

The Continuing Case for Emerging Markets, Revisited

In February 2004, Everest Capital authored a White Paper titled "The Continuing Case for Emerging Markets" highlighting our positive outlook for emerging markets equities. We revisit our thesis below, and reiterate our favorable view for the performance of the asset class.

- Emerging market equities remain a compelling investment opportunity, offering double-digit earnings growth at single-digit multiples, a concept we call "Super-GARP."
- Strong country fundamentals continue to provide a supportive economic backdrop for further equity returns. Key factors supporting our call remain intact.
- Higher profitability, stronger balance sheets and sustainable earnings growth are not reflected in current market valuations.

Emerging market equities outperformed developed market peers again in 2004, marking a fourth consecutive year of outperformance. Emerging market equities are currently trading at more attractive trailing and forward valuations than when we published our original white paper a year ago, as strong earnings growth outpaced the positive performance of the asset class over the past year. This underscores our view that the fundamental factors supporting our bullish case for the asset class have yet to be fully priced into equity valuations.

Chart 1: "Super-GARP:" GROWTH AT VERY REASONABLE PRICES

Emerging Markets Aggregate Financials

With earnings growth of 22% over the last five years, emerging markets as a group offer excellent growth opportunities . . .

	<u>1999</u>	<u>2004e</u>	<u>5-Yr CAGR</u>
Revenue	213.9	442.6	15.7%
EBITDA	50.1	111.5	17.4%
Net Income	20.4	55.6	22.1%

. . . yet are undervalued, trading at a 9.5x P/E ratio.



Emerging Markets:

A Rediscovered Asset Class

Emerging market equities outperformed the S&P 500 and the broader MSCI World Free Index over the one-, three- and five-year periods ending December 31, 2004. Emerging markets equities also outperformed the JP Morgan Emerging Market Bond Index (EMBI+), supporting our view, expressed in February 2004, that sovereign bonds have largely priced in the strong economic fundamentals that underpin our positive outlook for emerging market equities. The EMBI+ index rose 11.8% over the last year, while emerging market equities rose 25.1% over the same period.

Chart 2: Performance of MSCI Emerging Markets Free versus Developed Markets as of December 31, 2004

	MSCI EMF	MSCI WORLD	S&P 500
1 Year			
Annualized Return	25.1%	15.4%	10.8%
Volatility	18.2%	10.5%	10.8%
Sharpe Ratio	1.4	1.5	1.0
3 Year			
Annualized Return	20.7%	4.1%	1.0%
Volatility	18.0%	14.6%	16.1%
Sharpe Ratio	1.2	0.3	0.1
5 Year			
Annualized Return	3.6%	-3.0%	-3.3%
Volatility	20.1%	16.4%	19.0%
Sharpe Ratio	0.2	-0.2	-0.2

The MSCI Emerging Markets Free Index (EMF) has outperformed developed market equities on an absolute basis over the last one-, three- and five-year periods

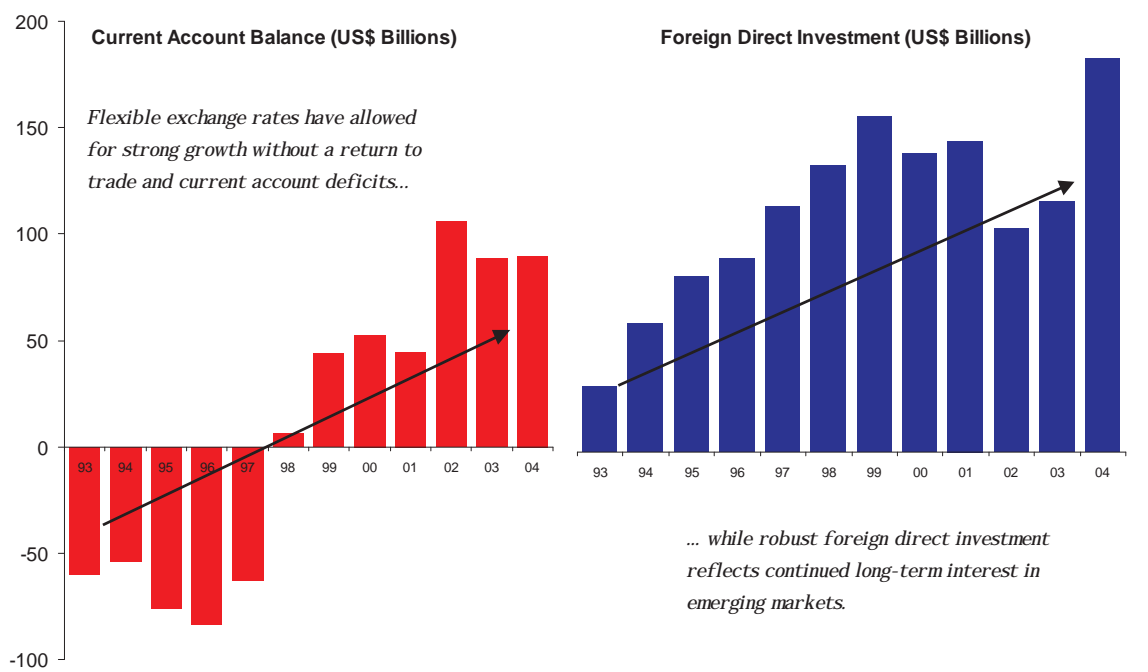
Source: MSCI, Bloomberg, Everest Capital

Emerging Markets:

Fundamentals Continue to Support our Bullish Outlook

The investment case for emerging markets is predicated on their ability to generate economic and earnings growth in excess of developed peers. We believe that fundamental factors, such as structural reforms, flexible exchange rates, easier monetary policies, the Chinese domestic growth story, elevated commodity prices, foreign direct investment and strong external accounts, remain intact and support the sustainability of the current growth cycle for developing countries (see Chart 3).

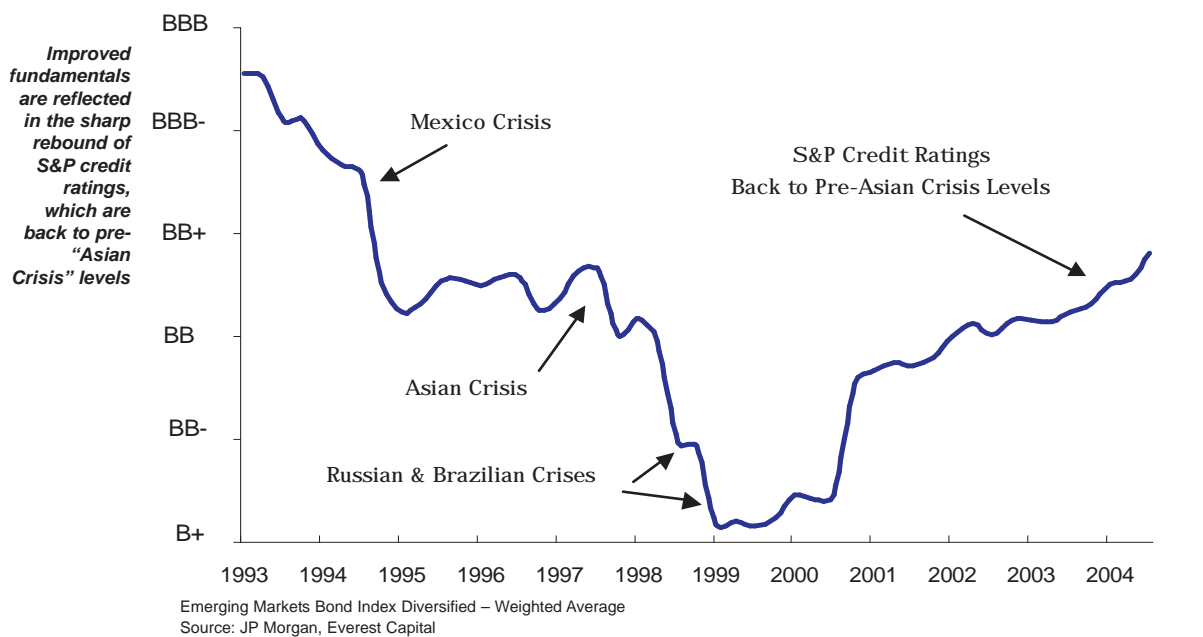
Chart 3: Emerging Market Current Account Balances & Foreign Direct Investment (1993-2004)



Positive reform momentum further bolstered our investment thesis over the past year, with numerous countries reaching notable milestones. The admittance of several Eastern European countries into the European Union was an important formal acknowledgement of structural reform gains made over recent years. Turkey also reached a previously unexpected agreement with the European Union to begin accession talks in 2005. In addition, Taiwan addressed inefficiencies within its capital markets via the removal of investment restrictions, while Brazil welcomed new equity issuers with simplified share structures and greater adherence to developed market corporate governance practices. The structural gains achieved by many developing countries were unfortunately accompanied by a high-profile setback to corporate governance practices in Russia with the Yukos affair, which succeeded in denting confidence in Russian policymakers' adherence to market reforms. This highlights the need for a diversified approach to investing in emerging markets.

We underscore that our constructive view of the asset class is in large part explained by the positive internally generated momentum associated with policymakers' and corporate managements' proactive reply to the difficulties of the late 1990's, rather than entirely a reflection of a more supportive global backdrop. This is evidenced by the continued rebound of the S&P credit ratings for emerging markets external debt (see Chart 4) and the sharp reduction in sovereign bond spreads, which are currently near six-year lows of 359 basis points above U.S. Treasuries.

Chart 4: Standard & Poor's Credit Ratings of the Emerging Markets Bond Index



Emerging Markets:

Emerging Markets Inc.: Super-GARP

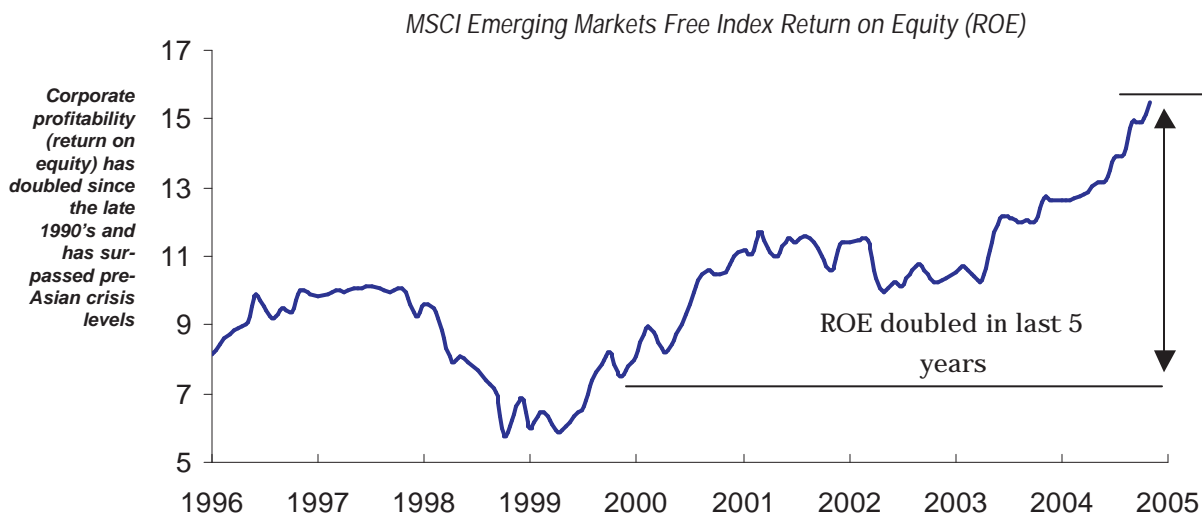
Corporate fundamentals also improved over the last year, as illustrated by the aggregated financial statements of emerging market companies. We have dubbed this “company” *Emerging Markets Inc.*, and have analyzed its financial statements as we would an individual company (see Chart 5).

Our analysis shows that *Emerging Markets Inc.* posted another strong year of earnings growth in 2004, driven by higher revenues and further margin expansion. *Emerging Markets Inc.* also further strengthened its balance sheet, reducing its leverage ratio (Net Debt to EBITDA) to a low of 0.7x versus 1.3x five years ago and 0.9x one year ago. Continued focus on profitability and corporate governance also led to further improvement in the return on equity (ROE) of the MSCI Emerging Market Free Index, rising to over 15% by year-end 2004 from 13.4% a year earlier and a low of 5.8% in early-1999 (see Chart 5).

Chart 5: *Emerging Markets Inc.* (Aggregated Financial Statements, in US\$ Billions)

With earnings growth at 22% over the five years and a significantly stronger balance sheet, *Emerging Markets Inc.* appears undervalued, trading at a single digit P/E ratio

	1999	2004e	5-Yr CAGR
Revenue	213.9	442.6	15.7%
EBITDA	50.1	111.5	17.4%
EBITDA Margin	23.4%	25.2%	
Net Income	20.4	55.6	22.1%
Net Income Margin	9.6%	12.6%	
Net Debt Leverage Ratio	1.7	0.7	



Note: Aggregated Financial Statements for approximately 85% of market cap of MSCI Emerging Markets Free Index (ex Financials)
Source: UBS, CSFB, Everest Capital

Emerging Markets:

Positives *Still* Not Priced In

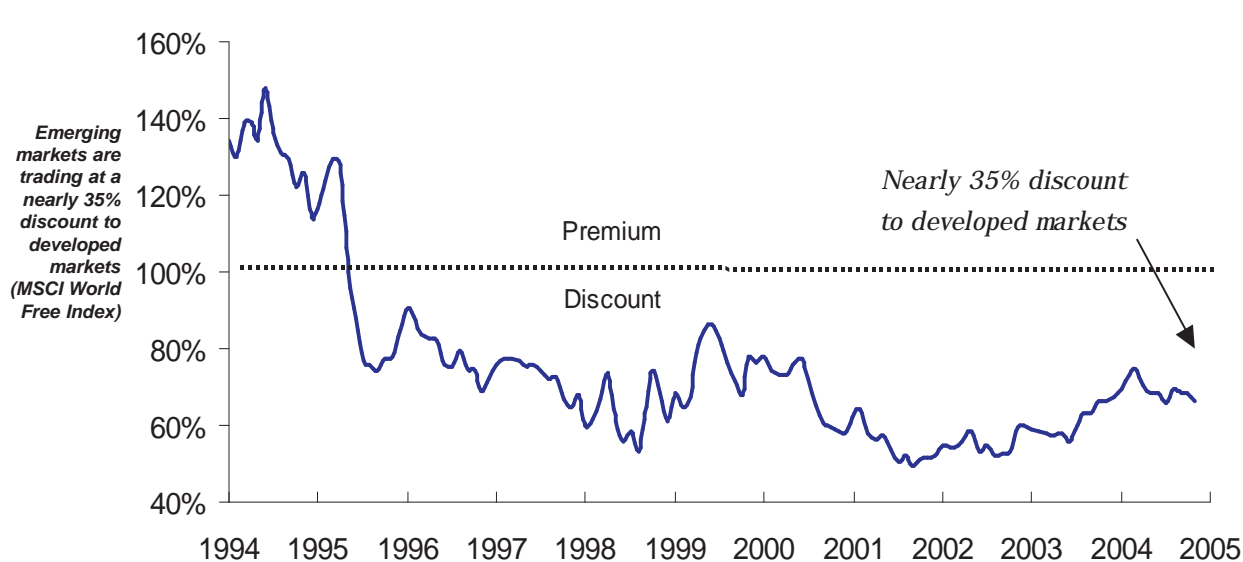
We continue to believe equity prices have yet to fully reflect improvements in corporate fundamentals and profitability. Furthermore, valuations are more attractive than they were a year ago, despite the strong performance of the asset class (see Chart 6).

Valuations remain compelling on several measures:

- The asset class is trading at close to a ten-year low price-to-earnings (P/E) multiple of 9.5x.
- On a relative P/E basis, the asset class trades at close to a 35% discount to developed peers (see Chart 6)
- ROE rose further to 15.5%, ahead of last year's level and above that posted by developed markets of 13.4%.
- On a price-to-book basis, emerging market equities are trading at 1.9x and a 22% discount to the MSCI World Free Index.

In our opinion, emerging market equities continue to offer a compelling investment opportunity given strong economic growth, improving fundamentals, higher corporate profitability and attractive valuations. We further expect the asset class will continue to outperform developed market equities and developed and emerging market debt.

Chart 6: Relative Price to Earnings - MSCI EMF Index versus MSCI World Free Index



Source: Bloomberg, Everest Capital

Notes

There are, of course, risks to our favorable case for emerging market equities, including: a precipitous slowdown in economic growth for G7 countries; an acceleration of monetary tightening by the U.S., resulting in less favorable global liquidity conditions; and a deterioration of China-Taiwan relations.

If you would like a copy of our original white paper, please contact Mrs. Christiane Bosson at cbosson@evcap.bm or +1 441 292 2200.

NOTES TO THIS PUBLICATION

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