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Innovation and strategy for hedge funds and investors



New Thinking on Absolute Returns

Is there any money to be made after 2009?

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*Global Perspective, Local Advantage*SM

Overview

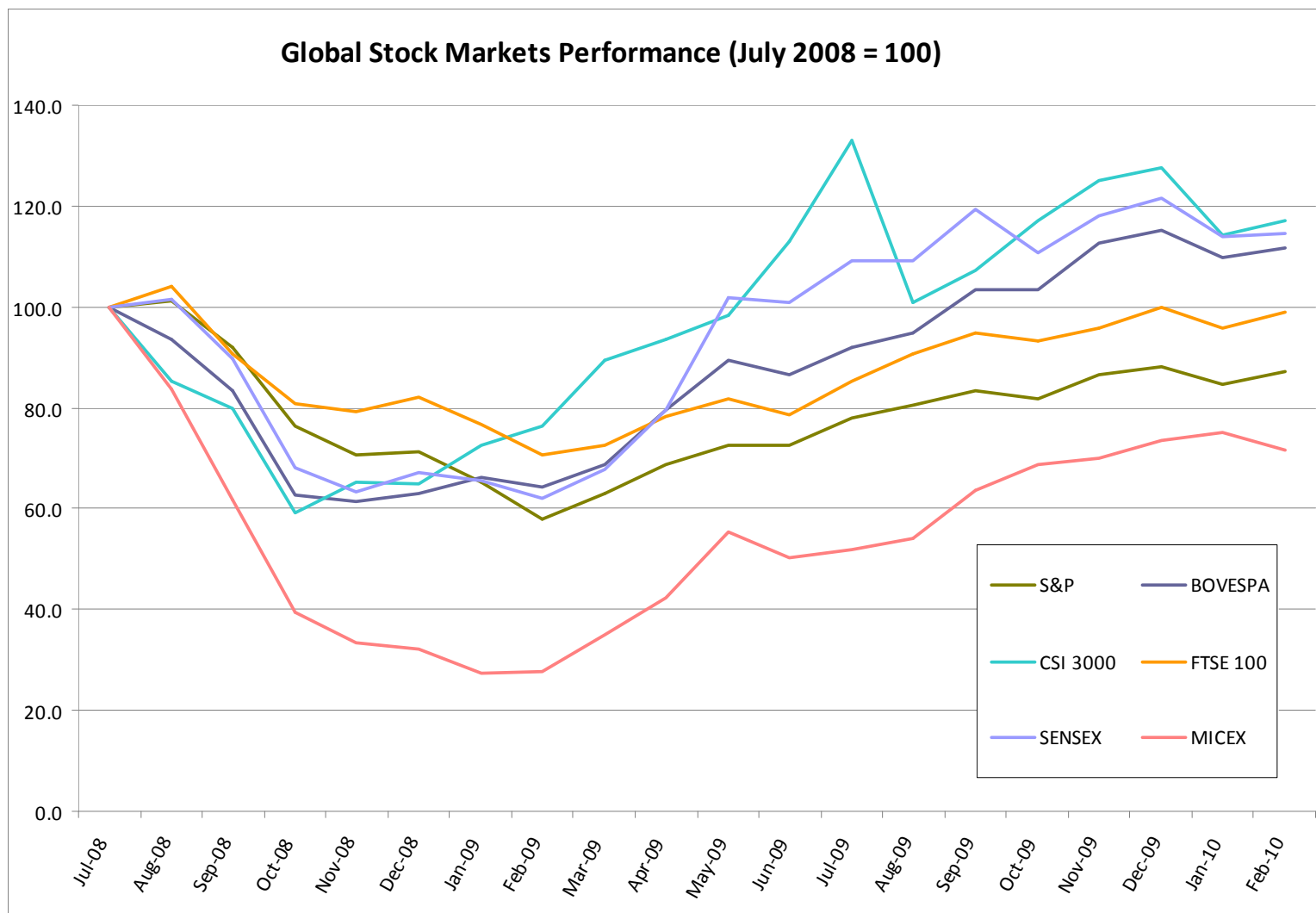
2009 was an extraordinary year for investing, with virtually all asset classes providing atypical gains

The obvious question for 2010 and beyond is whether there is any money left to be made and, if so, where does an investor find it

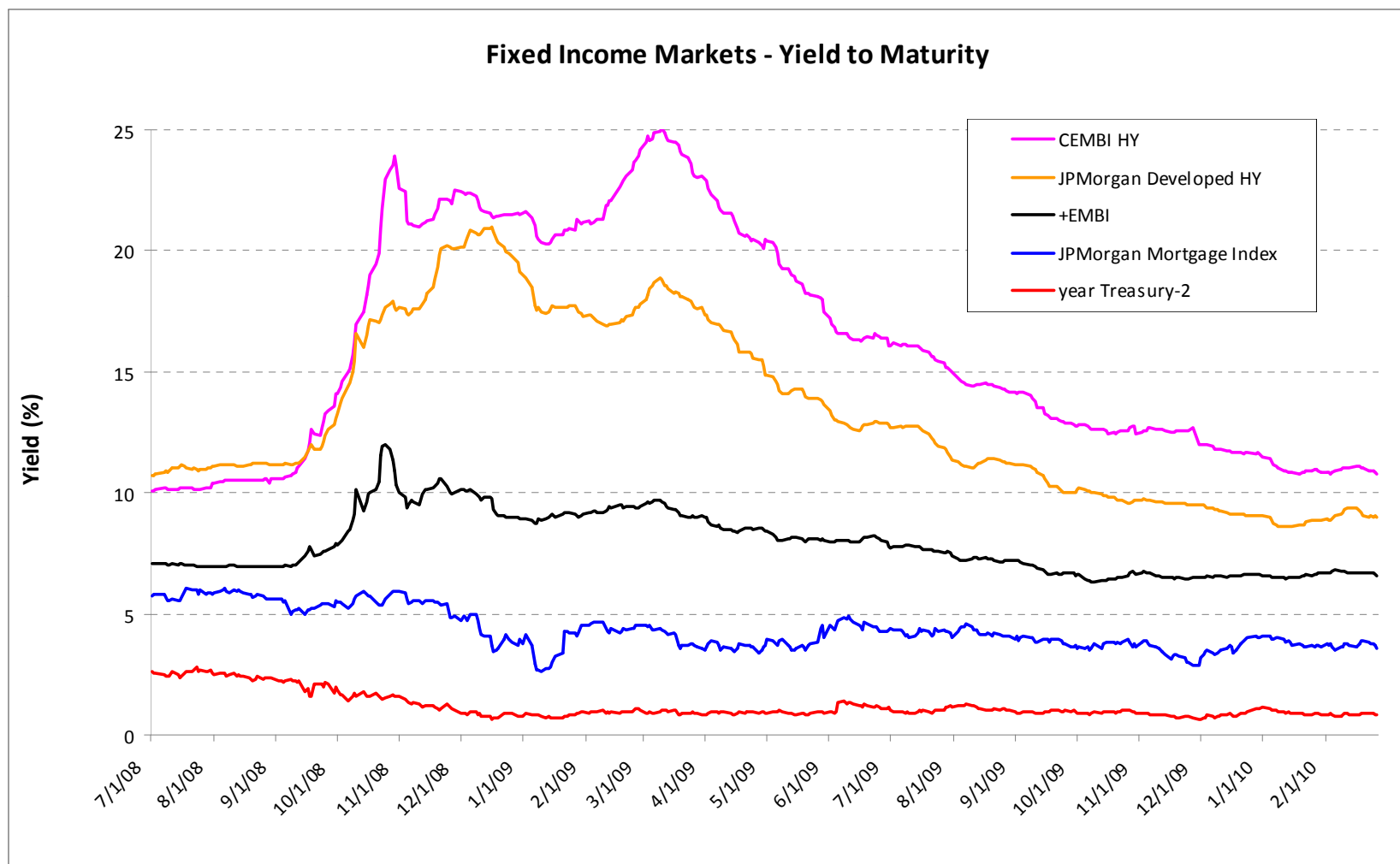
In providing our opinion on this, we will (very) briefly cover the following topics:

1. Can we identify a principal driver for the superior returns of 2009?
2. If so, what does that mean for the investment return outlook for 2010 and beyond?
3. In that context, are there any asset classes that may still provide superior returns?

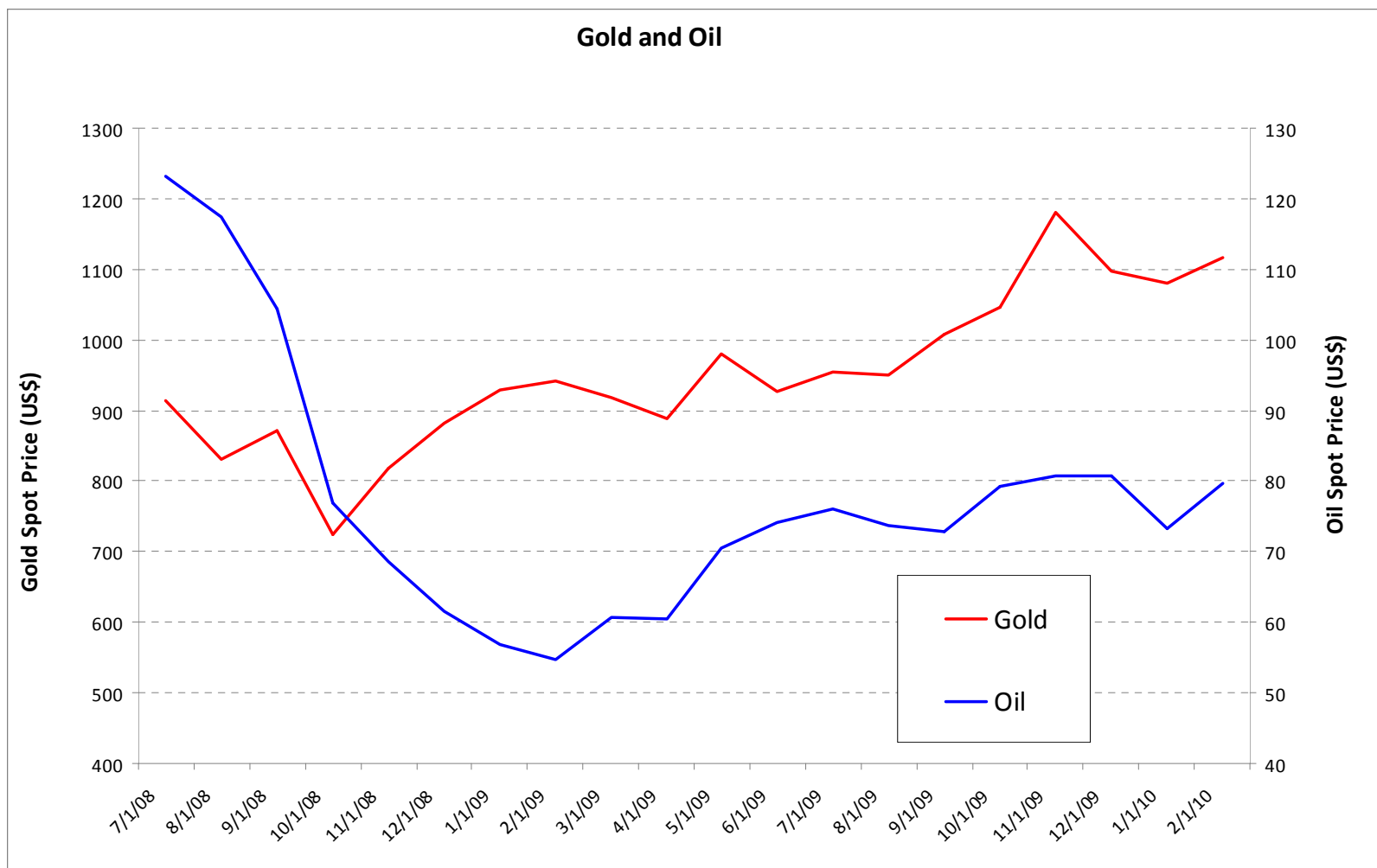
The Crisis and 2009 Rebound



The Crisis and 2009 Rebound

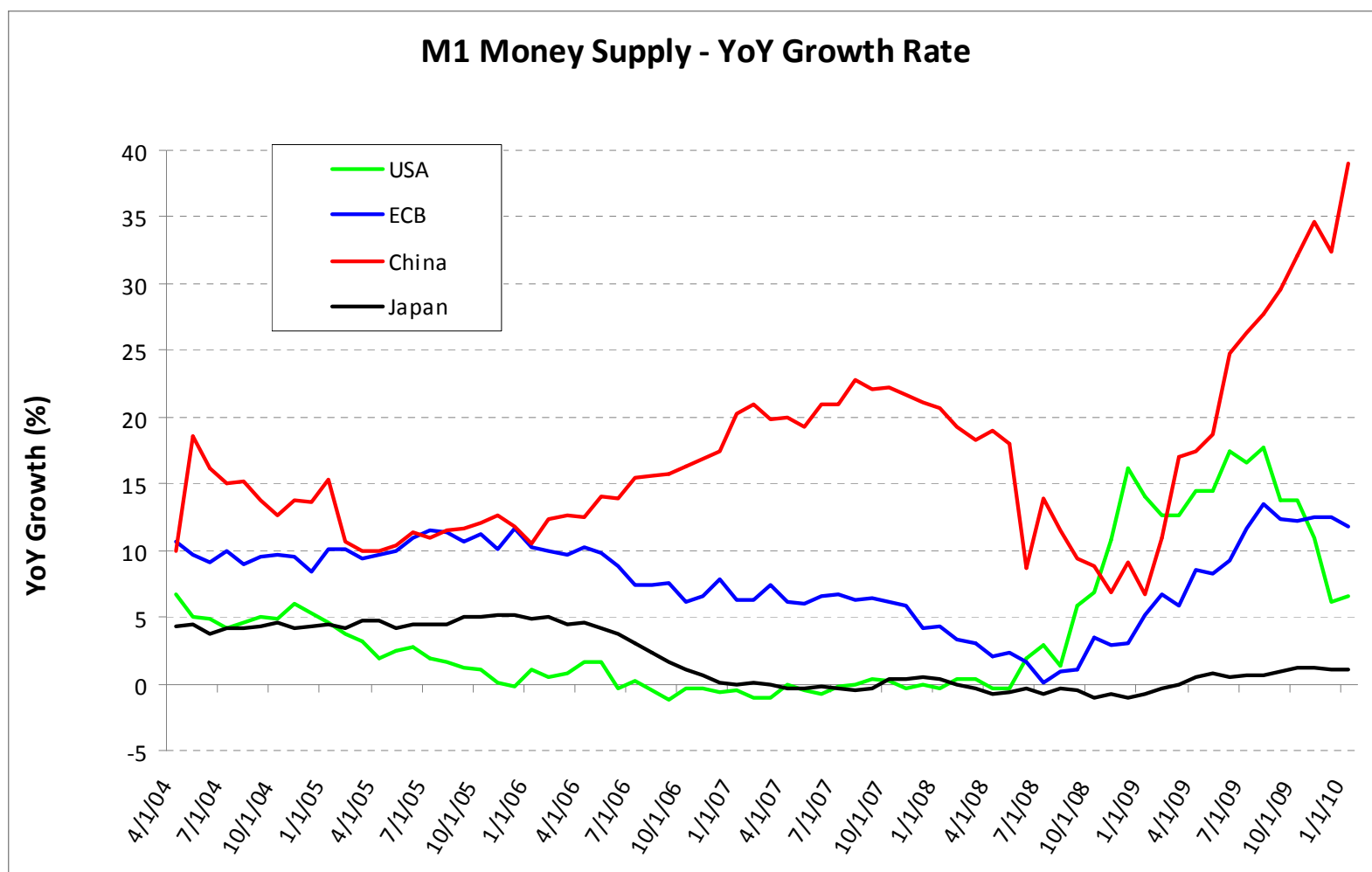


The Crisis and 2009 Rebound



Principal Driver for the Superior Returns of 2009

Stimulus Does Work: Money Supply



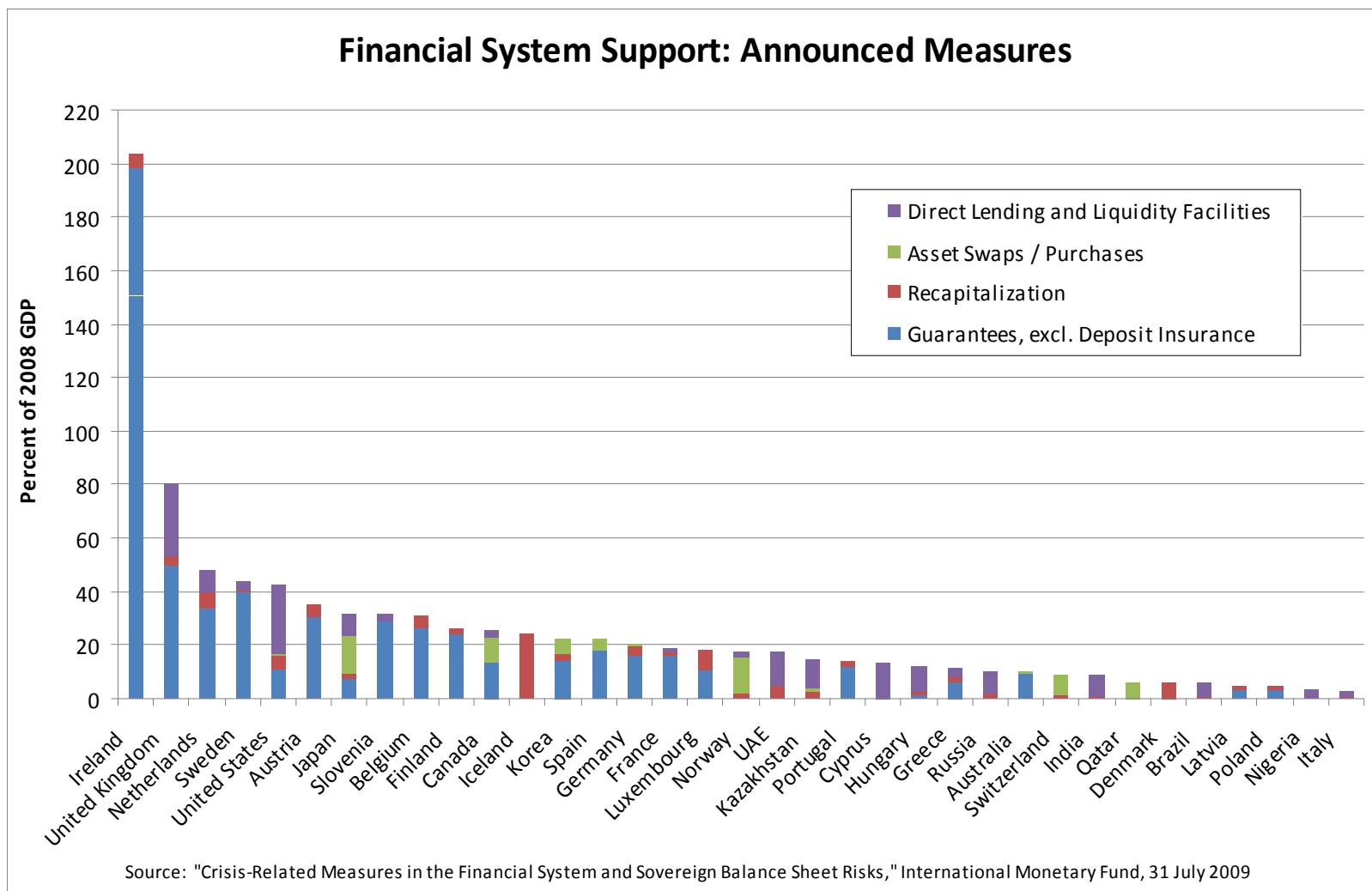
Principal Driver for the Superior Returns of 2009

Stimulus Does Work: Government Stimulus Packages

Country	Total Announced Fiscal Rescue Package	Fiscal Package in \$ billions	Rescue Package as a % of GDP
Argentina	\$13.2 billion	13.2	3.9
Australia	\$10.15 billion	10.2	0.9
Austria	\$3.7 billion	3.7	0.6
Belgium	€2 billion	2.5	0.6
Brazil	\$3.6 billion	3.6	0.2
Canada	\$43.6 billion	43.6	0.7
Chile	\$4 billion	4.0	2.2
China	\$586 billion	586.0	6.9
Czech Rep	\$7.8 billion	7.8	
Finland	\$2.6 billion	2.6	1.7
France	€26 billion	33.0	1.3
Germany	€82 billion	103.3	1.6
Hungary	\$6.5 billion	6.5	4.0
Iceland	\$2.1 billion	2.1	5.3
India	\$4 billion	4.0	0.3
Indonesia	\$4.5 billion	4.5	0.9
Italy	€5 billion	6.3	0.3
Japan	\$110 billion	110.0	2.9
Korea	\$10.8 billion	10.8	1.1
Malaysia	MYR 7 billion	1.9	1.0
Mexico	\$54 billion	54.0	4.7
Netherlands	€6 billion	7.6	1.0
New Zealand	\$5 billion	5.0	3.7
Norway	\$2.9 billion	2.9	0.6
Philippines	PHP 300 billion	6.1	4.0
Poland	\$31.4 billion	31.4	5.5
Portugal	€2.2 billion	2.8	1.3
Russia	\$20 billion	20.0	1.1
Saudi Arabia	\$17.3 billion	17.3	3.3
South Africa	39 billion Rand	3.8	
Spain	€90 billion	113.4	8.1
Sweden	\$1.0 billion	1.0	3.0
Switzerland	\$1.34 billion	1.3	0.3
Thailand	THB 300 billion	9.1	3.3
United Kingdom	£25.6 billion	36.4	0.9
United States	\$787 billion	787.0	5.5
Vietnam	\$1 billion	1.0	1.1
Total		\$2,060	
World GDP in 2008		\$62,054	
Total Fiscal Package as a % of World GDP		3.32%	

Principal Driver for the Superior Returns of 2009

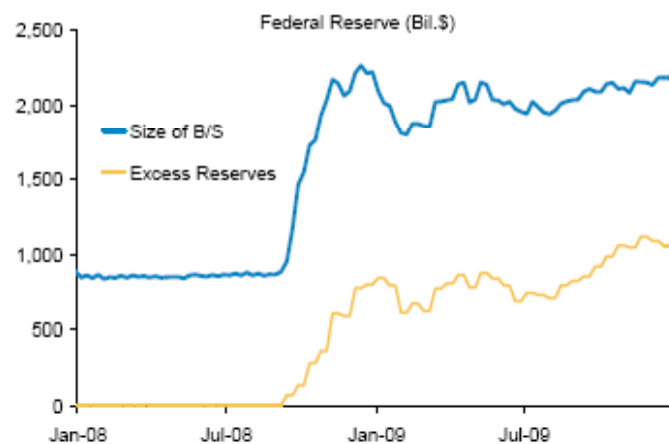
Stimulus Does Work: Financial System Bailouts



Principal Driver for the Superior Returns of 2009

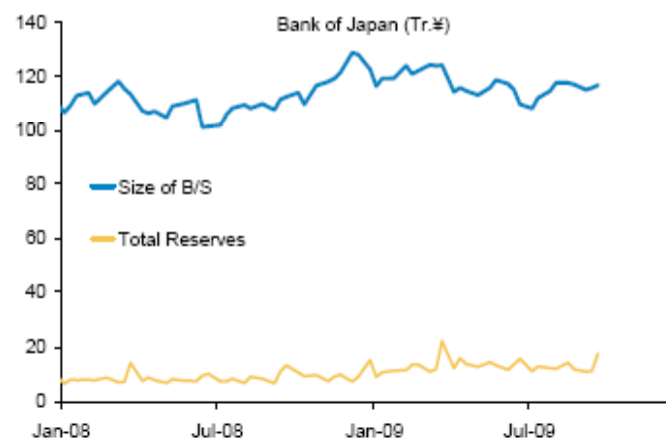
Stimulus Does Work: Central Bank Bloating

US



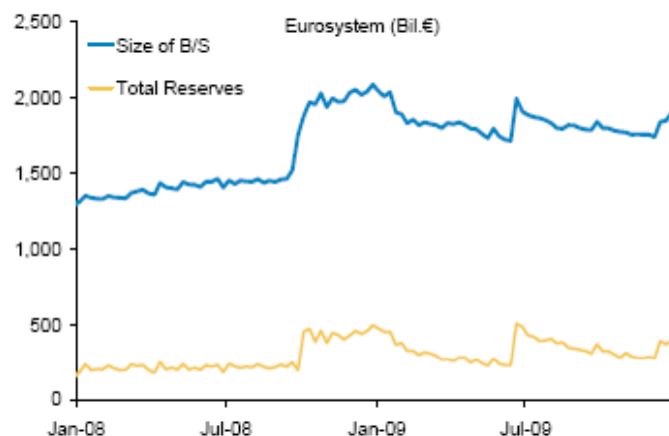
Source: Haver Analytics

Japan

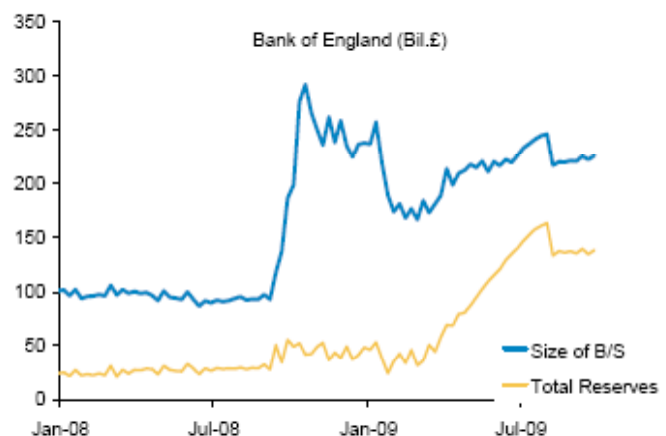


Source: Haver Analytics

Europe



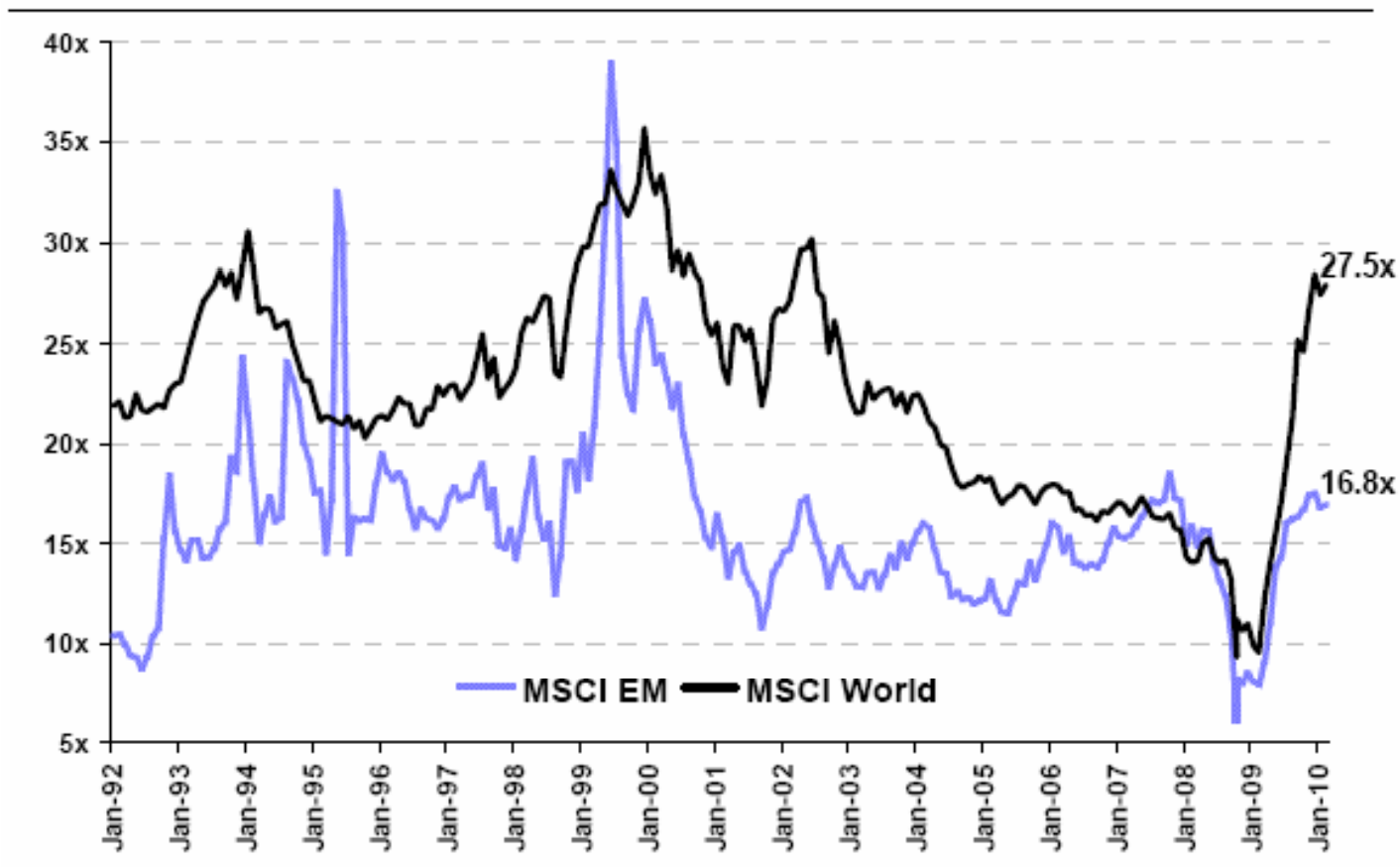
UK



Source: Haver Analytics

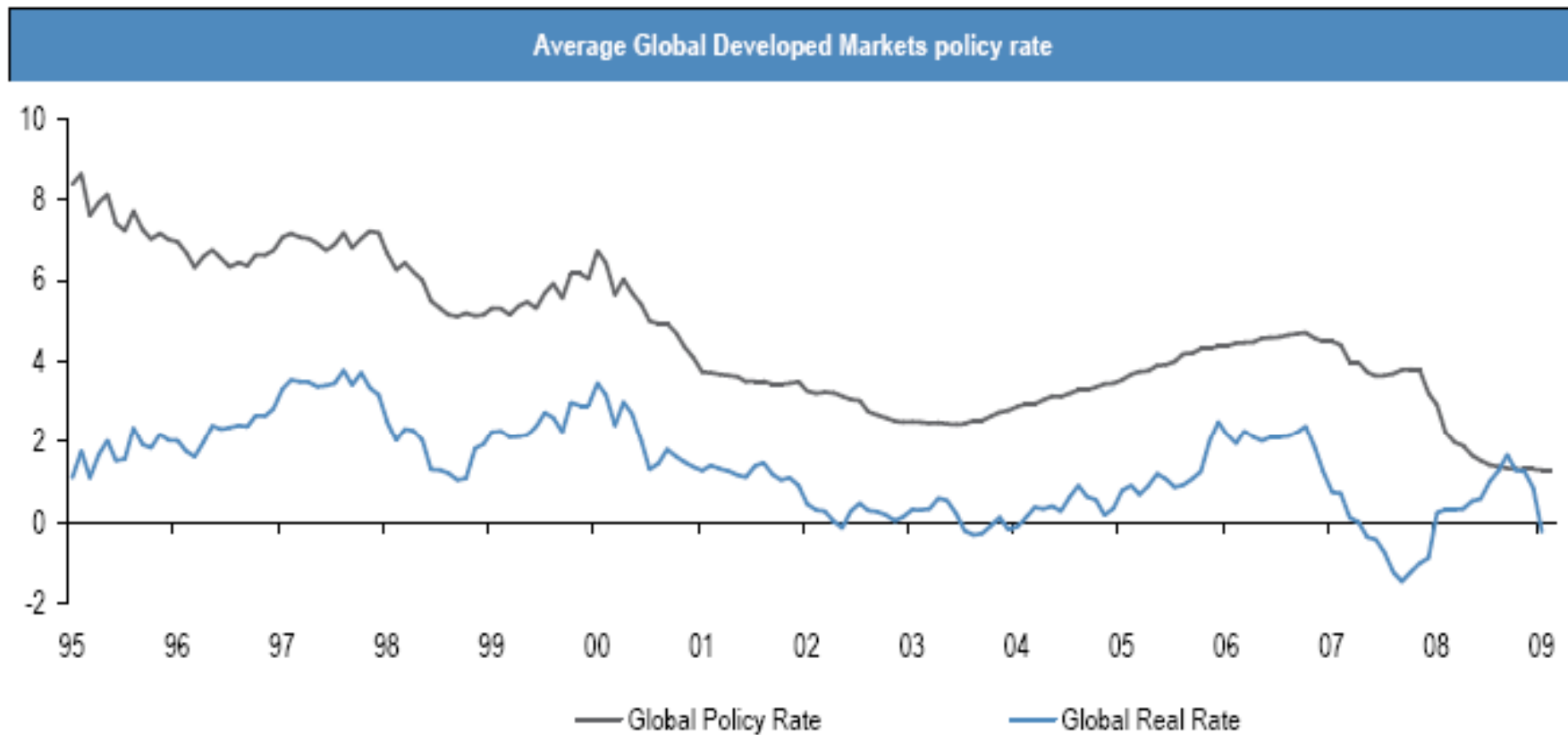
Post-Crisis, Pre-Tightening State of Affairs: Equities

Trailing P/E, 1992-2009: MSCI EM versus MSCI World



Source: MSCI, FactSet, Morgan Stanley Research. Data as of 02/18/10.

Post-Crisis, Pre-Tightening State of Affairs: Real Rates



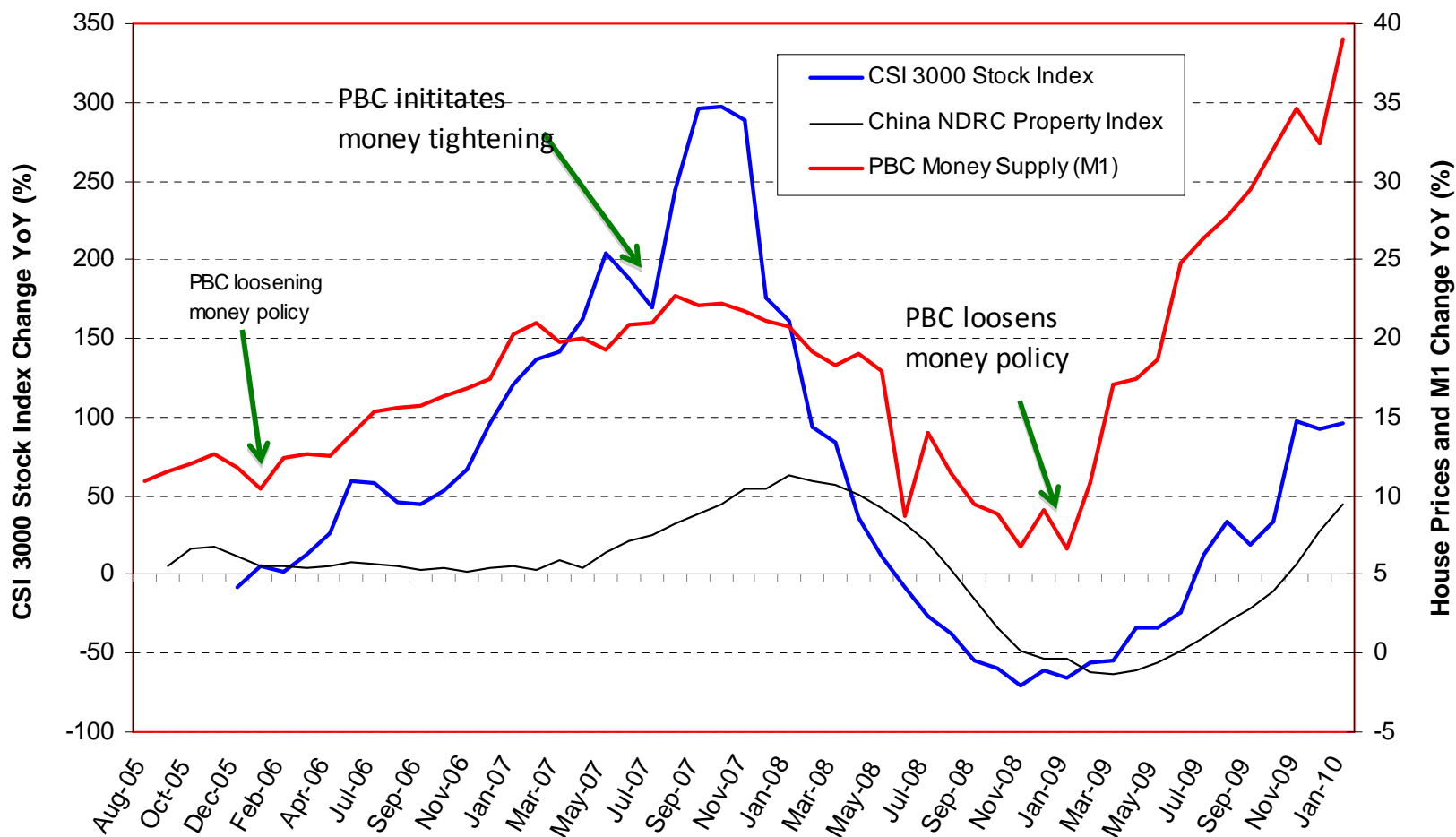
Post-Crisis, Pre-Tightening State of Affairs: Correlation

Correlation Matrix (7/1/08 - 12/31/09)

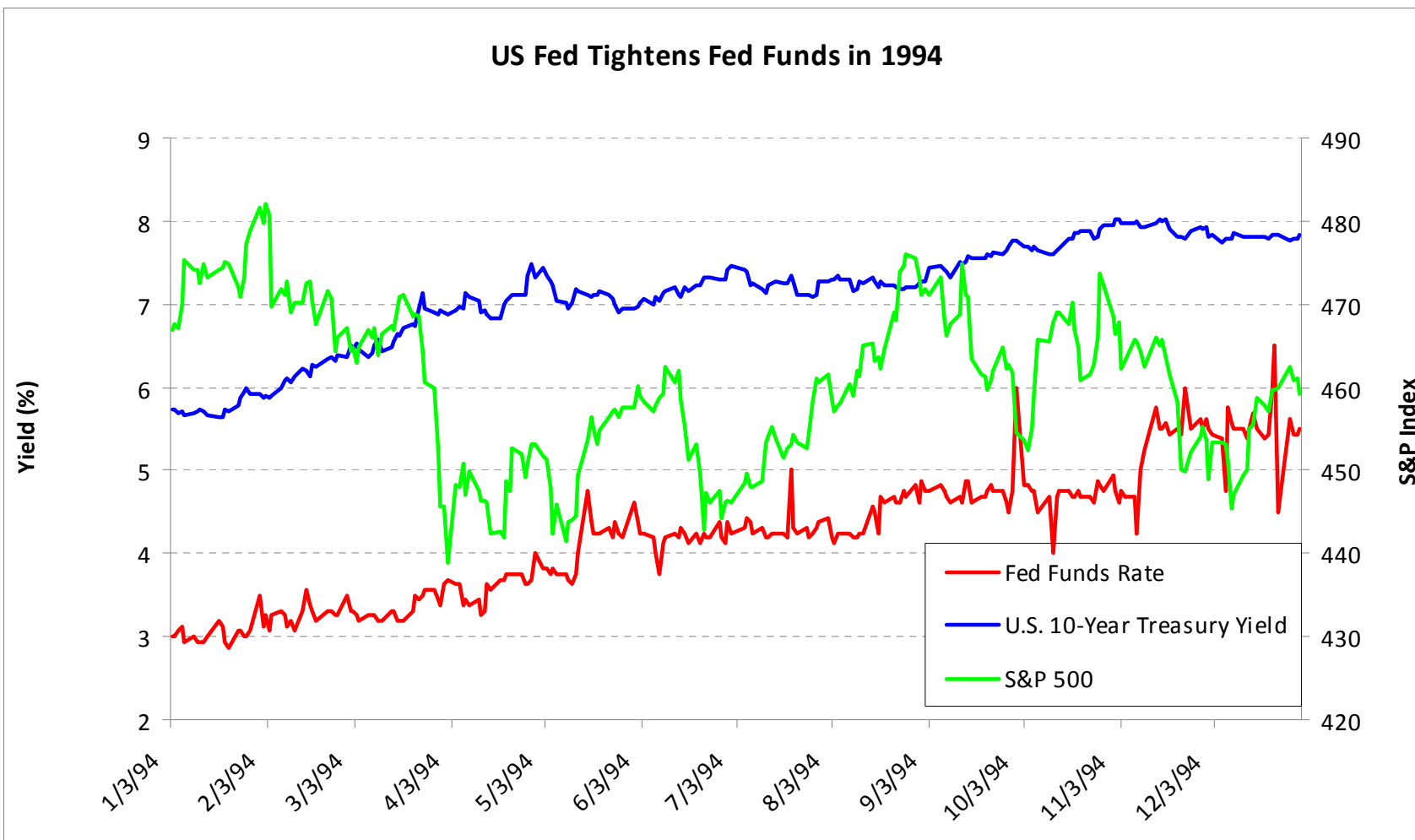
	S&P 500	MSCI EM	DJ-UBS Commodity	US\$ Dollar Index	EMBI+	JPM Global High Yield	Barclays U.S. Agg. Bond
S&P 500	1.00	0.89	0.80	(0.68)	0.75	0.78	0.44
MSCI EM	0.89	1.00	0.89	(0.81)	0.85	0.86	0.46
DJ-UBS Commodity	0.80	0.89	1.00	(0.73)	0.73	0.78	0.37
US\$ Dollar Index	(0.68)	(0.81)	(0.73)	1.00	(0.72)	(0.57)	(0.66)
EMBI+	0.75	0.85	0.73	(0.72)	1.00	0.84	0.72
JPM Global High Yield	0.78	0.86	0.78	(0.57)	0.84	1.00	0.31
Barclays U.S. Agg. Bond	0.44	0.46	0.37	(0.66)	0.72	0.31	1.00

What Goes Up Must Come Down: Stimulus Will End

China's Booms and Busts are Highly Correlated to Monetary Policy



What Goes Up Must Come Down: Stimulus Will End



It's 2010, What Will It Take to Generate Returns?

We at Gramercy have several elements underlying our investment thesis:

Investors must brace themselves for a post-stimulus environment, ie the world is entering a tightening phase as stimulus of all kinds will be withdrawn

All asset classes were correlated on the way up and will be correlated on the way down

Outside of China, most stimulus measures have been introduced in the developed markets and so it is these markets that will bear the brunt of the investment return pressure

Despite the withdrawal of stimulus measures, there is still a lot of private sector liquidity to be invested, and we would expect that it will all be chasing the same asset classes

It's 2010, What Will It Take to Generate Returns? (cont.)

Our conclusion is that the only investment strategies that will achieve reasonable absolute returns over the next couple years will have to have the following attributes:

Away-from-the-crowd strategies that nonetheless are large enough to have capacity

Strategies that are based on some form of strategic transformation

Investments that are not dependent on market beta

Inefficiencies in markets or barriers to entry that discourage homogenization

Core portfolio returns from traditional investments (equities and bonds) will be limited and thus less traditional investments should be seen as supplementing the core

We see two asset classes as meeting the criteria in today's environment:

Distressed Debt (Opportunistic Credit)

Emerging Markets

The Context for Distressed Debt Investing

Distressed debt investing has been recognized since the late 1980s as a legitimate investment strategy for institutional investors

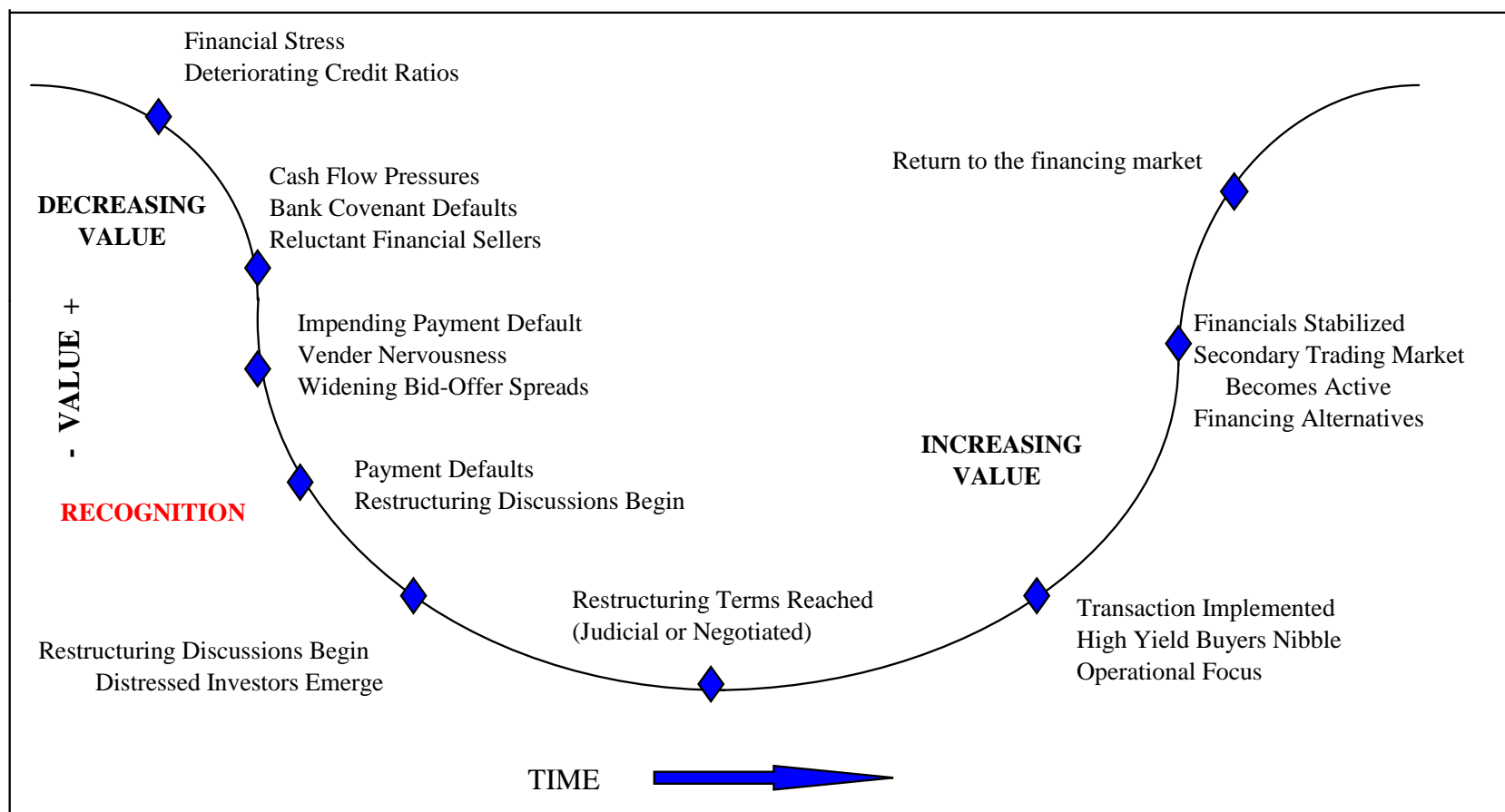
By its nature, distressed investing is an opportunistic strategy, where the potential for outsized returns is extremely cyclical by definition

The opportunities in this distressed cycle are unique and unprecedented.

- First, largely as a result of the LBO boom, years of excess liquidity, and the explosive growth of derivatives, the size of both the leveraged loan and high yield markets is now over \$2.5 trillion. With record amounts of debt outstanding, limited liquidity and risk-averse markets, there is an increased likelihood of future defaults.
- Moreover, as opposed to the previous distressed cycle, which was characterized by industry-specific effects (eg technology), and by isolated instances of fraud (eg Enron, WorldCom), the current cycle spans all industries, further widening the potential opportunity set.
- Finally, the difficult market of the past year and a half has reshuffled the key players: former investment banks' once-powerful proprietary trading desks have closed down. In addition, there are fewer providers of credit and substantially less competition to buy quality assets at attractive prices.

For survivors with capital and distressed expertise, the investment opportunities in this cycle are unprecedented.

The Context for Distressed Debt Investing



The Context for Distressed Debt Investing



Nathan Mayer Rothschild (1776 - 1836), financier and patriarch of the legendary House of Rothschild, attributed his success to two things.

- buying when “there was blood in the streets.”
- selling “too soon”

So distressed investing isn’t all that new!



The Context for Emerging Markets Investing

Most emerging markets countries have come a long way from the “lost decade” of the 1980s

Capital markets have become very active for sovereign and corporate external debt, tradable equities, and even local currency instruments

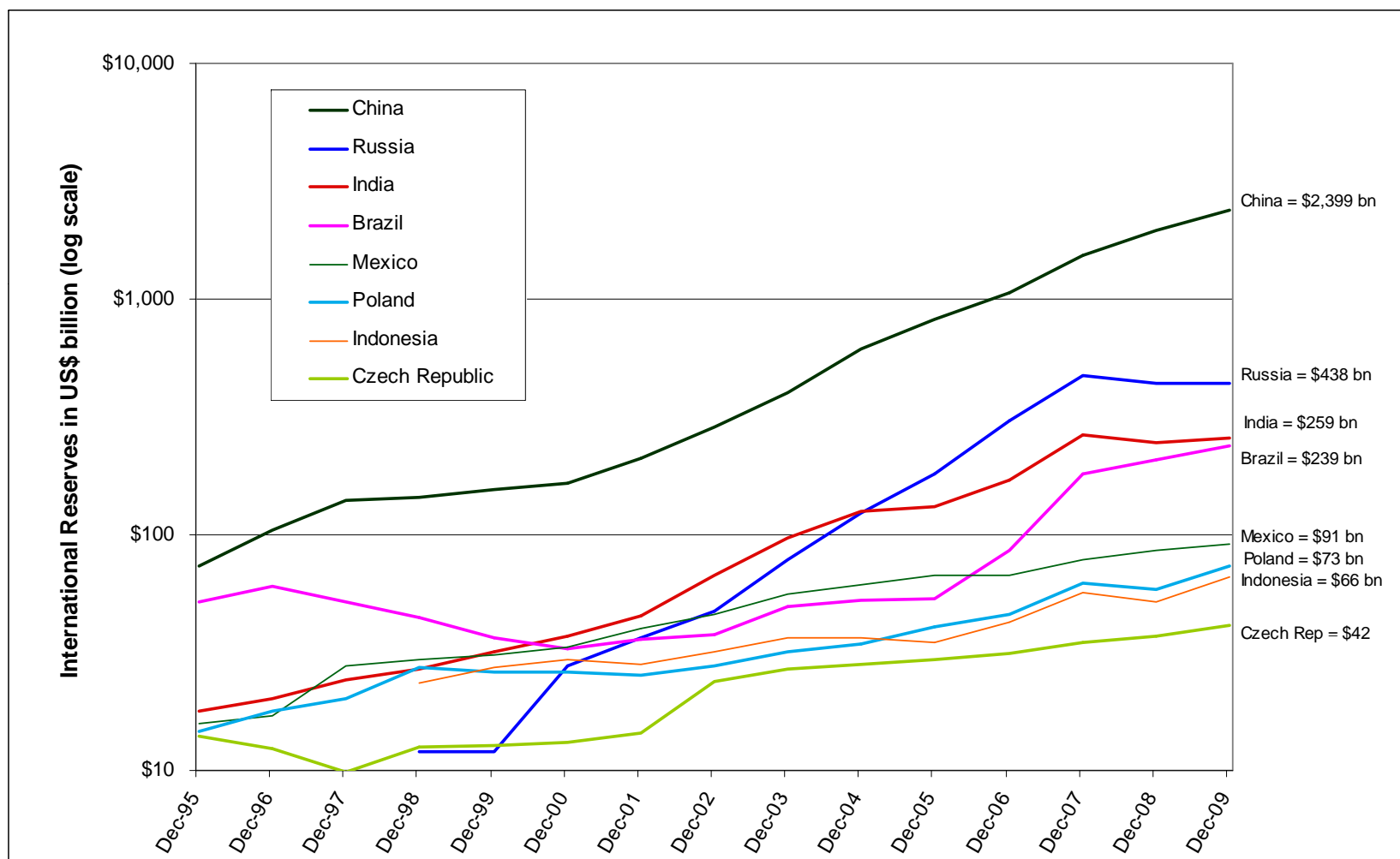
The markets have become fairly institutionalized since the mid-1990s with “real money” players as well as hedge funds and private investors, supported by extensive investment and commercial banking groups

Although the level of return potential reflects the current creditworthiness and current state of many EM situations, the underlying fundamentals continue to improve, which we believe will be supportive for generating absolute return over the next several years:

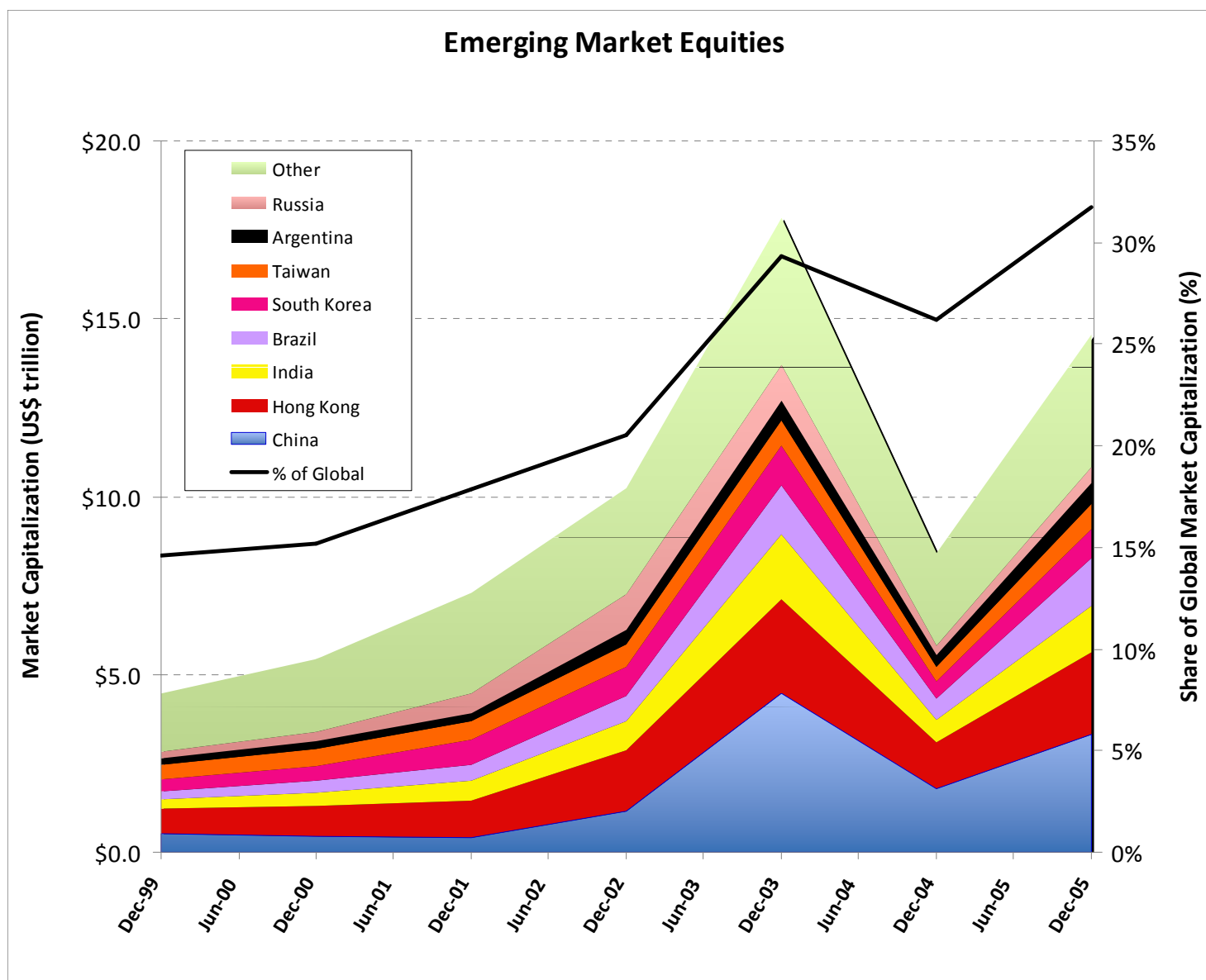
- commodity-rich economies benefiting from the eventual global economic rebound
- labor cost advantages and positive demographics
- ongoing improvement in governmental institutionalization and judiciaries
- fiscal discipline and sharply improving macroeconomic performance

The Context for Emerging Markets Investing

One Measure of the Transformation Taking Place in EM is the Level of Sovereign Reserves

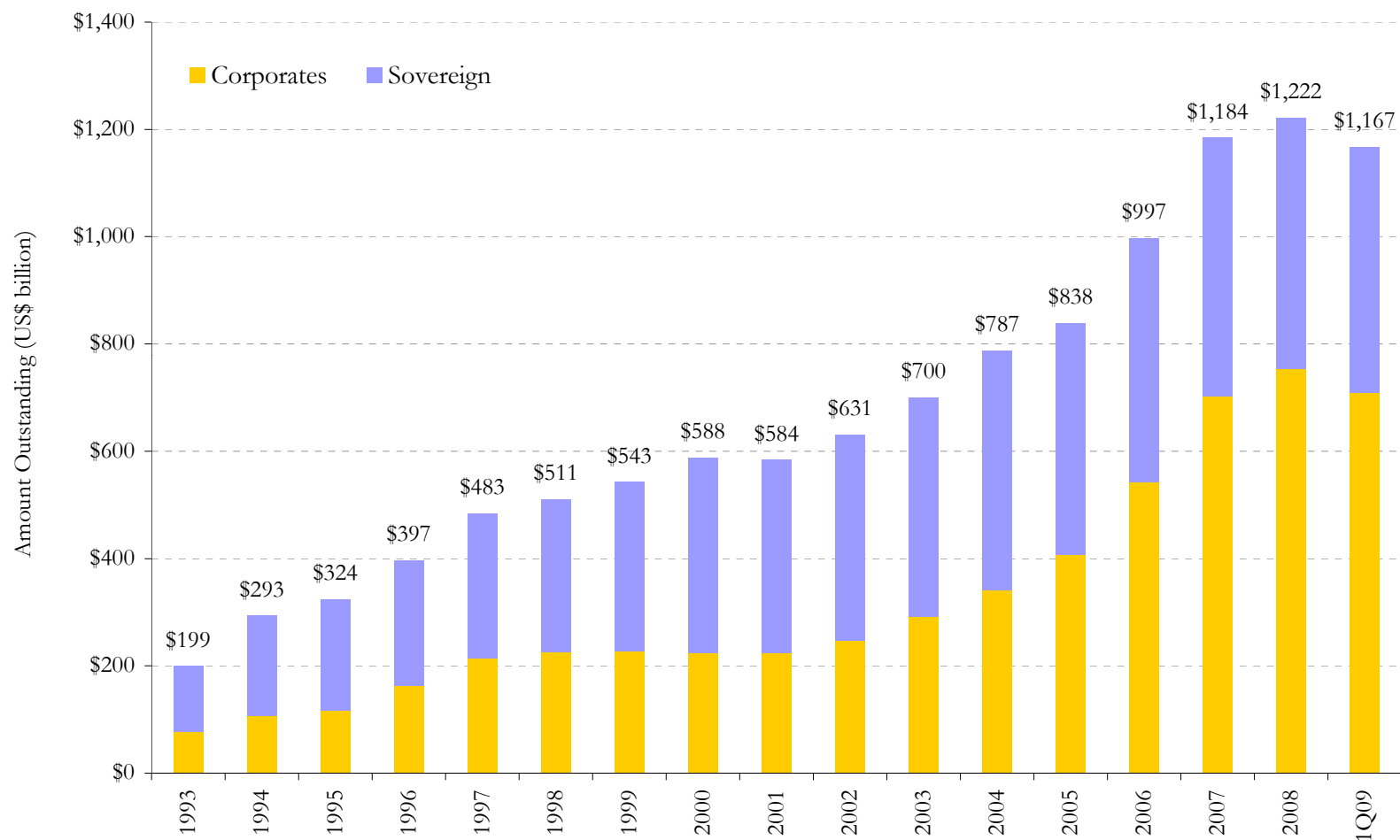


Emerging Markets Equities



Emerging Markets External Bonds Outstanding

Excludes Local Currency Issues



- Over the past three years, the sum of syndicated loans and bonds raised by EM corporates exceeded \$1.3 trillion including short term facilities rolled over during this time.
- Reliance on external financing has grown significantly.

The Context for Distressed Debt Investing in Emerging Markets

In the context of the global opportunity, we often get asked:

- Isn't distressed investing risky, and distressed investing in emerging markets even riskier?
- Why invest in emerging markets if you can get the same returns in the US?

As to general risk, buying debt securities once the bad news is already known and you are paying 60, or 30, or 10 cent on the dollar seems less risky than buying most high yield securities at 100 cents on the dollar when times are good

And there are three elements that make distressed debt investing in emerging markets, instead of just in the US or Europe, extremely attractive:

1. Breadth of market opportunity
2. Characteristics of the opportunities
3. Inefficiencies of the market

Emerging Markets Debt Amortization Schedule

We estimate there to be \$761.2 billion in emerging markets corporate syndicated loans and bonds amortizing by year end 2011 or roughly 32% of the total outstanding.

GLOBAL EMERGING MARKET'S DEBT AMORTIZATIONS: 2 nd Half 2009 -2011													
(US \$ billions)													
Region	Debt Amortizations – 2 nd Half 2009				Debt Amortizations – 2010				Debt Amortizations – 2011				Grand Total
	Sovereign Bonds	Corporate Bonds	Corporate Loans	2009 Total	Sovereign Bonds	Corporate Bonds	Corporate Loans	2010 Total	Sovereign Bonds	Corporate Bonds	Corporate Loans	2011 Total	
Asia	0.0	11.3	38.2	49.5	0.0	29.0	79.2	108.2	0.0	31.2	114.7	146.0	303.7
Emerging Europe	0.8	2.5	10.6	13.8	9.4	3.0	20.4	32.8	8.1	5.3	13.1	26.4	73.0
CIS	1.4	10.8	15.7	28.0	2.1	16.1	36.7	54.8	2.9	13.8	23.9	40.6	123.4
Middle East / Africa	2.2	7.9	24.2	34.4	2.4	12.9	26.2	41.4	3.4	12.9	49.3	65.5	141.4
Latin America	1.36	3.1	17.9	22.2	7.9	9.6	31.5	48.9	8.4	7.2	33.0	48.6	119.8
Total	5.7	35.6	106.5	147.9	21.7	70.5	194.0	286.2	22.9	70.4	234.0	327.2	761.2

Characteristics of Emerging Markets Distressed Opportunities

US and European distressed debt opportunities are predominantly with significantly overlevered companies which had undergone LBOs in the liquidity driven frenzy of the 2005-2007 period.

We have always viewed emerging markets as an opportunistic, spillover asset class, a beneficiary of excessive global liquidity and a casualty when global liquidity recedes.

Companies in the emerging markets with access to the capital or syndicated loan markets were those who were globally competitive and maintained above average corporate governance standards.

Despite record levels of issuance in emerging markets over the same period, most of the lending/investing was done for expansion or refinancing, not for wildly aggressive LBOs.

With credit availability limited (or at least prohibitively expensive), many otherwise sound emerging markets companies will either default on their obligations or seek the assistance of private investors to restructure.

We expect most corporate or sovereign defaults in emerging markets to be driven by a lack of ability to refinance in the current market environment, not due to a lack of solvency. By the end of this current cycle, we expect US\$300-400 billion of defaults.



Inefficiencies in the Emerging Markets Distressed Market

Careful consideration of both process risk and valuation analysis

- Controlling shareholders
- Creditors involved in the process
- Technical factors of the markets
- Legal and other negotiating leverage
- Fundamental valuation understanding

Willingness to take an active (control) role

Market-making role in the absence of positioning capacity by Wall Street

In the end, you will get what you negotiate, not what you deserve, so the process requires an understanding and management of the process risk elements.

Inefficiencies in the Emerging Markets Distressed Market

Market pricing is extremely inefficient because there are very few investors focused on this market in comparison with the developed markets

- Limited number of dedicated players
- Few active (control) players
- Selective information flows
- OTC trading
- Non-judicial restructuring solutions typically

Returns in distressed investing are typically driven by the level at which you get in; this lack of competition is the basis for the alpha generating opportunities we see in the distressed emerging markets, which we anticipate will exceed 40% p.a. over the next several years.

With all of the capital mobilized over the last three years for distressed investing in the US and Europe, we anticipate actual returns will fall far short of expectations due to the competition for product.

Background of Robert L. Rauch

Robert L. Rauch, 51, is a Partner and Director of Research of Gramercy Advisors LLC. Gramercy is an event-driven hedge fund with US\$ 2.6 billion of funds under management specializing in opportunistic corporate and sovereign investments in global emerging markets. Mr. Rauch oversees research and the corporate restructuring activities of Gramercy, chairs the Investment Committee, and serves as portfolio manager for several Gramercy funds. He has been, or is currently involved, as a leading creditor or advisor in the restructuring of numerous companies in Asia, Eastern Europe, and Latin America including Accel, Alestra, Asia Pulp and Paper, BTA Bank, Dina, Durango, Essar Steel, Grupo Industrias Unidas, Iusacell, Mechala, Medefin, San Luis, Satmex, SIDEK, Synkro, and Transtel. He also oversees the firm's investments in and proprietary servicing platform for non-performing residential mortgage and commercial loan portfolios.

Prior to joining Gramercy at the end of 2000, Mr. Rauch worked as a consultant to hedge funds managed by Van Eck Global and Farallon Capital Management, specializing in the analysis of emerging markets special situations. From 1994 to 1999, Mr. Rauch was President of The Weston Group, where he was responsible for overseeing the firm's securities research and brokerage activities focusing on Latin America. In the early 1990s, Mr. Rauch worked as a Vice President with Lehman Brothers and CS First Boston in their emerging market fixed income trading groups. In the second half of the 1980s, he was a Vice President and trader with First Interstate Bank's loan syndications group, where he was responsible for structuring and syndicating loan facilities to highly-leveraged American and Asian corporations. In 1980, he began his career with Swiss Bank Corporation in several credit and corporate finance roles.

Mr. Rauch received a BA in Political Economy at Williams College and an MM in Finance and International Business at Northwestern University – Kellogg Graduate School of Management. He is a Member of the American Bankruptcy Institute and is a registered representative of FINRA (series 7, 24, 63).