



Picture: Manus

The many faces of Latin America

«News behind the news» | Author Matthias Knab edits Alternative Market Briefing (published by Opalesque Ltd). In this column, exclusively available to swissHEDGE readers, he reflects and analyses what is behind current topics that dominate the industry and the media.

The quality of your decisions is determined by the quality of your information. When it comes to investing and asset management, especially abroad, I have always believed it helps to have a local base, access to “hands-on” expertise. Another dimension is acquired by visiting the country, at least once. Ideally you should give yourself enough time to get a feel of the country: to build meaningful insights and to learn about its economy, natural and “human” resources, its culture and its peculiarities.

For example, addressing India’s failure in the development of Chinese-style special economic zones, the Financial Times recently pointed out that “if you’re sitting in a hedge fund somewhere in London or New York and spending much of your time reading panglossian BRIC reports, it’s quite possible to be completely oblivious to the social protests that are gathering pace and force across much of India. You will miss out, for example, on the fact that the government’s strategy to promote industrialisation through the development of Chinese-style special economic zones has all but run into the ground. The significance of this is hard to overstate: SEZs were supposed to provide red-blooded industrialists with capitalist enclaves where they could escape from the stifling inspector raj, burdensome labour laws and high tax rates that hamper businesses in the country at large. They were meant to create millions of jobs by extending to manufacturers the same tax breaks and labour law flexibility that have helped make the country’s IT sector world-class during the last decade. In the last few weeks,

however, it has become clear what a dreamy vision this was....”

Take a look, for example, at the extraordinary difficulties the state government of West Bengal has been having in securing land for flagship industrial developments. In the last quarter of 2006, the state’s communist chief minister, Buddhadeb Bhattacharjee, expended virtually all his considerable political capital in forcing through the compulsory acquisition of farmland in the fertile Singur district so that Tata Motors could build a car assembly plant within easy reach of Calcutta. At one point, the protests reached such a pitch, with one opposition leader engaging in a lengthy hunger strike that almost killed her, that chief ministers in the rest of the country began to question whether Buddha, as he’s known, had not made a massive miscalculation.

Buddha prevailed at Singur in the end and the land is now ready to be handed over to the Tatas, but social activists, including Booker prize winning author Arundhati Roy, campaigning on behalf of those displaced by such industrial projects, smell blood. Literally. In the first month of this year, in copy cat protests against another of Buddha’s flagship projects, six people during the protests against a development by Indonesia’s Salim group of a huge tract of land for a special economic zone at Nandigram. Buddha was forced into a humiliating retreat.

However, for my personal insights in India, please refer to my last contribution to swissHEDGE “India falling flat?” Let’s talk about Latin America.

Colombia

In 1995 I started to learn Spanish. My numerous trips to Latin America together with a fierce resolution to master that language ensured progress within a surprisingly short span of time. Today I think learning to speak Spanish was one of the best decisions in my life. The ability to communicate and read a language provides access to intelligence in the language spoken by the natives – and this is priceless. Besides, there is something infectious about the Latin American lifestyle: the music, the sincere friendliness of the people, the “joie de vivre”. The following are my subjective impressions on some Latin American countries according to recent trips and many conversations with locals.

I am just returning from Colombia, a beautiful country with amazingly friendly people. I can confirm that President Uribe, in power since 2002, has transformed the country. His father was a wealthy landowner and cattle rancher who

was assassinated by the FARC guerrillas during a 1983 kidnapping attempt. Uribe promised a more intensive military campaign against the guerilla. I felt extremely safe during my time and my travels there and can confirm what travel guide “Lonely Planet” writes: “So far, Uribe has delivered and the security situation has drastically improved in Colombia, giving way to a new period of national optimism. Uribe’s popularity has tilted to 80%, making him the most popular elected leader in Latin America.” On May 28, 2006, Uribe was re-elected for a second presidential term (2006-2010), and became the first president to be consecutively re-elected in Colombia in more than a hundred years. Uribe received about 62% of the vote.

However, the country is still divided: there are areas where guerrilla or paramilitaries wield power – the fact that the government does not actually control parts of a country is hard to imagine coming from a Western country – and then there are the safe and prospering regions. At the beginning of January 2006, one story grabbed headlines - a previous minister, who was kidnapped and held as hostage for over six (6!) years by the guerrillas, managed to escape and after days of wandering and eating roots, found his way into “the 21st century”, as he said. His eyes were sparkling and happy, but his face showed signs of ageing and malnutrition, not to speak of having to come to grips with the fact that two years after the kidnapping, his beautiful wife had given up the marriage and is now living with someone else. This is a typical example how NOT to do things in Colombia, explained a Colombian friend to me. “There are things and areas in Colombia where everyone knows you will run into trouble when you cross a certain line. The minister was kidnapped because he was travelling to a place where he was not supposed to be...”

As I wrote before, the good news is that the government has strengthened the military and reclaimed much of the land that was ceded to the guerrillas in the late 1990s. Although as long as there are drug consumers in Western countries, the illegal drug industry in Colombia and Brazil will operate and supply what “hip” and not so hip drug addicts demand. Colombia is the world’s largest producer of cocaine, controlling 80% to 90% of the global markets. The 1980s and 90s were the hey-days of the drug cartels. In 1983, Pablo Escobar and other cartel bosses offered the government a “peace-treaty” where for immunity from both prosecution and extradition; they offered to invest their capital in national development programs, and, according to Lonely Planet “more tantalizing still, proposed to pay off Colombia’s entire foreign debt, USD13b at that time.” The



government rejected the offer and open war broke out. While the drug mafia was assassinating politicians, the government retaliated with confiscating nearly 1000 cartel-owned properties. Another low point was the bombing of an Avianca flight from Bogotá to Cali, killing all 107 passengers on board, intended to “just hit one guy on the plane”, according to a local entrepreneur.

Geographically, more than half the country (56%) is woods and jungle – an extensive area east of the Cordillera. It is there where the drug cartels operate today, withdrawn from the rest of the country. While in the “old days”, according to the locals, you could identify a Mafiosi by his hair cut, jewellery, clothing and manners, today the drug barons and their clout are ousted and have to go under-cover. According to locals, the country applies strict money laundering rules. Today “a Mafiosi won’t be served in a bar or restaurant, nor would he be able to buy an apartment (due to strict anti-money-laundering rules).”

Sometimes a trifle of the almost immeasurable money the drug cartels make still finds its way back to the Colombian society. Also in January, the police confiscated around USD57m a large number of gold bars (worth USD6m) in the south-eastern city of Cali. The money was hidden in simple houses and allegedly belonged to Juan Carlos Ramirez Abadia, a member of the North of the Valley Cartel and for whom the United States is offering a USD5m reward. The Colombian government now says it intends to use the money for the construction of low-income housing in Cali.

Real estate and timber

In the safe and prosperous regions, particularly in the scenic Caribbean historic city of Cartagena (worth a trip!), with a sweeping oceanfront beach strip, which almost reminds one of Miami, is slowly being developed. About 10 years

ago, a local pioneering entrepreneur first set up “Hotel Las Americas” on the strip that lay outside the historic city. At the time, nobody thought it made sense – in fact they thought it would go bankrupt.. but the hotelier wasn’t the only one developing a site there. On the strip, one today finds beautiful condominiums, and in Avianca’s in-flight magazine you can find at least 20-30 different projects advertised. I stayed in a 250 square meter apartment, top floor, ocean front and beautifully fitted, which a stock broker from Barcelona just bought for EUR250k. The prices have been, and are expected to continue, rising by 20% each year.

I also looked at timber and noble woods. A Colombian relative of the stockbroker owns a business dedicated to exporting and planting noble woods. He said the Colombian government has started to copy a Chilean model to boost its forestry industry, particularly planting noble woods. In this plan, the government actually refunds 50% of the planting costs, which would be USD2k per hectare. We were looking at piece of land of 156 hectares and he thought of using 100 hectare to plant trees. Sixteen or eighteen years from now, the proceeds of just one hectare of timber would equal the land price for the full 156 hectares, at current prices. And realistically, timber prices know only one direction: north.. Each year there would be more demand, each week he could ship more containers to Asia and China than what is available.

On another interesting note, Latin American consumers are borrowing like never before and mortgages are set to explode. A Merrill Lynch report states that mortgages and consumer loans in Latin America are all set for a period of rapid growth. Alexander Batchvarov, the firm’s head of international structured finance research, reviewed consumer borrowing data in eight of the region’s major economies: Brazil, Mexico, Argentina, Chile, Colombia, Panama, Trinidad and Tobago and Jamaica. His findings are released in a book entitled the “Merrill Lynch Guide to Emerging Mortgage and Consumer Credit Markets”. Increasing economic stability and expanding liquidity indicate that demand for housing and consumer credit will grow significantly over the next 10 years. I just read that Colombia’s FX reserves are growing, a bank just reported 19% growth over the last quarter, and foreign direct investment has reached USD16m per day.

Chile

On an earlier trip in 2006, I visited Argentina, Chile, Uruguay and Brazil. While I had not been to Sao Paolo, and

cannot include this Brazilian powerhouse in my reflections, I actually thought that Santiago de Chile was the most developed and prosperous city I have seen in Latin America. I lived in the business district, and just by looking at the architecture, the streets, the infrastructure and the way people dressed left me impressed. It almost felt like being in the US. Chile has become a rich country, and I also noted a very well developed educational system, which will continue to contribute to the country’s prospects.

Of course, a few days later I drove to the Pacific ocean, and getting to know other Chilean cities and the country side quickly made clear that life outside of the capital still has that distinct Latin-American flavour. When I pointed out the advances I noted in Chile, especially comparing the country to its neighbours, some locals tell you the prosperity and development would be a result of Pinochet’s reign and politics, focusing the country on “hard work and discipline”.

Impressions of Argentina

You can still see some people begging in the streets of Buenos Aires, with the country’s most unfortunate still suffering from the catastrophic events that hit country when it defaulted in 2002, the 11-year dollar peg was abandoned and all bank accounts were frozen. A friend of mine, a Colombian businesswoman, who was moving to Buenos Aires that year and lives there since, says the shock people suffered from not being able to access their bank accounts any more and the break down of the economy is unimaginable. Since the banks were closed, there was no access to



bank notes and the authorities were issuing a currency substitute that people used to barter. People also directly bartered services and goods without using a currency.

Still today, she believes that the Argentinean economy is still fragile and thinks the real damage has happened to the Argentinean psyche, to the “inside” of its citizens. “While in every country, more so in Latin America, you will find people complaining about the current state of affairs, the situation in Argentina seems different. Due to the relatively recent, painful experience, which many describe as “being robbed by the banks and the politicians”, the average Argentinean appears to have lost hope on the country, its prospects, and worse, has given up initiative. Out of all Latin Americans, the Argentinean is the one who complains the most and does the least. They go in circles. In fact, I thought of printing a T-Shirt, wearing it and point to it all day. It will say “Do it first, then talk to me about it!” “

Uruguay, Brazil

Uruguay. Just across the Rio de la Plata you find Uruguay. The Argentinean banking crisis also infected Uruguay, and when I was wandering through Montevideo in March 2006, I was struck by the contrasts between its prosperous past (like the marble-plastered parliament), when the country was still known as the “Switzerland of Latin America”, and today’s reality. For example, just a few blocks from the city center you’ll run into abandoned streets where the only thing you’ll find along the sidewalk are closed businesses. 15% of the country’s 6.5m inhabitants are living abroad, in search of better opportunities.

Brazil. In October 2006, I was invited to chair a hedge fund conference on Latin America in Miami, and one thing I hear there time and again was that the Brazil story is “not just a commodity story”, that there is high consumer demand, a developed and diverse industry and growing exports due to improved product quality. Brazil’s power and future is its 188 million people. However, compared to other Latin American countries, Brazil seems to have the most challenges to educate them properly.

Latin America – the ultimate lesson

For me, the ultimate lesson that Latin America has taught me is that everything, also the wealth and power of nations, comes in cycles. On the Miami conference, I was talking with a Mexican fund manager and he said when he was

young, people used the phrase “rich as an Argentinean” for a really wealthy person. Uruguay has fallen from a Swiss status into boring stagnation and even Brazil is a good example. From 1890 to 1920 the rubber boom brought immeasurable prosperity to the country, so that in Manaus, actually in the middle of the jungle, a opera house was built that is actually larger than the famous Garnier Opera in Paris. The best entertainers from Europe and North America were brought in for the pleasure of the 100 or so families that then controlled the economy of the area. The advent of synthetic rubber in the early 1920’s brought an abrupt end to the party in the jungle. In my view, especially the “old” Europe may face a similar fate over the next decades.

Robert Shiller, one of the world’s most renowned academic economists and a professor at America’s Yale University, told the delegates at the 2007 Davos business summit that the rise of these twin economic powerhouses was “the greatest economic event since the Renaissance and the Industrial Revolution”.

The Financial Times reported that Professor Shiller and other panellists sounded an ominous warning over the risk that a backlash across Western electorates could spark social unrest and a retreat by leading developed economies into protectionism. He called for governments to raise taxes on the wealthy to counter this danger, so that the proceeds could be used to ease the economic strains now afflicting large sections of Western societies and fostering increased inequality. “The political discourse about this problem is way too low,” he added. “We really need in every major country a serious debate about how we are going to stop this inequality getting worse. And do it now, not after it has created all of these problems.”

Shiller is focusing on the sociological and political consequences of economical downturns. Personally, I am pretty bearish on Europe in the long run. Another reason to start thinking about Latin America?

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