

Magni Client Information

Talking Points on International Equity Research and Investing

November 2015

Country Ranking Trends

- Chile, France, Hungary, India, Indonesia, Spain, and the United Kingdom were downgraded for newly apparent shortcomings in each country's respective fiscal transparency. At the same time Italy, Malaysia, Peru, Poland, and Thailand were upgraded for recent progress in making each respective country's fiscal policy more transparent. A stable and transparent fiscal policy provides a better environment for capital investment as the risk discount associated with projects tends to be lower.
- Over time countries tend to improve. This year will probably end with a typical amount of improvement. Despite the improvement trend, 14 countries have deteriorated over the past year with the United Kingdom experienced the largest deterioration. Further, they are at risk of an additional downgrade (see below).

Growing Importance of Islamic Finance

- The 22nd annual World Islamic Banking Conference was held in Bahrain during early December. With more than 1,200 attendees, including central bankers, sovereign wealth funds, Islamic banks, and many others from the \$2.2 trillion Islamic Finance industry, the conference draws a powerful group of attendees.
- Magni participated and spoke at the conference regarding governance in majority Muslim countries. Magni discussed the governance strengths and weaknesses in countries such as Indonesia and Malaysia, as well as the potential for one of these countries to become a leader in the emerging markets over the next several years.
- Information collected during the conference confirmed Magni Country Scores for the majority Muslim countries. In addition, Ms. Manjiang Cheng, chief economist of the Bank of China, presented at the conference. Her presentation included many more economic statistics than normally available from China and reconfirmed recent upgrades of the Magni Country Score regarding the country's greater transparency in the area of Data Dissemination.

China Reforms May Accelerate

- The IMF just decided to include the Chinese yuan in its basket of reserve currencies. The composition of the basket known as Special Drawing Rights (SDR) consists of the currencies that represent the largest share of export payments where the currency is also freely usable. During their last review the yuan did not meet the freely usable criteria. As part of the announcement, the IMF clarified that the determination of the yuan to be freely usable currency was made despite remaining operational challenges. The yuan will join the U.S. dollar, euro, Japanese yen, and pound sterling as the fifth currency in SDR. The announcement positions Beijing to implement more of its overall financial reform agenda, while setting the stage for further opening of the country's financial markets. Magni will continue to monitor these developments and upgrade China as reforms are successfully implemented.

Britain Headed Toward a Downgrade

- Market Integrity is an Economic Standard of Magni and represents the ability of businesses to conduct routine business. For the most part, developed countries tend to score fairly highly in this standard. Countries with good anti-money laundering provisions tend to have good Market Integrity.

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- Recently information has become available that calls into question prior progress made by the UK in its anti-money laundering practices. The current patchwork regulatory system has holes and does a poor job in terms of identifying and reporting money laundering; particularly in non-financial services organizations such as professional services firms. The patchwork regulatory system creates risks that property, luxury goods, high value art and antiques can be used to integrate ill-gotten wealth into the legitimate financial system. Magni is reviewing its findings and will determine how much to downgrade the UK.

Depressing News from Brazil

- Impeachment procedures have begun against President Dilma Rousseff for allegedly breaching federal accounting laws in 2014 and 2015. The motion was initiated by Speaker Eduardo Cunha, who is himself under corruption investigation and has been under pressure to leave his post. This latest episode of political uncertainty came a day after it was announced that Brazil's economy contracted on an annualized basis by a surprisingly large 4.5 percent during the third quarter of 2015. This decline was the biggest recorded since the start of the historical data in 1996. Goldman Sachs is now calling the downturn in Brazil "an outright depression". The ongoing political crisis has stalled the passage of austerity measures in Congress needed to shore up Brazil's fast-deteriorating finances. Last month Standard & Poor's downgraded Brazil's credit rating to junk grade citing political problems that have hobbled economic policy.
- These events reinforce the validity of Brazil's current Magni Country Score which remains relatively low.

Will Argentina Rejoin the Emerging Markets?

- Argentina is currently part of the frontier markets and hence is not routinely part of Magni Research. The recent election could be the start of a repositioning of the country for promotion to the emerging markets.
- In the recent elections, Mauricio Macri, the mayor of Buenos Aires, won the presidency with just over 51% of the vote. His coalition of centrist parties defeated the Peronist candidate endorsed by President Kirchner. She and her husband had ruled Argentina for the past 12 years, and their penchant for excessive government control has created a negative investment climate and a stagnating economy. Inflation is estimated at around 25% and the budget deficit is more than 6% of GDP. Institutions such as the state statistics agency have been subjected to undue political influence leading to an inaccurate and misleading picture as to the state of the economy. Macri has promised rapid market reforms including scrapping capital and currency controls as well as restoring the Central Bank's independence. If the new president is able to overcome significant challenges, his ascension to the presidency could mark a new and positive period in Argentina.