

An Everest Capital White Paper

The Continuing Case for Emerging Markets

- **Emerging markets continue to offer a compelling investment opportunity.**
- **Emerging market equities are undervalued. While growing faster than developed markets, emerging market equities are trading at near-historically low absolute valuations, and at much cheaper valuations than developed markets. Emerging markets currently trade at 10.5 times earnings versus 18.0 times earnings for developed markets.**
- **Emerging market equities now offer growth at very reasonable prices, a concept we call "Super-GARP."**

"Super-GARP:" GROWTH AT VERY REASONABLE PRICES

Emerging Markets Aggregate Financials

With earnings growth of 20% over the last five years, emerging markets as a group offer excellent growth opportunities...

| | <u>1998</u> | <u>2003e</u> | <u>5-Yr CAGR</u> |
|------------|-------------|--------------|------------------|
| Revenue | 220.7 | 393.4 | 12.3% |
| EBITDA | 46.6 | 96.0 | 15.6% |
| Net Income | 16.5 | 41.7 | 20.3% |

...yet are undervalued, trading at a 10.5x P/E ratio and a wide discount to developed markets.

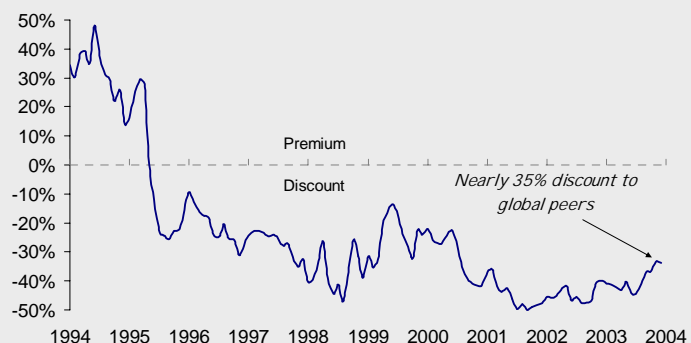


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Highlights

- Emerging markets currently offer a compelling investment opportunity.
- Emerging market equities are undervalued. While growing faster than developed markets, emerging market equities are trading at near-historically cheap absolute valuations, and at much cheaper valuations relative to developed markets. Emerging markets currently trade at 10.5 times earnings versus 18.0 times earnings for developed markets.
- Significantly improved fundamentals and structural reforms are not yet fully priced into emerging market equities. Emerging market debt already reflects the strong improvement in fundamentals with emerging market sovereign spreads at five-year lows. Emerging market equities do not yet fully reflect these improvements and are in the early stages of a substantial re-rating.
- Emerging market equities have outperformed developed market equities over the last one-, three- and five-year periods.
- Despite strong outperformance, this ignored asset class is under-owned. U.S. emerging markets mutual funds cumulative net new cash flows were negative over the five years ending July 2003 and have only recently turned positive.
- We expect emerging market equities to continue to outperform most world debt and equity markets for the next three to five years.

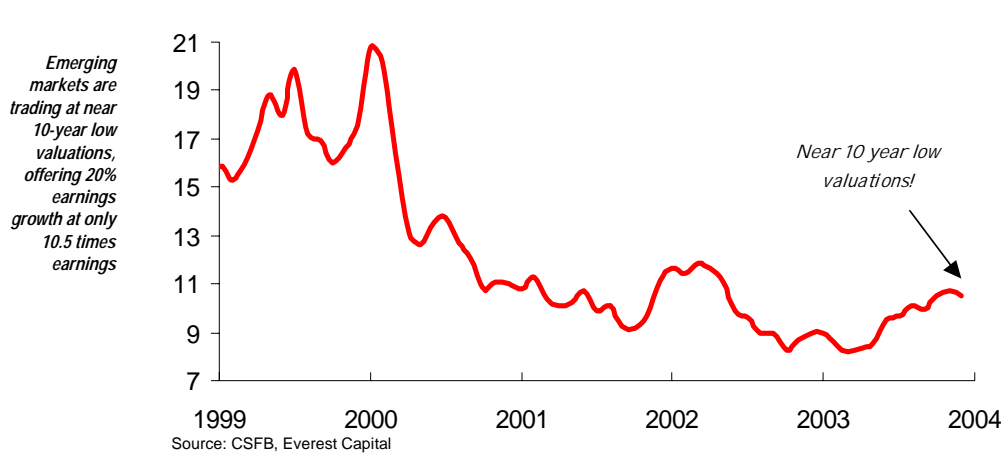
Emerging Markets:

A Timely Investment Strategy

Emerging markets have not yet fully made their way back onto investors' radar screens. Those who have not looked at the asset class since the turmoil of the late 1990s may be surprised by what they find a mere five years later.

Largely unnoticed, emerging markets have outperformed developed markets over the past one-, three- and five-year periods. Investment inflows into the asset class finally showed renewed signs of life in late 2003, following net outflows over the previous five years. This lack of investor interest was in stark contrast to the acceleration of foreign direct investment (FDI) during the same period.

Chart 1: MSCI Emerging Markets 12 Month Forward Price-to-Earnings Multiple



Fundamentals have improved markedly with the successful implementation of structural reforms and corporate governance measures. This improvement underpins our expectation of sustainable and balanced growth fueled in large part by endogenous factors, rather than just an overwhelming dependence on an acceleration of growth in developed markets.

Despite the outperformance of emerging markets over developed markets, we believe that many positives are only now being priced into emerging market equities. Valuations remain at attractive levels and do not yet fully reflect improved economic and corporate fundamentals, attractive market dynamics, sustainable growth in excess of developed markets, and cyclical catalysts.

We therefore recommend an investment in emerging markets, and believe they offer an attractive opportunity with significant upside potential on both an absolute and relative basis.

Emerging Markets: Rediscovering an Ignored Asset Class

Emerging markets became an ignored asset class following the economic tumult of the late 1990s. As a result, emerging markets disappeared from many investors' radar screens and investment inflows dried up. However, while the investment community was largely focused on the bear market in developed markets over the last five years, emerging markets were busy building a solid record of outperformance:

- Emerging market equities have outperformed developed market equities over the past one-, three- and five-year periods.
- An investment in the asset class over the last five years would have increased +48.2% versus the MSCI World Free and S&P 500 indices which returned -10.0% and -2.8%, respectively. This outperformance is equivalent to an 8.2% annualized return in emerging markets versus -2.1% and -0.6% with the MSCI World Free and S&P 500 indices.
- Investors were also rewarded for their investment in emerging markets on a risk-adjusted basis (as measured by the Sharpe Ratio). The asset class outperformed the developed markets in our sample over five years despite emerging markets' higher volatility of returns.

Chart 2: Performance of MSCI Emerging Markets Free versus Developed Markets

| | MSCI EMF | MSCI WORLD | S&P 500 |
|-------------------|--------------|-------------|-------------|
| 1 Year | | | |
| Annualized Return | 51.6% | 30.8% | 28.4% |
| Volatility | 15.2% | 12.3% | 11.4% |
| Sharpe Ratio | 3.3 | 2.4 | 2.4 |
| 3 Year | | | |
| Annualized Return | 9.9% | -5.3% | -4.1% |
| Volatility | 23.4% | 17.7% | 18.3% |
| Sharpe Ratio | 0.3 | -0.4 | -0.3 |
| 5 Year | | | |
| Annualized Return | 8.2% | -2.1% | -0.6% |
| Volatility | 23.3% | 16.2% | 17.1% |
| Sharpe Ratio | 0.2 | -0.3 | -0.2 |

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

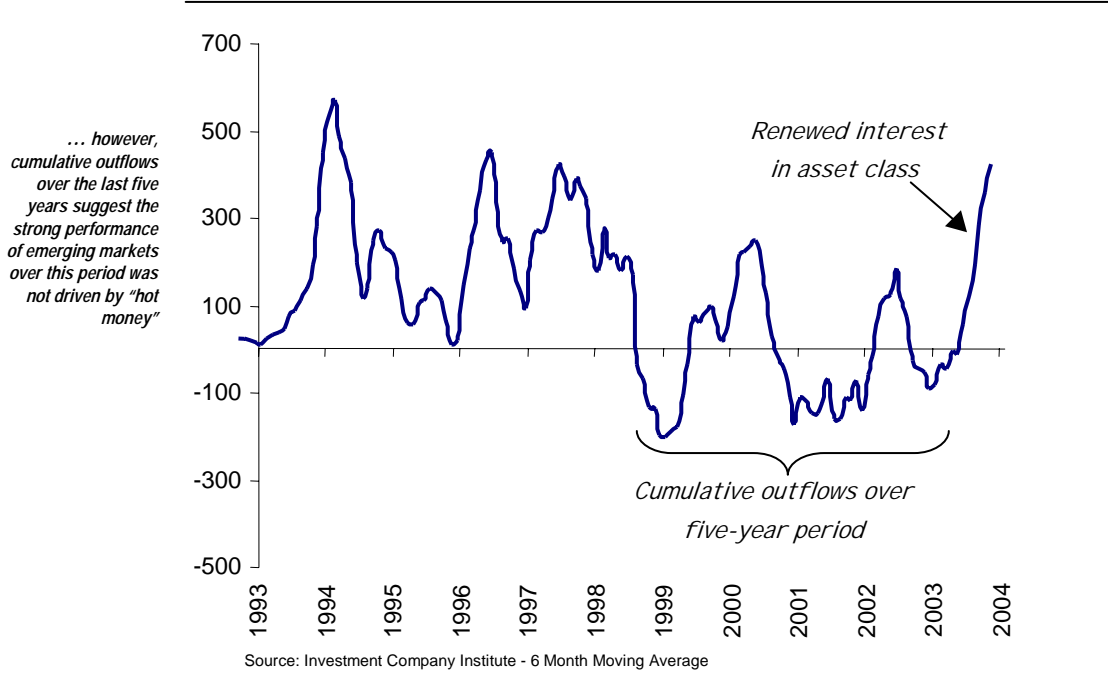
Source: MSCI, Bloomberg, Everest Capital

Despite the sustained performance of the asset class over the last one, three and five years, investor interest and investment flows are showing only early signs of life.

- Over the five-year period ending mid-2003, investment inflows were negative on a cumulative basis, versus over \$14 billion of inflows in the prior five-year period.
- In stark contrast to the nonexistent equity investor flows over those five years, foreign direct investment (FDI) accelerated to over \$650 billion during the same period, nearly doubling the level of the prior five-year period.

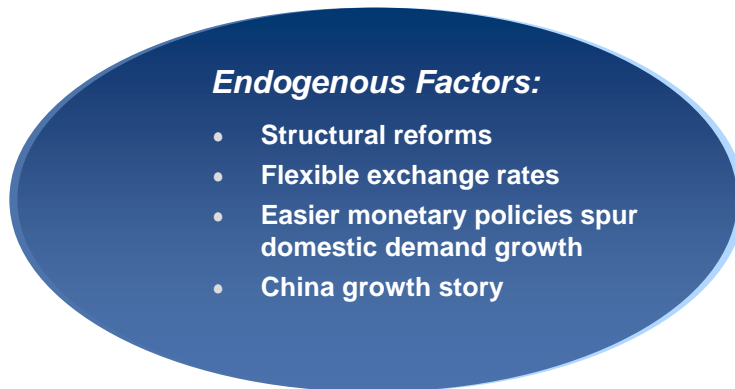
It is only in the last six months that we have seen a return to positive inflows in the asset class as investors are starting to recognize the attractive opportunities in emerging market equities.

Chart 3: US Emerging Market Mutual Fund Flows (Net New Cash Flows -- US\$ Millions)

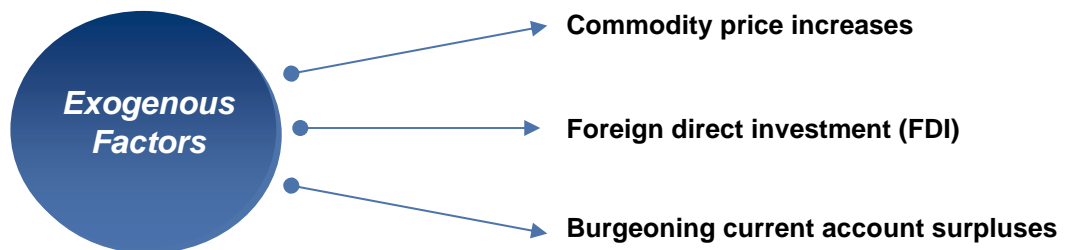


Emerging Markets: Confluence of Factors Supports Our Bullish Outlook

Growth rates in excess of those in developed markets are a key driver of investment returns in emerging markets. Our bullish investment thesis is predicated on the belief that, unlike the mid to late 1990s, emerging markets are currently in a unique position of sustainable growth based primarily on endogenous factors such as:



In addition to the continued growth of the asset class based on positive internal factors, we expect economic growth in developing countries to benefit from several exogenous factors including:



While developing economies will benefit from catalysts both inside and outside their borders, we believe the key to our positive investment thesis is that emerging markets can continue to outgrow developed markets without an acceleration of growth in developed countries.

Structural Reforms

We believe the strong fundamentals underpinning the sustainability of the current growth cycle in developing countries are, in large measure, due to the successful implementation of structural reforms by policymakers and corporate managements. These reforms addressed structural inefficiencies and bolstered investor confidence following the abandonment of fixed exchange rate policies.

Structural reforms include political and fiscal reforms, changes in monetary policy management, and corporate governance measures. The successful implementation of these reforms and improved economic fundamentals are reflected in the rebound in S&P credit ratings of emerging market bonds (see Chart 4) and a sharp reduction in sovereign bond spreads (see Chart 5) over the last five years.

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

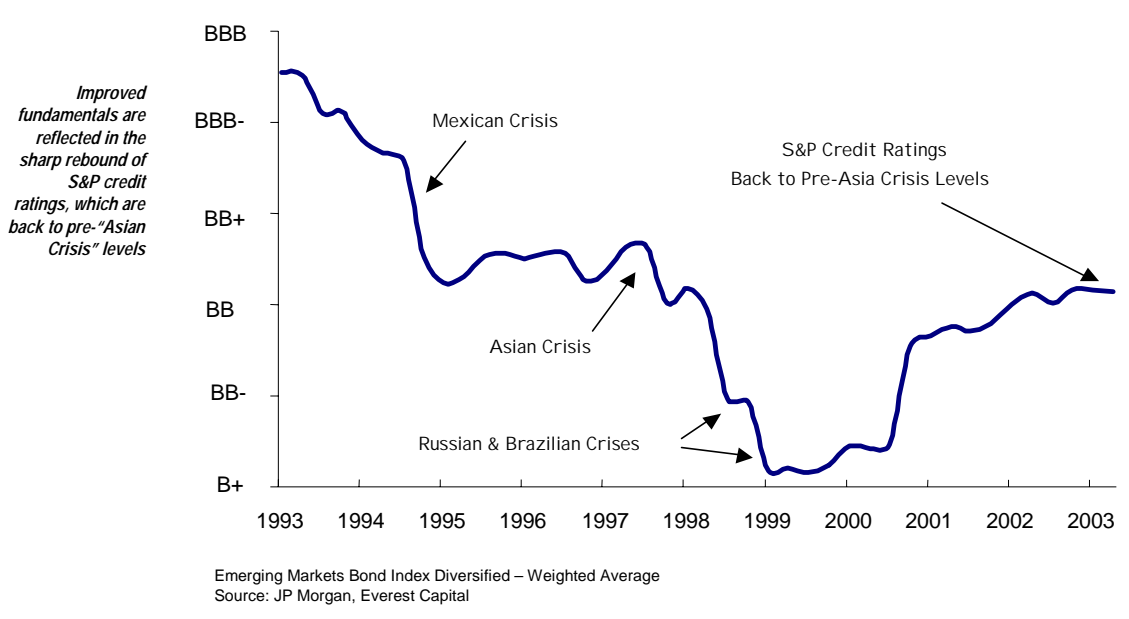


Chart 5: JP Morgan EMBI+ Sovereign Spread versus US Treasuries (1999-2003)



Flexible Exchange Rates

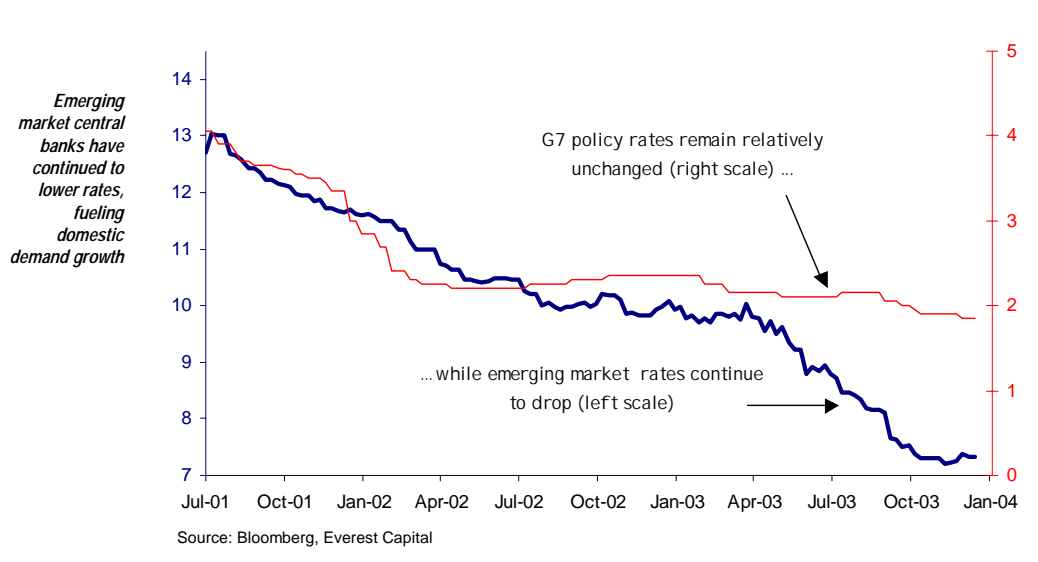
The adoption of flexible exchange rate regimes in emerging markets over the last decade is an important factor in our positive outlook and has had at least two important impacts on the sustainability of economic growth:

- The loss of fixed exchange rates as an artificial anchor for investor confidence led countries to proactively address structural inefficiencies in their political systems, economies and financial markets in order to generate a sustained improvement of investor confidence.
- Second, floating exchange rates act as an important safety valve. Without the need for strong fixed exchange rates to bolster investor confidence, developing countries have maintained cheaper currencies, thereby fueling exports as an important and sustainable engine of growth.

Easier Monetary Policies Spur Domestic Demand Growth

Developing countries have capitalized on floating exchange rates, foreign investment inflows, positive trade balances, and continued fiscal discipline to ease monetary policy and spur domestic demand growth (Chart 6). Monetary policy has become an important driver of growth for policymakers given the absence of an expansionary fiscal policy. Adherence to a disciplined (tight) fiscal policy has replaced fixed exchange rate policies as a barometer, for investors, of responsible policymaking by governments in developing countries. This has provided another engine of growth for the asset class without a return to the exaggerated boom-bust cycles that plagued the asset class in the past.

Chart 6: G7 and Emerging Market Central Bank Policy Rates

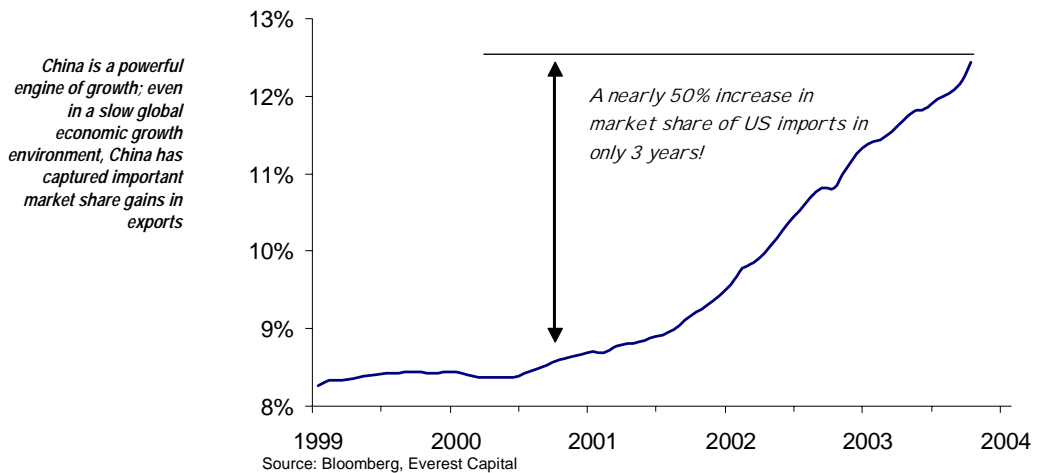


China Growth Story

China is an important engine of growth for the world economy, and in particular, emerging markets. In addition to being an export powerhouse, China is an important domestic demand growth story. We believe it is reshaping entire industries and its impact on global markets cannot be underestimated.

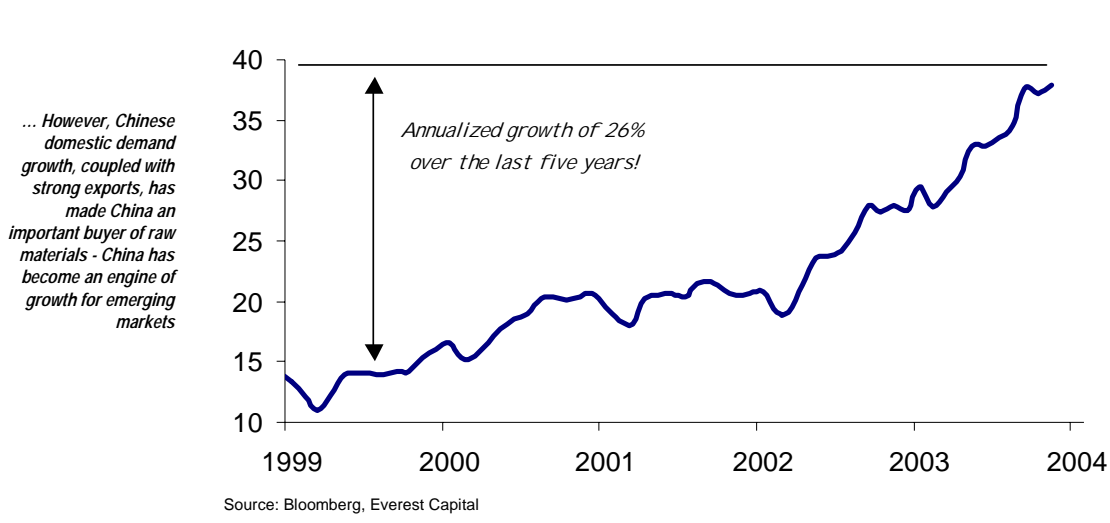
First, China has clearly been gaining share in the export market. The country is already Japan's and Korea's largest trading partner. China has also increased its market share of U.S. imports by nearly 50% over the last three years (see Chart 7). The sharp increase in exports and significant foreign direct investment flows have generated hard currency revenues for the country and fueled domestic demand growth.

Chart 7: Chinese Imports as a Percentage of Total US Imports



Second, and more important as an engine of global growth, is the Chinese domestic growth story. For example, domestic auto sales have doubled in China over the last 18 months. Despite this outstanding growth rate, Chinese auto sales remain only a fraction of U.S. levels, approximately one-tenth the rate of auto sales in the United States. We believe China may become the third largest auto market globally within five years. Domestic demand growth requires significant resources from abroad. This growth will require large imports of steel, aluminum, copper, nickel and oil. Many Chinese imports come from other emerging markets. The continued increase in imports should further support global economic growth and commodity prices (see Chart 8).

Chart 8: Chinese Total Monthly Imports (US\$ Billions)

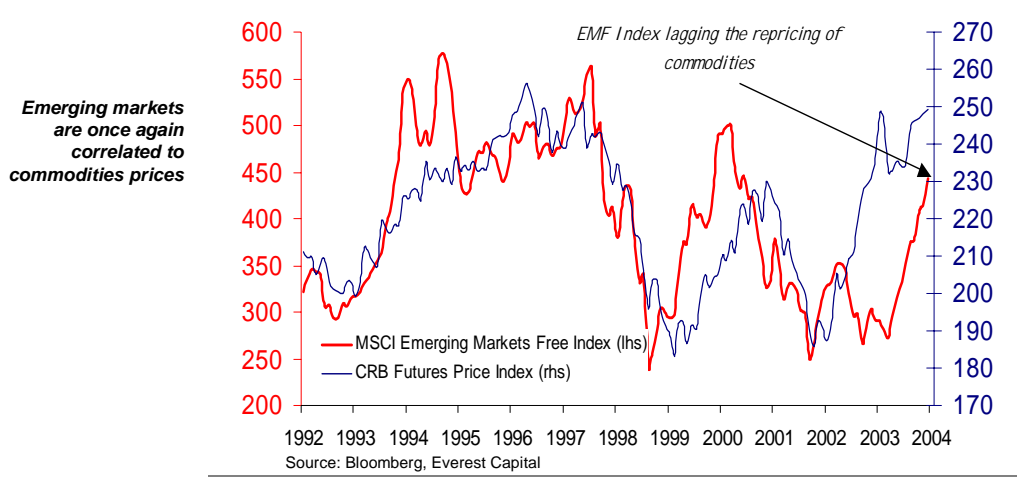


Commodity Price Changes

Commodity demand and pricing have historically been an important catalyst for growth in developing markets. Over the last year, prices have rebounded sharply, led in large part by Chinese growth. China's strong export and domestic demand growth have resulted in a sharp increase in demand for commodities.

- China currently accounts for:**
- 26% of global steel demand (up from 14% in 1995)
 - 24% of global copper demand (up from 11% in 1995)
 - 22% of global nickel demand (up from less than 6% in 1995)
 - 20% of global aluminum demand (up from 9% in 1995)

Chart 9: Commodities Resource Board (CRB) Futures Price Index versus MSCI EMF Index



In addition to the growing importance of China's demand in the market for commodities, we expect that a rebound in global economic growth will further support an improvement in prices of major commodities as well as bolster the performance of developing countries. Chart 9 illustrates the importance of commodity prices for emerging market equities, as evidenced by the correlation of the Commodity Research Bureau's Futures Price Index and the MSCI Emerging Markets Free (EMF) Index. Until recently, the asset class has lagged the most recent improvement in the CRB Price Index.

Foreign Direct Investment

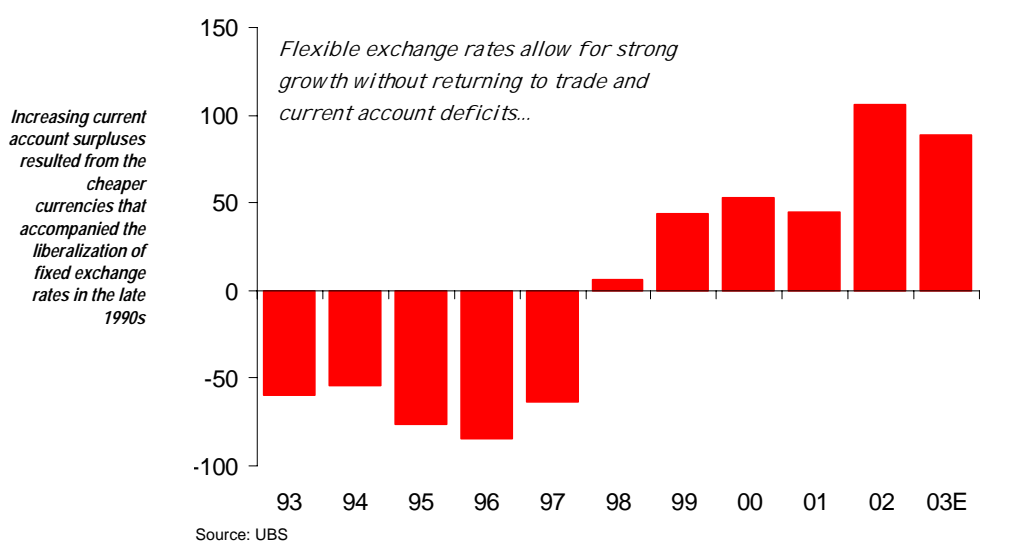
Long-term investor confidence in the competitiveness of emerging markets is evidenced by acceleration in foreign direct investment (FDI) over the last five years. FDI into emerging markets has totaled over \$650 billion, nearly doubling the level of investment inflows over the prior five-year period. We attribute this acceleration in investment from long-term investors to the implementation of corporate governance measures and greater regulatory transparency, which bolster domestic growth prospects.

We view the closing chasm between the acceleration of inflows from long-term investors and the previously nonexistent inflows from mutual fund investors (Chart 3 on page 6) as another bullish factor supporting our positive view for emerging market equities.

Burgeoning Current Account Surpluses

Chart 10 illustrates the vast improvement in the aggregate current account of emerging markets following the liberalization of many fixed exchange rate regimes in the late 1990s. The cheaper currencies resulting from maintaining flexible exchange rates have allowed trade balances to improve on the back of growing exports, despite a rebound in domestic demand.

Chart 10: Emerging Market Current Account Balances (1993-2003) – US\$ Billions



Emerging Markets:

Emerging Markets Inc.: Super-GARP

The structural improvements we have discussed on a macro level in developing countries have also occurred at the corporate level. To illustrate this improvement, we have aggregated the financial statements of companies in the MSCI Emerging Markets Free Index and analyzed their performance as we would an individual company. We have dubbed this “company” *Emerging Markets Inc.*

A snapshot of selected financial statements (Chart 11) paints the picture of an attractive investment opportunity and solid five-year fundamental performance:

Chart 11: *Emerging Markets Inc.* (Aggregated Financial Statements, in US\$ Billions)

With earnings growth of 20% over the last five years and a significantly stronger balance sheet, *Emerging Markets Inc.* appears undervalued, trading at a single digit P/E ratio

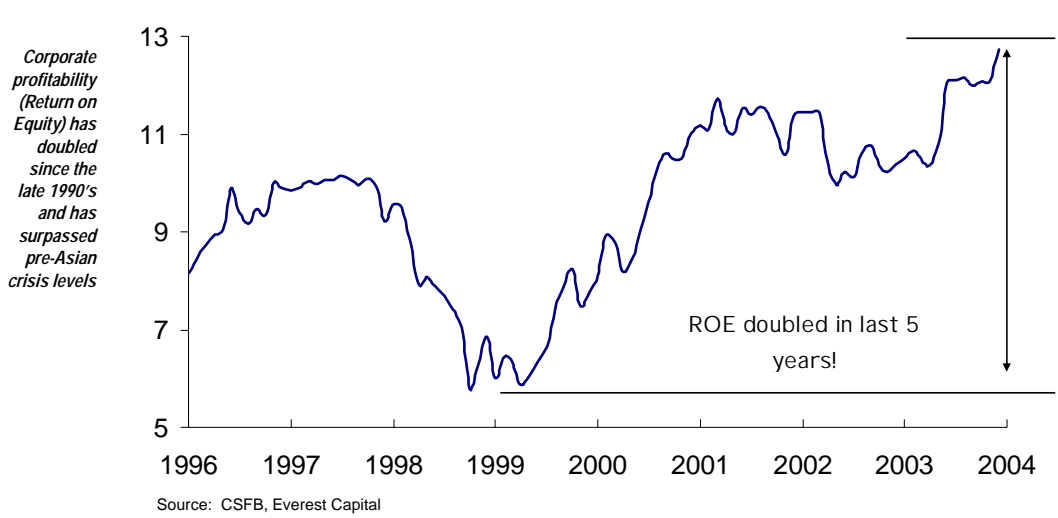
| | 1998 | 2003e | 5-Yr CAGR |
|--------------------------|-------|-------|-----------|
| Revenue | 220.7 | 393.4 | 12.3% |
| EBITDA | 46.6 | 96.0 | 15.6% |
| <i>EBITDA Margin</i> | 21.1% | 24.4% | |
| Net Income | 16.5 | 41.7 | 20.3% |
| <i>Net Income Margin</i> | 7.5% | 10.6% | |
| Dividend Yield | 2.3% | 2.6% | |
| Net Debt | 91.6 | 87.3 | |
| Net Debt to EBITDA | 2.0 | 0.9 | |

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

- Earnings growth has been stellar since 1998. Net income has increased by over 150% over the last five years, or at an annual rate of 20% through year end 2003.
- Profitability growth (margin expansion) accounts for nearly one-half of the improvement in earnings growth. Net income margin has increased by 300 basis points to 10.6% at year-end 2003.

- Financial strength has improved for Emerging Markets Inc. An increased focus on profitability and cash flow management has also resulted in stronger finances. Financial strength, measured as a ratio of debt to cash flow (Net Debt to EBITDA) improved from 2.0x in 1998 to an estimated 0.9x in 2003.
- The sharp turnaround in corporate earnings coupled with an increased focus on profitability and corporate governance has resulted in a sharply higher estimated return on equity (ROE) over the last five years. ROE has doubled to over 12% from its low in mid-1999 (Chart 12).

Chart 12: MSCI Emerging Markets Free Return on Equity



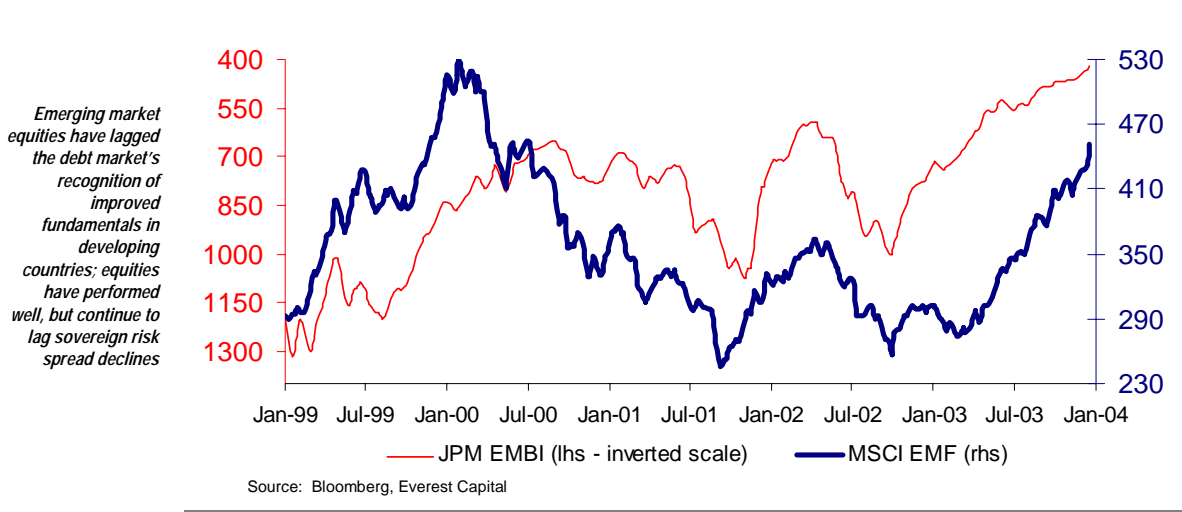
We believe that the bond market already reflects the improvement in the financial strength of Emerging Markets Inc. (see tightening bond spreads in Chart 13). However, we do not believe that equities, currently trading at a 10.5 times price-to-earnings (P/E) multiple, have priced in the improvement in profitability and sustainable double-digit earnings growth rates.

Positives Not Priced In

Despite the out performance of emerging market equities versus developed markets over the last one-, three-, and five-year periods and the improved fundamentals driving our sustainable growth outlook, we believe that emerging market equities remain *undervalued* and *overlooked*.

In contrast to equity investors, we believe that emerging market debt investors have already priced in the improvement in emerging market fundamentals. A decline in sovereign spreads is usually a precursor to positive performance in equities (see Chart 13). Sovereign spreads have tightened sharply and are currently at five-year lows.

Chart 13: MSCI Emerging Markets Free Index versus JP Morgan EM Bond Index

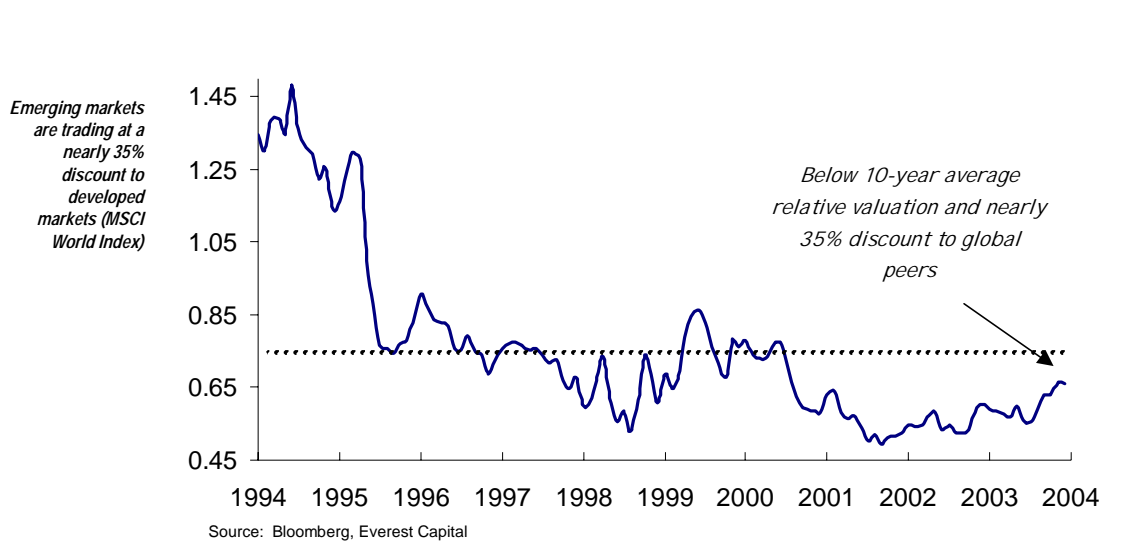


We believe equities have yet to fully price in the improvement in fundamentals and the growth in earnings. Furthermore, cumulative investment flows into the asset class that remained flat for five years have recently turned positive, and valuations do not reflect the improvement in corporate fundamentals.

Valuations look compelling on several measures:

- The asset class is trading at close to a ten-year low price-to-earnings (P/E) multiple of 10.5x.
- On a relative P/E basis, the asset class trades at close to a 35% discount to developed peers on a 12-month forward P/E ratio (see Chart 14).
- ROE has rebounded to a new 10-year high of 12.7%.
- On a relative price-to-book (P/B) basis, the asset class trades at a 25% discount to its 10-year average versus the MSCI World Index.
- The dividend yield of emerging markets at 2.4% remains above its average of 2.3% and the MSCI World Index level of 2.0%.

Chart 14: Relative Price to Earnings - MSCI EMF Index versus MSCI World Index



Emerging Markets: The Case for a Multi-Strategy Approach

In addition to our positive outlook for the asset class, we believe low correlations across emerging market countries also present portfolio managers an opportunity to generate further returns by identifying relatively attractive opportunities within the asset class. The average correlation between emerging market countries is 0.27, nearly one-half that of developed markets.

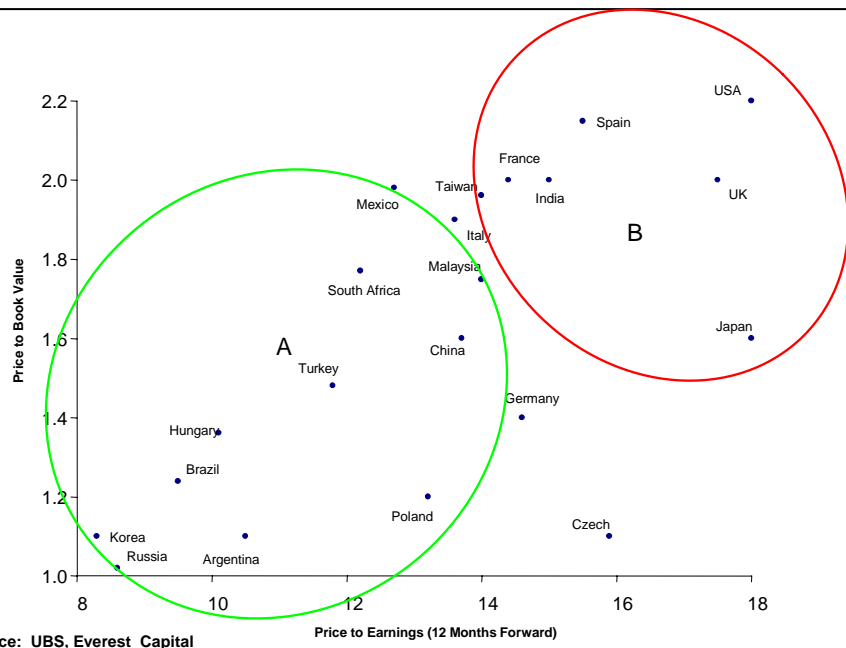
The following chart captures the relative valuations of numerous global markets using Price-to-Book (*vertical axis*) and Price-to-Earnings (*horizontal axis*) multiples.

The chart highlights two main points:

- (1) Most emerging markets (found under area A) trade at a discount to developed markets (found under area B); and,
- (2) Relative valuations within emerging markets suggest opportunities to generate additional returns using a multi-strategy, active approach including shorting overvalued markets.

Chart 15: Global Price To Earnings (12 Months Forward) versus Price to Book (2003)

Emerging markets are generally more attractively valued (Area A) than developed peers (Area B). The Chart also highlights opportunities for a multi-strategy approach to generate further positive investment returns given the low correlations and relative valuations between emerging market countries.



Emerging Markets:

Risks to Our Outlook

We can see three principal risks to our favorable case for emerging markets:

A double dip in developed economies

This bearish scenario, which is still fairly popular, centers on the argument that the current pick-up in U.S. activity was essentially supported by refinancings and tax cuts. Therefore, this growth spurt would be a one-time phenomenon and this year the U.S. would go back to low growth or even a recession in 2005. Europe is in even worse shape and Japan remains a basket case. This scenario implies that emerging markets suffer along with developed markets.

We put low odds on this outlook; but interestingly, these are the economic conditions that prevailed in 2002, and emerging markets, while down -8%, that year handily outperformed developed markets which were down -21%.

A rise in U.S. yields

This scenario is the opposite of the previous one: in this case, the U.S. recovery surprises on the upside, with commodity prices having already risen sharply, and the Fed is forced to quickly raise interest rates like in 1994. The yields on long-term bonds rise in tandem creating a moderate sell-off in developed markets (-3.1% between February and April 1994) and a sharper one in emerging markets which were down -12.8% in the same period in 1994. For the full year 1994 developed markets were up 3.3% while emerging markets were down -8.7%.

We believe this scenario of rising interest rates to be more probable than the first one. However, unlike 1994, most emerging markets are running large current account surpluses (see Chart 10) and are not dependent on external financing by foreign investors (the two major exceptions currently being Brazil and Turkey). If there were a sell-off, it would represent a buying opportunity because global growth is a strong positive for emerging markets, more than compensating for the negative of higher interest rates.

Political risk in this year's U.S. presidential election

Some of the democratic contenders are promoting a populist agenda bent on increasing protectionism. Some senators from both parties have also proposed a law calling for high tariffs on Chinese exports. If a populist left-leaning president was allied to a rising tide of protectionist legislation created by Congress, it could spell trouble for globalization in general and emerging markets in particular. While presidents tend to govern more from the center once elected, this is something to watch over the next few months.

While there are risks to our thesis, we believe that over a three to five year horizon emerging market equities will be one of the best places to invest among global debt and equity markets.

Conclusion

Although emerging markets have outperformed developed markets during four of the last five years, it is only within the last six months that we have seen renewed enthusiasm and positive inflows for the asset class. We believe that improved fundamentals, continued growth and still-attractive valuations will lead to strong performance in emerging markets for the next several years.

Structural reforms and corporate governance improvements are the primary reasons for improving fundamentals. Valuations are at attractive levels, and do not fully reflect the impact of these improvements, nor do they take into account the strong growth potential of many emerging market companies. Specific endogenous factors that will help sustain this growth across emerging markets include structural reforms, flexible exchange rates, favorable monetary policies, and the continued growth of China. In addition, we see exogenous factors such as commodity price increases, foreign direct investment and growing current account surpluses as beneficial to emerging market economies.

Beyond their attractiveness as an asset class, emerging markets are themselves less correlated to each other than are developed markets. Thus, additional profits can be made by successfully picking the best-performing developing countries.

As outlined in this paper, there are risks inherent in our bullish outlook. For example, should the United States experience low growth or a recession in 2005, emerging markets would also suffer. Secondly, a rise in U.S. yields on long-term bonds could create a sell-off that negatively affects the asset class. Political risk related to the 2004 presidential election in the United States also exists, since if Congress were to enact protectionist legislation, global emerging markets would likely suffer. We do not believe these scenarios are likely.

In summary, we believe that investors who capitalize on the opportunities of emerging market investing will be well rewarded in 2004 and for the next three to five years.

Notes

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Contact Information

Everest Capital Limited
65 Front Street
6th Floor
Hamilton HM 12
Bermuda
Phone +1 441 292 2200
info@evcap.bm

Everest Capital Inc.
2601 S. Bayshore Drive
Suite 1700
Miami, Florida 33133
USA
Phone +1 305 666 1700
info@evcap.com

Everest Capital Pte Ltd.
Singapore Land Tower
50 Raffles Place
37th Floor
Singapore 048623
Phone +65 6829 7193
info@evcap.com.sg

Everest Capital SA
7 Route de Geneve
1291 Commugny/Geneva
Switzerland
Phone +41 22 789 4000
info@evcap.ch