



## Frontier in the Southern Cone: *Uruguay, Paraguay & Argentina*

By Larry Speidell

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*Puerta de la Ciudadela, 1833, and the Palacio Salvo, 1927, Montevideo, Uruguay*

For \$25,000 you can get your Jeep Cherokee bullet-proofed... with Kevlar in the doors and 3/4" glass. It is a good thing my friend in Sao Paulo did that. His wife was at an intersection when a thief tried to climb in, found the doors locked and fired two shots at her through the glass. He ran off. The bulletproofing saved her life.

In addition to riding around in bullet-proofed cars, this trip to the Latin American winter included speeches to the CFA Societies of Sao Paulo, Montevideo and Buenos Aires, as well as company visits in the frontier countries of Uruguay, Argentina and Paraguay. The CFAs everywhere were wonderful. They know about hard work under adverse conditions and lately they've had to deal with falling commodity prices in Brazil, drought in Uruguay and Paraguay, baffling government policies in Argentina and fallout from the Euro crisis. The tough times are not over, but valuations are low and as the saying goes, "it's always darkest before the dawn..." (The other saying, however, is that "the light at the end of the tunnel could be an oncoming train.")

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My CFA Society talks are usually rallying cries for the fundamental attractiveness of frontier stock markets. In this case, however, something else was required, because Latin America is different: it isn't poor like Ghana, Kenya or Bangladesh, there is already an established middle class, and furthermore, Argentina was dropped from "emerging" to "frontier" status by MSCI in 2009.

I decided to talk about the conditions that can lead to progress and economic growth, drawing on work with Art Laffer from 2002 to 2006, plus the excellent insights in two recent books: Breakout Nations, by Sharma, and Why Nations Fail, by Acemoglu & Robinson. This work leads to highlighting four major factors that influence success and failure: human capital, investment, government and culture.

First, however, the basic features some of the countries in the Southern Cone are shown below. These countries are relatively developed compared with Africa, where GDP per capita is \$3,000 or less and literacy is generally below 80%. Still, the Latin countries have yet to realize their potential. Brazil struggles with slow growth on the back of lower commodity prices, Argentina is haunted by its usual political demons, Uruguay feels squeezed between its giant neighbors and Paraguay is finally beginning to discover its way forward.



	Argentina	Uruguay	Paraguay	Brazil
GDP Growth (2012 est)	0.0%	6.0%	6.4%	2.5%
Inflation	26.0%	8.0%	6.0%	7.0%
Population (mil)	42.2	3.3	6.5	205.7
People / km sq	15	19	16	24
% Literate	97%	98%	94%	89%
% Literate Female	97%	98%	93%	89%
% under age 15	25%	22%	29%	26%
Life expectancy	75.4	76.4	77.8	72.8
% Urban	92%	92%	61%	56%
GDP / cap (PPP)	\$17,400	\$15,400	\$5,500	\$11,600
Electricity/cap kWh	2,481.6	2,400.5	1,299.5	2,215.4
% Unemployed	7%	6%	7%	6%
Land (km sq)	2,780,400	176,215	406,752	8,514,877
Market Cap (\$ bil)	\$43.5	\$0.2	\$0.9	\$1,229.0
Market Cap/GDP	6.1%	0.4%	2.5%	53.9%
GDP	\$709.7	\$52.0	\$36.2	\$2,282.0

Source: CIA Fact Book



## Uruguay

Uruguay's beautiful coastline, trendy resort (Punta del Este) and lovely tree-lined streets in Montevideo make it a favorite holiday destination for Argentines and Brazilians. However, with only 3.3 million people, does Uruguay deserve a stock market of its own? This was the debate over lunch with CFAs at the lovely Rara Avis restaurant in Montevideo's century old opera house. Some of the CFA Society board-members said "why bother... just have everything list on the stock exchange in Sao Paulo". Others felt that a local exchange would encourage a local equity culture, promote understanding of capitalism and add to national pride. I agreed with their side, noting that many other frontier countries have small but beneficial stock markets, including those in the table below:

	Montenegro	Bahrain	Qatar	Macedonia	Uruguay
Population (mil)	0.67	1.2	1.5	2.1	3.3
GDP / cap (PPP)	\$9,900	\$27,300	\$121,400	\$9,400	\$15,400

*Source: CIA Fact Book*

While Uruguay's \$230 million market cap is insignificant in the context of the world, the country has a lot going for it. The Heritage Foundation ranks Uruguay in the top third of the Economic Freedom Index, well above the BRICs and higher than even Belgium, Norway and France. Modern agricultural techniques are starting to transform the productivity of the country's rich farmland. One agri-business company is said to be planning a \$100 million listing in the fall. And it is possible that more companies will choose to list on the exchange, since listing provides a five year holiday from the annual 1.5% wealth tax and also a permanent exemption from the 7.5% dividend tax.

Recently, a forward-thinking education program called Plan Ceibal gives laptop computers to every schoolchild. The World Bank says Uruguay is "the only country in the world where all students in publicly-supported primary schools have been provided with their own free laptop computer. Almost all Uruguayan schools are connected to the Internet and work is well underway to put free laptops in the hands of all public secondary school students." <http://blogs.worldbank.org/edutech/planceibal2>

One of our hosts in Montevideo is a recent refugee from Buenos Aires, having just moved his wife, baby and household belongings. He had landed a new job at Citibank in wealth management and was giving up on Argentina for good. He warned of grim conditions and depressed people on the other side of the Rio de la Plata. In addition, I met a financial manager from Barclays on the flight to Buenos Aires (that was delayed two hours by an Argentine air controllers strike). He warned that government thugs and petty crime are worsening threats. He has become extremely cautious about his emails and Facebook postings. After hearing this and recalling that a California friend had lost his passport to pickpockets in Buenos Aires recently, I prepared for the worst.



## Argentina

*“There are four sorts of countries, developed, undeveloped, Japan and Argentina” – Simon Kuznets*

Since my last visit in 2004, Argentina has built gleaming new buildings in Puerto Madero, the old port of Buenos Aires. However, behind these glass and chrome facades, the economy is hollowed out.



*Puerto Madero, Buenos Aires*

Back in 1993, I had joined a group of investors to visit Economic Minister Domingo Cavallo at a table seating forty in the imposing granite ministry building facing Plaza de Mayo. Those were heady times: President Menem and Cavallo, advised by Art Laffer and economists from the University of Chicago, had pegged the peso at one to the U.S. Dollar, promising an end to Argentina’s recurrent inflation crises. Their policies worked... for a while.



*Plaza de Mayo, Buenos Aires*

By 2001, however, union demands had pushed up wages, making exports uncompetitive and flooding the country with imports. (Perhaps there are parallels between Argentina in 2001 and Southern Europe in 2012...)

In December 2001, the Argentine government suddenly acted. First, they froze U.S. dollar deposits in the banks with a policy called “El Corralito” (the little corral). Then, they devalued the peso from one per dollar to four per dollar. Next, the government forced deposit holders to convert their dollars into pesos at the old rate of one peso per dollar rather than the new rate of four to one. Thus, “El Corralito” effectively confiscated 75% of the wealth of those Argentines who had tried to move out of pesos into dollars.

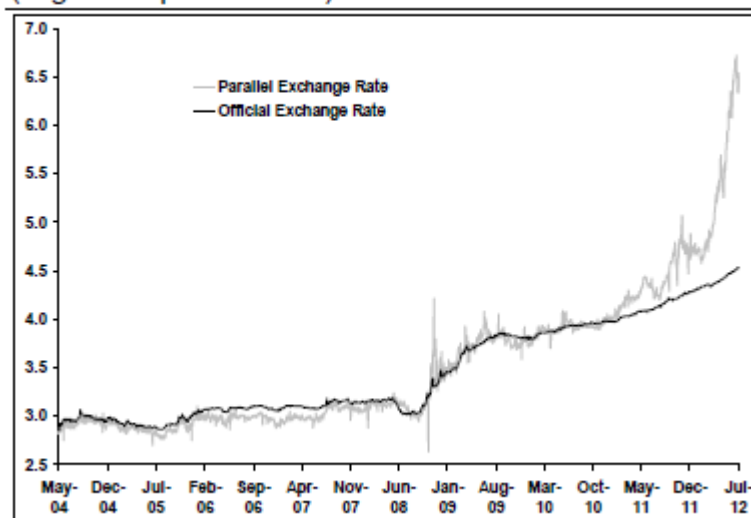
Some say that Argentina has a crisis every ten years, and it looks like 2012 is another one of those years. Following the death of her husband, President Cristina Kirchner has tried to liken herself to “saint-like” Evita Peron, who died in 1952 at age 33. Cristina, however, is simply called “that woman” by the people I met. She won 54% of the vote in the fall 2011 election, but her popularity has since plunged.

There is a bitter clash with her former allies in the Mojano family (that the Kirchners had helped install at the head of the trade unions). Wage negotiations stalled in the spring of 2012 and a truckers’ strike crippled transportation, causing fuel shortages. At last the union settled for a 25% wage hike, but further confrontations lie ahead. Meanwhile, Cristina has become isolated, relying on her whims to execute economic policies. These have included taking over the pension plans, raiding the central bank, halting bank dividend payments (to prevent money from going to foreign partners) and nationalizing the stake in oil company YPF that had been held by Spain’s Repsol. This leaves scant hope of attracting foreign capital to develop the oil shale discovered in 2011 (although there are talks with Gazprom). Christina has two close advisors, the only holdovers from her husband’s cabinet, who are said to be rough, stubborn and in favor of price controls.

The government is trying to hold the Peso at 4.6 to the U.S. dollar, but this is costly and reserves are running out. Some say that a 10% devaluation is likely. Political tensions aren’t likely to get much better either. The next presidential elections will not be until late 2015, but the political rhetoric will no doubt become very heated around the mid-term elections in the summer of 2013.

As for stocks, the banks are cheap at roughly 3x PEs and less than 1x book value, with a number of them having ADRs that make it easier to hold.

### Argentina: Official vs. Parallel Exchange Rates (Argentine pesos/dollar)



Source: BCRA, Bloomberg, Morgan Stanley Latam Economics



## Paraguay

### *El Corazon de America – The Heart of America*

We think of the heartland of America as the prairies of our mid-west states, but Paraguay can fairly claim to be the heart of Latin America. It was once the seat of Spain's ambitions on the continent, but Paraguay has followed a catastrophic path.

In 1865, Paraguay's megalomaniac leader Solano Lopez made the mistake of declaring war against the combined forces of Brazil, Argentina and Uruguay, resulting in the War of the Triple Alliance. By 1870, when Lopez was killed in the northern Chaco region of Paraguay, two thirds of all the men and boys in the country had been killed. Paraguay's population was cut by more than half; and after 150 years, the population balance between men and women is only now returning to normal.



*Monument to the Triple Alliance War*

It didn't help that in 1932 war broke out again in the Chaco region against Bolivia, resulting in the death another 40,000 men. Sadly, this war was over suspected oil reserves that were never found. It is rumored that the war was instigated by oil companies, with Standard Oil backing Bolivia and Shell backing Paraguay.

Fortunately, things are better today, even though president Lugo was impeached while I was there. He had mishandled some protests, resulting in several deaths, but his main offence was initiating closer ties with Chavez in Venezuela. Following Lugo's ouster, Argentina, Brazil and Uruguay suspended Paraguay from the Mercosur trade block for violation of the Democratic Clause - while announcing that Venezuela would become a full member... A UPI report (September 18, 2012) observed: "Increasingly, however, Paraguay's suspension and Venezuela's admission is emerging as a diplomatic and economic ploy designed to reap maximum profit from Venezuela's voracious consumer market." The report went on to say that Paraguay is highly dependent on trade routes through its neighbors, but that Paraguay is "a considerable exporter of commodities its neighbors may not go without for long." Assuming this dispute is resolved by elections scheduled for April 2013, Paraguay could have a bright future. Its agriculture is being reformed by modern farming techniques that promise a tripling of yields. And there is talk of finally finding natural gas in the Chaco region where exploration has begun.

While the stock market in Paraguay is small and liquidity is low, with strong economic growth things may change.

## 2050 Hindsight\*

For talks to the CFA Societies in Brazil, Uruguay, and Argentina, I looked at long-term trends and conditions today that might help us to imagine the world of 2050. Data on 114 countries with stock markets (24 developed, 21 emerging and 69 frontier) was collected from the World Development Indicators database of the World Bank, The Heritage Foundation, The Pew Foundation, and the World Values Survey. A framework to rank countries was developed, narrowing down from 45 growth factor variables, to settle on thirteen in three major categories: Human Capital, Investment, and Government. These growth ranks can then provide a foundation for adjusting recent growth rates and projecting economies and even market capitalizations 38 years hence (albeit with significant ranges of error!).

One “wild card” that is missing but hard to quantify may be the most important piece of all: Culture. We can be certain that the French will never be like the Germans and that the Chinese will not become like the Indians. These cultural differences will continue to determine variations in economic success over the coming decades.

For the Human, Investment, and Government factors, however, it is possible to assume that their effects will still be noticeable in 2050 and that they will have implications for economic prosperity and capital market returns. As long as we look at the data with humility, we may gain some helpful insights about future opportunities.

- 1) **Human Capital** – In this category, we include five of the many possible factors that one could consider:
  - a. Ratio of experienced workers, age 35 to 49, compared with younger workers, age 20 to 34. This ratio measures the potential growth in both productivity and savings. Studies by Barry Bannister of Stifel Nicolaus, among others, have concluded that changes in this ratio may be correlated with productivity and stock market returns.
  - b. Growth in urbanization, % change since 2000. Inclusion of this factor is based on the notion that productivity increases significantly (perhaps as much as 10x) for urban workers compared with rural workers. We are simply looking at the recent trend in urbanization and presuming it will continue.
  - c. Literacy rate of adult females (a proxy for education quality and discrimination).
  - d. Population % over age 65. If high, this places a burden on younger people in the workforce.
  - e. GINI Index is a measure of inequality in society. High numbers indicating a high percentage of very rich people, which can be a barrier to successful long term growth.

*\*This section was also included in our 2Q12 client letter*

The table below shows the results for some of the top ranked countries, some in the middle and some of those at the bottom.

		Age 35-49 /20-34 2040/2010	Urban % chg 2000-2010	Literacy rate, adult female (% of females ages 15 and above)	Population ages 65 and above (% of total)	GINI index	Human Capital
Emerging	Philippines	21%	7.9	95.83	3.64	42.98	68
Emerging	Indonesia	22%	11.7	89.10	5.55	34.01	67
Frontier	Bangladesh	42%	4.5	51.02	4.59	32.12	67
Frontier	Iran	46%	5.3	80.66	5.23	38.28	65
Frontier	Vietnam	32%	4.5	90.50	6.00	35.57	65
Frontier	Uzbekistan	32%	(0.4)	99.09	4.35	36.80	64
Frontier	Pakistan	30%	3.8	40.08	4.30	30.02	64
Frontier	Serbia	21%	1.3	99.00	14.35	27.80	63
Frontier	Zimbabwe	47%	4.5	89.36	4.21	50.10	63
Frontier	Slovak Republic	22%	0.5	99.00	12.08	26.00	63
Frontier	Montenegro	22%	1.0	99.00	12.46	29.99	62
Frontier	Paraguay	27%	6.2	93.45	5.10	52.42	60
Emerging	Brazil	35%	5.3	90.22	7.00	54.69	55
Frontier	Argentina	22%	2.3	97.74	10.58	44.49	51
Developed	United States	-6%	3.2	99.00	13.06	45.00	45
Developed	France	-12%	2.0	99.00	16.79	32.70	45
Developed	Portugal	9%	6.3	93.25	17.94	38.50	45
Developed	Germany	-18%	0.7	99.00	20.38	27.00	41
Frontier	Uruguay	16%	1.2	98.61	13.76	45.32	41
Developed	Belgium	-18%	0.3	99.00	17.43	28.00	41
Developed	Germany	-18%	0.7	99.00	20.38	27.00	41
Developed	United Kingdom	-8%	0.7	99.00	16.59	34.00	39
Emerging	Russia	3%	(0.6)	99.43	12.80	40.11	38
Developed	Japan	-7%	1.6	99.00	22.69	37.60	38
Developed	Switzerland	-13%	0.3	99.00	16.70	33.70	38
Developed	Singapore	23%	-	91.95	9.01	47.30	37
Developed	Spain	-15%	1.1	96.93	16.97	32.00	34
Developed	Greece	-10%	1.7	96.09	18.55	33.00	33
Developed	Italy	-28%	1.2	98.60	20.35	32.00	33
Frontier	Zambia	4%	0.9	61.34	3.05	54.63	32
Developed	Hong Kong	-1%	-	99.00	12.74	53.30	32
Frontier	Sri Lanka	4%	(0.6)	89.07	8.16	40.26	28

As shown by our sample, The Philippines, Indonesia, Bangladesh and Vietnam look strong on the overall Human Capital rank in the right column, while Greece, Italy and Russia are among countries at the bottom. The Latin countries we visited in June are in the middle with Paraguay being the strongest because of its prospects for growth of productive workers and its low percentage of elders.

2) **Investment** – In this category, we include four factors:

- a. Gross Capital Formation as a % of GDP
- b. Foreign Direct Investment as a % of GDP
- c. Gross Savings as a % of GDP
- d. Electric power transmission and distribution losses as a % of output. We believe this is a reasonable measure of the effectiveness of the government in providing services to the country. Thus it reflects the presence of conditions necessary for investment to be productive.



		Gross capital formation (% of GDP)	Foreign direct investment, net inflows (% of GDP)	Gross savings (% of GDP)	Electric power transmission and distribution losses (% of output)	Investment
Emerging	China	47.78	3.12	52.93	4.90	93
Developed	Singapore	23.83	18.51	45.89	5.16	93
Frontier	Vietnam	38.88	7.52	31.86	9.60	88
Frontier	Mongolia	40.79	23.46	27.13	11.82	87
Frontier	Kazakhstan	25.11	7.16	27.99	8.20	80
Emerging	Thailand	25.94	3.04	30.89	5.91	80
Emerging	Malaysia	21.42	3.86	32.91	3.80	79
Developed	Belgium	20.19	15.53	22.86	4.53	76
Developed	Australia	28.01	2.70	24.30	6.52	75
Frontier	Bangladesh	24.41	0.91	38.45	2.28	75
Developed	Hong Kong	23.71	31.66	29.89	13.16	75
Frontier	Saudi Arabia	22.00	4.96	33.24	8.28	74
Emerging	Indonesia	32.49	1.89	31.96	9.88	73
Emerging	Peru	24.43	4.67	22.81	7.60	72
Emerging	South Korea	29.15	-0.01	31.65	3.71	72
Frontier	Paraguay	19.49	1.88	22.58	5.70	56
Developed	Germany	17.34	1.41	23.12	4.26	52
Frontier	Argentina	22.00	1.91	22.46	14.75	47
Developed	France	19.35	1.32	17.47	6.13	44
Frontier	Uruguay	19.07	4.17	16.66	12.78	44
Developed	United Kingdom	15.42	2.34	11.95	7.18	38
Developed	United States	15.05	1.62	10.91	6.26	34
Emerging	Brazil	19.25	2.32	16.53	17.17	32
Emerging	South Africa	19.26	0.34	16.45	9.84	31
Developed	Portugal	19.61	0.65	10.43	7.66	31
Developed	Greece	16.19	0.14	4.63	5.28	27
Emerging	Turkey	19.93	1.24	13.61	14.88	26
Frontier	Pakistan	15.37	1.14	21.76	19.70	26
Frontier	Kenya	19.30	0.58	15.56	15.53	23
Frontier	Cote d'Ivoire	13.85	1.83	14.73	24.99	18

The top countries in our rankings of Investment are no surprise: China, Singapore, Vietnam and Mongolia. When looking at these ranks, it is important to consider that the rich developed countries may have lower ranks because they have already made most of the huge investments in infrastructure that are ongoing in the developing world. Among countries at the bottom, we are hopeful that Cote d'Ivoire will improve following its resolution of the 2010-2011 election crisis. The Latin countries are relatively low on investment, which is one of the handicaps facing Brazil. Paraguay is somewhat better, partly because of hydroelectric dams that enable it to meet its power needs as well as to export power to Brazil.

3) **Government** – In this category, we include four factors:

- a. The Heritage Foundation ranks of Economic Freedom. These are based on ten factors and include the World Bank's scores for the ease of doing business as well as property rights, corruption (from Transparency International) and measures such as monetary and fiscal freedom.
- b. Rule of Law & Corruption. These two factors come from the World Bank Governance's ranks, and they are averaged.
- c. Current account balance (a measure of government discipline).

- d. General government final consumption expenditure as a % of GDP. We give a negative score for large governments, based on historical evidence of the inefficiency and the risks- of corruption in the government sector.

		Heritage Economic Freedom	Rule of Law & Corruption	Current account balance (% of GDP)	General government final consumption expenditure (% of GDP)	Government
Developed	Singapore	87.5	191.9	23.74	10.68	105
Developed	Hong Kong	89.9	185.7	5.70	8.44	104
Developed	Switzerland	81.1	191.4	14.02	11.47	102
Developed	Luxembourg	74.5	192.8	7.73	16.63	92
Emerging	Chile	78.3	178.6	1.79	12.50	90
Frontier	UAE	69.3	143.4		8.25	89
Frontier	Bahrain	75.2	128.1	2.72	13.47	81
Developed	Germany	71.0	185.7	5.73	19.73	81
Developed	Ireland	76.9	187.1	0.46	18.93	80
Emerging	Malaysia	66.4	126.6	11.48	12.73	79
Emerging	South Korea	69.9	150.4	2.78	15.35	79
Frontier	Uruguay	69.9	157.2	-0.41	13.15	79
Developed	Austria	70.3	189.0	3.02	19.37	79
Developed	Australia	83.1	191.4	-2.83	18.20	78
Developed	Japan	71.6	180.0	3.59	20.05	78
Developed	Denmark	76.2	198.6	5.49	29.08	78
Developed	United States	76.3	177.1	-3.23	17.29	73
Developed	United Kingdom	74.1	184.7	-3.33	23.05	62
Developed	France	63.2	179.5	-1.74	24.83	52
Frontier	Paraguay	61.8	44.3	-3.50	9.33	50
Frontier	Argentina	48.0	72.4	0.80	14.92	44
Developed	Portugal	63.0	164.8	-10.00	21.56	42
Frontier	Venezuela	38.1	8.6	3.08	13.27	42
Frontier	Uganda	61.9	62.8	-10.23	11.85	42
Frontier	Georgia	69.4	102.9	-11.46	21.02	41
Emerging	Brazil	57.9	115.3	-2.27	21.17	40
Developed	Italy	58.8	120.0	-3.49	21.06	39
Emerging	Russia	50.5	39.0	4.75	19.45	38
Frontier	Mongolia	61.5	69.0	-14.30	13.73	37
Developed	Greece	55.4	122.3	-10.26	18.18	36
Frontier	Ecuador	48.3	31.9	-3.08	11.74	36
Frontier	Serbia	58.0	94.8	-7.34	19.21	36
Frontier	Nigeria	56.3	26.7	1.22		33
Frontier	Tanzania	57.0	73.8	-8.63	18.18	31
Frontier	Kenya	57.5	35.2	-7.80	16.65	29
Frontier	Malawi	56.4	92.8	-11.90	20.16	27
Frontier	Ukraine	46.1	42.3	-2.19	20.11	26
Frontier	Uzbekistan	45.8	10.5		17.58	20
Frontier	Moldova	54.4	69.4	-8.32	23.70	17
Frontier	Zimbabwe	26.3	3.3		19.07	15

At the top, Singapore, Hong Kong, Switzerland, Chile and several developed countries look good on the Government rank, but so does Uruguay (although some of the local CFAs I met there might disagree). Zimbabwe, Moldova, Uzbekistan, and Ukraine have much work to do to improve their Government ranks, but at least Mr. Mugabe may be nearing the end of his regime in Zimbabwe, where investors need to be patient. Since our scores are somewhat backwards looking, Argentina is probably a lot worse today based on recent actions by Cristina Fernandez de Kirchner. As for Brazil, its low score is due to the bloated size of its government. The recent publication of excessive government payrolls has embarrassed many bureaucrats in Brazil, so perhaps reform will be on the way.

- 4) **Z- Score** – We add the three elements of Human Capital, Investment and Government to calculate an overall ranking. Using a “Z-Score” allows us to reflect the fact that many countries are bunched together in the middle of each of our measures. This means that the actual distinctions that are meaningful among countries close to the mean are considerably smaller than a simple ranking would indicate.

The Z-Score is derived for each growth factor by calculating the average and standard deviation across the universe of 114 countries. Then each country’s level is measured by the number of standard deviations above or below the average:

		Human Capital	Investment	Government	Z-Score
Developed	Singapore	-0.2	1.2	1.6	2.7
Emerging	Malaysia	0.5	0.5	0.8	1.7
Frontier	Qatar	0.4	1.1	0.1	1.6
Developed	Hong Kong	-0.7	0.7	1.5	1.5
Emerging	China	0.4	1.2	-0.1	1.5
Developed	Switzerland	-0.5	0.4	1.5	1.4
Frontier	Vietnam	0.6	1.0	-0.1	1.4
Emerging	Indonesia	0.7	0.5	0.0	1.3
Emerging	South Korea	0.1	0.5	0.5	1.2
Frontier	Barbados	1.0	0.1	0.1	1.1
Emerging	Chile	-0.1	0.1	1.0	1.0
Frontier	Bangladesh	0.3	0.6	0.1	1.0
Developed	Germany	-0.5	-0.1	0.6	0.0
Frontier	Paraguay	0.4	0.0	-0.1	0.2
Frontier	Uruguay	-0.2	-0.3	0.6	0.0
Developed	United States	-0.3	-0.5	0.5	-0.3
Frontier	Argentina	0.0	-0.2	-0.4	-0.6
Developed	France	-0.4	-0.2	-0.1	-0.7
Developed	UK	-0.4	-0.5	0.2	-0.7
Emerging	Brazil	0.2	-0.5	-0.4	-0.7
Frontier	Venezuela	0.3	-0.5	-0.8	-1.0
Frontier	Ukraine	-0.1	-0.2	-0.9	-1.2
Frontier	Kenya	0.0	-0.6	-0.7	-1.3
Developed	Italy	-0.7	-0.2	-0.4	-1.3
Developed	Greece	-0.5	-0.7	-0.5	-1.7
Frontier	Zimbabwe	0.5	-0.9	-2.1	-2.5

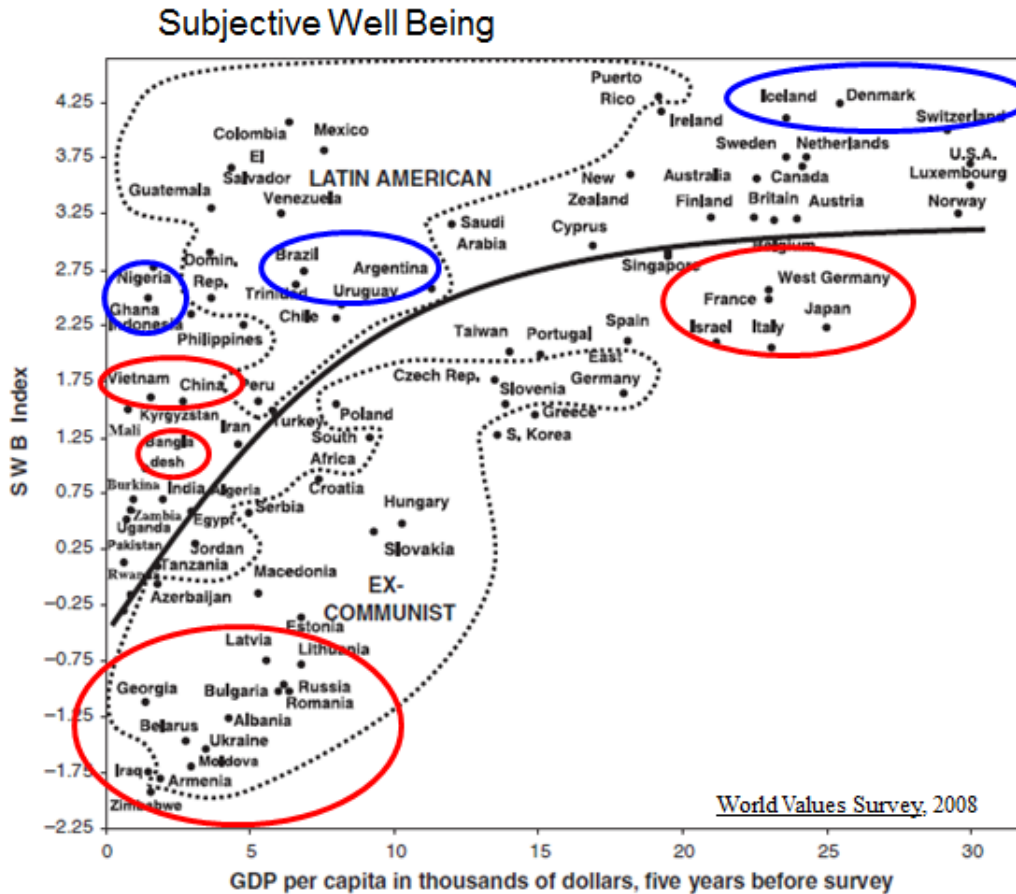
The overall results are not surprising. Singapore, Malaysia and China near the top while Italy and Greece are the laggards, along with Ukraine and Venezuela. Among surprises near the top are Indonesia and Bangladesh. And among our Latin group it is interesting that Paraguay, Uruguay and Argentina are in company with many much more developed countries.

Whether these ranks will prove predictive of future growth is not clear; however, we hope that they offer guidance that is better than a random guess.

## Culture

*“Toute nation a le gouvernement qu’elle mérite”*  
*“Every nation gets the government it deserves”*  
– Joseph de Maistre, 1753-1821

Despite our quantitative data, the “elephant in the room” is culture. The chart below, from the World Values Survey, compares “Subjective Well-being” with GDP per capita:

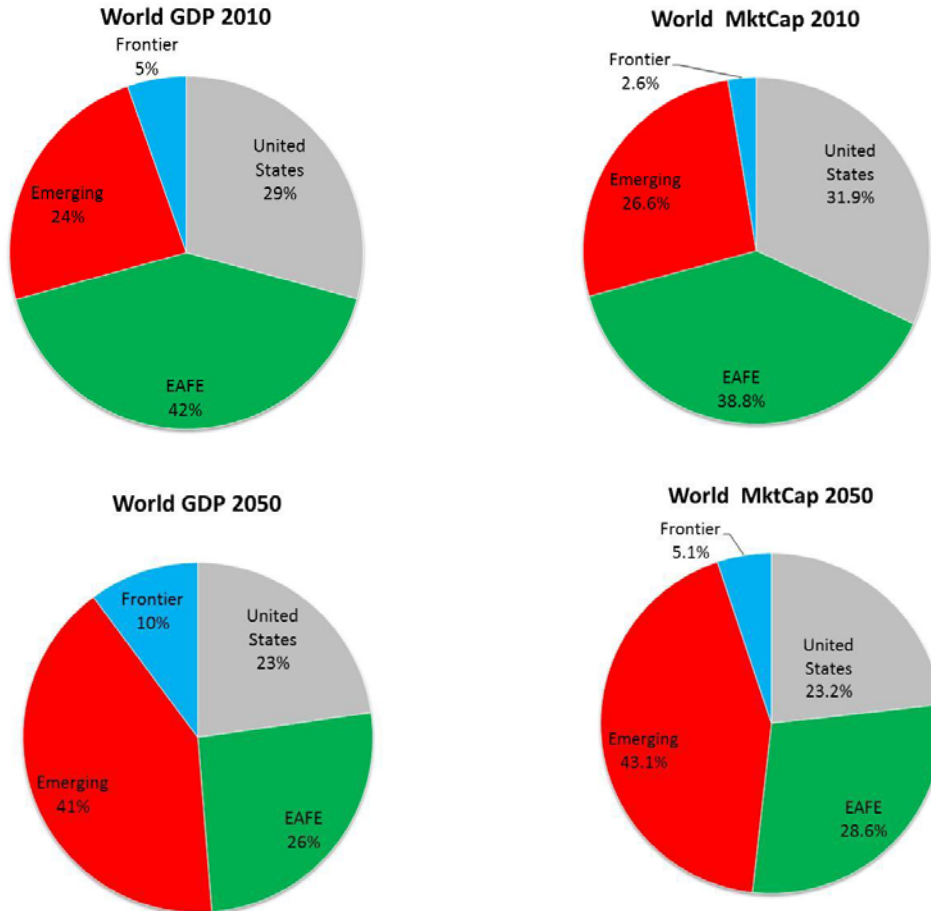


While the logarithmic trend-line is not a perfect fit, it appears that money does buy happiness. Also, some countries are happier than their incomes might suggest while others are more depressed. An earlier version of this chart showed that the Former Soviet Union countries were much higher (happier) before the chaos that followed the fall of the Iron Curtain. Overall, however, the chart suggests that countries do have cultural biases in contentment that may influence their optimism, ambition, work ethic and economic success.

These biases may impact the kinds of government that people choose. A theory of government developed by George Tsebelis of UCLA holds that the number of “veto points” determines the effectiveness of rule. Too many veto points results in weak, ineffectual coalitions of many special interests, as in Greece. On the other hand, a one party system such as Peronism in Argentina, can lead to what one Argentine analyst calls “heterodox policy responses” (to put it mildly!) In Malaysia, during the 1990s, Mahathir’s era was a similar example of unfortunate consequences from the concentration of

power in a single veto point. In the U.S. we are blessed with what may be the optimal number of three veto points: Executive, Legislative and Judicial.

One goal of our effort to investigate growth drivers is to allow us to suggest the possible shape of the world in 2050, compared with 2010 in the charts below:



We project that the GDP of frontier countries could rise from 5% of the world to 10% while the market capitalization of frontier countries goes from 2.6% to 5.1% of the world. We also estimate strong gains in stock market capitalization for many frontier countries such as Paraguay, Uruguay, Tanzania, Bangladesh, Vietnam, Malawi, Zambia, Ghana, Nigeria, Georgia and Mongolia. That should be exciting in 2050, and it should be rewarding along the way.

## Conclusion

When we try to peer into the future, we need to be humble. "2050" is easy to say, but it is hard to see 38 years hence.

If we were suddenly back in 1974 (38 years ago) we would not have known of Deng Xiao Ping and his influence on China or Gorbachev's influence on Russia. We would not have anticipated the rise of militant Islam, beginning with the Ayatollah in Iran and Bin Laden. Nor would we have known about PCs, spreadsheets, email, cellphones or iPods.

I am optimistic that countries learn from experience. Even politicians learn, although more often it's the voters who learn and throw out the bad ones. My view is that the "Chinese model" will be replaced, just as the "Japanese model" has been.

As for the Latin countries we visited, their cultures are rich and they know there is more to life than work. Yet they are acutely aware of their economic and political shortcomings. They may not become Asian Tigers, but I am optimistic about all of them... in the year 2050.



*With the Board of the CFA Society of Uruguay, at Rara Avis restaurant, Montevideo*

### About Frontier Market Asset Management

*Founded in 2006, Frontier Market Asset Management holds more than 45 years worth of collective investment experience including work in Emerging and Frontier Markets since 1987. For more information, please contact us at (858) 456-1440.*

*This is not an offering. An offering will be made only by means of a final offering memorandum and only in those jurisdictions where permitted by law. The fund is subject to a variety of risks, including but not limited to: investments may be volatile depending on the type of hedging techniques employed and subject to stock market risk; investments may be illiquid; an investor could lose all or a substantial amount of any investment in the fund; there is no secondary market for interests in the fund nor is one expected to develop, and there are substantial restrictions on transferring an investment in the fund; fees and expenses of the fund may be higher than those of other investments and will reduce the portfolio return. Consult the fund's offering memorandum for complete risk disclosures and other important information.*



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