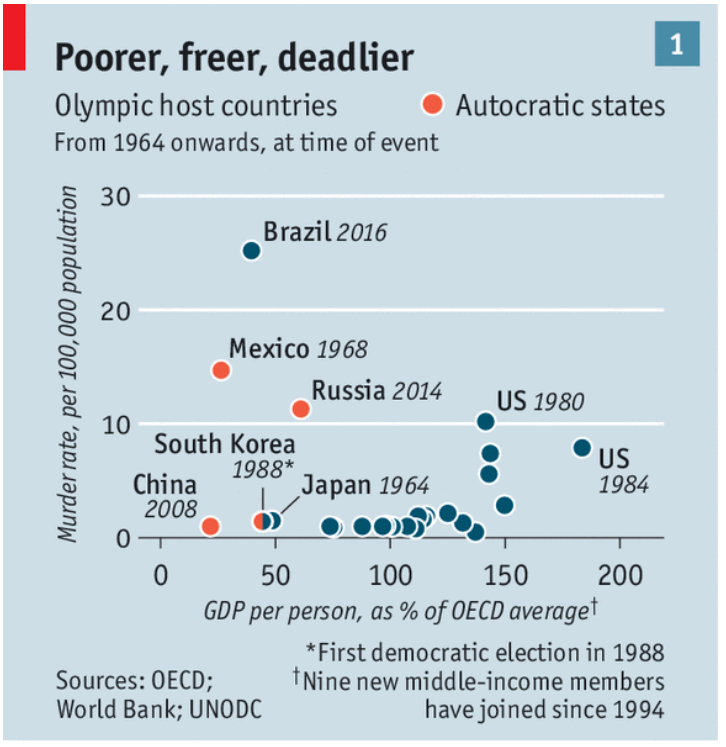
EMERGING MARKETS ON THE GREATEST SPORTING STAGE OF ALL

July 2016

A specialist alternative asset manager

Over the coming weeks, millions of tourists will start heading to Rio de Janeiro, Brazil for the 2016 Olympic Games, and countless millions more from countries both rich and poor will be tuning in to the most ancient and global of all sporting extravaganzas. Whilst this is not the first time the Olympics are being hosted by an Emerging Market, as both Russia and China have hosted them before, it is perhaps interesting to note that this is the first time the games will be hosted by a country which is neither rich nor autocratic. Not only this, Rio de Janeiro is also by far the most violent place to have hosted the Olympic Games!

Can the relative economic power of nations and regions be reflected in the soft power of sport or in the shifting of global power?



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As the world turns its attention to the Games in Brazil, and after a period where international investors have generally shunned emerging and frontier markets, we sought to examine both whether there is a link between sport and economic development and whether investors should once again be eyeing up opportunities in these markets? Can we find a relationship between sport performance measured by the number of medals won in an Olympics and a country's economic status? More importantly, can the relative economic power of nations and regions be reflected in the soft power of sport or in the shifting of global power? In examining these questions we will refer to the usual distinction of Developed and Emerging Markets, of G7 and BRICS and to the more difficult definition of Frontier Markets or Small Emerging Markets. In drawing the lines between these notions and Olympic performance we will also try to understand the path of these countries towards future economic and market performance.

SIZE MATTERS?

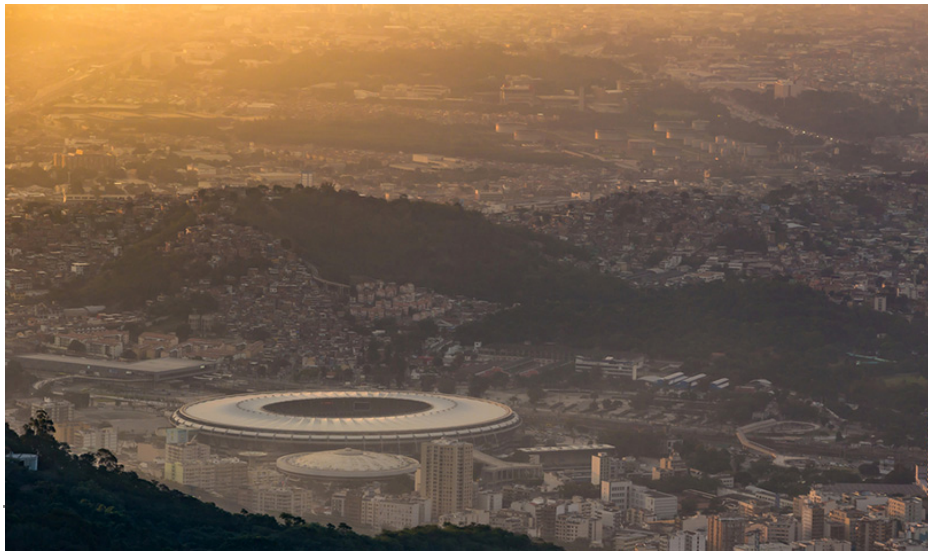
Many papers[1] have tried to find a clear relationship between economic development and Olympic performance as measured by total medals won. In explaining the share of the total medals awarded to each country, various studies have generally considered the following factors:

- size of the population
- size of economies (as measured by GDP at PPP exchange rates)
- performance in the previous Olympic Games
- whether the country is the host nation.

Intuitively one would expect that population size should play a role in determining country medal total…

Intuitively one would expect that population size should play a role in determining country medal total with larger countries having a deeper pool of talented athletes and thus a greater chance at fielding medal winners. Clearly this is true for the USA and China who compete to get the highest number of medals, but it is definitely not true for India who floundered in London (6 medals total, 2 silver and 4 bronze) and for which cricket and hockey are the only sports in which it has had consistent past success. Jamaica, a tiny country, always ranks very high in athletics and Cuba is typically quite successful in the overall medal total list.

We must also recognise the importance of the resources available to enabling gifted athletes to train for and succeed in the Games. In other words, without proper sport infrastructure it is difficult to excel in some sports. This seems to be particularly true for some disciplines like sailing and equestrianism where high costs limit participation from low income countries. Interestingly enough, recent studies[2] suggest that the most sensitive sports in this regard are: canoeing, diving, fencing, and swimming.



[1] A. Bernard and M. Busse, *Who wins the Olympic Games: Economic Development and Medal Totals,* NBER Working Paper 7998

PWC, *Modelling Olympic Performance*, Economic Briefing Paper, 2012 and 2016, www.pwc.co.uk/economics-policy;

[2]GS Economics, *The Olympics and Economics, 2012*

INCOME AND HOST EFFECT DIFFERENTIATED BY OLYMPICS SPORTS (GS 2012)

	R^2	Income Effect	Host Effect
All	0.87	6.57	20.85
Archery	0.43	0.34	0.52
Canoeing	0.67	0.43	*0.04*
Cycling	0.43	0.95	1.44
Diving	0.68	-0.08	0.60
Equestrianism	0.55	0.12	0.66
Fencing	0.71	0.22	*0.24*
Football	0.14	0.06	0.10
Gymnastics	0.55	*0.30*	2.63
Handball	0.23	0.12	*-0.03*
Hockey	0.38	0.21	0.28
Judo	0.57	0.73	0.44
Pentathlon	0.29	*-0.05*	*-0.04*
Rowing	0.54	0.56	1.00
Rythmic Gym.	0.54	*0.04*	0.15
Sailing	0.53	0.47	1.14
Shooting	0.63	*0.26*	0.50
Softball	0.22	0.09	0.05
Swimming	0.82	0.53	1.98
Syncrh. Swim.	0.36	0.11	*0.09*
Table Tennis	0.72	*0.21*	0.22
Taekwondo	0.22	0.46	0.31
Tennis	0.21	0.32	0.37
Trampolining	0.19	0.09	0.29
Triathlon	0.07	0.16	*0.01*
Voleyball	0.21	*0.09*	0.34
Water Polo	0.27	0.07	0.21
Weightlifting	0.54	0.01	0.38
Wrestling	0.61	*0.11*	1.36

Note: results from panel regression (OLS), sample 1956-2008, dependent variable is sum of gold, silver and bronze medals. Independent variables are log(GDPpc) and its square, ratio of income to US, democracy and host dummies. Income effect is based on 1 SD increase over median. Source GS Global Research

Not surprisingly various studies have shown that it is total GDP that matters most in explaining Olympic performance rather than how this splits down between population size and average income levels. Yet the small and poor Davids sometimes do beat the Goliaths of this world. Again think not only of Jamaica and Cuba, but also of Kenya and Ethiopia (larger though in terms of population). How can we explain this? In the case of Jamaica, Kenya and Ethiopia this is mostly due to specialisation in a narrower range of disciplines where there is a local track record of success (long distance running for the African countries and sprinting for Jamaica). This can prove very efficient in producing Olympic medals and can be compared to development of specialised industry "clusters" in regions that can lead to world class performance.

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'SOFT POWER' - A PROPAGANDA TOOL?

The case of Cuba is again pretty specific and common to most of the former "Soviet Block" nations and to China today. The "Soviet Block" effect captures the historical higher probability that a country formerly in the Soviet bloc (or in a communist regime like China or Cuba) could get a higher number of medals, ceteris paribus other variables, given the high political importance of sporting success in many of these countries. Although this effect is fading over time, it has been deemed statistically significant in the papers considered, especially when it includes China[3]. Talking about changing global power equilibrium, it is obvious that countries like China do place an enormous importance on the soft power of sport. Finally, there is an obvious positive effect of hosting the Games, which translates into a higher number of medals for the hosts. The most recent and clear example was the very good performance of UK in the London Olympics of 2012 where team GB won a total of 65 medals (29 gold, 17 silver and 19 bronze) versus an average of the previous 5 Olympic Games of 28 medals in total (9 gold, 8,6 silver e 10,4 bronze).

[3] A. Bernard and M. Busse

On the economic side though, there seems to be no positive short or long term effects of hosting the games. In a recent book by an American sports economist, Andrew Zimbalist[4], hosting the competition is compared to an "economic gamble". The book analyses the previous Games and concludes that prudent city governments[5] should avoid the contests at all costs. Twelve cities bid for the 2004 Olympics, while just 5 bid for the 2020 edition. A recent report commissioned by the Dutch government suggests that in the future only non-democratic countries will pay up to host the events - quite a paradox for an event that should promote peace and harmony, but may turn out to be a propaganda tool for autocratic regimes with impetuous economic growth and therefore dampening the credibility of the Olympic Movement.

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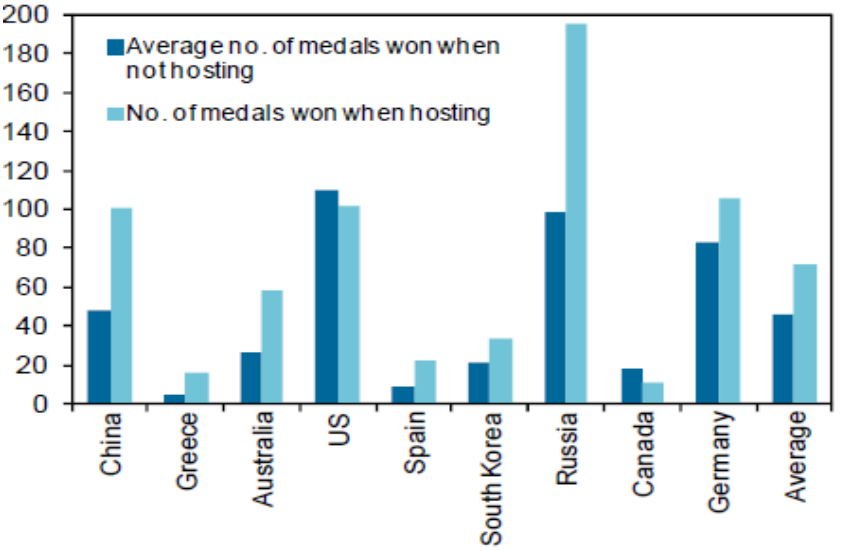
The Host Nation has won on average 54% more medals, on average, that it typically does (Source: GS Economic Research, Sport Reference)



[4] A. Zimbalist, Circus Maximus: the Economic Gamble behind Hosting the Olympics and the World Cup, 2015

[5] Dutch Ministry of Infrastructure and the Environment, 2012, ref. press@x-m-l.org

As briefly mentioned before, the Olympics also represents an international stage to demonstrate and exercise 'soft power'. Soft power is about the 'attractiveness' of a country, where other countries seek to follow its lead because they admire its values and seek to emulate its examples[6]. This includes the importance of hosting the Games to emphasize the increasing role of a country in the international stage and/or winning the higher number of medals to prove its power. Doing well at an Olympics has its own implications for boosting a state's prestige, a point not lost on the Chinese in hosting the 2008 Beijing Olympics.

GEO-POLITICS AND POWER PLAYS

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At the same time, the Olympics have been frequently used to test power relations and play international geo-politics. The first half of the 20th century - in the Olympics, as in the real world - is a story of Western domination. Not surprisingly, this was also reflected in the choice of Olympic disciplines, some of which are considered old aristocratic sports practised by small leagues in the Western world. The composition of sports did not change much through time though. In terms of participation, among the BRICS (the name was coined in 2001) only India and South Africa competed in the Olympics on any sort of regular basis. China on the other hand, opened the rounds of Olympic boycotts in the 1956 Melbourne games, deciding to withdraw following the International Olympic Committee's (IOC) recognition of Taiwan. In 1976 Montreal games, over 30 African states stayed away in response to New Zealand's international rugby tour to apartheid South Africa.

The Cold War period saw the emerging importance of another BRIC champion: Russia (formerly the Soviet Union). China's long boycott of the Games meant that, until 1980, the Soviet Union accounted for more than 95 percent of the BRICS' medal haul. Furthermore the tensions between the two blocs saw a number of Western states fail to participate in the 1980 Moscow games, while the USSR did not participate in the 1984 Los Angeles games. The USSR won 39 percent of all gold medals at the 1980 games in Moscow and the United States 37 percent in 1984 in Los Angeles.

6. J.Nye, Soft Power: The Means to Success in World Politics, 2004

The last two decades are the first in which we see a straight race between the BRICS and the G7. Following the demise of the Soviet Union, Russia has taken the lead of the former Soviet Block and China, which returned to the games in 1984 after a long absence, has taken the games much more seriously. South Africa was officially banned from participating in the Olympics from 1964 until 1992, in response to widespread international condemnation of the domestic policy of apartheid. In the last decade, China has become a powerful economic engine contributing to the economic development of the BRICS, as well as sporting success. Its rising dominance is a result of massive resources devoted to achieving Olympic glory, precisely to gain the soft power mentioned above.

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There have already been studies[7] comparing the number of medals achieved by developed and developing countries in demonstrating a changing international order. At the last London edition, the United States (103 total medals) ranked first, China (88 total) second and Russia (82 total,) third trailed by – surprisingly - Great Britain (65 total) and Germany (44 total), now punching much below the weight of its one-time Cold War divided constituent parts.

Still, by re-aggregating medals by past and current regional aggregates, using the Sport Reference database, the results are quite interesting. If the constituent elements of the dissolved Soviet empire were to be summed up, the medals first place would be theirs once again. With 23 golds, 19 silvers and 40 bronzes, for a total of 82 medals tallied by Ukraine, Kazakhstan, Belarus, Azerbaijan, Georgia, Lithuania, Uzbekistan, Armenia, Latvia, Estonia, Tajikistan and Moldova, added to Russia's, the once and no longer USSR could claim a total of 162 medals, far in front of the United States' total of 103, and also matching the US in golds 46 to 46. This result was achieved despite the negative effect of political and economic instability of the region.

The 27-member European Union would fare even better, with Great Britain, Germany, and France leading the way to a dominant overall EU haul of 305 medals—almost 150 ahead even of a mythically reconstituted Soviet Union and nearly three times that of the United States. Still, with Brexit on the way and with all the headwinds of EU, limiting the counting to the 10-member Eurozone reduces that result to 156 total medals (40 gold, 59 silver, 57 bronze).

Finally, among the "BRICS" in the London games of 2012, Russia and China contributed nicely, India was non-existent, Brazil (17 medals in all, 3 gold, 5 silver, 9 bronze) decent and South Africa won 6 medals (3 gold, 2 silver and 1 bronze).

[7] H.Fetter, Did the US really win the most Olympic Medals?, The Atlantic, 2012
I. Masters, The Olympics, International Geo-politics and Soft Power IGD, 2012

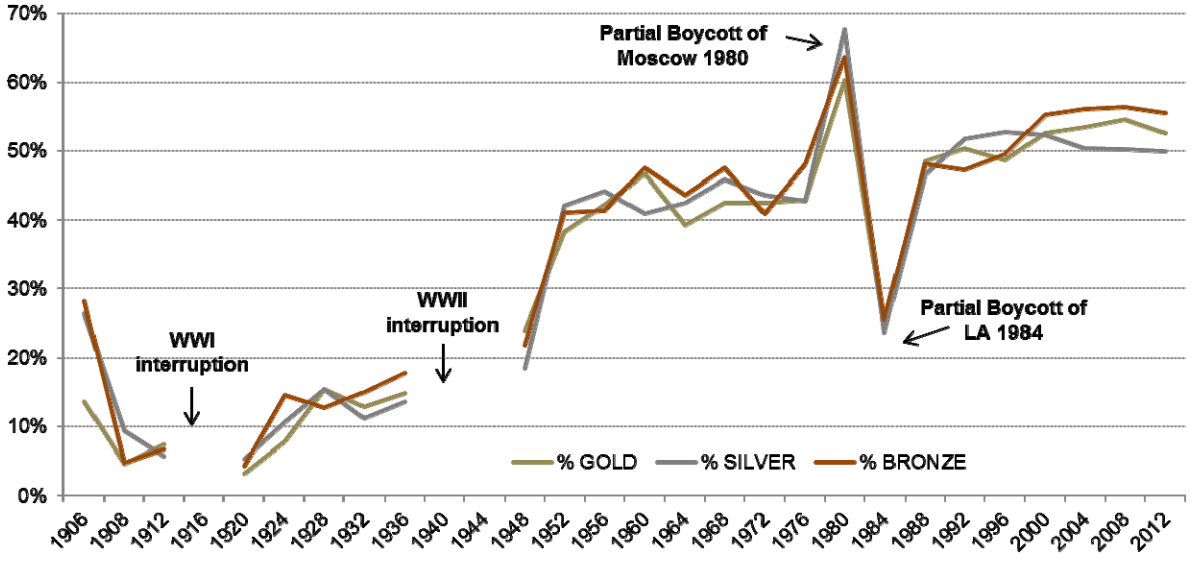
THE EMERGING MARKETS ARE CATCHING UP

A study conducted by Sheffield Hallam University has considered the difference in medal totals between the G7 states (US, UK, France, Italy, Germany, Japan and Canada) and the emerging BRICS countries (Brazil, Russia, India, China and South Africa), in reflecting the changing geo-political trends in broader international relations. The research highlights the closing gap in terms of gold medals won, where 1996 saw the G7 having twice the number of medals compared to BRICS countries. Yet by 2008 this difference had been reduced to a gap of approximately 20%. In 2012 though, at the London Olympics, the UK as the host nation gained a much higher number of medals, therefore widening again the gap with BRICS.

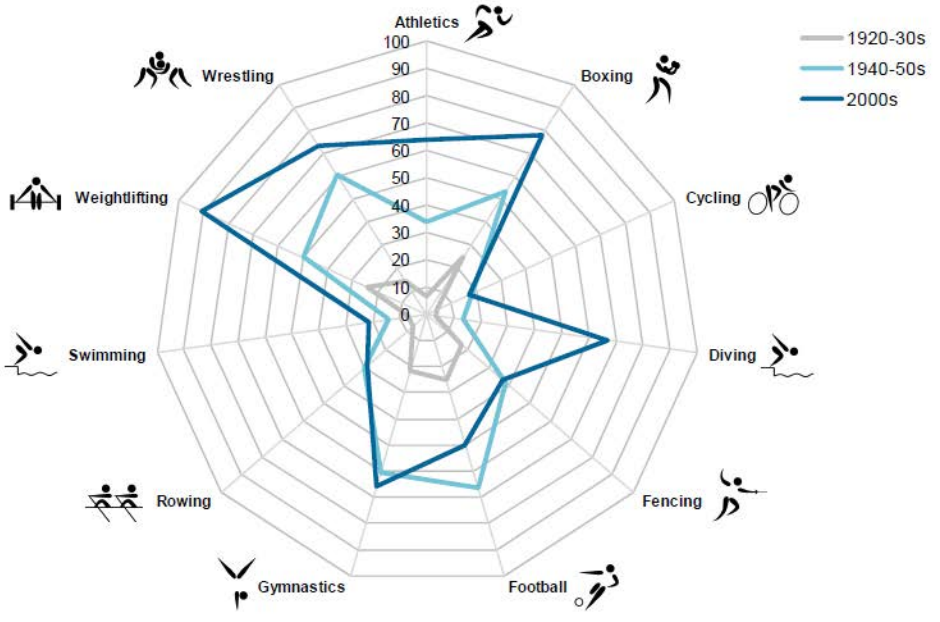
Number of gold medals gained by G7 and BRICS in the last Olympic Games (Source: Sports Reference)

Olympics	1996	2000	2004	2008	2012
G7	99	95	98	98	113
BRICS	48	60	66	78	68
Diff	51	35	32	20	45

Emerging Markets now win half of all Olympic medals, reflecting their growing influence (Source: Sports Reference)

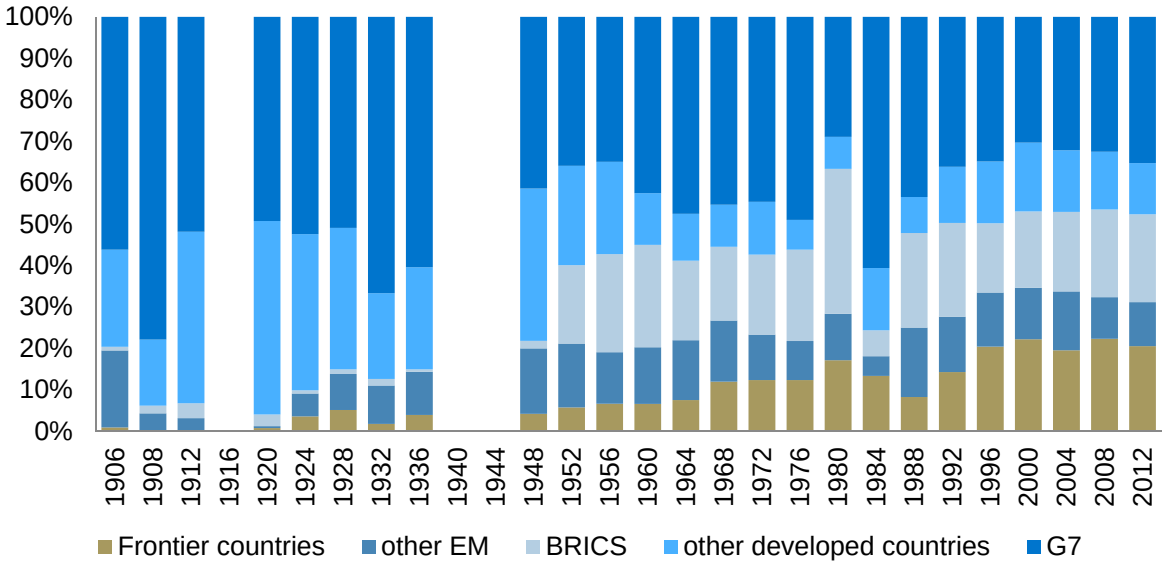


Emerging Markets have become leaders or stronger competitors in many sports (Source: Sport Reference, data till Beijing 2008)



Source: GS Research

Split of total Olympic Medals (aggregating using Fibonacci weighted point system (3:2:1) - gold 3 points, silver 2 points, and bronze 1 point) Source: Sports Reference



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WHO IS GOING TO WIN MORE?

The last few years have definitely not been very much in favour of BRICS, Emerging and Frontier markets on the economic and financial side. A perfect storm of slowing Chinese growth, USD strength and falling commodities have affected most of the space. However, over time Emerging and Frontier Markets have been evolving from being a somewhat homogenous asset class to becoming an aggregate of idiosyncratic stories, sometimes behaving and adjusting very differently to macroeconomic challenges. Although in the short term, investors can still treat EM and FM as monolithic blocks, in the mid to long term their components have proved to behave rather differently. Investing in this space is more and more about identifying winners and losers and discriminating within the space. Long term winners are typically to be found in countries that are involved in a political and economic reform process while losers stay in the bucket of countries with low political turnaround and instability. The most interesting opportunities are also to be found where the perception-reality gap is the highest and where value is more difficult to detect and understand.

See below some of the countries that for different reasons we are closely monitoring and the reasons why we believe that they may represent interesting investment opportunities in the future. We will also look at their past scoring in the Olympic Games to try to detect some parallel with their economic trajectory.

LATIN AMERICA

Brazil is the obvious starting point. Brazil has won more medals on average over the past four Games than in the past, but its Olympic record still lags its economic growth. Brazil is now the world's eighth biggest economy (nominal GDP in billion USD, IMF April 2016) but it has never come that high on the medals table. After having hosted the World Cup in 2014, the country is going to host the Olympics in less than a month's time. In the past few years, Brazil's economy has disappointed. It grew by just 2.2% a year, on average, during President Dilma Rousseff's first term in office in 2011-2014, a slower rate of growth than most of its neighbours, including China and India.

Since summer 2014, investing in Brazil has been a roller coaster ride. Volatility has been impressively high, most of the time due to changes and rumours about politics rather than economic fundamentals. Since early last year, the main questions have been around a potential impeachment of Dilma, which indeed took place in May 2016 on the basis of budgetary mismanagement. The whole process was quite dramatic and in some cases almost paradoxical, with a parliament filled with corrupt members voting to overthrow the President on the basis of an inspired aspiration for greater legality and transparency. Temer's interim government is now trying to ease the economic crisis with market friendlier reforms. Investment opportunities are now getting more exciting, on the equity, credit and macro side. Although it is difficult to be optimistic about the broader economic situation, there are notable changes in the outlook and markets are starting to price in positive developments. Furthermore Brazil has high interest rates, a floating FX rate and liquid markets, all of which make it an interesting place to source for investment opportunities.

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More broadly, with some notable exceptions such as Venezuela, Latin America is starting to be more interesting from an investor's perspective. After years of populist governments, first Argentina and then Peru have demonstrated to the world their ability to democratically and peacefully change the political environment. In the case of Argentina, after a breathtaking presidential campaign, Macri started the engine of reforms last December, which are still going full speed. In the Olympics, Argentina never scored that high. London was worse than Beijing, with 4 medals in total vs. 6 at the previous edition. If Macri turns out to be as successful in activating more economic growth for the country as he has been at managing the Boca Juniors football club, we should expect better Olympic performance as well for the country in Rio 2016.

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AFRICA

Interestingly enough the Olympic story of Argentina is also connected to another of the major frontier markets: Nigeria. A story of soccer, an important one, that started in 1994 at the World Cup in the US, when after the first round victory against Nigeria, Maradona was tested for doping, found guilty and abruptly removed. Revenge could have come at the next Olympics in 1996, where Argentina again faced Nigeria for the final match in Atlanta. Nigeria won the gold and Argentina got silver. La Selecion finally managed to win 2 gold medals in the Olympics, in 2004 and in 2008, eventually replacing Maradona with Messi as the favourite national soccer champion.

Nigeria won a total of 23 medals since its first participation at the Helsinki Games in 1952. No medals at all in London 2012, a very disappointing result for the most important economy in Africa ex South Africa. Nigeria managed to address an important political change in 2015 in a relatively peaceful and democratic way, but the economic and financial situation since has deteriorated. Oil prices tumbled and, contrary to other oil exporters, authorities decided to keep the peg on the currency, an unsustainable decision that eventually on June 20th led to a partial and ineffective one-time devaluation of the Naira of around 40%. The situation remains very challenging for an economy that struggles to diversify away from oil and where investors remain reluctant to re-enter a market with extremely illiquid conditions. Despite having all the elements to score well, it is difficult to expect good results both in sports and in the economy for Nigeria.

LOOKING EAST

Jumping to another continent, there are two very different and promising frontier markets in Central Asia: Pakistan and Iran. Pakistan has just been upgraded to EM status by MSCI, effective in June 2017; while Iran is normalising its relationships with the West (more so with Europe than US) and will hopefully soon re-enter global markets.

Pakistan first participated in the Olympics in 1948 and has since won a total of 10 medals, of which 3 were gold, with the last gold won in Los Angeles 1984 at field hockey. They have won no more medals of any sort since Barcelona 1992. As in economic performance, it can only get better for Pakistan in sports!

Pakistan is a perfect emerging frontier story. In the past years, it has established a pro-business reform agenda, with the government delivering deficit reduction, cuts in subsidies and privatisation, all underpinned by an IMF programme. Although the pace of reforms is gradually slowing down, Pakistan can count on well-managed companies operating in a country with a large population and with strong demographics and improving security. The equity market is undervalued (vs MSCI Frontier Markets and neighbouring India) but has decent liquidity (within the context of frontier markets). Pakistan has one of the lowest levels of banking penetration in the world. Furthermore the China-Pakistan Economic Corridor (CPEC) should lead to a much-needed pick-up in investment. The cherry on the cake is that EM equity funds are marginal buyers in the MSCI transition, therefore there is potential for the market to perform well in the next 12 months.

If we are bullish about Pakistan, we are even more so for Iran, whose potential is still completely unlocked as we write, despite good developments with respect to sanctions…

PERCEPTION VERSUS REALITY

If we are bullish about Pakistan, we are even more so for Iran, whose potential is still completely unlocked as we write, despite good developments with respect to sanctions. Iran has a long and fairly successful Olympic story (60 medals in total), ranking 20th out of 85 countries in the London Olympics (12 medals, 4 gold, 5 silver and 3 bronze). They boycotted both the 1980 and 1984 editions, but managed to partner up with both Russia and US two years ago to keep wrestling as part of the summer Olympics. Wrestling is definitely the national Olympic specialty, which got Iran more than half of all its medals. At the Games and in other sporting competitions, Iranians also proved to be very good at weight lifting, as they endured years of total economic and financial embargo by the West! It was not by fighting but by smart diplomatic efforts that the Rohani government managed to break the strangling grip of sanctions. In view of a potential complete opening of the economy, Iran is the most compelling frontier story out there. A country with a population of 80 million with a well-educated and young population, a diversified economy and liquid market all make Iran an extremely attractive destination for foreign investors. The Perception versus Reality gap is at the maximum when it comes to Iran and it is defying the usual prejudices that the Iranian delegation to London Olympics was composed of 52 athletes of which 8 were women who competed in disciplines such as rowing, shooting, archery, taekwondo and athletics… We hope Iran will win the gold medal in the steeplechase in Rio 2016 and will run fast towards a full readmission to the global financial markets.

TIME TO LOOK AGAIN

In conclusion, we believe it is once again time to take a closer look at Emerging and Frontier markets, not just in relation to the financial markets but also at the Rio Olympics. We think that the gap between Developed and Emerging / Frontier markets has stretched too far and that the spread is likely to close at the benefit of the second group. We will also be curious to check if this holds true for the medal total!

We conclude this piece with the words of Nelson Mandela**: "Sport has the power to change the world. It has the power to inspire. It has the power to unite people in a way that little else can. Sport can awaken hope where there was previously only despair".**

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