suited to the richest man in Latin America. But, unlike many other rich Latin Americans, Slim is not prone to showing off his wealth. The only embellishment he wears is the sweet smell of his own success.

In addition, his family owns an exceptional art collection. His wife Soumaya, who died four years ago, was responsible for putting together the collection. Alongside works by Degas and Monet, Slim also owns the largest Rodin collection outside of the Rodin museum in Paris. His collection of artifacts from the Aztec Empire is considered to be better than the Mexico City Anthropological Museum's holdings.

Slim does not simply amass fortunes for himself and his heirs, however. He runs two charities that between them have more than USD 1 billion in assets. Last year he gave almost 20,000 scholarships to students, paid the bail money for about 5,000 underage first-time offenders (thereby avoiding their long wait pending trial) and financed 11,000 plastic surgery operations for disfigured children.

Slim may not see eye to eye with President Fox, but he does consider himself a patriot with a duty to do something good for his country. All three of his sons (who now work in the family business which includes Slim's holdings in publishing, tires, cosmetics, tobacco, real estate, insurance, loans, etc.) studied in Mexico, not abroad at elite US universities. Carlos, Marco Antonio, and Patrick are slowly taking over more responsibilities from their father, but at the age of 64 he is far from ready to hand over the reins. However, the short-statured patriarch still takes time out from his busy schedule to practice his favorite hobby – growing bonsai trees. ❚

	Nominal GDP (2003E)	Inflation (2003E)	Foreign debt (2003E)
ARGENTINA	USD 135 billion	3.7 %	USD 146.9 billion
BRAZIL	USD 500 billion	9.3 %	USD 219 billion
CHILE	USD 72 billion	1.1 %	USD 43.2 billion
ECUADOR	USD 27 billion	6.1 %	USD 12 billion
COLOMBIA	USD 79 billion	6.5 %	USD 39.1 billion
MEXICO	USD 625 billion	4.0 %	USD 141.1 billion
PANAMA	USD 12.8 billion	1.7 %	USD 35 billion
PERU	USD 60.9 billion	2.5 %	USD 28.8 billion
URUGUAY	USD 11 billion	10.2 %	USD 10.4 billion
VENEZUELA	USD 88.3 billion	271 %	USD 35 billion

The growth path is a very fine line

Economic growth will pick up significantly in Latin America this year. However, the region remains susceptible to crises due to its reliance on foreign capital. **Walter Mitchell, Credit Research**

› After three lean years, hope is re-emerging in Latin America. Real GDP growth in the region is likely to reach about 3.8 percent this year. This would be the highest level of growth since 2000 (see graph below). The recovery, from Mexico all the way to Tierra del Fuego in the south, is largely being driven by the global economic upturn, high commodity prices and larger net capital inflows. The question is, will the recovery be sustained, or will it falter on account of internal or external factors before living standards for the region's people improve?

Adjustment leads to strength

Latin America has emerged from a difficult period of adjustment. This process was triggered when capital flows into the region abruptly ended following the Asian and Russian crises. Previously, net private capital inflows to the region had reached a peak of USD 105 billion in 1997. Inflows collapsed after this and totaled no more than USD 19 billion in 2002. This led to collapsing growth rates and forced Brazil and Argentina to abandon their fixed exchange rates in 1999 and 2001 respectively. Latin America has emerged stronger after this dramatic period of adjustment. The last three years have not only seen a positive improvement in the trade balance in a number of countries in the region, but many countries have also enjoyed lower inflation and a reduction in public sector debt. However, the recovery is dependent on a very favorable environment, combined with rising commodity prices and record-low interest rates in the industrialized countries. Low interest rates not only reduced the cost of loans, they have also had the effect of boosting capital flows to the south. These external factors will not always be this favorable, however.

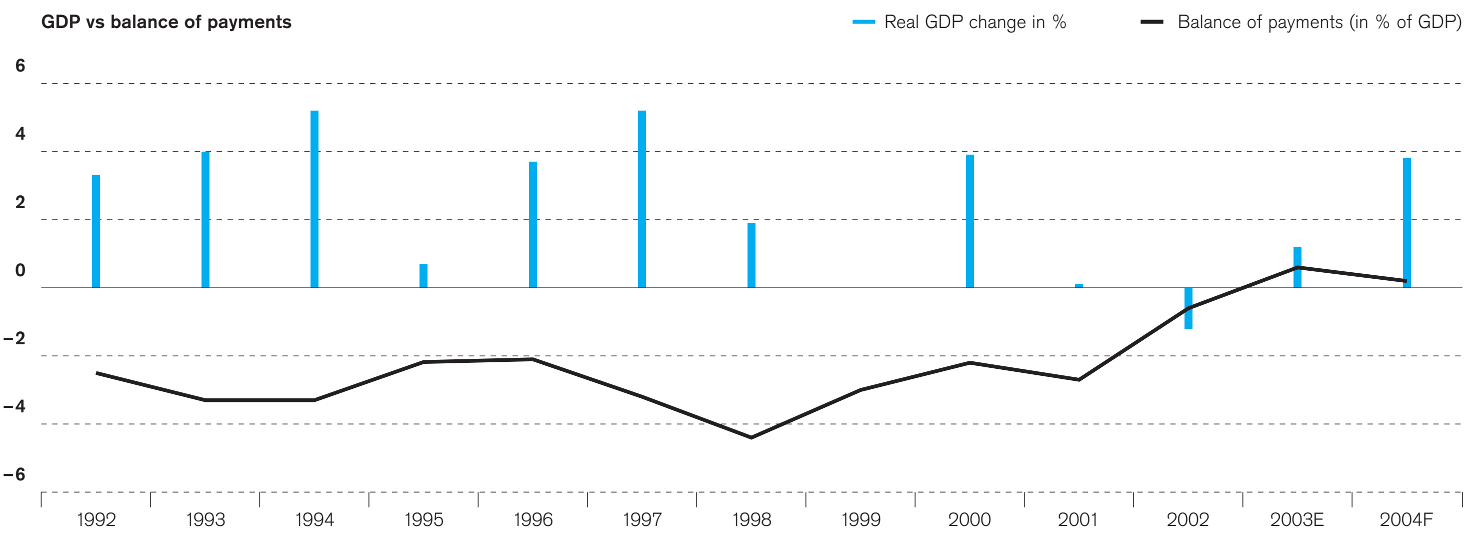
Danger persists

The danger of a balance of payments shock in many Latin American countries persists (with the exception of Chile and Mexico), despite the progress made in combating inflation and reining in government deficits. When all is said and done, whether external or internal factors trigger such a shock is unimportant. What matters is the region's continuing dependency on foreign capital inflows, making it vulnerable in the event of fluctuations in international financial flows. The problem can be traced back to a low savings ratio and the limited openness of the Latin American economies. The low

Promising improvement in balance of payments vs GDP

In 1998, the balance of payments deficit was 4.4 percent, while in 2003 there was a small surplus of 0.6 percent. The lean years look to be over, and there is major hope for a sustainable recovery. Source: Institute for International Finance (IIF)

GDP vs balance of payments



level of savings means that the region's governments as well as private businessmen have to look abroad to raise loans. At the same time, the export sectors of most countries are too weak to generate sufficient earnings in hard currency (i.e. assets) to settle their liabilities, leaving the entire region in a net debt situation.

Exports lag behind

Exports have increased in the last few years, but this has only been due to higher commodity prices. Exports from Latin America continue to lag behind those in Asian and European countries. Panama and Chile have the most open economies, with exports of 58 and 34 percent respectively. The remaining countries generally fail to achieve an export ratio above 30 percent. Emerging market countries in Asia and Europe boast average export rates of 52 and 45 percent of GDP respectively. The region's vulnerability to external factors is particularly pronounced in the case of Brazil. Despite a record high trade surplus of USD 25 billion in 2003, exports only make up 17 percent of the country's GDP. At the same time, Brazil's foreign debt at the end of last year amounted to 44 percent of GDP. Servicing of net debt is feasible during good years but quickly becomes a problem as soon as capital inflows decline for any reason. Brazil's dependence on these capital inflows became apparent in the last few weeks when the liquidation of bond market positions coincided with a weakening in the national currency, the real (see box on Brazil).

The people's patience is becoming exhausted

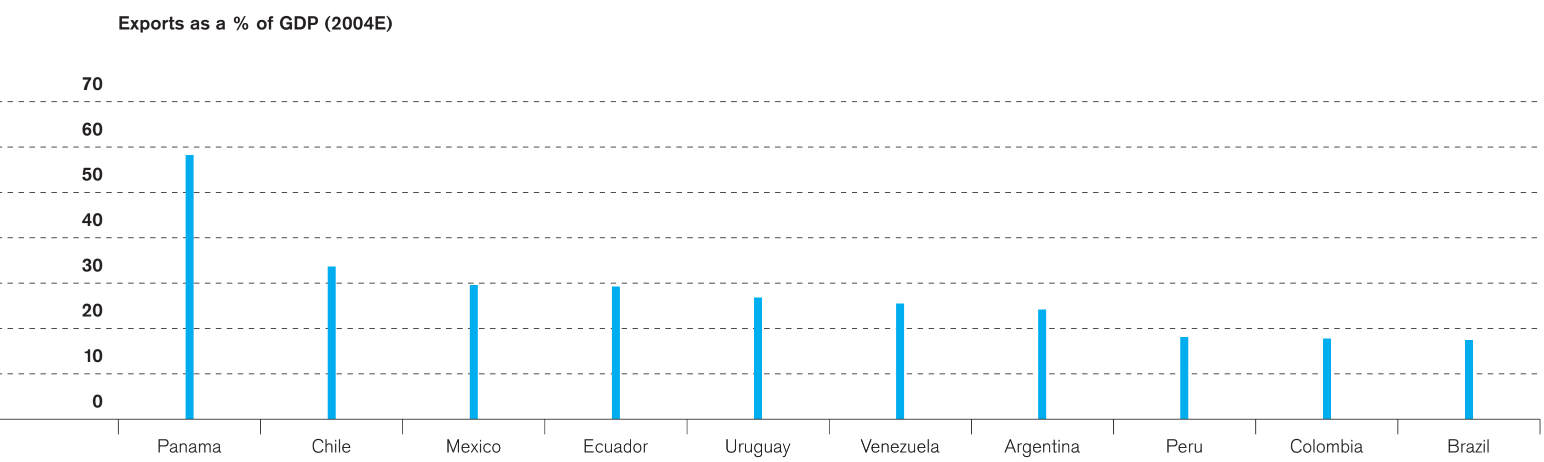
How can Latin America reduce its dependence on foreign capital and thereby improve its chances for sustainable growth? The solution to becoming less dependent on external factors is the active encouragement of exports. If exports rise then there is more hard currency to service debts. Secondly, the region's governments must create an attractive environment for direct foreign investment (in equities). This requires improvements in protecting property rights as well as a proper regulatory framework. Finally, governments will have to further reduce their budget deficits to keep inflation low and improve access to domestic savings for the private sector. It is encouraging to see that most governments in Latin America are pursuing such measures in some form or other. However, corrections to the balance of payments take a long time. And the patience of the Latin American people, and especially the poor, may well have been exhausted by then.

Brazil: Can Lula survive the pressure?

After 18 months in office, President Lula is still pursuing a market-friendly macroeconomic policy. He has limited increases in minimum salaries to 8 percent (based on the expected inflation rate) and resisted pressure for larger salary increases. Despite the clamor for an easing of the tax policy reins, he has stuck to his guns for a primary surplus of 4.25 percent of GDP. But his left-wing past is catching up with him. He will be put under pressure to intervene politically, and the markets will never be sure that he won't suddenly change course in midstream. This political uncertainty has resulted in slightly higher interest rates and a moderately weaker rate of economic growth. This creates an erratic scenario that only holds up as long as the friendly economic environment persists. However, if interest rates shoot up or commodity prices collapse (especially the price of soya), Brazil's public finances and currency would come under much greater pressure, and the reserve bank would curb its pace of fiscal policy easing. The government must stay the course of its macroeconomic policy, particularly when the environment becomes less friendly.

Closed Latin America

The export share of GDP in most Latin American countries is lower in comparison to emerging markets in other regions, for example many of the emerging markets in Asia. Source: CSFB

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