Magni

Global Trends

Volume 1, Issue 1

WELCOME TO MAGNI'S GLOBAL TRENDS, a monthly commentary that discusses major trends occurring globally and the impact on Magni's country rankings. Because at Magni: "*Countries Matter*™".

We think these topics are worth your attention:

- This month's Global Trends
- While the BRIC's get the press, the real story is in the rest
- Egypt's problems are greater than current political turmoil
- Worker issues in South Africa not likely to impact underlying strengths over the long-term

Plus this issue's *Standards Spotlight* shines on Sustainable Wealth Creation principles: "What are they and why do they matter". *Recommended Reading* profiles a recently published book with an interesting perspective.

THIS MONTH'S GLOBAL TRENDS

The long-term case for investing in emerging markets is strong and rests on a variety of arguments including their faster growth rate than in developed countries. Even this month's worst market performers are positioned well for the long-term as *Countries Matter*™ and that is especially so in the emerging markets. Magni believes those countries that put in place policies to achieve Sustainable Wealth Creation principles will outperform those that do not. We will explore a few cases, but first let's examine recent market activity in the emerging markets.

At the margin, clearly the announcement by the Fed that quantitative easing will taper, likely this fall, initiated a selloff in emerging markets. We expect this initial liquidity shock to taper as well and money will flow back into those markets most affected, namely India, Indonesia, Philippines, Thailand and Turkey.

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Emerging Market Country	Benchmark Return of Country (August 2013)	Magni Allocation versus MSCI in Emerging Markets
Indonesia	-20.6%	Overweight
Turkey	-13.8%	Overweight
Philippines	-13.4%	Overweight
Thailand	-11.9%	Overweight
India*	-10.6%	Overweight
* India is discussed in the article covering the BRIC's		

Those looking to recent history, namely the Asian crisis of the late 90s, will note that the investor base for emerging markets has changed radically. Importantly, nearly 40% of all emerging market assets are now held by long-term investors, including pension funds and sovereign wealth funds. Whereas in previous crises, the hedge fund community and others running "hot money" were the predominant holders of emerging market assets. That said, Magni's optimism for these markets runs to the fundamental factors which Magni tracks. Overall each country named above adheres to many Sovereign Factors, which will continue at the margin the economic structural transformation in these countries and thereby position their equity markets to outperform their peers. Let's look at a few examples.

Commentary on Affected Countries

Indonesia

- The falling currency has forced Indonesia's central bank to increase interest rates by 50 basis points.
- However, not all is lost in Indonesia. It is a resource-rich economy exporting liquefied natural gas, rubber, gold, and others. Indonesian GDP has been growing at 6% over the last few years, unemployment has been trending down, per capita income has been improving, and life expectancy has increased dramatically.
- Following the market lows in March 2009, Indonesia's equity markets gained nearly 300%, significantly outperforming the MSCI Emerging Markets Index.
- Prior to the emerging markets sell-off in June, Indonesia's markets were up 11.2% compared to the emerging markets index decline of 3.3%.
- Although the market has been free-falling, at 6% GDP growth and with other major economic statistics trending favorably, their economy has underlying strength.
- Strengths from Magni Sovereign Factor Analysis: relatively good adherence to Sustainable Wealth Creation principles with noteworthy adherence in key aspects of their financial services infrastructure, the quality of their banking regulation, and the impact of their fiscal policy on creating a less risky environment for business decision making.

Turkey

- The Syrian crisis has created refugee problems along the Turkish border, growing animosity between the two countries, and the risk of new problems among their Kurdish minority. As the Syrian crisis stabilizes, the underlying strengths of Turkey should re-emerge.
- Strengths from Magni Sovereign Factor Analysis: relatively good adherence to Sustainable Wealth Creation principles with noteworthy adherence in key aspects of accounting standards and the financial services infrastructure for payments.

Philippines

- The Philippines does not have the same problems as other emerging countries.
- Despite being down nearly 20% during the middle of August, the Philippines ETF rallied near the end of the month to finish down only 13.4%.
- Unlike neighboring countries, the Philippines has a current account surplus.
- In addition to a current account surplus, the Philippines has a high level of foreign exchange reserves and low foreign currency debt that puts them in a strong position to weather the current emerging markets exodus.
- The Philippines is less exposed to China.
- The Philippines government announced that the economy expanded at a higher-than-expected 7.5% in the 2nd quarter. It was the fourth quarter of growth above 7%.
- Strengths from Magni Sovereign Factor Analysis: relatively good adherence to Sustainable Wealth Creation principles with noteworthy adherence in key aspects of auditing and securities regulations.

Thailand

- Has entered into a mild recession for the first time since the global financial crisis.
- Like many other developing and emerging countries, Thailand has seen a significant downturn due to weak exports, sluggish domestic demand, falling currency, and decreasing consumer confidence.
- Strengths from Magni Sovereign Factor Analysis: relatively good adherence to Sustainable Wealth Creation principles with noteworthy adherence in key aspects accounting and auditing regulations, along with the financial services infrastructure for payments and shareholder protections during insolvency.

While the BRIC's get the Press, the Real Story is in the Rest

Since Paul O'Neil coined the phrased BRIC's, the media has written about little else in the emerging world. While always quick to fall in love with a pithy acronym, the media is discovering the fact that the BRIC's have been underperformers for some time and Magni knew it. Still every dog has its day and this past month the decline in the cap-weighted MSCI Emerging Market index (the BRIC's represent ≈ 44% of the MSCI EM Index) was mitigated by the BRIC's as the emerging world took a blow on the chin.

Magni's intensive research revealed a number of interesting trends once the heavy digging was done. While the equity markets in the BRIC's experienced periods of superior returns, the performance has proven to be unsustainable (see below).

BRIC Country Performance Among Emerging Market Countries*					
Country	MSCI Weighting**	Magni Allocation Relative to MSCI***	Emerging Market Relative Performance Rankings****		
			1 Year	5 Year	10 Year
China	18.3%	Underweight	11	14	11
Brazil	12.6%	Underweight	19	15	6
India	6.7%	Underweight	9	13	12
Russia	6.0%	Underweight	12	16	19

* As of June, 2013
** MSCI Weighting – The countries share of MSCI EM as of 12/31/12
*** Magni Allocation Relative to MSCI – Overweight or underweight when comparing Magni Global Portfolio – Emerging Markets to MSCI Emerging Markets
**** 1, 5 and 10 Year Relative Performance Rankings – The relative rank of the country's equity performance compared to other Emerging Market countries. Currently there are 21 emerging market countries

Given the rapid growth, associated economic development, increases in the number of billionaires, and other signs of success, why haven't the equity markets of these countries performed better? Other countries such as Turkey, the Philippines, Colombia and similar countries have delivered much better performance in their equity markets.

Magni believes the answer lies in these countries' lack of adherence to the Sustainable Wealth Creation principles. Currently, Magni ranks the BRIC's 6th, 7th, 15th, and 17th among the 21 emerging market countries. Brazil, Russia, and India tend to have specific weaknesses, whereas China adheres to few of the Sovereign Factors contained within the Sustainable Wealth Creation principles, though China does have some relative strength in auditing and banking regulations. In a future issue, Magni will cover some recent changes in China that may reflect an infection point in Chinese adherence to the Sovereign Factors.

Magni research indicates that Brazil's equity markets would be much better positioned if the country strengthened its auditing practices, securities regulations, and shareholder protections when companies get into trouble. In order to work efficiently, markets must a) protect investors, b) be fair and transparent, and c) reduce systematic risk. Brazil fails on all three factors because markets are poorly regulated and provide few creditor rights, while shareholders lack confidence in the reliability of the data to make informed decisions. This has predictably resulted in an equity market prone to boom/bust cycles.

Beyond the well-recognized systemic corruption in major parts of Russia, Magni research indicates that the equity market of Russia would be much better positioned if the country had a more stable and open monetary policy, stronger accounting systems, healthier and more predictable payment systems, and improved banking regulation. Consistent with Russia's authoritarian regime, the Russian central bank employs opaque polices and is less independent than many other central banks, which limits its ability to balance economic growth and price stability. Equity markets in countries with lesser commitment to monetary policy transparency tend to suffer because investors' ability to gauge the rationale behind policy decisions is lessened and the lack of transparency increases risks when making investment and business decisions.

In contrast, Magni research indicates that the equity market of India scores reasonably well in several areas and would be better positioned if the country strengthened its accounting systems and banking regulations. India has traditionally been a difficult place for foreigners to invest. While it experienced periods of increased investment, it never reached its full potential due to a myriad of issues confronting foreign investment. Compounding matters is India's lack of commitment to international accounting standards, which increases the uncertainty of foreign investors.

BRIC Country	Areas for Improvement
Brazil	• Strengthen auditing practices • Better securities regulations • Stronger shareholder protections, particularly when companies get into trouble • Reliable government data
Russia	• More stable and open monetary policy • Stronger accounting systems • Healthier and more predictable payment systems • Better banking regulation • More transparent and independent central bank
India	• Strengthened accounting systems • Better banking regulations • Fewer restrictions on foreign investment
China	• Most areas need to be improved, though auditing and banking regulations are relative strengths

Egyptian problems bigger than current political turmoil

Egypt faced widespread economic problems before the Muslim brotherhood rose to power in Cairo. The government has failed to move people out of widespread poverty and to transform the country into a modern urban economy. Egypt's lack of adherence to many of the basic structural factors which Magni measures means it will be difficult to create a vibrant economy with economic mobility.

For the past few years, the world has watched as the Arab Spring held much promise and then gave way to various current outcomes ranging from anarchy to military rule to sectarian violence. With the fall of Hosni Mubarak and the proud history of a major Arab country, many people believed Egypt might avoid the same disappointment. One of the few good things we can say about Egypt is that, miraculously, investors didn't completely abandon the country after widespread protests in the streets and brutal conflicts with the Egyptian military…maybe investors will continue to remain resilient, for some reason.

Worker issues in South Africa not likely to impact underlying strengths over the long-term

South Africa's economy is struggling due to devastating labor strikes, increasingly militant workers, and overall political unrest. By some estimates, these strikes are costing the economy $60 million a day. It's no wonder the equity markets are suffering. While the effects of these disruptions are disastrous in the short-term, they are fixable over the long run. If South Africa's industry leaders and unions come to terms and reach an amenable agreement, South Africa could be poised to realize superior economic and investment growth.

South Africa has strong commitment to fiscal policy transparency, which leads to sustainable economic development. This transparency helps hold those responsible for the design and implementation of fiscal policies more accountable, while allowing business leaders to make decisions more confidently with better information. South Africa has proceeded much further than other emerging market economies in adopting international accounting and auditing standards, which allows investors to be more confident when making investment decisions. Further, they have a strong banking system to go along with good securities and insurance regulations. These strengths provide for greater investor rights, which are a crucial component for attracting foreign direct investment.

STANDARDS SPOTLIGHT: SUSTAINABLE WEALTH CREATION PRINCIPLES – WHAT ARE THEY AND WHY DO THEY MATTER?

The idea is simple enough – Applying Sustainable Wealth Creation principles make for a dynamic and sustainable economy rich with investment opportunity and return potential. But what are Sustainable

Wealth Creation Principles? They represent generally accepted economic principles which are split into 12 standards and expressed in nearly 300 factors ("Sovereign Factors").

Traditional investment research typically involves analyzing the financial information of companies. When investing internationally, deeper research is required. Are the financial statements of a company an accurate representation of the health of its business? Do shareholders benefit from the successes of the business and are their rights protected? Is the macroeconomic of the country stable with transparent policies and accurate government information so business leaders can confidently make decisions? Each of these questions relates to a country as opposed to a company. The countries where each question can be answered affirmatively are ones where Sustainable Wealth Creation is occurring. Researching each country's adherence to the nearly 300 Sovereign Factors provides an objective method for assessing Sustainable Wealth Creation.

This research also has another value: global and country-specific events can be viewed through the likely impact on the individual Sovereign Factors in order to determine whether the resulting performance in the country's equity markets is likely to be transitory or enduring. If an event is not likely to impact the Sovereign Factors, the medium to long-term prospects for the country's equity market are unchanged and the event should result in transitory performance.

The good news for you is that Magni is the world's leading research and asset management company specifically dedicated to scoring investible countries on their adherence to the important underlying factors that make a country work. Which is why at Magni: "*Countries Matter*™".

RECOMMENDED READING

"Why Nations Fail: the Origins of Power, Prosperity, and Poverty" by Daron Acemoglu and James A. Robinson.

"Why Nations Fail" is a well-researched book highlighting the importance for including all citizens in the success of an economy. Escaping widespread poverty occurs when key economic institutions such as private property and competition exist. Countries are more likely to exhibit such institutions where they have societies with pluralistic political systems and broad based participation. The recommendations of the authors fit well with the Sustainable Wealth Creation principles.