



# The BRICS and the Beatles

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**I**n the last Latin Letter (*Watch with Glittering Eyes – Issue 233*) I ended the column by mentioning how morals were now being used by developed countries as part of their arsenal in the assault on the traditional offshore financial centres.

Although it now becomes even more important for those financial centres to defend their virtues (but also to recognise, and remedy as best they can, their vices), it is essential for them at the same time to recognise that for the foreseeable future things have changed.

In the same vein it is equally important for developed countries, intent on a new commercial moral code, to accept that money, which George Bernard Shaw said was one of the two things necessary to salvation (the other being gunpowder), carries no passport and is now more at home in the emerging world, a world which can certainly no longer be identified by the nomenclature, the third world. This new world is expected to account for three-quarters of global economic growth by 2020, but, unfortunately, it doesn't follow that any Western moral code will travel as smoothly to other destinations as money does, but that's a subject for another time.

This emerging world has a powerful symbol in the acronym BRIC. But what makes a BRIC tick? It has been suggested that this grouping of four diverse countries (Brazil, Russia, India and China) has concealed their individuality as the exceptionally good times rolled during the last 11 years and they were the darlings of stock market bulls. In 2002 the BRIC stock exchanges accounted for 3% of the total market value of members of the World Federation of Exchanges and by 2011 this figure had increased to 20%. It was also the year when funds raised for private equity and venture capital investment in Latin America hit a record, with investors taking advantage of the pace of the region's economic growth. The sum raised was USD10.3 billion (27% more than 2010 which had already been a record year) according to the Latin American Private Equity & Venture Capital Association. So Brazil, despite wearing the mantle of a BRIC, is not the only regional success story.

Since 1990 the Morgan Stanley Capital International index of Latin American stocks has risen by nearly 1,400% (double that of the MSCI World index) and during that period Latin American capital markets have matured considerably. Banking systems have become much stronger (consider the subdued impact the West's own banking crisis had) and domestic bond markets have become sturdier. Additionally, stock markets have expanded whilst local pension funds have grown with corresponding development of alternative markets such as derivatives and exchange traded funds. Today Brazil has the third largest securities exchange in the world.

In the first nine months of last year, the latest data to hand, Latin American bond issues reached a record USD120 billion and last September Spanish bank Santander raised USD4.1 billion in an initial public offering of its Mexican subsidiary which turned out to be the third largest IPO globally that year. These and other related successes boil down to several factors, the most important being not just better economic policy but improved financial regulation and supervision too. Not to be overlooked, however, in the equation is that, similar to China, there is a growing middle-class domestic market for goods and services.

Even if most Latin American equity markets remain concentrated and illiquid, global seekers of investment yield see plentiful opportunities. Near the end of last year, for instance, Bolivia issued its first overseas bond since the 1920s, a USD500 million ten year issue with a 4.9% yield which was then almost a percentage point less than Spain's ten year borrowing costs. Domestic markets are also being tapped by Latin sovereigns to raise money, particularly those fixed income markets in Brazil, Mexico, Colombia and Chile.

In fact, Chile (the region's investment-grade pioneer) has set its sights on becoming a centre for investors from abroad to profit from a region with sustained growth and potential high rewards. The country has professionals with knowledge of the big South American economies and

thus considers itself the platform from which to make regional investments. The only (and considerable) hurdle, however, it needs to surmount is the enactment of solid supporting regulation.

Aligned with Chile's ambitions has been the creation of Mercado Integrado Latinoamericano which has now integrated the national exchanges of Colombia, Peru and Chile; their central securities depositories have also been combined. This harmonisation of information technology and trading rules is the start of providing attractive access to investments; the inclusion of other big countries would only enhance the attractiveness of this rich and diverse region to outsiders.

But first there is a need to address cross-border tax issues. To work best a tax-neutral level playing field is necessary. Worryingly, individual countries have great difficulty in reconciling the myriad problems within their own tax systems (particularly Brazil) so it begs the question: what chance has an expansion of the integration model got? It will be a slow process developing the necessary dialogue among regulators and tax authorities.

A constant theme in my writing over several years has been the importance of culture in business, whether specifically investment or not. This theme was again brought to mind when I heard that the BRICs had been compared to the Beatles – although, rather than fans throwing jelly babies, it has been money instead. The question posed was whether or not the BRICs popularity, in investors' eyes, will come to an end like the pop group did?

I don't blame you scratching your head, but the analogy added to the rich seam of evidence leading to my point about culture. I should say, though, that the acronymic order in which the countries were placed corresponds with the name-order by which the Beatles were known to their fans: John, temperamental (Brazil), Paul, combining coldness and warmth (Russia), George, contemplative and spiritual (India) and unpredictable Ringo (China).

Importantly, the Beatles were all English (they even came from the same city) and they always sang in harmony. Not the BRICs. Although bunching four emerging markets into a brand name or applying an acronym (this does seem, in particular, to be an

American proclivity) it is very misleading when these countries have such deep cultural, intellectual, religious and social differences. Just as the former Beatles illustrated after they disbanded, each member of the BRICs has its own destiny and will enjoy varying degrees of success. Like the Beatles music, they too are evolutionary in the scheme of things and form part of the next generation of countries that will be driving the world's economy in the future.

But all of the emerging markets present political risks, and in that context the BRICs are a good illustration of this. Russia, for example, is much riskier than Brazil as we see its energy industry stall and the middle class tires of deep-seated corruption. Both, however, will be challenged by the reduction in exports because the appetites of consumers in the United States of America and Europe have been curbed as the flow of credit-fuelled purchases slows down; at the same time, however, Russia is also benefiting from a growing number of middle-class domestic consumers.

Besides studying the culture of each emerging market where investment is contemplated, it is equally important to consider each country's governance – even if politically the picture is good. Latin America, for example, has issues surrounding transparency, legality and fairness. Investors – be they individuals or multinational companies from abroad – have to accept the differing levels of enforcement of those three factors to be found across the region. In particular, for commercial or industrial enterprises it is possible that any litigation that arises could take years to resolve. Brazil, the continent's leading economy, remains near the bottom of the World Bank's index for ease of doing business in Latin America; already its complex tax code and labyrinth of regulation presents a daunting challenge.

Generally, the region's countries also suffer from highly politicised justice systems and so the patience of Job and the wisdom of Solomon would be helpful for those who believe that large sums of money are necessary for salvation. Meanwhile, let's hope that economies in the West will stop reminding me of the title of one of The Beatles' many hits, "Help!".

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