Tera Capital Fund

Investor Fact Sheet

November 2010

(final)

Altima asset management

Tera Capital Fund is the only Fund of Funds in the world which pays no fees other than a success fee

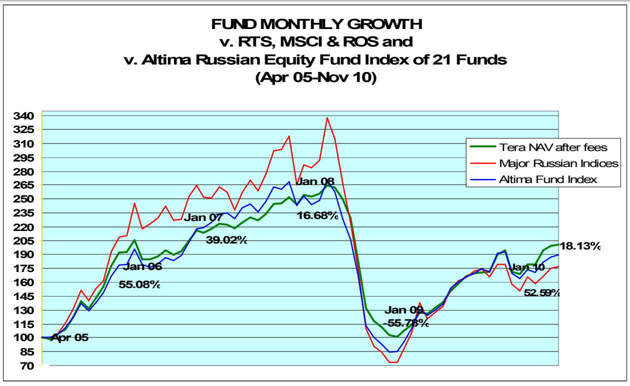
No early investor in Tera saw the value of his investment fall below the amount invested at any time during the 2008-09 economic crisis

Fund Information

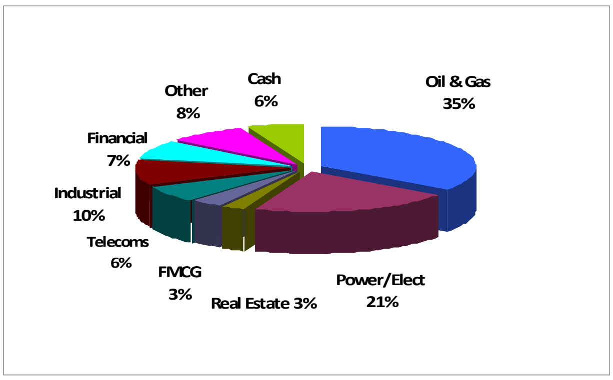
Strategy: Tera Capital Fund is a Russian-focused fund of funds that invests in 5-8 funds (usually long equity funds) that are diversified by sector, size, geographic focus and strategy.

Date Formed	April 2005
Investment Advisor	Altima Asset Management
Fund Size	$4.5 M
Currency	US dollar
Current Price (NAV)	$200.64
Min. Investment	$100,000
Fees/Expenses	**Success fee only (20%)**
Subscription	Monthly
Redemption	Monthly, with 30-days notice
NAV	Monthly
Administrator	Maples Fund Services
Auditor	Altschuler, Melvoin & Glasser
Bank	Bank of New York
Legal Advisors	Maples & Calder
German Tax Transparency Advisor	PriceWaterhouseCoopers
ISIN	KYG8760X1034
Eurekahedge ID No.	15532
URL	www.altim.ru
Advisory Board	**Michael Wallenberg**, SVP EFG Bank, Geneva **Bruce Bean**, Co-Chair ABA Russian Law Committee

NAV



Sector Allocation



Performance (net of fees)

Returns	Tera (%)	RTS, MSCI & ROS Avg* (%)	AAM Russia Fund Index[1] (%)
Monthly	0.63	0.52	0.99
Year-to-date	18.13	2.67	11.25
Trailing 12 months	20.53	7.26	13.94
Since Fund inception (Apr 05)	100.64	76.52	88.75
Anlzd mnthly rtrn (since Fund inception)	16.06	13.87	14.59
Annualized Stand. Dev. (since inception)	24.63	39.11	31.81
Sharpe Ratio[2]	0.55	0.39	0.38
Trailing 12 m Sharpe	**1.05**	**0.31**	**0.62**

****RTS: 0.64%, MSCI: -0.08%, ROS (Crédit Suisse): 1.00%***

Investment Advisor's Assessment

Russia

November and early December were nothing less than spectacular for Russia! It would be difficult to imagine more positive news at all levels: international, political, macroeconomic and microeconomic. The overarching theme of all of these developments: Russia is completing major steps to become an integrated member of the world community.

In particular, there were three major events that illustrate this conclusion. The major events were (1) **Russia reached an agreement with the European Union on its entry into the WTO** (after doing the same with the US just one month before); entry is now expected within 6 months; (2) **PepsiCo announced that it will pay $3.8 billion for 66% of Wimm-Bill-Dann**, the largest milk product and juice producer in Russia (with an option to buy the entire company for $5.4 billion); and (3) **FIFA selected Russia to host the 2018 football World Cup**. The latter two events were both announced on December 2, which may well go down as a benchmark day in Russian history.

1) Russian entry into the WTO

On December 7, President Medvedev and EU leaders signed an MOU that resolved all EU-Russia bilateral issues for Russia's WTO entry. Russia is the largest economy – at $1.3 trillion – outside the WTO and has been negotiating for entry since 1993.

The World Bank estimates that entry could **increase Russian gross domestic product by as much as 3.3%** in the medium term and a **stunning 11% in the long term**.

As noted in last month's newsletter, the last issues to be resolved were Russia's pricing policies for lumber exports and railway fees. Russia agreed to cut the timber export duty from 25% to 15% and to lower fees on Asian freight reaching Europe by train through Russia.

The EU is Russia's biggest trading partner, accounting for just over half of its foreign trade; through Q3 2010,

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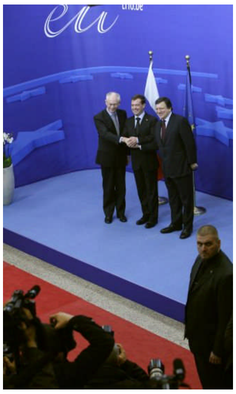
[1] Altima Asset Management created this index of 21 Russia-focused equity funds created on or before May 2005 to provide an appropriate benchmark.

[2] Risk free rate: 2.5%

their trade in goods and services increased almost 35% to $217.8 billion. Russia is also the EU's third-largest trading partner (after the US and China).
The EU sold about € 66 billion of machinery, transport equipment, food and live animals to Russia last year and bought € 115 billion Russian goods, three-fourths of which consisted of energy and minerals.
Certain multi-lateral issues remain to be ironed out before Russia can enter the WTO, mainly conditions for trade-related investment, health rules on food imports, over-flight fees and intellectual property rights. The best current estimates are that Russia will actually join the WTO mid-way through 2011.



WTO entry will give an almost immediate boost to the Russian economy, as it would remove certain export barriers (especially for the steel industry which would see quotas disappear altogether) and prompt credit-rating agencies to raise Russia's sovereign-debt grade, which most analysts believe is long overdue.
Perhaps most importantly, WTO entry would improve investor attitudes toward Russia. **BofA Merrill Lynch** wrote in a research note, "As a WTO member, Russia will have to import rules and regulations that will open up uncompetitive sectors to non-residents, thus improving overall business environment, increasing production and leading to structurally lower inflation". In another research note, **Citigroup** stated that "foreign companies already operating in Russia could accelerate their investments as business confidence improves". Finally, **ING Group** stated that "WTO accession could improve investors' sentiments toward Russia."
However, the biggest sticking point may be reaching an agreement on its WTO accession with Georgia, which is already a member. The former Soviet republic has threatened to block Russia's entry if Russia fails to lift a four-year-old economic embargo. Georgia says Russia cannot join the WTO because of its support of two breakaway regions of Georgia, after their war in 2008, which deprives Tbilisi of control of customs points on its internationally recognized frontier where it would like to post customs officials. Under the WTO's system of decision by consensus, Georgia has an effective veto over Russian membership. It is allowing negotiations to proceed informally but is blocking formal steps. Georgia has said it is prepared to discuss Russia's bid to join the WTO.

EU-Russia Free Trade Zone

In a related development, on November 26, Prime Minister Putin proposed a free trade zone with the EU that would stretch "from Lisbon to Vladivostok" and would be worth trillions of euros; he also pushed for visa-free travel between Russia and the EU.
Putin said that improved bilateral ties should seek to encourage a "new wave of industrialization" for Europe by creating "strategic alliances" in the car industry, shipbuilding, aviation, space technologies, pharmaceuticals industry, nuclear power and logistics. He also again stressed the need for a common energy market.
While there have not been – and may not be – concrete results from this initiative, it is noteworthy that it was Russia that took the first formal step to try to establish such a free trade zone and not vice versa.

2) PepsiCo's $5.4 billion bid for Wimm-Bill-Dan

PepsiCo announced that it will acquire a controlling stake in **Wimm-Bill-Dann**, the largest juice and dairy producer in Russia, and will become the biggest food and beverage company in the country. As a result of the deal, Pepsi will have 49 manufacturing facilities and employ over 31,000 people in Russia, the Ukraine and Central Asia. Zein Abdulla, chief executive of PepsiCo Europe, stated that the business will be "the crown jewel of PepsiCo Europe." Russia will be PepsiCo's biggest market outside the United States.
PepsiCo will initially pay $3.8 billion for 66% of the company and will have an option to buy the rest of the company later for a total of $5.4 billion, a 32% premium over the value of Wimm-Bill-Dann shares on the day the deal was announced. (Interestingly, Wimm-Bill-Dan was valued at $2.6 billion when **Danone** sold its 18.4% share in October for $470 million. Danone sold that stake to comply with antitrust laws so it could acquire **Unimilk**, another Russian dairy company.)
This transaction is **the largest in Russian history outside of the oil and gas sector** and shows the tremendous confidence in Russia that experienced players are showing more and more interest and commitment.
Wimm-Bill-Dann was the last major independent player in the market after Pepsi's acquisition of **Lebedyansky** in 2008 and **Coca-Cola**'s acquisitions of **Nidan Soki** earlier in 2010 and **Aquavision** in 2007. The Russian juice market is now effectively divided between the two US rivals.

Pepsi co-founder Donald Kendal, now 90, attended the announcement ceremony. Mr. Kendal conducted a taste test for Soviet Premier Nikita Khruschev in Moscow in 1959, the first time Pepsi was drank in Russia.
In a related announcement, PepsiCo said it is setting up a $250 million "ecosystem" of farming and production in the southern Russian city of Azov, opening a new potato chip plant and laying the cornerstone for a beverage plant. The chip factory cost $110 million and will produce Frito Lay brand potato chips. The Azov beverage plant is expected to open in 2011 after a $140 million investment. The two plants will eventually employ over 1,000 people.

3) Russia's winning 2018 World Cup bid

FIFA announced that Russia's bid to host football's 2018 World Cup won. The announcement drove the biggest bond rally in five months for Russia's largest steelmakers since the government plans to spend at least $9.6 billion on stadiums and expanding airports and roads.
In addition to the direct economic stimulus, the award provided a major boost to Russia's growing acceptance in the world community and confidence in its long-term stability.
Construction and transportation companies are expected to directly benefit from the construction boom that preparations will cause. As Chris Weafer, chief strategist at UralSib Financial Corp., noted, "It's a boost for

Russian equities, bonds and the Russian investment case. The news is very good as it sets down a specific six-year timeline for Russia to complete its infrastructure program."

Net Impact for 2011: more than 30% growth in equity prices

The fundamental strength of the Russian economy, combined with the many recent positive developments, of which the three described in detail above are only the most dramatic, led **HSBC Global Asset Management to make Russia its biggest overweight position in emerging markets**, predicting 2011 returns in **Russia would outstrip the 10-30% gains** it expects from broader emerging equities.

Obviously, HSBC is far from the only company that believes this as, on 1 December 2010, **Mubadala Development**, the **investment arm of the Abu Dhabi government**, said it will make a **$100 million investment with Russian hedge fund** Verno Capital, its first in Russia. As Chief Executive Khaldoon al-Mubarak wrote in an e-mailed statement, "Russia's recent economic performance and the future potential for the broader region make it an exciting new market for Mubadala." Dmitry Kryukov, CIO of Verno said that "Mubadala may add to its investment, which is also the first by a sovereign wealth fund from the Middle East in a Russian-focused equity fund and is a vote of confidence and a signal to top emerging market investors around the globe."

Industrial Production and Manufacturing Accelerate

Russian industrial production increased at an annual rate of 6.6% in October, after a 6.2% advance in September, led by the production of cars, trucks and other manufactured goods. **New sales of passenger cars and light vehicles jumped 62% in October** from the same period last year to 188,478. Manufacturing output rose an annual 9.9%, with **truck production increasing 97%**.

Russian Stocks Cheapest in the World

As the Bloomberg article attached to October's Fact Sheet stated: **"The [Russian ruble-denominated] Micex [index] is valued at 6.8 times profit forecasts for the next 12 months, the lowest level among 59 world stock indexes tracked by Bloomberg and about half the global average of 12 times."**

Despite recent price growth, **Russian stocks are actually getting even cheaper** after Russian companies posted record profits that **topped analysts' estimates by the widest margin in emerging markets**.

MICEX Index companies reported combined earnings of 178 rubles a share ($5.70) during the past year, the most since 2003 and 29% above the average of about 400 analyst estimates. **While the MICEX advanced 13% in the past year, its valuation fell 31%** because Russian equities failed to match growth in earnings estimates caused by oil prices increasing to almost $90 a barrel.

Maarten-Jan Bakkum, an emerging market equity strategist in The Hague at **ING Investment Management**, which oversees about $100 billion in developing nations, said that "**Russia really stands out as being cheap and attractive**. Investors will increasingly be looking for emerging economies that can still improve. For Russia, there should be some room for improvement."

For instance, **Gazprom**, the country's largest listed company, trades at **4.3 times 2011 profit estimates**, compared with **10 times for PetroChina**, the biggest Chinese energy company. **The discount on the gas export monopoly compared to PetroChina has actually increased from 50% to 58% since the beginning of 2010**.

Sberbank trades at a 60% discount to India's ICICI Bank, compared with 38% at the end of 2009.

Jim O'Neill, who helps oversee about $820 billion as chairman of **Goldman Sachs Asset Management** and coined the term BRICs in 2001 to describe the four biggest emerging markets, said **"If I look at the forward PE, for Russia it's really cheap."**

In 2010, MICEX companies beat analysts' estimates by 29%, while earnings in the MSCI Emerging Markets Index surpassed forecasts by 5.7%. Companies in the

	Brazil	China	India	**Russia**
Difference from Analyst Estimates	+1.5%	-2.4%	+7.7%	**+29%**

Hang Seng China Enterprises Index trailed projections by 2.4%, profits in India's Bombay Stock Exchange Sensitive Index topped estimates by 7.7% and Brazil's Bovespa Index exceeded expectations by 1.5%.

Jonathan Garner, the chief Asia and emerging markets strategist at **Morgan Stanley** in Hong Kong, wrote in a Nov. 8 report that **Russia has the cheapest stocks among major developing nations**, based on 10-year reported earnings, a valuation measure designed to adjust for economic cycles. ING's Mr. Bakkum also that that **Russia "is probably the cheapest market among global emerging nations" and recommends an "overweight" position in Russia**. "A lot people are prepared to buy Russian assets," he said.

Ballmer Vows Millions for Skolkovo

Microsoft CEO Steve Ballmer signed off on a plan Monday to join Russia's Skolkovo innovation hub, which could see Microsoft invest **tens of millions of dollars** in the project and Russian tech ventures.

Ballmer signed an MOU with billionaire Viktor Vekselberg, whom President Dmitry Medvedev has tasked with overseeing the project and attracting big-name foreign investors. **Cisco Systems agreed in June to invest $1 billion over a decade** in the project.

"The timing could not be better," Ballmer said, "the **opportunities [in Russia] are fantastic**. That's why we're here." Microsoft will make five major contributions to Skolkovo, each totaling tens of millions of dollars annually and will offer 100 new Russian companies anywhere from $50,000 to $500,000 a year to get started. It will also start an R&D center at Skolkovo to work on mathematics-heavy technical computing. The company may use Russian firms as subcontractors and sell the end product outside of Russia.

And Nokia does the same…

In November, **Nokia also signed an MOU to open a research facility at Skolkovo**. Esko Aho, Nokia Executive Vice President and board member, said there that the "knowledge-intensive ecosystem that is being designed at Skolkovo" would suit Nokia's development needs. Victor Saeijs, CEO of Nokia Eurasia, said Russia will now join Europe, India and China as key sites of Nokia intellectual activity and will be the eighth country where the company has such a center.

Goldman Sachs says Balanced Budget Possible in 2011

Goldman Sachs Group is of the opinion that Russia will balance its budget in 2011, four years earlier than the government itself estimates and post a surplus in 2012 as oil prices rise. Clemens Grafe, a Moscow-based economist at Goldman Sachs, said in an e-mailed report that the Russian economy will grow 5.3% next year and 5.6% in 2012. Goldman feels that oil futures will average $100 a barrel in 2011 and $110 a barrel in 2012. Oil currently trades at just under $90.

$14Bln Plan for Far East Railroad

In the continued development of Russian infrastructure pointing east rather than west, Prime Minister Vladimir outlined plans for a multibillion-dollar extension of the Trans-Siberian Railroad to boost commodities production and investment in the Far East. The project will cost an estimated $14 billion.

Company News

Gazprom and **Bulgarian Energy Holding** signed an agreement on forming a 50-50 joint venture that will build and operate the stretch of the **pipeline running though Bulgaria**. The venture will be registered in Bulgaria by the end of the month.

Through the South Stream project, Bulgaria will receive almost € 2.5 billion for the pipeline alone. The € 20 billion South Stream project is run by **Gazprom** and **Italy's Eni**. Bulgaria became the eighth country to sign on to the 900-kilometer South Stream pipeline, following Austria, Croatia, Bulgaria, Serbia, Hungary, Greece and Slovenia.

In a final move showing the friendship between the two countries, Bulgarian Prime Minister Boyko Borissov gave Putin a Bulgarian shepherd puppy.

X5, Russian biggest food retailer by sales, reached an agreement to buy rival **Kopeika** in a deal worth $1.65 billion. It will be financed solely with cash and debt. Kopeika has 591 stores, including 33 franchises. Kopeika was also seen as a takeover potential target for U.S. **Wal-Mart**. Russian retail sales grew 2.9% in October over September.

VTB, Russia's second-largest lender, said it generated **more profit than estimated** in Q3 after a loss a year earlier as economic growth fueled loan demand. **Net income reached $468 million**. The bank posted **record profit of $1.2 billion** for the first nine months of 2010, compared to a loss of $1.5 billion during the same period last year. VTB also issued guidance for significant profit growth next year, up from estimated net income of $1.7 billion this year as lending increases.

Russia's financial sector has recovered from the 2008-09 economic crisis and is approaching the industry's 2007 record profitability of $17 billion.

Russia Car Sales rose 80% in November, the most in two years, as the economy rebounded. Sales of automobiles and light trucks reached 189,902 vehicles last month, pushing the year-to-date total to 1.7 million, or 28% more than for the same period last year. Sales may reach 1.9 million units this year, significantly above any previous forecast

Foreign carmakers including **Volkswagen AG**, **Ford Motor Co.** and **Toyota Motor Corp.** are increasing output in Russia and rolling out new models as the country's economy expands.

Sberbank said that its Q3 net income was up 10-fold as it boosted lending and decreased the share of bad loans. **Net income rose to $1.5 billion** from $120 million a year earlier.

Russian bank lending to individuals has increased eight straight months, while loans to companies have climbed seven. Total corporate loans increased 8.9% in Q3 to $140 billion. Loans to individuals increased 3.9% to $80 billion during the same period.

Coal exporter **SUEK** opened a new office in Tokyo to expand its sales into Asia. The Pacific region has become an increasingly important market for Russian thermal and coking coal because demand there, led by China, has boomed, while Russia's traditional key market in Europe has stagnated. SUEK has invested heavily in building its own port at Vanino in Muchka Bay on the Pacific coast that it will expand again in 2011 to boost Asia sales. **SUEK currently exports about 12 million tons of coal a year** through three different ports in the Far East into the Pacific region, primarily to Japan, China, South Korea and Taiwan.

The new Tokyo office is part of the expansion in the pacific region by SUEK, which opened Beijing and Seoul offices earlier this year in addition to the existing Taipei and Jakarta offices. This expansion will be completed in 2011 with the opening of an office in India.

Iron ore miner **Metalloinvest will supply 2 million metric tons of ore, worth about $320 million, to Baosteel, as the Chinese giant diversifies its supply sources**. Baosteel, China's second largest steel producer, traditionally buys from global leaders such as VALE, Rio Tinto and BHP Billiton.

Sukhoi Civil Aircraft Company won a **$300 million order from Orient Thai** for 12 of Russia's first major passenger planes since the collapse of the Soviet Union. Sukhoi agreed to deliver 12 of the mid-range Sukhoi Superjet 100 airliners before 2014. Orient Thai plans to use the aircraft on domestic flights, gradually replacing its current fleet. Delivery of the first two planes is planned for November 2011. The Russian 98-seat planes will replace U.S.-made, 172-seat MD-80s and MD-90s. Sukhoi is competing with **Bombardier** and **Embraer** in the regional carrier sector.

Intourist, the face of Russia for foreign visitors from Soviet days to the present, and **Thomas Cook**, Europe's second-largest tour operator, signed a $45 million agreement to create a joint venture. Thomas Cook will get a 50.1% stake in the newly established company by paying $10 million in cash and the remaining $35 million in its own shares. The new venture will operate under the Intourist brand. Thomas Cook's CEO Manny Fontela-Nova said that "the move into Russia is in line with our established strategy of capturing growth in emerging markets. I am glad we have taken our time to secure a strong partnership. We think that Russia is a very attractive market. Within the next **five to 10 years Russia will become Europe's biggest market**."

The joint venture has some grand plans in mind, hoping to take leadership positions in both domestic and international travel.

Thomas Cook, which has $14.9 billion in revenues, is planning to diversify its business by moving away from Europe's saturated market through the purchase of Intourist's tour operator and retail business. In exchange for access to the Russian market, Intourist, with $324 million in revenues, wants to tap into Thomas Cook's

European clientele. The new venture is hoping to revamp Russia as a tourist destination by launching a new marketing campaign and introducing new products.

Magnitogorsk Iron & Steel Works spent $129 million on a steel mill that it opened near St. Petersburg to meeting surging domestic car sales. The company is already planning on spending another $120 million to expand production.

Severstal announced that **net income nearly doubled to $368 million** in Q3 from the previous quarter, allowing the country's largest steelmaker to resume dividends halted during the crisis. 2010 revenue through September increased by 43% to reach $11.3 billion, while **EBITDA skyrocketed 416% to $2.2 billion.**

Severstal reported it saw almost double-digit growth in prices and production volumes across all key product lines in the first nine months of 2010, with coal sales increasing by 36% and iron ore pellets growing 19%.

Ironically, the only dark spot in Severstal's earnings was in its **North American division**, which reported negative EBITDA of $59 million for Q3 quarter because of lower prices, higher raw material prices and its Sparrows Point plant idling.

Nissan announced that it will buy 10% of **AvtoVAZ** at an estimate price of $240 million. According to CEO Carlos Ghosn, Nissan and **Renault** intend to take a majority stake in Tolyatti-based AvtoVAZ, the maker of Lada vehicles, after Renault bought 25% in 2008. Renault paid $1 billion for its 25% stake and it is upgrading AvtoVAZ's plant to roll out new models in 2012 under all three brands.

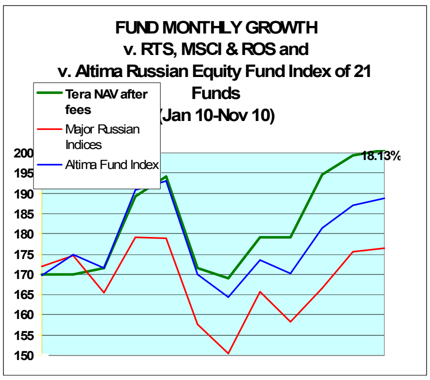
Tatneft will start sales by early next year from Russia's **first new refining complex** since the collapse of the Soviet Union, as it doubles capacity. The goal of the **$9.5 billion** project is to raise the price of the Urals crude export blend by removing lower quality oil from pipelines and refining it domestically.

Russia

Russian markets moved essentially sideways the entire month of November as recent market gains and continued uncertainly regarding European sovereign debt and the US economy left traders unsure as to which way to move. From a technical standpoint, it was reassuring to see a solid "bottom" put in as the market was almost never down for the month – and was never up more than a couple percent. There was tremendous news for Russia itself, but international news dampened – or perhaps more accurately delayed – the impact on stock markets.

Tera November Performance

Tera's NAV broke through the $200 level for the first time since before the crisis. It outperformed the Russian market indices by a small degree and under-performed the Altima Russia Fund Index Average by a small degree as well – but none of the differences were material. YTD, however, Tera has still outperformed the markets by almost 15% and the Altima Russian Fund Index by 7%, as you can see in the above graph. Also, the gap between Tera and the indices and other funds in terms of volatility and Sharpe Ratio continues to increase as Tera's performance is both better and more stable than these two benchmarks.



After several months of relative stability, there were some significant changes in Tera's sector allocation in November. The telecoms sector doubled to 6% while the FMCG, industrial, financial and "other" sectors all fell 1%. Oil & gas increased for the first time this year to 35% of the portfolio – a record. Physical gold (held by one underlying fund in lieu of cash) increased from 2.5% to 3.5% of the overall Fund.

The main drivers behind these moves are the general economic recovery, the tremendous potential for growth in the Russian economy in 2011 and the anticipated increase in commodities prices as the global recovery from the 2008-09 economic crisis gains strength.

Underlying Funds

The performance of Tera's underlying funds was more varied than usual, with the worst-performing dropping 3% and the best-performing up by the same amount. Half of Tera's underlying funds rose in the 2% range. There were no major investments in or reallocations among underlying funds in November.

Other Russian Funds

While all but five of the funds in the AAM Russian Fund Index were up in November, only three were up more than 3% and half were up less than 2%. Those that fell, however, fell rather significantly: an average of over 3%. In general, however, the performance range was quite narrow. Eliminating outliers, the range was from -3% to +3%.

December First Look

We have been predicting an end-of-year rally for several months now and, at first glance, we got it at the beginning of December, with Russian stock indices up just over 10% at one point. However, we feel that this was more a "relief rally" due to yet another "recovery" after European debt concerns and a reaction to the tremendous news described above that appeared at the very end of November and very early December. Unfortunately, the rally was quite narrowly focused and did not spread to the general market as much as we would like: our underlying funds are up about half of the market. However, we do not believe that the good news is all behind us and would look to see further progress in the second half of December – although perhaps a bit more broadly based – which would make December a truly excellent month.

Fund Awards

No. 1 ranked fund of funds in the world for **March 2010**	No 8 ranked fund of funds in the world for **2009**

Contact Information

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E X C E R P T E D F R O M :
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Investing in a Russian Fund of Funds

TIMOTHY ENNEKING, ALTIMA ASSET MANAGEMENT

TIMOTHY ENNEKING has lived and worked in Russia since 1994. Prior to founding Altima Asset Management and the Tera Capital Fund, he was a Director of two diversified private equity funds, one founded in 1996, and the second created in 2005 by splitting the original into two funds, with approximately $50 million under management.

As Vice President for Mergers and Acquisitions of a major European company, Mr. Enneking has conducted analyses of approximately 1,000 companies throughout Europe, and he was the Principal on transactions totaling over $8 billion over the past 12 years. Mr. Enneking holds an undergraduate and three graduate degrees in international business and law, including one post-doctoral degree. He also holds a graduate degree in international security studies. He has taught in English, Russian and French in various undergraduate and graduate business schools in the U.S., France and Russia.

SECTOR — GENERAL INVESTING

(ABT506) TWST: What was the impetus behind the founding of Altima Asset Management?

Mr. Enneking: When we were thinking about setting up a fund, we realized that the successful existing funds all have relatively large entry fees. Six years ago, although Russia was wealthy, the wealth hadn't trickled down that much, so there weren't a lot of people who could toss around $5 million to go in a fund. They didn't have a half a million or a million dollars to go in a fund, although these funds were earning 30%, 35%, 40% a year. I was managing P.E. funds and decided to research fund of funds. I realized that we could gather $100,000, $500,000, a million or more dollars from various people and instantly we'd have a lot of diversification across a whole range of funds with a much smaller amount of money. That is what lead us to set up Altima.

TWST: What is the Tera Capital Fund?

Mr. Enneking: Tera is a fund set up on the Cayman Islands. It's the only fund that Altima Asset Management manages. It is a fund of funds that only invests in funds that primarily invest in Russia. I am told there are no other country-specific funds of funds in the world that invest in another country. In other words, in United States, you will find U.S. fund of funds; in Japan, you will find Japanese fund of funds. You will find others in Europe, where you have a French fund of funds that invests in France; you have funds of funds in Europe that invest in the EU, etc. But Tera takes money mainly from Western investors and invests it in another and, as a far as we know, it is the only fund in the world that invests in a single country. And we're definitely the only fund of funds that invests in Russia.

Highlights

Timothy Enneking provides an overview of the Tera Capital Fund, which invests in funds that primarily invest in Russia. He points to Russia s market size, increasing growth rate and large foreign currency reserves to placate investor fears. Altima manages the risk of investing in Russia by making transactions in U.S. dollars and diversifying geographically, by market capitalization, and by type of stocks and sectors, including FMCG, energy, heavy industry, manufacturing and, recently, agriculture. Mr. Enneking points to corruption in Russia as the major reservation many investors have, but reminds investors that Russian corruption is standardized and does not prevent investors from making money. The Tera Capital Fund generated returns of 35% annually for three and half years and continued growing at 17% annually during the 2008-2009 economic crisis. He credits his Ride It Out strategy for obtaining favorable returns during the crises.

TWST: What is a fund of funds?

Mr. Enneking: Fund of funds means that investors invest in Tera by purchasing shares, and with that money Tera invests in other funds.

TWST: How would you describe your investment philosophy and what is the strategy you use to implement that philosophy?

Mr. Enneking: Our goal is to maximize diversification and minimize risk. That's really the strategy and almost the tactics as well of what we do. Tera is diversified at several different levels. Even in a country like Russia, you have geographical diversification because you have Moscow versus essentially the rest of the country. Tera also diversifies in terms of strategy and market capitalization, in terms of whether funds invest in blue-chip stocks, second-tier stocks, third-tier stocks or other types of stock. We have radically different sector diversification compared to all Russian indices and almost all other Russian funds. The RTS, the Russian Trading System, is the main dollar-denominated index in Russia. Between 65% and 75% is invested in oil and gas, and oil and gas infrastructure. Tera is 15%, 20% or maximum 40% invested in that sector. Our sector profile is radically different from the sector profile of almost all other funds and all indices. An interesting statistic that results from this is that 80% of equity investments in Russia is made in just 20 stocks.

"Our goal is to maximize diversification and minimize risk... Even in a country like Russia, you have geographical diversification because you have Moscow versus essentially the rest of the country. Tera also diversifies in terms of strategy and market capitalization, in terms of whether funds invest in blue-chip stocks, second-tier stocks, third-tier stocks or other types of stock."

TWST: You mentioned your oil and gas holdings. What are the other sectors you invest in?

Mr. Enneking: After the 2008-2009 financial crisis, we expanded our oil and gas holdings in early 2009 for obvious reason. Oil had fallen to $33 and it was good time to buy, so we did. The other sectors we track are FMCG, energy, heavy industry, manufacturing. We sometimes add new sectors. For instance, this month we began discussing adding agriculture as a separate sector, because although agriculture was destroyed here after the revolution when it was collectivized, now 20 years after the Soviet Union broke up the agricultural sector has begun to get its act together. And now we are starting to see larger companies and some vertical integration. For example, we are seeing juice companies and milk producers buy farm, processing plants and other infrastructure in the sector.

TWST: How do you manage risk?

Mr. Enneking: We manage risk in a lot of different ways. First of all, structurally, we do virtually nothing in Russia. The management company is located outside of Russia, the fund was formed outside of Russia. The underlying funds were also formed outside of Russia — their auditors, their administrators, their banks, everything possible — is outside of Russia. Although I'm not particularly worried about many types of risk inside the country because we understand the institutions in Russia and we can do things effectively and with little risk here, investors may not see it that way. So for the sake of the investors, we developed all of Tera's infrastructure outside of Russia. Secondly, we're denominated in dollars. Even domestically, there is very little currency risk in most companies, because the export-based economy is almost entirely denominated in dollars. One of the two major stock exchanges is denominated in dollars; the other is in rubles. A lot of our underlying funds trade Russian equities through ADRs and GDRs in London, New York, Hong Kong, etc. Those funds are all denominated in dollars and much B2B business is denominated in dollars, although paid in rubles. So we've deliberately structured the fund so that there very little ruble exposure.

In terms of trading risk, we minimize that by diversify in the various ways we just discussed about. Taken together, all of these approaches have a tremendous risk-reduction effect. After almost six years, you can see that clearly because our Sharpe ratio, a measure of risk versus return, is almost four times higher than the Sharpe ratio of the index average over the last 12 months, and over twice as high as the Russian fund average.

TWST: You have about 5% cash right now, but some of that is in physical gold. Why do you hold physical gold?

Mr. Enneking: Actually it is one of our underlying funds that owns the gold. We don't like to have much cash at all in the fund, and 5% is really quite high for us. In reality, we have less than 3% cash, if you exclude the physical gold in that underlying fund. Because Tera is a fund of funds, we have to add up the cash in each underlying fund and then add Tera's cash to the total as well. So there's a bit of math involved for what percentage of your fund is actually in cash. Although it wasn't our decision, the decision of one underlying fund to invest in physical gold is an excellent illustration of the kind of diversification an investor can achieve in a fund of funds, which is impossible through a single fund.

"Although I'm not particularly worried about many types of risk inside the country because we understand the institutions in Russia and we can do things effectively and with little risk here, investors may not see it that way. So for the sake of the investors, we developed all of Tera's infrastructure outside of Russia."

TWST: Why did you decide to make Russia the focus of your fund?

Mr. Enneking: I had been working here for a long time and when my partner Alexander Polykovskiy and I had the initial idea, we first considered Western and/or Eastern Europe. Then we decided that given how rapidly markets were evolving, we did not want to invest in a market we didn't live in or know very well. If you do, you can't wake up in the morning, sniff the air and get a feel for which direction things are moving. So we quickly decided that we could read analysts' reports like everybody else about Bulgaria, Romania, the Czech Republic, Hungary and everyplace else, but we really had no competitive advantage in that regard. We decided to focus on what we knew, and obviously we know this place better than the vast majority of people. I'm probably one of the longest established foreigners in Russia at this point in time.

"This place is skyrocketing and it's going to continue. Even the IMF, which is rather pessimistic, has Russia growing at 5% a year for as far out it predicts. According to the IMG, Russia's GNP will grow by 60% over the next five years and become the eighth largest economy in the world. In fact, it's already become the biggest consumer nation in Europe."

TWST: What are the major trends in Russia?

Mr. Enneking: When we decided to invest in Russia, we knew that it was taking off and that it is going to explode economically. This place is skyrocketing and it's going to continue. Even the IMF, which is rather pessimistic, has Russia growing at 5% a year for as far out it predicts. According to the IMG, Russia's GNP will grow by 60% over the next five years and become the eighth largest economy in the world. In fact, it's already become the biggest consumer nation in Europe. Russians consume more than Germans, but there are almost twice as many Russians as there are Germans. So although this has been a capitalist country now for 20 years, it still needs almost everything. Moscow has almost all the consumer goods you could ask for, but in some places in Russia you need virtually everything and in most cases you need a lot of it.

TWST: Is corruption a problem?

Mr. Enneking: The single biggest problem I suspect in Russia is corruption. Let me talk, address an initial observation, however. While corruption, lack of an independent judiciary, little independent media, etc., are all problems — and actually they are quite serious problems — they have not prevented, are not preventing and will not prevent investors from making a lot of money in Russia. That's the first point. To an investor, one of my first my responses when this issue is raised is, rather bluntly, "So what? It doesn't prevent people from making money here. It prevents them from making even more money." For instance, before the crisis, Tera had been generating 35% annually for three and half years. With the crisis, its annualized rate of return fell to about 17% annually. Without corruption, I suspect, we'd still be making 25%, 30% annually. Corruption is a major menace here, but it doesn't mean you can't earn very good rates of return.

One of the things I find really ironic is that investors have less fear of investing in China, which is a communist country and has a tradition of corruption going back thousands of years, than investing in Russia. Yet by any reasonable standard, Russia is both a capitalist and a democratic country — although perhaps an imperfect one — yet people are still more afraid of it. One of the terms Altima has copyrighted that reflects this is "fear arbitrage." Investing in Russia, notwithstanding many people's fear of it, is arbitraging fear.

Let's say I took a blank sheet of paper, and on that sheet of paper I put the macroeconomic statistics about some single, unidentified country, third largest foreign currency resource in the world, half a trillion dollars, 143 million people who are now making $10,000 a year; and in five years, the IMF says that they will be making $18,000, an 80% increase in personal income, a 60% increase in GNP over five years in a primarily export-based economy where much of that income is virtually guaranteed in long-term contracts. The finance minister of which at the October annual World Bank/IMF Conference in Washington, D.C., was designated as the most successful finance minister in all of Europe, which nowadays is almost 60 countries. The average annual growth of this country for the six years prior to the crisis was 6%-7%, and the growth of which even the IMF says for the next five years will be around 5% — which most people think is a low estimate.

Lastly, the p/e ratios of this country, according to Bloomberg, are the lowest of the 59 largest markets on the planet Earth. If I were to describe that country to any financial adviser that you and I have ever met, they would look at us and say that it is a screaming buy, that they had to invest in that country and that they'd be crazy not to invest in such a place. It goes on. Mortgages as a percentage of GDP in the United States is 80%; in this particular country, it's 3%. All indebtedness added together — governmental, federal, state and local, corporate and personal — in the United States is about 270% of GDP. In this particular country, it's 49% of GDP. So there are no debt concerns with respect to this country. And guess what, it could repay almost all of its debt tomorrow in cash because of its cash reserves. So here is this country that is just an amazing place, and people are saying, "Get out of my way, I want to be in." Then you add just one little word to this piece of paper and everybody goes nuts and starts retreating. The word you added is "Russia."

"To an investor, one of my first my responses when this issue [of corruption] is raised is, rather bluntly, 'So what? It doesn't prevent people from making money here. It prevents them from making even more money.'"

So we coined the term "fear arbitrage," because arbitrage is taking advantage of different levels of information, knowledge, etc., in different places. People who are in Russia know you can make incredible amounts of money here, but people who are outside of Russia don't realize that or think you can only do so dishonestly. Why? Because of all the negative news they've heard about Russia, and so they are afraid of it. Consequently, investing in Russia is a fear arbitrage play because the people who know what they are doing and who know Russia aren't afraid of it, and the people who don't know Russia or don't know what they are doing here, are.

One of the reasons for fear arbitrage is yellow journalism. You rarely hear or read positive stories about what is happening in Russia. How is it possible that the largest country in the world in terms of geographic area, with a 143 million people — almost half the population of the United States — the eighth largest economy in the world, soon to be the seventh, never has anything good happen to or in it? It's totally absurd. So if you look closely at the media coverage of Russia, it's not that the stories are inaccurate, it's that almost no good news is ever reported. And virtually everything that is reported has a negative slant. There is almost positive news at all to overcome the negative. The best example of this I can give you is a CNN report several years ago the point of which was announcing that the opposition could not get the word out about its platform, candidates, etc., to Russians. As the reporter was explaining this, the viewers saw a video of some guy from Yabloko party, which was one of the major opposition parties at the time, standing outside a metro exit handing out flyers. He probably handed out 150 flyers during the commentary. The reporter obviously had no idea what Yabloko was and had no idea he was showing a video that completely contradicted everything he was saying. The anchor then went to address the election of the prime minister in Russia, saying that it would not be a fair election. But a prime minister is never elected. Ministers are appointed. That's why they're called "ministers." There is no such thing as the election of prime minister in any parliamentary system of government that I'm aware of. It's nonsense. In terms of the media, correspondents rarely read, write and speak Russian, so unfortunately what you often get is a distorted view, sometimes intentionally and sometimes nonintentionally, of Russia and what's really going on here.

Returning to your question, corruption is indeed a big problem, but it is a problem in a different way than one might think. Corruption here is endemic. For instance, if you have somebody who is corrupt in the United States, they generally have to be quite careful. It's rather unusual behavior, although certainly not unheard of. Here, it's far more standardized, industrialized and happens quite smoothly. Everybody has got their mechanisms worked out. Nobody is particularly worried about running into any issues or difficulties. It's quite institutionalized and well run, and strange as that may sound when talking about corruption. My theory is that corruption is more prevalent in this culture in particular because under communism people had to have two faces. They had to find ways to survive while singing the praises of communism, all the while knowing it didn't work.

"If you look closely at the media coverage of Russia, it's not that the stories are inaccurate, it's that almost no good news is ever reported. And virtually everything that is reported has a negative slant. There is almost [no] positive news at all to overcome the negative."

However, democratic institutions are slowly beginning to form here, and the relaxed attitude is beginning to change. There is also a supply and demand for corruption. As Prime Minister Putin pointed out recently, corruption is a two-way street. There are the people seeking bribes, and there are people giving bribes. If you pay public officials a decent wage, they won't be as likely to seek out bribes. Likewise, if companies simply refused to pay bribes, that would help eliminate the problem, although the transition would be a tough one because many things would just freeze for a while.

"Tera doesn't really invest in funds, it invests in managing teams. That's the first thing. Second, we obviously want the performance of potential underlying funds to be at least as good as ours, and that's actually getting quite hard as Tera's performance is so much better than most funds."

If you ask a Russian, he will tell you that you'll never drive corruption out of this culture. I think that's mainly due to the fact that that's all they've ever known. If you look at it a little bit from the outside, we are already seeing some small positive trends. The biggest problem of corruption of course is the larger payments, larger kickbacks, etc., and those are going to be more difficult to eliminate even with greater corporate transparency. In fact all major corporations in Russia have to file financial statements according to international accounting standards. The audits that take place now are often conducted by the big four accounting firms, which are enormous here. Further, all of the IPOs that have been and are being completed mean more corporate transparency and that those companies at least are more accountable. So corruption, yes, it's a huge issue. However, there are attempts to mitigate it like never before, so we'll see. Has there been a lot of progress yet? No, because most of these measures are quite recent.

TWST: Tera Capital Fund is ranked the number one performing fund of funds in the world out of 2,468 by Eurekahedge in terms of year-to-date performance through the end of October 2010. What is it about your selection process that has given you this advantage?

Mr. Enneking: I'll give you the quantitative reasons, then I'll give you the qualitative ones. The quantitative reasons are that on the management teams of the funds in which we invest there must be at least one key member who has now survived two crises. We managed through the 1998 crisis, although in different capacities, and we managed the 2009 crisis successfully. On a related point, Tera doesn't really invest in funds, it invests in managing teams. That's the first thing. Second, we obviously want the performance of potential underlying funds to be at least as good as ours, and that's actually getting quite hard as Tera's performance is so much better than most funds. The fund average that we publish consists of 21 funds. It was 29 before the crisis, eight closed during as a result of it, so there are 21 left.

There are very large funds in the index and very small ones. When we formed Tera, there were only at a time 29 mainly long equity, mainly Russian funds that existed. Since Tera's creation, it has significantly outperformed them.

We are also unique that Tera is one of the very few funds in the world that doesn't charge a management fee. It only charges a success fee. That notwithstanding, the management company Altima still takes 20%, and we nevertheless outperform the fund and index averages significantly. Although ultimately we look for performance, there are a number of outperforming funds that we've said "no" to for all reasons — because they are not based in Russia, because they overlap the strategy of another fund, because they are too erratic, too volatile, any number of different reasons. One fund we recently looked at has done very well, but it's recently gone through huge management changes. Another important aspect of how we invest is that we know all of the investment managers. We have known some of these for 10, 12 years. That's probably the biggest intangible factor that really has an impact on Tera's performance.

TWST: You've mentioned several issues that set you apart from other firms. What makes Tera and Altima different?

Mr. Enneking: We have two universes we compare ourselves to. We manage a fund of funds, so we have to compare ourselves to other funds of funds. And Tera invests in Russia, so we have to compare ourselves to other Russian funds and to Russian indices. Compared to all other Russian funds, we are performing extremely well. We're not the top performer all the time, but we are one of the best funds in Russia. When you look at the other universe, funds of funds, for more than five years we have been arguably the best fund of funds in the world, because Tera was number one for 2005, number eight for 2009; this year we'll probably be in the top three. So Tera does very well against various sets of metrics, if you will. But the reasons Tera does so are different depending on which universe you are talking about.

One of the major reasons for our success is really simple, almost embarrassingly so. I don't know why other people don't do country-specific fund of funds. We've been asked to do a country-specific fund of funds for China, we've been asked to do one for India, and Africa and Middle East — both for a region and for individual countries. Again, Tera is totally unique. It is the only fund of funds that focuses on Russia. It is the only fund of funds that is country specific that's not focused on the same country where it is located. It is the only fund of funds and one of the very few funds of any type of whatsoever that doesn't charge a management fee, only a success fee. If our investors don't make money, we don't take 2% of the principal. So Tera has all of those unique things going for it and because of what a fund of funds does, it diversifies, it lowers volatility, it has an incredibly high Sharpe ratio relative to virtually every other fund in the market, etc. The fund of funds mechanism by itself perfectly suits volatile growing markets such as Russia.

TWST: Is there anything you would like to add?

Mr. Enneking: Two things. First, Tera has been ranked in the top 10 in terms of annual performance 30 times since its inception. It has appeared in one of the top 10 tables — monthly performance, performance YTD and annualized performance — 69 times in the 65 months of its existence.

Secondly, I would explain that part of our investment philosophy is what we now call "RIO," or "Ride It Out." Once the 2008-2009 crisis ended, or at least wound down, we did an analysis of which funds did better during the crisis, comparing funds that tried to time the market and those that simply stayed in it. The market-timing people are those who say, "Okay, we've peaked, let's bail out now and then when things hit bottom, we'll go back in." The other type is guys who say to themselves, "I can't predict markets and I believe in the fundamentals of this market, so I'm staying in." If you look at who did better, what you discover is that there were almost no market-timing funds that got it right and many that got it spectacularly wrong. Selling in December of 2008 and January 2009 and buying back in July and August 2009 was not a good idea. That's the concept of "sell low and buy high." The funds that rode it out did far better. The reason for this in Russia is very simple. The best time to invest in Russia would have been February 25, 2009 because on February 24, the markets bottomed out. Market timers would have been shot had the even suggested investing in Russia then.

Lastly, it's important to note that Tera does not gate and had very few redemptions during the 2008-2009 crisis. The main reason for this was that at no time during that crisis did early Tera investors lose money, even on paper. The performance had been so good during the three years prior to the crisis that it offset all of the drop during the crisis. That made it much easier for Tera's investors to stick with the fund.

TWST: Thank you. (LMR)

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Bloomberg

World's Cheapest Stocks Getting Cheaper as Russian Profits Climb to Record

By Michael Patterson - Nov 18, 2010

Russian stocks, the cheapest worldwide, are getting cheaper after the nation's companies posted record profits that topped analysts' estimates by the widest margin in emerging markets.

Micex Index companies reported combined earnings of 178 rubles a share ($5.70) during the past year, the most since at least 2003 and 29 percent above the average of about 400 analyst estimates compiled by Bloomberg. The Micex is valued at 6.8 times profit forecasts for the next 12 months, the lowest level among 59 world stock indexes tracked by Bloomberg and about half the global average of 12 times.

While the Micex advanced 13 percent in the past year, its valuation tumbled 31 percent because Russian shares failed to keep pace with a surge in earnings estimates spurred by oil's rally above $80 a barrel. Equity mutual funds in the world's largest energy exporter attracted less money in the past six months than funds in the other so-called BRICs -- Brazil, India and China -- as investors favored more expensive shares in faster-growing economies, EPFR Global data show.

"Russia really stands out as being cheap and attractive," said Maarten-Jan Bakkum, an emerging-market equity strategist in The Hague at ING Investment Management, which oversees about $100 billion in developing nations. "Investors will increasingly be looking for emerging economies that can still improve," he said. "For Russia, there should be some room for improvement."

'Out of Favor'

The Micex index climbed 1.2 percent to 1,552.21 at 6:45 p.m. in Moscow, with shares of OAO Sberbank and OAO Gazprom contributing most to the advance.

Russia's economic expansion will probably accelerate to 4.3 percent next year from 4 percent in 2010, according to October estimates from the International Monetary Fund.

China's growth will slow to 9.6 percent from 10.5 percent, while the pace in India will drop to 8.4 percent from 9.7 percent, and Brazil's expansion will decelerate to 4.1 percent from 7.5 percent, IMF forecasts show.

Russia has lagged behind the other BRIC nations in luring investors. Chinese equity mutual funds attracted about $3.3 billion in the past six months, while Indian funds received $1.3 billion and Brazil got $1.9 billion, data compiled by Cambridge, Massachusetts-based EPFR Global show. Russian funds took in $637 million, the data show.

Earnings Surprises

"Russia remains relatively out of favor in an emerging markets context," said Lewis Kaufman, a money manager at Thornburg Investment Management, which oversees about $65 billion in Santa Fe, New Mexico. "If we can sustain oil prices of $80 to $100, Russian equities offer a unique combination of cyclical and structural recovery potential."

Gazprom, Russia's largest listed company, trades at 4.3 times 2011 profit estimates, compared with 10 times for PetroChina Co., the biggest Chinese energy company, according to data compiled by Bloomberg. The discount on the Moscow-based natural-gas monopoly to Beijing-based PetroChina has widened to 58 percent from 50 percent at the start of 2010, the data show.

Sberbank, Russia's largest lender, trades at a 60 percent discount to India's ICICI Bank Ltd., compared with 38 percent at the end of 2009, according to price-earnings ratios compiled by Bloomberg.

Tax Concern

"I find, opportunistically, Russia pretty interesting," said Jim O'Neill, who helps oversee about $820 billion as chairman of Goldman Sachs Asset Management and coined the term BRICs in 2001 to describe the four biggest emerging markets. "It is structurally the weakest of the four but it's not all as gloomy as people seem to be talking about," he said. "If I look at the forward PE, for Russia it's really cheap," he said in an interview in London.

While Micex companies beat analysts' estimates by 29 percent, earnings in the MSCI Emerging Markets Index surpassed forecasts by 5.7 percent, data compiled by Bloomberg show. Companies in the Hang Seng China Enterprises Index trailed projections by 2.4 percent, profits in India's Bombay Stock Exchange Sensitive Index topped estimates by 7.7 percent and Brazil's Bovespa Index exceeded expectations by 1.5 percent.

Analysts may be too optimistic in their outlook for Russian energy company profits because Prime Minister Vladimir Putin's government is likely to raise taxes on the industry to help pay for increased spending ahead of the 2012 presidential election, Alex Kantarovich, a strategist at New York-based JPMorgan Chase & Co., wrote in a Nov. 15 report.

Transparency Discount

Energy companies account for about half of the Micex Index's capitalization, according to data compiled by Bloomberg. The sector's low equity valuations are the main reason Russian shares appear cheap relative to the rest of emerging markets, said ING's Bakkum.

Russian profits may be overstated because companies have been slow to write off the value of aging machinery and factories, Kingsmill Bond, the London-based chief strategist for Troika Dialog, Russia's oldest investment bank, wrote in a report e-mailed Nov. 3.

Stock valuations for some Russian companies already reflect the "lack of transparency" in the country's financial disclosures, said Kaufman, whose Thornburg Developing World Fund has beat 97 percent of peers this year with a 25 percent gain.

The Micex index's valuation discount of about 42 percent to the MSCI All-Country World Index of global shares compares with a 24 percent average gap since January 2006, according to price-earnings ratios compiled by Bloomberg.

Magnit

Thornburg owns shares of Sberbank because of "massive" consumer deposits that make its funding stable and the potential for better-than-estimated loan growth, Kaufman said. Sberbank's deposits amount to 77 percent of assets, compared with the 55 percent average for global peers, according to data compiled by Bloomberg. The lender's per-share earnings will probably surge 87 percent next year, four times the average gain for emerging- market financial companies, analysts' estimates compiled by Bloomberg show.

OAO Magnit, the Krasnodar-based food retailer, is another Thornburg holding, Kaufman said. While the stock is more expensive than the Russian equity market at 25 times analysts' 2011 earnings estimates, it's cheaper than Beijing-based supermarket operator Wumart Stores Inc., which trades at 30 times profit estimates, data compiled by Bloomberg show.

Magnit will grow earnings by 91 percent during the next two years, almost double the 51 percent growth projected for Wumart, the data show.

'Cheapest Market'

Gazprom shares are poised to rally 34 percent in the next 12 months, according to the average of 10 analysts' share-price estimates compiled by Bloomberg. The stock has retreated 7.8 percent this year, compared with a 2.3 percent gain for PetroChina.

Russia has the cheapest stocks among major developing nations, based on 10-year reported earnings, a valuation measure designed to adjust for economic cycles, Jonathan Garner, the chief Asia and emerging markets strategist at Morgan Stanley in Hong Kong, wrote in a Nov. 8 report.

"It's probably the cheapest market among global emerging nations," said ING's Bakkum, who recommends an "overweight" position in Russia. "A lot people are prepared to buy Russian assets."

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» Print

HSBC AM says Russia top 2011 emerging markets pick

Tue, Dec 7 2010

By Sujata Rao

LONDON (Reuters) - HSBC Global Asset Management said it had Russia as its biggest overweight position in emerging markets, predicting 2011 returns would outstrip the 10-30 percent gains it expects from broader emerging equities.

Nick Timberlake, HSBC's head of emerging market equities, told the Reuters 2011 Investment Outlook Summit on Tuesday that the fund is underweight India and China and neutral on Brazil but likes South Korea and Turkey.

"We have our most significant overweight position in Russia today. Russia is our favorite market for next year," Timberlake said at the summit, held at the Reuters office in London.

"There's a strong valuation case."

He noted Russian stocks trade around 6.3 times forward 12-month earnings, compared with a five-year average of 9 times. The Moscow stock market has posted gains of almost 20 percent year-to-date, boosted by FIFA's decision to award the 2018 soccer World Cup to Russia, a rise in oil prices and Pepsico's $5.8 billion acquisition of Wimm-Bill-Dann.

The market may rise further as Russia is expected now to finally join the World Trade Organization next year, a deal that could add up to 3.3 percent to the economy.

Timberlake noted the price paid by Pepsi represented a 35 percent premium to where Wimm-Bill-Dann traded two days ago.

"This gives an idea of the value hidden in the market."

Timberlake, who manages $10 billion, also predicted overall emerging equity markets to do better next year than in 2010. They are up around 14.5 percent year to date.

"What drives the market up is: earnings, profit growth and valuations. Consensus for earnings growth is 16 percent next year ... Valuations are somewhere around average of the history," Timberlake said.

"(Expect) continued re-rating of the asset class. A 0-10 percent re-rating should be perfectly reasonable so you get 10-30 percent returns. "I'd go for around 20 percent returns."

Investors who spoke earlier at the summit also forecast the equities bullrun to continue as ample cash levels are deployed for mergers and acquisitions, dividends and capital expenditure.

Aside from Russia however, Timberlake is cautious on Brazil, India and China -- the other BRICs.

He is underweight China but likes Chinese financials, which have been shunned this year by investors on worries Beijing will continue to rein in loan growth, especially in housing.

But recapitalization has already taken place and Chinese growth is not expected to slow significantly, Timberlake said.

"So (banks) are well placed to stimulate the economy next year. There has been a bit of consolidation and that's an opportunity to add again for 2011," he added, noting the shares were also attractively valued at less than two times book value.

While Indian stocks have performed reasonably this year, with returns of around 14 percent, Timberlake said the market was too expensive, trading around 17 times forward earnings. That would make it almost three times pricier than Russia.

"India is the market we are most cautious about from a valuation point of view. Brazil too looks very expensive relative to history," he said.

The other markets Timberlake tips to outperform in 2011 are South Korea and Turkey, with the latter benefiting from strong growth and low inflation, though valuations are not cheap.

South Korea, like many other emerging markets, should benefit from the China effect, he said, citing engineering and tech stocks as posed to make gains.

"There's no inflation problem in Korea and there are many bottom-up investment opportunities. Financial companies are attractive, many of them are trading book to value and generally generating double digit returns," Timberlake said.

In terms of headwinds, he noted the euro zone crisis and the growing risk of trade protectionism in the West as the external risks. Within emerging markets, inflation is on the rise and China could be a key test.

"If you get an inflationary spike in China how would authorities react to that, it could create hard landing. It's not our central case but it's a risk," Timberlake said.

EMERGING MARKETS REPORT

Dec. 8, 2010, 2:12 p.m. EST

From Russia, with love

New openness toward foreign investment encourages deals

By Aude Lagorce, MarketWatch

LONDON (MarketWatch) — Thank you for trusting us.

Moscow International Business Center and Moskva River.

Those were the words of Russian Prime Minister Vladimir Putin to the world after his country won the right to host the 2018 World Cup last week. They were fitting for that occasion but could just as well have been addressed to the growing number of foreign firms coming back to Russia after a two-year hiatus.

For Russia is in favor again. The evidence is everywhere: from U.S. drinks giant PepsiCo Inc. (NYSE:PEP) buying a 66% stake in Russia's leading dairy and juice group Wimm-Bill-Dann Foods (NYSE:WBD) for $3.8 billion last week, to Italian bank UniCredit SpA (MILAN:IT:UCG) recently vowing to add hundreds of branches in the country, and U.K. travel specialist Thomas Cook Group PLC (LONDON:UK:TCG) entering the fast-growing tourism market with a 50.1% stake in local expert Intourist.

"There is renewed interest in Russia, definitely. But it's a return of foreign capital and interest rather than something completely new," said Roland Nash, chief strategist at Russia-focused investment bank Renaissance Capital. "There was recognition of the country's potential before the crisis. What made it attractive then is still true today."

Russia is set to become the largest consumer market in Europe within a decade. That means no global consumer-goods, financial, automobile or food company can afford to ignore it. Most are highly aware of that and had started making inroads into Russia before the global economic downturn.

But then the crisis hit, and they got cold feet.

A dramatic collapse

Perhaps because it was so hyped in the pre-crisis era, Russia saw its profile decline very rapidly as the global economy began to unravel.

"In late 2007 early 2008, you couldn't move in Moscow for Western banks and investors trying to get exposure. Then, in a matter of months, the discourse went from 'We want to put as much money in Russia as possible' to 'Give us our money back,' " Nash recalled.

From one day to the next, investing in Russia had become a big no-no.

"For two years people looked at Russia as being at risk both economically and fiscally, and they wanted nothing to do with it," said Chris Weafer, chief strategist at Uralsib.

It was an illustration, if needed, that Russia is not a country that invites moderation.

Before the turmoil, the country was growing at a fast, furious and many now say unsustainable pace, propelled by record-high oil prices. When the crash happened, it was as violent as the boom before it. The stock market plummeted, wiping more than $1 trillion off the value of Russian companies, while crude-oil prices sank 70%, the ruble weakened 35% against the dollar, and the economy contracted by nearly 9%.

Foreign investors left en masse.

In hindsight, many observers now say the sudden aversion to Russia was excessive, pointing out that its BRIC bedfellows — Brazil, India and China — didn't suffer nearly as much.

"There was clearly an overreaction. Many people misunderstood the situation on the macroeconomic side. There was a time of panic during the devaluation of the ruble when forecasts became overly gloomy," said Evgeny Gavrilenkov, chief economist at Troika Dialog.

And a rapid recovery

Reuters

Prime Minister Vladimir Putin speaks to the media after the announcement that Russia will host the FIFA World Cup 2018.

Russia's woes got plenty of coverage at the time. What hasn't, Gavrilenkov noted, has been the country's swift recovery.

After bottoming spectacularly in early 2009, Russian equities rebounded sharply to double by the end of the year. The gains have continued in 2010, with the RTS index up around 20% so far this year.

The recovery in the economy, while less dramatic, has picked up in 2010, with growth of around 4.5% forecast. Economists predict a similar pace in 2011.

"This growth rate is perhaps a bit lower than what Russia could grow at considering the current oil price, but it's OK and it's sustainable, contrary to the much faster rate seen before the crisis," said Marcus Svedberg, chief economist at East Capital.

Overall, fiscal and economic conditions have stabilized. Interest rates and inflation are at all-time lows, making it possible for small businesses and consumers to gain access to credit for the first time.

PepsiCo

A yogurt product called Bio-Yogurt from Wimm-Bill-Dann Foods.

"We are delivering balanced growth. I am not going to paint a rosy picture: There are still well-known issues with our institutions, but the growth prospects for Russia are solid, and better than for most Eastern European countries thanks to the lower debt," said Gavrilenkov.

One of the main issues plaguing Russia is corruption, both real and perceived. The country ranked 146th out of 180, right next to Zimbabwe and Sierra Leone, in a corruption-perceptions index published by Transparency International.

There is hope the government will start tackling the issue as Russia turns increasingly outward in the wake of the global financial crisis.

"There is a sense that the crisis has brought about a change of priorities. The country no longer wants to rely solely on petrodollars. It is focusing less on grandiose projects like a new financial center and more on basic things like infrastructure," Uralsib's Weafer said. "The government's program has become more realistic, pragmatic and achievable."

In the two decades following the collapse of the Soviet Union, Russia relied almost exclusively on its extraordinary wealth of natural resources for growth. The recent crisis and accompanying collapse in the oil price validated fears that its economy was too reliant on commodity exports. Since then, Russia has put more effort into developing other sectors of its economy.

'The World Cup win has increased confidence that the changes needed will happen and the work will be done.'

Chris Weafer, Uralsib

Bagging the 2018 World Cup may help it achieve more diversification, Weafer said, because it puts a clear time frame for infrastructure improvements.

"The World Cup win has increased confidence that the changes needed will happen and the work will be done," he said.

A more welcoming stance

With the realization that it must look beyond oil, Russia has also started to adopt a more welcoming stance toward foreign investors.

"Before the crisis, Russian companies knew that they would eventually need to become more open, but they didn't actually have to. Now they're much more receptive," said Weafer, who reported that it's recently become easier to get Russian companies to go and speak to foreign investors.

The government in July also announced a privatization program under which it plans to raise around $10 billion annually over the next five years by selling noncontrolling stakes in large players in the financial, energy and transportation sectors such as Rosneft, RusHydro, Sberbank and VTB.

Some of the shares could go to strategic foreign investors.

"I think a lot of foreign investors are interested, particularly in the banks, which we view as a good proxy for the economy," said East Capital's Svedberg.

Banking is also a less sensitive sector in Russia than oil, which will come as a relief to investors wary of the country's poor track record of protecting private ownership in what it deems strategic industries.

Energy giant BP PLC's (LONDON:UK:BP.) (NYSE:BP) acrimonious relationship with its local joint-venture partner, which culminated in the departure of Robert Dudley as chief executive of TNK-BP in late 2008, served as a warning to many of the difficulties of operating in Russia.

Still, the financial sector is particularly attractive to foreign firms as the opportunities are big, especially in the nascent mortgage business.

Among European firms, Italian bank UniCredit is keen to add branches, while Barclays PLC (LONDON:UK:BARC) (NYSE:BCS) has made no secret of its goal to become Russia's top foreign investment bank.

Another sector that appeals, as Pepsi's move on Wimm-Bill-Dann showed, is food and retail.

Pepsi isn't the first global food company seeking to bolster its Russian presence. Earlier this year, French yogurt firm Danone SA (EURONEXT:FR:BN) teamed up with local dairy company Unimilk, creating a group that captures more than one-fifth of the Russian market.

Better international relationships

Such large deals have been helped by the thawing of Russia's relationship with the Western world and with its neighbors in Eastern

Europe.

Just this week, Russian President Dmitry Medvedev called for a new chapter in Polish-Russian relations in an effort to overcome historic tensions. Industrial ties with Italy and Germany have gotten stronger, benefiting the likes of Finmeccanica SpA (MILAN:IT:FNC) and Siemens AG (FRANKFURT:DE:SIE)

And membership in the World Trade Organization now seems firmly within reach for 2011, with the European Union on Tuesday endorsing Russia's candidacy.

Domestically, the political focus is already on the next presidential election, in 2012, but observers believe that whether Putin runs — seeking to reclaim a post he held from 2000 to 2008, before yielding to Medvedev and moving into the prime minister's position — matters little as the same elite will keep ruling the country.

What is key is a smooth transition and a steadfast approach to foreign investment.

"The companies coming now, like Pepsi, are the vanguard," Weafer said. "They're coming in early. But the big strategic investors will likely come after the elections, when they're confident of Russia's direction."