



Tera Capital Fund

Investor Newsletter

October 2011



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

Based on Tera Capital Fund's performance and innovation, World Finance announced that Tera had won its prestigious award for being the most innovative fund of funds in the world

According to Eurekahedge, Tera Capital Fund was the No. 2 performing fund of funds in the world in 2010

Fund Performance (net of fees)

Returns	Tera* (%)	RTS, MSCI & ROS Avg** (%)	AAM Russia Fund Index ¹ (%)
Monthly	14.61	19.09	8.46
Year-to-date	(13.79)	(11.71)	(17.98)
Trailing 12 months	(9.32)	(1.85)	(9.39)
Since Fund inception (Apr 05)	180.81	172.35	169.36
Anlzd mnthly rtn (since Fund inception)	12.78	11.96	9.62
Annualized Stand. Dev. (since inception)	25.27	38.85	31.52
Sharpe Ratio ²	0.41	0.35	0.23
Trailing 12 m Sharpe	-0.30	-0.26	-0.36

*Weight averaged, all series (currently 6) combined

**RTS: 16.57%, MSCI: 18.40%, ROS (Crédit Suisse): 16.57%

Investment Advisor's Assessment

Russia

Russia reached an agreement with **Georgia** on a bilateral deal that paves the way for its much-anticipated entry into the **World Trade Organization**.

Georgia was the final WTO member to give its approval after the **European Union** recently backed Russia's bid. According to the World Bank, joining the WTO may **boost Russia's \$1.5 trillion economy by more than 3% in the medium term**.

Russian entry, which now looks all but certain to take place by the end of 2011, would come after 18 years of negotiations and represents the biggest step in world trade liberalization since China joined a decade ago. Russia, the largest economy outside the WTO, has an **economic output of \$1.9 trillion**, or about 2.8% of the world economy. Russia's road to the WTO stretches back to 1993, **exceeding only China's 15-year application**.

The **WTO Working Party on Russia's Accession** completed its work and forwarded its recommendations to a ministerial conference scheduled for December 15-17 to make a final decision on Russia's entry.

Russia is the largest economy and the only Group of 20 nation outside the WTO, whose members conduct 97% of world trade. The world's biggest energy producer is counting on WTO entry to help lure foreign investment and reduce its reliance on energy exports, which account for 40% of budget revenue.

With financial crisis concerns still very much alive, Wall Street executives flew to Russia and to advise **President Dmitry Medvedev** on how Moscow can turn itself from a business backwater to a financial center that's rated higher than 61st in the world.

James Dimon, chief executive of **J.P. Morgan Chase & Co.**, joined **Blackstone Group's Stephen Schwarzman** and **Citigroup Inc. Chairman Richard Parsons** met

Medvedev at the Moscow headquarters of state-controlled **OAQ Sberbank**. **Lloyd Blankfein** of **Goldman Sachs Group Inc.** participated via video screen. In a relaxed atmosphere, the financiers provided dozens of suggestions for the Russian president.

Moscow has been designated the **most desirable European city for companies to expand into** for the second year running, according to a survey by global property consultant **Cushman & Wakefield**.

Of the 501 European companies participating in the survey, 57 said they expect to open an office in Moscow within the next five years — up 20% from 2010.

"This [rise in corporate development in Moscow] is being accelerated by very strong expansion in consumer spending, with the potential for this to be leveraged up considerably due to the current low levels of penetration of consumer credit, strong growth in B2B sales and large potential in regional cities beyond the traditional powerhouses of Moscow and St. Petersburg," said **Tim Millard**, managing director of Cushman & Wakefield in Russia.

One of the factors driving Moscow's popularity as a destination is an **increasing focus by European companies on growth markets**. Those surveyed viewed "new opportunities from the emerging markets for products and services" as the No. 1 trend likely to impact business over the next five years.

Companies also increased their opinion of **Moscow's ability to provide easy access to markets**, moving up to 11th position, from last year's ranking of 19th.

The **oil industry** expects a **2012 windfall** of almost **\$6 billion** after changes in the oil tax rules designed to sustain high production levels went into affect.

The "60/66 reform", which has been debated for more than two years, will **lower the marginal rate** on the export duty for crude oil from 65% to 60% in an attempt to stimulate investment in upstream developments and extend the lifespan of declining western Siberian fields.

With an average oil price of \$100 a barrel, the fall in export duty will **give oil companies an extra \$4 to \$5 in profit per barrel of oil** they pump abroad. This will generate the industry an **extra \$5.8 billion in EBITDA** in 2012 and **\$7.1 billion** in 2013.

About 40% of federal revenues comes from taxes on the energy industry and the Kremlin has to strike a balance between generating as much tax as possible from the sector while allowing companies to retain enough cash to invest in the new developments.

Crude exports have been climbing as the implementation date for the new tax regime approached. Exports in September jumped to 5.47 million barrels a day – 7.2% higher than September last year and 5.7% more than August.

However, the changes are not just good for the industry. Some experts expect the federal budget to benefit heavily. **Alexei Kondrashov**, global oil and gas tax chief

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%

at **Ernst & Young**, who was involved in the negotiations over the new legislation, said that the new tax rules “will create an incremental increase in oil production which will, in turn, create increased tax revenues.” Kondrashov estimated that **the government could receive up to \$4.7 billion** annually in additional revenue.

While crude export duties will fall, the export duty for light and dark petroleum products will be calculated at 66% of the export duty for crude. The customs rate for gasoline and naphtha will stay at 90%, a change introduced in May to guard against shortages.

Grigory Vygon, director of the **Skolkovo Energy Center**, said that tax changes are essential if Russia is ever going to develop its huge hydrocarbon reserves on its continental shelf. While it costs **\$2.2 million to drill a well in western Siberia**, it costs **up to \$200 million to drill one in the Arctic**.

The impact of the oil tax changes on Russia's largest oil companies appears below:

	EBITDA*, \$ mln							
	2012				2013			
	Current Rules	60/66	Windfall	Change, %	Current Rules	60/66	Windfall	Change, %
Rosneft	20,750	22,232	1,482	7	21,256	23,005	1,749	8
LUKoil	16,793	17,796	1,003	6	17,079	18,381	1,302	8
TNK-BP	11,885	12,894	1,009	8	11,151	12,133	982	9
Gazpromneft	6,421	6,841	420	7	6,072	6,441	369	6
Surgutneftegaz	8,515	9,229	714	8	7,647	8,318	734	9
Bashneft	3,292	3,142	-150	-5	3,132	2,982	-150	-5
Tatneft	3,271	4,279	1,008	31	3,263	3,638	375	11
Alliance Oil	746	821	75	10	908	1017	109	12

Russian domestic demand, fueled by consumer loans, propelled **economic growth to the fastest rate in three years in Q3. GDP grew 5.1% from 2010**, the highest rate since Q3 2008, compared with 3.4% in April-June. That brought nine-month growth to 4.2%, or 0.1% point faster than the full-year forecast.

“The main factors behind the acceleration in GDP growth were household consumption and fixed investment growth, supported by more vibrant construction activity,” the head of research at **Deutsche Bank** in Moscow said. “We expect **growth in the final quarter to stay above 4%**, which is likely to be supported by higher budget spending at the end of this year and the still-high growth in household consumption.”

Loan growth may reach 30% this year, above the central bank forecast of 24%.

Prime Minister **Vladimir Putin** said that Russia would “do everything” to **achieve faster growth of 6% to 7%** annually. GDP expanded 4% in 2010 after a record 7.8% contraction the previous year. Russia posted an average growth rate of almost 7% from 1999 to 2008.

The **inflation rate this year may be less** than the lower end of the government forecast range of between 6.5% and 7%, which would be **the slowest since the fall of the Soviet Union** two decades ago.

Russia left borrowing costs unchanged in October after **inflation slowed** and **booming consumer demand** spurred the economy to the fastest growth in three years.

Bank Rossii left the refinancing rate at 8.25% after two increases this year. The overnight auction-based repurchase rate, used to provide banks with cash, stayed at 5.25% and the deposit rate, used to withdraw liquidity, was held at 3.75%.

Bank Rossii has raised the overnight auction-based deposit rate five times since December 2010 to 3.75% from 2.5%. It increased the repurchase rate twice, from 5% to 5.5%, before reducing it by a quarter-point last

month. That narrowed the “interest-rate corridor” in which market rates tend to fluctuate to 1.5% points from 2.5% points. The benchmark refinancing rate remained at 8.25%.

Russia's **federal budget surplus** through September 2011 **expanded to almost \$35 billion**, or 2.8% of GDP. The Russian government and central bank have said they expect the budget to be close to balanced by year-end.

Options traders are making more bets than any time since 2009 that **emerging market equities will climb** after valuations fell to the lowest levels in three years.

The ratio of calls to buy the iShares MSCI Emerging Markets exchange-traded fund has jumped to a **22-month high** of 0.80-to-1, up from 0.65 a month ago and the 0.59 average since 2006. Calls that pay if the fund climbs 4.2% to \$42 by December are the fastest-growing bet and now account for the largest share of the ETF's 5.46 million options.

Stocks in **developing countries are rebounding** from the longest losing streak in more than a decade as EM countries cut borrowing costs. While bears say the stocks will decline as inflation and Europe's debt crisis crimp growth, bulls say smaller government debt levels give policy makers more ammunition to keep their economies expanding. The **MSCI Emerging Markets Index has risen more than 20%** since its Oct. 4 low, meeting the common definition of a bull market.

“These countries are still poised to move ahead,” **James Swanson**, who oversees about **\$208 billion** as chief investment strategist at **MFS Investment Management**. “The long-term story is intact, the stocks are depressed by historic standards and they trade at very low multiples.”

Investors increased purchases of emerging-market equities after the MSCI Emerging Market Index's five straight monthly declines drove its **price-earnings ratio to 9.5** earlier this month, the lowest since December 2008. The equities have trailed advanced-nation stocks for four quarters, the longest streak since Russia's default in 1998, amid concern that a global economic slowdown will hurt emerging markets more.

Stocks in developing countries trailed advanced-nation shares during six periods of financial stress that sparked global losses in the past two decades, including Latin America's so-called **Tequila Crisis** in 1994 following a devaluation of the Mexican peso. The peak-to-trough drop in the emerging-market index was 12% points bigger on average during the six retreats.

The MSCI gauge for developing countries has surged 16% from its two-year low on Oct. 4, beating the 11% advance by the Standard & Poor's 500 Index and the Stoxx Europe 600 Index.

Developing nations have less debt. Government debt in major economies will amount to **107% of GDP next year, up from 94%** in 2009, while in emerging markets, the **average debt-to-GDP ratio will fall to 34% from 35%**, according to the IMF.

Developing countries are likely to expand 6.4% this year and 6.1% in 2012, according to the IMF forecasts in September. That compares with the **average growth rate of 1.6% and 1.9% in the developed world**.

“The story in emerging markets is more of a vote of confidence not just for those markets, but also the developed world not going into a recession,” **Brian Jacobsen**, who helps oversee **\$209.1 billion** as chief

portfolio strategist at **Wells Fargo Advantage Funds**. "Central banks are going to be putting the pedal to the metal."

Company News

Dow Chemical Company's single biggest local investment, **\$38M**, is now yielding **\$200 million in annual sales**, almost a third of its annual \$700 million Russian sales.

The US company created a JV with Russian chemical firm **Izolan** five years ago to make polyurethane systems that produce flexible, highly resilient foam materials used in car steering wheels, shoe soles, refrigerators and oil pipeline insulation.

The Dow-Izolan plant has the capacity to manufacture 100,000 tons of Component B – half of the chemical input needed for polyurethane systems. The plant has more than 1,000 buyers all over Russia and the former Soviet Union.

Kraft Foods said it would invest more than **\$100 million** in its **Russian coffee plant** until 2015 to **double production** and meet growing demand for the beverage in the fast-growing market.

The move comes a week after **Nestle**, the world's biggest food group, completed an extension of its Krasnodar region coffee plant, which now has become its **biggest soluble coffee factory** in Europe.

Kraft said the plant would boost coffee production to **16,900 tons in 2013** and to **23,000 tons by 2015**, compared with the current output of 10,500 tons a year. Since 2000, the company has invested more than **\$150 million in the factory** located in the Leningrad region.

Transaero Airlines plans to order four **Airbus SAS A380s** in the first success in the country for the double-decker airliner.

Transaero chief executive **Olga Pleshakova** and

Christopher Buckley, Airbus **Executive Vice President for Europe, Asia and the Pacific**, signed an MOU. The first deliveries are planned for Q4 2015. The commitment has a value of about **\$1.5 billion** at list price.

In August, Transaero ordered **eight Airbus A320** single-aisle planes.

Walt Disney Company, owner of **ABC television**, agreed to buy a 49% stake in Russia's **SevenTV network** and will rename it the **Disney Channel**.

Disney is acquiring the stake from **United Television Holding Russia**, a Moscow-based television broadcaster. Financial terms were not disclosed.

Disney currently provides Disney Channel programs to cable and satellite operators in Russia. SevenTV reaches more than 75% of Russia's viewers through a network of stations. United Television Holding also owns the **MuzTV** channel, which targets 11- to 34-year-old viewers.

Fund Awards



Most Innovative Funds of Funds
(for innovation and performance)



No. 2 ranked fund of funds
in the world for 2010



No 8 ranked fund of funds in the
world for 2009



No 1 ranked fund of funds
in the world for 2005

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