Foreign Investment Funds in Emerging Markets

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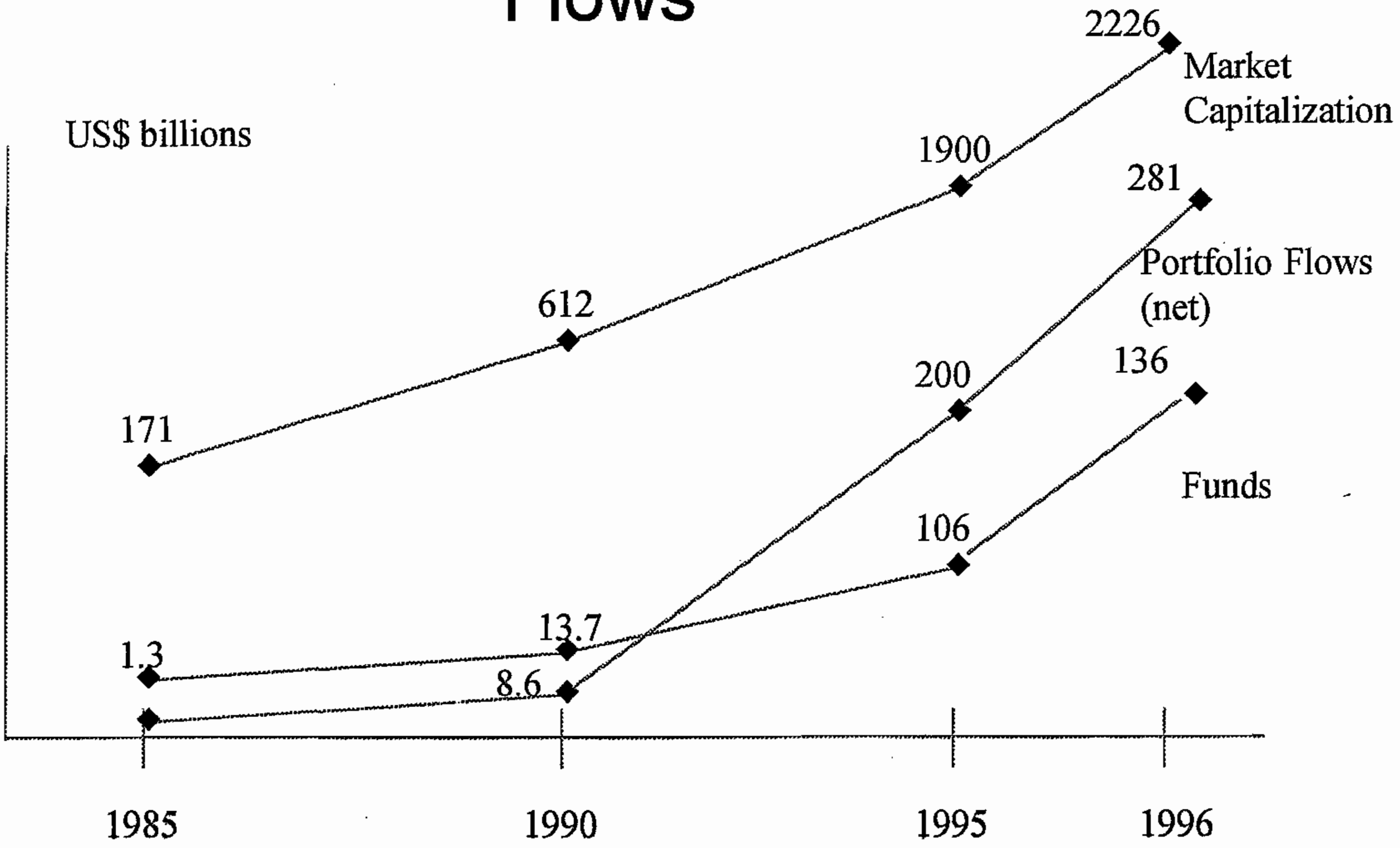
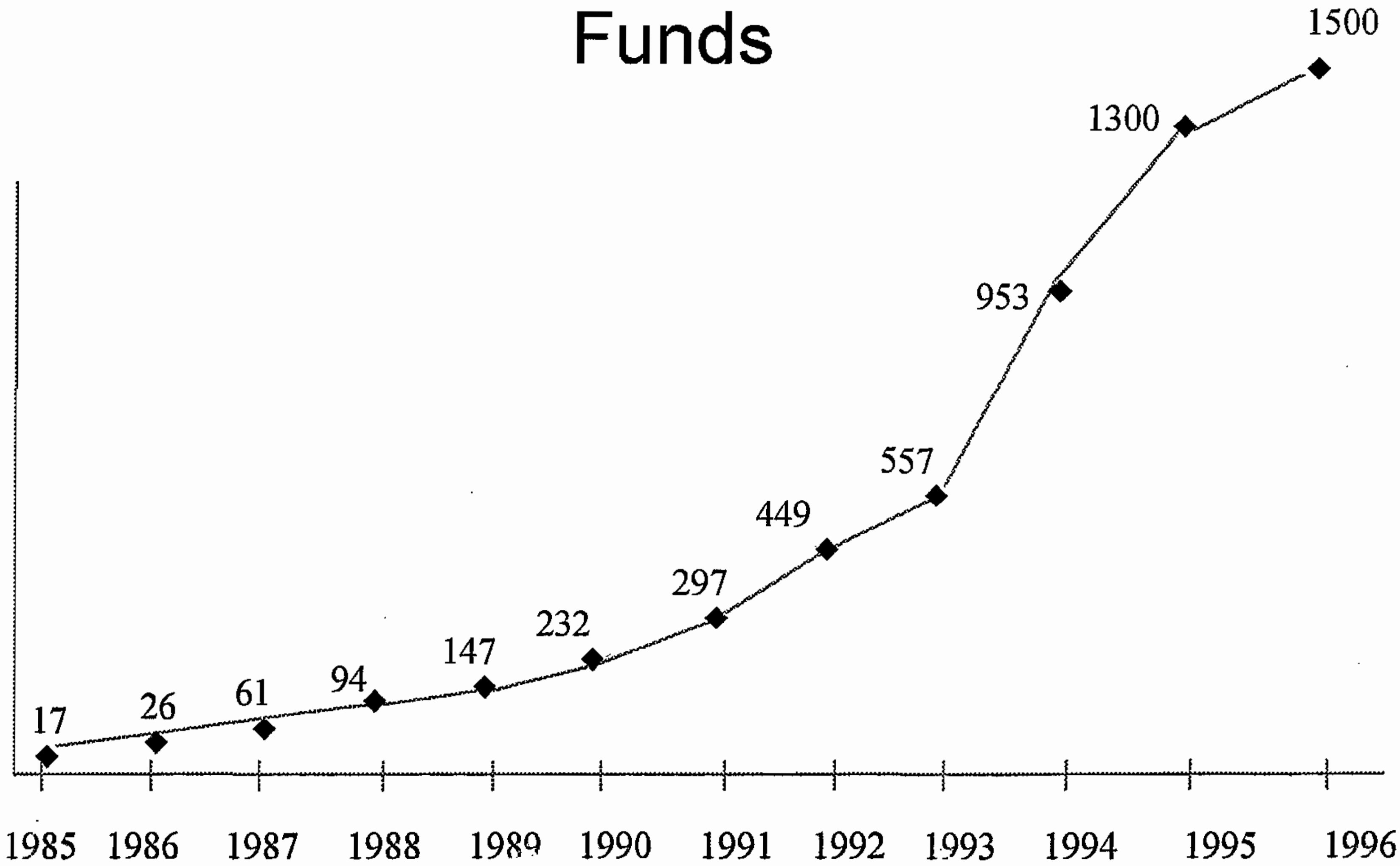
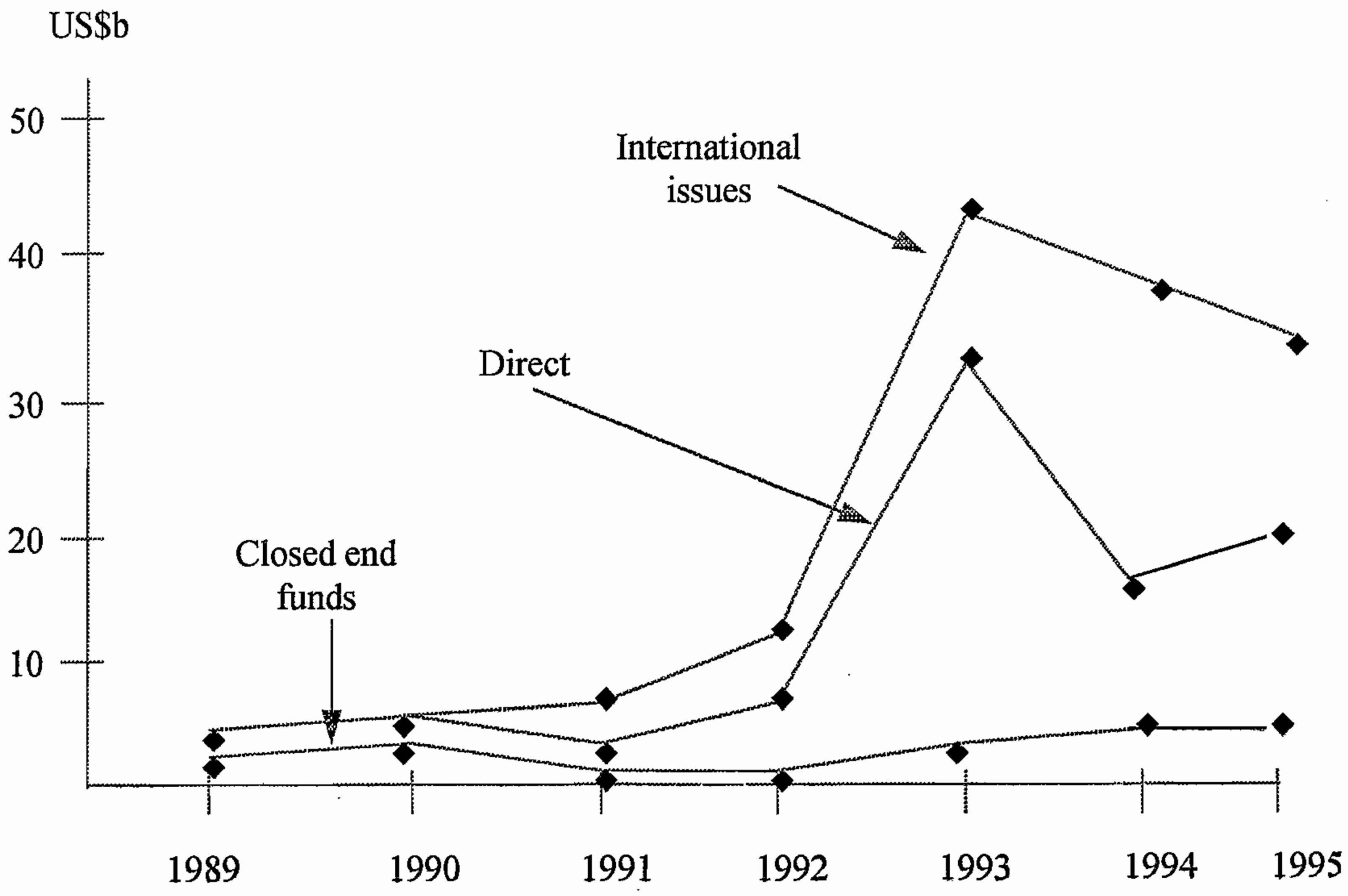
Emerging Markets
Stock Market Capitalization and Foreign Flows



Number of Emerging Market Equity Funds

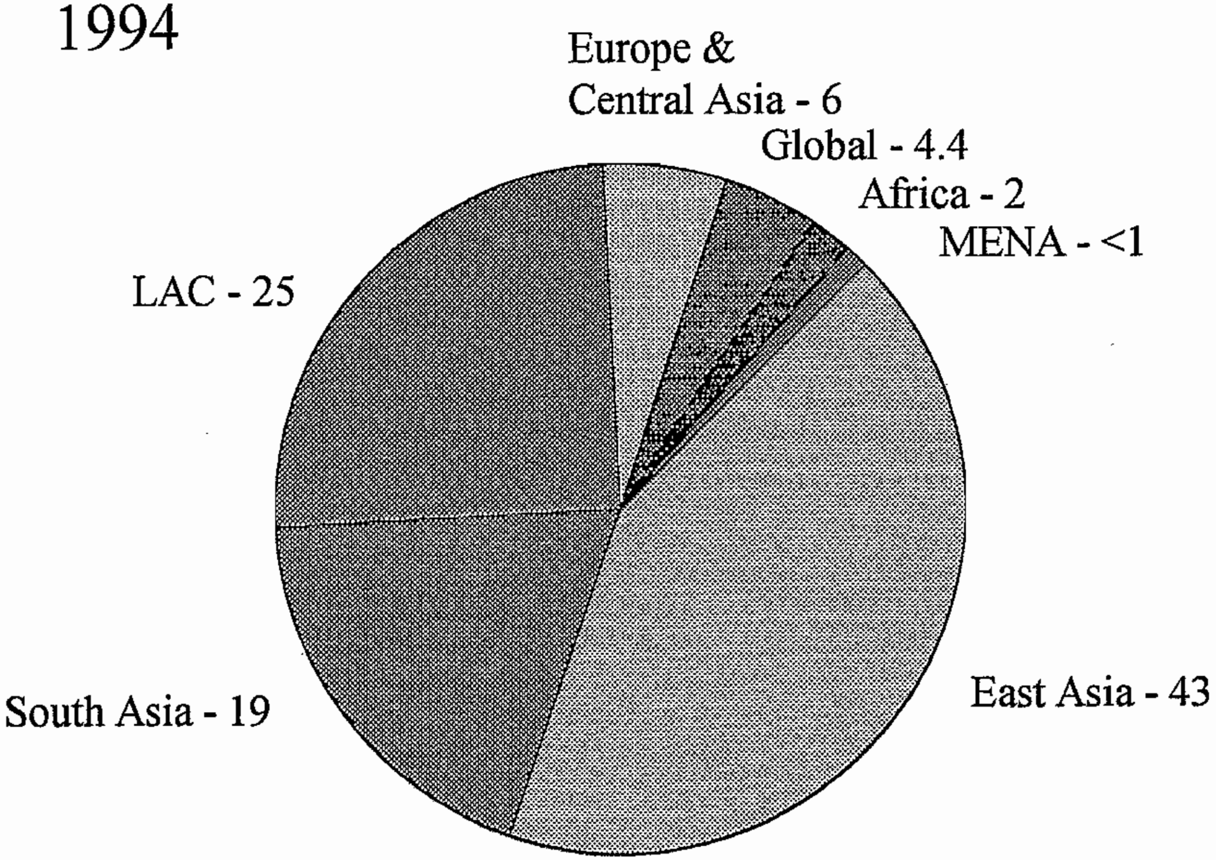


Portfolio Equity Flows 1989-95



Portfolio Flows by Region

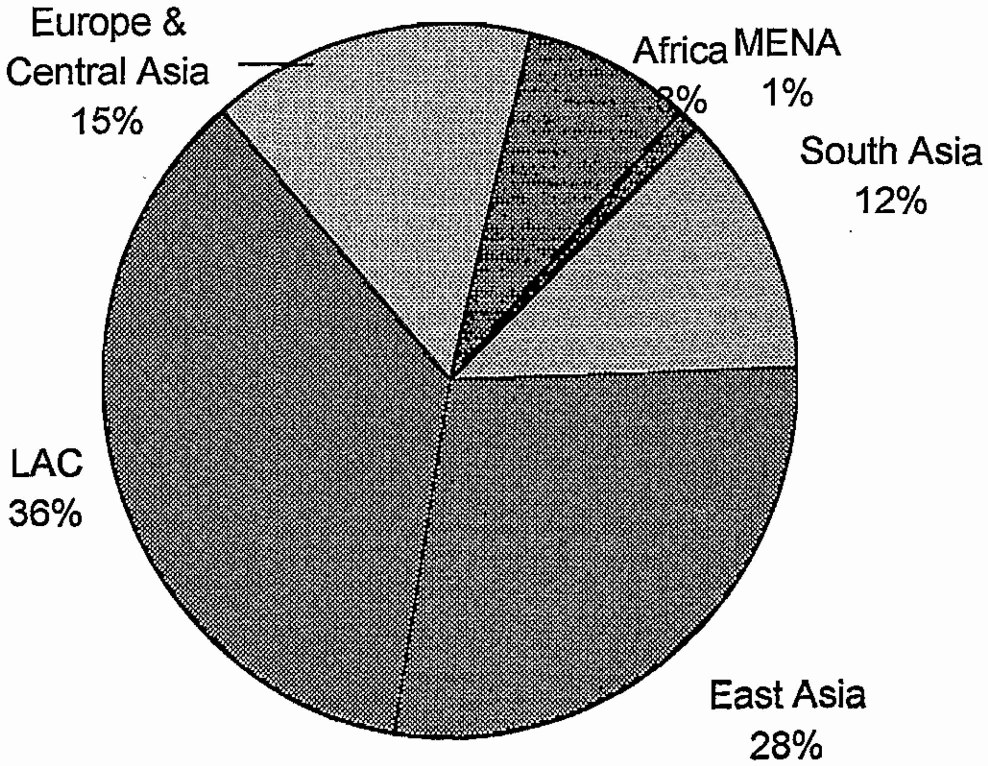
1994



Portfolio Flows by Region

1996

100% = US$45.7 billion



Why Were Funds Attracted to Emerging Markets

- "Pull" forces:
  - macro stabilization
  - financial market liberalization
  - 1980s debt crisis resolution
  - high growth
  - high rates of return
  - privatization increased supply

- "Push" forces:
  - reduced OECD restrictions on foreign investment
  - declining interest rates
  - 1980s debt crisis resolution

- Wheels greased:
  - EMDB, MS-CI
  - Technology made investment easier

Benefits of Funds

To Investors:

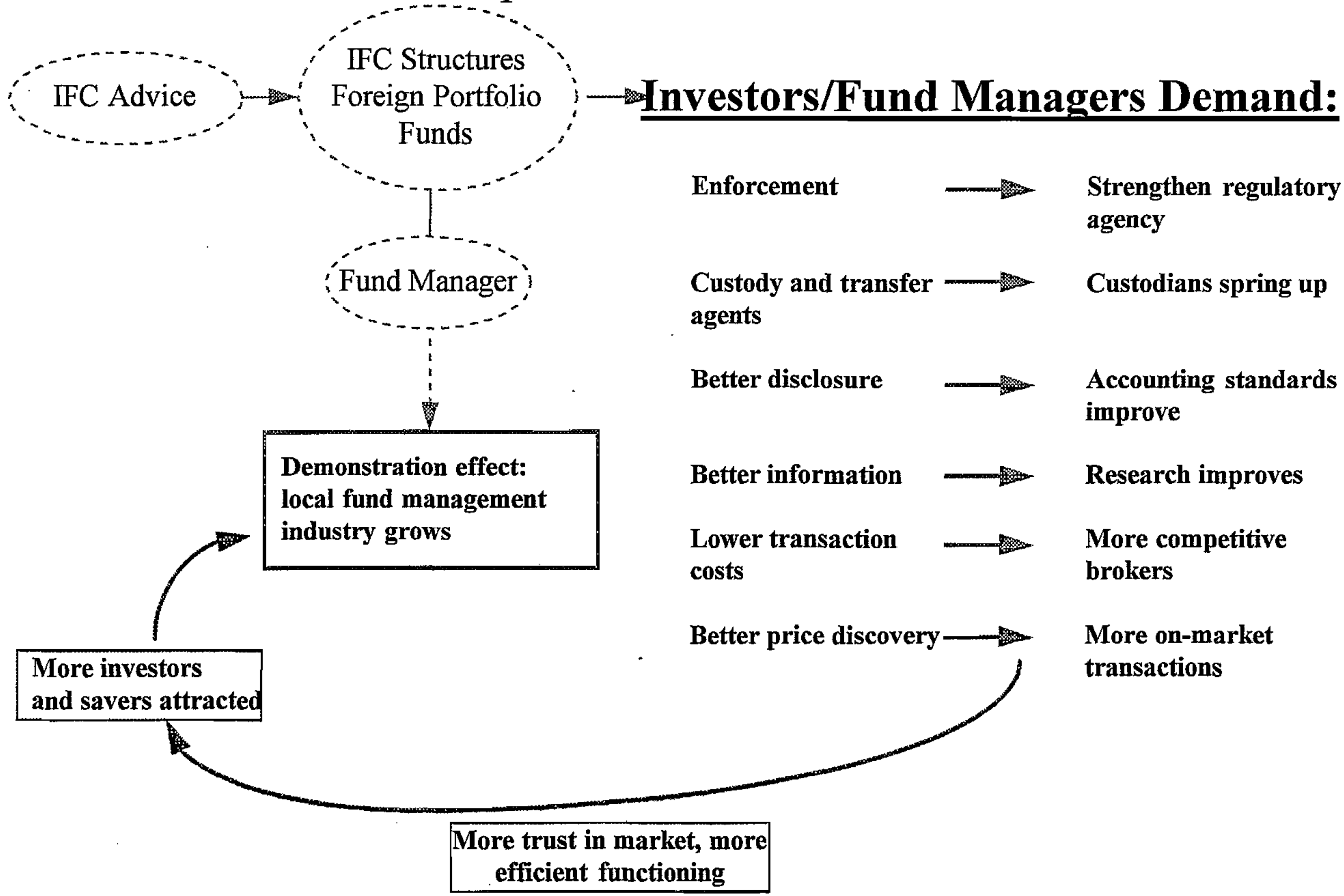
- portfolio diversification (1% vs. 11%)
- professional management
- economies of scale in management and administration costs
- easy divestment
- (sometimes) privileged access

- To Local Firms:
- improved access to longer term capital
- better information and higher standards
- ultimately push toward higher productivity as research increases

Benefits to Governments

- Augment domestic savings
- Reduced volatility vs. bank credit
- Ownership diversification
- Valuation and operational skills
- Higher stock prices, lower cost of equity
- More liquidity

The entry of foreign fund managers often inaugurates a virtuous circle of market development.



Within a relatively short period of time, the effects of foreign fund entry can be seen in the local markets.

Sample of 8 countries *

	Market Cap US$ billion	Avg. Turnover Ratio	# of Firms
Year of First Fund	61	35%	1,350
Two Years Later	132	46%	1,482

* Chile, Korea, Malaysia, Mauritius, Philippines, Portugal, Thailand, Turkey

Local markets have understood the benefits of foreign investment and have continued to liberalize.

	Percent of emerging stock markets *		
Market Status	Feb 1991	Dec 1994	Dec 1996
Free entry	26%	58%	63%
Relatively free entry	48%	24%	25%
Restricted	15%	16%	10%
Closed	11%	2%	2%

* Percentages are based on 27 markets in 1991 and 45 in 1995.

The Case of Mauritius

	Dec 1992	Dec 1993	Dec 1994
Number of listed companies	22	30	35
Market capitalization US$m	416	791	1,514
Turnover US$m	10	39	85
Turnover ratio	2.9%	6.5%	7.0%
Market index	183	303	474
Price/earnings ratio	11.6	12.8	18.4

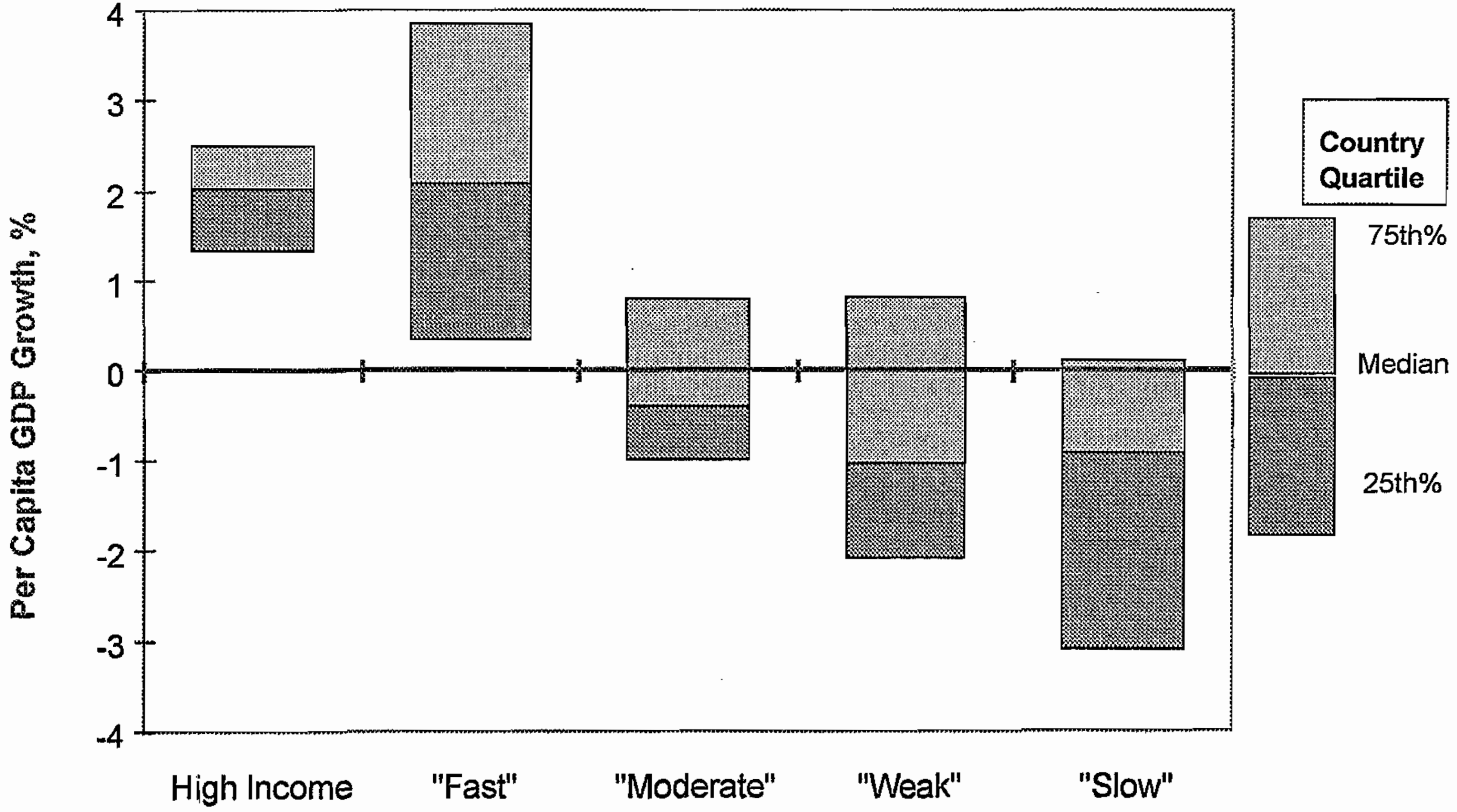
Index Funds

January 1994	First index fund, Emerging Markets Index Fund $44.8 million
May 1995	EMIF at $938 million
May 1997 index	US$10.5 billion managed on basis

New Research Shows:

- Banking depth and stock market depth are both independently correlated with:
  - economic growth
  - capital accumulation
  - productivity growth
- Stock market liquidity is most important factor in determining correlation with growth
- International integration correlates with faster stock market growth

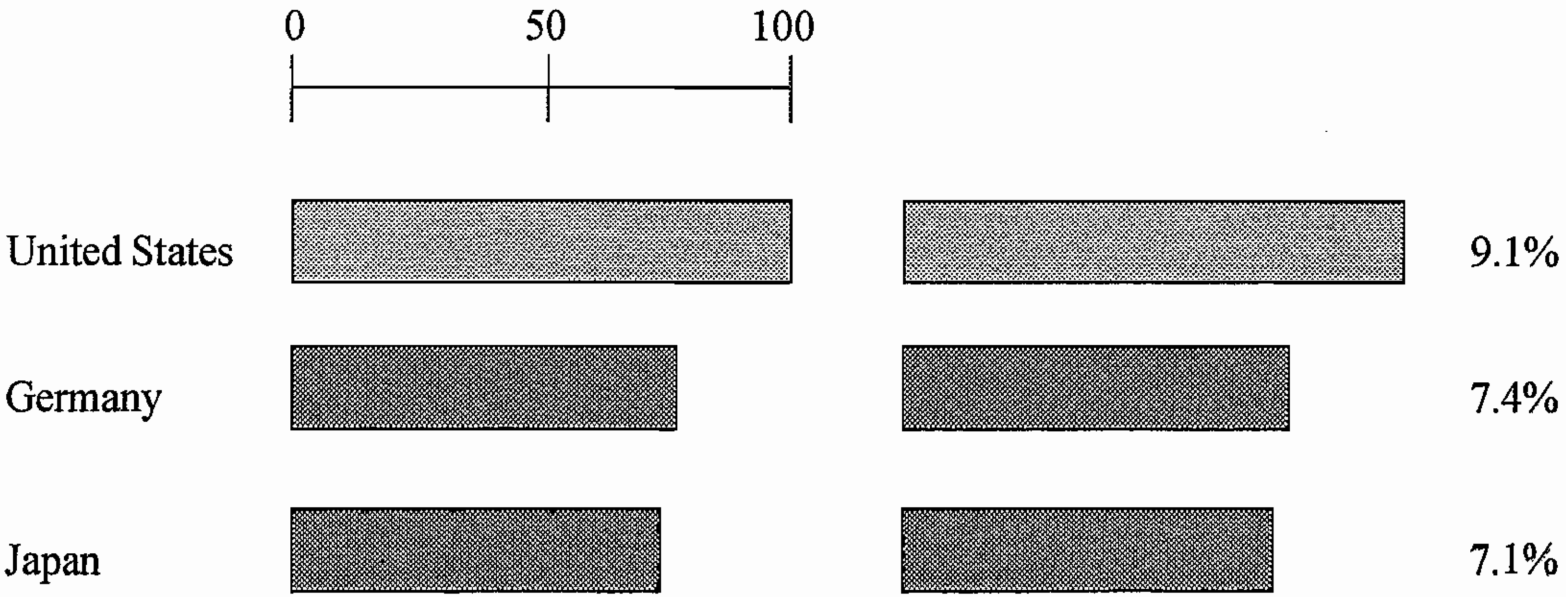
COUNTRY SPEED OF INTEGRATION AND GROWTH, 1984-1993



Capital productivity may be a key component of determining national well-being and GDP per capita.

Capital Productivity
1990-93 avg. US = 100

Rates of return on debt and equity



QUESTIONS:

- Why so many closed-end funds trading at a discount to NAV?
- Why are they still being developed (Wednesday's WSJJ)?
- Effect of first dollop of FPI often salubrious, what is effect of lots of FPI?
- Will rise in direct investment again raise issues of national patrimony and volatility or has globalization taken the world beyond that?