## International Business News

### G8 talks turn spotlight on Europe's banks

AFP, *Lecce, Italy*

Pressure mounted on Europe to reveal the viability of its crisis-hit banks after a meeting of G8 finance ministers in southern Italy over the weekend ended in disarray over the thorny issue.

Britain and the United States have already carried out "stress tests" to gauge the capital requirements of their banks -- a painful exercise seen as boosting confidence in a sector at the epicentre of the global economic crisis.

But Berlin has resisted calls for tests on its banks saying they could undermine fragile economic confidence.

London meanwhile warned its European partners that their failure to clean up banks could hold back Britain's recovery.

The contentious issue was not even mentioned in a statement at the end of the G8 meeting despite it dominating on the sidelines of the talks.

"The uncomfortable truth for Europe is that, however flawed it might have been, the US stress test exercise has so far proved effective in bolstering confidence and helping banks to raise capital," said Marco Annunziata, chief economist at Italian banking giant Unicredit.

"Eurozone policymakers appeared somewhat divided against criticism that Europe has not yet undertaken a coordinated and transparent stress testing of its major financial institutions," he added.

### Economic vision sought in 'Davos in Detroit'

AFP, *Washington*

A US summit opening Monday aims to "define America's future in the global economy" in a gathering of business and economic leaders billed as "Davos in Detroit."

Organizers of the three-day Michigan gathering argue that the world's biggest economy needs a new vision to maintain leadership and competitiveness, and will seek a consensus among leaders in the corporate, academic, labor and political sectors.

"There have been other conferences and summits but on US soil there has never been anything like this before on the most important subjects on the economy," said Matt Friedman, spokesman for the Detroit Economic Club, which convened the event.

"The closest thing is Davos," he said, referring to the World Economic Forum's annual gathering in the Swiss alpine resort on global economic issues.

Among the 90-plus speakers are chief executives Richard Anderson of Delta Air Lines, Steve Ballmer of Microsoft, Vikram Pandit of Citigroup, Fritz Henderson of General Motors and Alan Mulally of Ford.

For the US government, the line-up includes new chief technology officer Aneesh Chopra and Commerce Secretary Gary Locke.


AFP

**People demonstrate on Saturday in the streets of Paris, against President Nicolas Sarkozy's policies for tackling the economic crisis. France's eight main unions had staged their fifth day of action this year to demand stronger measures to cushion families from a global downturn that has plunged the country into recession and sent unemployment soaring.**

### Britain eyes green shoots in struggling economy

AFP, *London*

Britain's battered economy is witnessing "green shoots" of recovery after a deep recession, but they could remain fragile for some time as the jobless toll continues to rise, analysts warn.

Major economies including Britain, the eurozone, Japan and the United States were dragged into recession last year as a result of the global financial crisis and the credit crunch, leaving many people facing a bleak winter.

But as the summer warms up shopkeepers and businessmen are reporting signs that customers have money in their pockets again, while banks are lending more, helping to steer the housing market out of a steep slump.

Mexican food chain Chilango has bucked the downturn, launching its first restaurant in Islington, north London, in 2007 amid the eruption of the global financial crisis. It opened a second outlet on Fleet Street last October.

"My gut feeling is that the recession's not going to get worse than where we are now -- it may stay at the point we are at -- but it will only get better from this point," Chilango founder Eric Partaker told AFP.

### US removes Laos, Cambodia from trade blacklist

AFP, *Washington*

US President Barack Obama on Friday removed Laos and Cambodia from a trade blacklist, opening the way for US loans to companies doing business in the former US adversaries.

The United States has been boosting ties with both Southeast Asian nations. But the decision on Laos was sharply criticized by campaigners for the country's Hmong minority, which says it faces persecution.

In brief declarations, Obama said Cambodia and Laos had each "ceased to be a Marxist-Leninist country," a designation that prevented financial support by the US Export-Import Bank for businesses operating in the two nations.

The move, which still must go through formalities, means that US businesses would be eligible for US government-backed loans and credit guarantees as they can receive when operating in most countries.

CAPITAL MARKET

# Mutual funds on the rise

AMINUL HAQUE

Recently we observed a heightened interest in the country's capital market surrounding mutual funds.

Four new mutual funds have been launched since January 2007 with a target to raise Tk 2.55 billion. Another six mutual funds will be launched within the year and are expected to raise Tk 12 billion.

Most of these funds are sponsored by private financial institutions and offer an alternative to Investment Corporation of Bangladesh (ICB) mutual funds. Mutualisation of investors' fund is an old concept. Initially the goal was to create a large pool allowing investment in large projects. The advancement of investment theories in the 1950s and 60s and an understanding of the benefits of diversification added to the popularity of mutual funds.

Economic growth in developed countries after World War II led to a rapid growth in individuals' savings, which further encouraged a demand for better investment options. As of 2008, worldwide investment in registered mutual funds stood at $21.7 trillion. Although asset under management (AUM) declined from its 2007 peak of $26.2 trillion, this still amounts to a cumulative annual average growth rate of 10 percent over 85 years.

A mutual fund is usually a collection of a few separate companies. At the core is the fund itself whose sole purpose is to raise capital from investors and disbursement of the capital. The ownership of the fund is divided into many units, which are owned by individual investors. The fund is overseen by directors or trustees and managed by a fund manager or an asset management company (AMC). The AMC makes the investment decisions and is paid a fee for its services, usually a percentage of the total AUM.

A security broker executes trade for a fee. A custodian or trust company holds the securities for the fund. There are countless variations of this simple model depending on investment style, asset mix, size of the fund, fee structure, and inclusion or exclusion of new investors.

| | Size (BDT Mil) | Offer Date | Fund Manager | Formation Fee | Avg. Mngt Fee |
|---|---|---|---|---|---|
| Prime Finance 1st Mutual Fund | 200 | Jan-09 | ICB AMCL | 5.00% | 2.00% |
| Grameen One Scheme Two | 1,250 | Jun-08 | AIMS | 1.95% | 0.70% |
| ICB AMCL Second NRB Mutual Fund | 1,000 | May-08 | ICB AMCL | 5.00% | 2.25% |
| ICB AMCL First NRB Mutual Fund | 100 | Jan-07 | ICB AMCL | 5.00% | 2.25% |

Net asset value (NAV) of a fund unit represents the share of assets (less any liability) of each unit. There is no reason for a fund to trade above or below its NAV except for temporary or liquidity reasons or unless the NAV calculation is grossly erroneous.

The simple model of the mutualisation of individuals' funds offers a number of advantages. An average trade by a mutual fund is much larger than that of an individual's portfolio lowering overall transaction costs, asset diversification in a large portfolio is easier to attain and mutual funds can spread the cost of investment research over many investors.

The proliferation of institutional investors (mutual funds, private funds or retirement funds) brought some secondary benefits to the investment management industry, like institutional investors through large shareholding can exert strong influence to improve corporate governance of businesses and because of their large resources, institutional investors can take position in unconventional assets. This improves portfolio diversification and aid global capital flow.

The Securities and Exchange Commission (SEC) is responding well to the growth in institutional funds by formulating regulations and guidelines for the AMCs. Based on my experience in the mutual funds industry and my review of the prospectuses of the four latest mutual funds, I shall point out a few issues that are important, requires attention, and needs to be addressed for a healthy growth of the industry.

**Expenses and management fee**

A fund pays all its expenses and a fee to the AMC from its assets. Size of the expenses and fees affects the performance of a fund. Funds are free to choose their fees subject to the competitive environment. Of the four funds, annual fees ranged between below 1 percent (Grameen Mutual) to 2.5 percent (two ICB NRB) before expenses. The three funds managed by ICB AMCL anticipate annual expenses up to 4 percent of the NAV. Taken together, management fees and expenses can cost as much as 6 percent annually. In comparison, investors in advanced countries pay about 2.5 percent in management expense ratio (MER). Bangladeshi AMCs charge a 'formation fee' between 1 percent and 5 percent at inception, which does not have a parallel in other markets. Because of compounding, high management fees and costs make a sizable dent in the total savings, as shown in the table below. Hopefully management fees will eventually decline as competition grows. For now however, should the funds be allowed to charge high fees simply because they can? I am not recommending regulation of fees, but some balance must be achieved by exact and prominent disclosure of the fees and expenses.

**Credentials of a portfolio manager**

In the investment management industry, portfolio managers are highly regarded for their knowledge of the profession and the high standards they practise. Portfolio managers must clearly understand and practise certain duties including the duty of care, duty of diligence and duty of a fiduciary. Managers in advanced markets undergo extensive training and licensing requirements. I understand that the SEC of Bangladesh grants a license to an AMC based on the credentials of its professional staff. The following questions should be answered to make the process transparent: is there a clear guideline that states who can be presented by an AMC as a portfolio manager? To what standards should a portfolio manager be held, and how are these standards enforced? The regulator and the market participants should also develop training and licensing programmes for mutual funds distributors, portfolio managers and other market participants. These programmes should focus on industry knowledge and the regulatory, legal and ethical aspects of the business.

**Fund objective/style and benchmark**

Based on the skills and strength of the AMC, mutual funds adopt an investment style and choose a benchmark based on the style. Fund performances are evaluated with respect to the benchmark. Because of a shallow market, the four listed mutual funds did not specify an investment style. They also did not offer a benchmark that could be used to evaluate their performance. The use of a broad index such as the DSE/CSE indices would assist investors' selection of a mutual fund.

**Performance standards**

Seasoned investors look at the past performance of a mutual fund when selecting a fund. Standardisation of performance reporting is necessary as AMCs can otherwise paint a rosier picture of their performance by cherry-picking the investment interval and other variables. It is important to establish the basic rules of performance reporting while the industry is still young. The SEC can look at various industry organisations and regulatory bodies that have established uniform performance measurement standards. The CFA Institute advocates use of the Global Investment Performance Standards (GIPS) and makes it publicly available.

**Use of unlisted securities and their valuation**

The last issue of concern is the inclusion of unlisted securities in mutual fund portfolios. All funds allow inclusion of unlisted securities. For our four funds, as much as 50 percent of the securities can be unlisted.

**Calculation of the NAV**

Valuation of unlisted securities poses a problem as they do not provide a daily closing price. The stated policy for valuation of unlisted securities, including the frequency, process and oversight by trustees, is not very transparent. In other words, AMCs are giving themselves a wide berth in valuing unlisted securities. Impact of the valuation is still more important as calculation of the NAV determines the management fees.

**Disclosure of holdings**

None of the AMCs make any promise about regular disclosure of their fund holdings. Registered mutual funds in advanced markets are required to disclose their holdings at least quarterly. This disclosure enables investors to monitor whether and how a fund is complying with its stated investment objectives. If a fund consistently trades in unlisted securities, lack of quality and liquidity of such securities can dramatically affect the risk profile of the fund. A mandatory policy of disclosure of portfolio holdings, especially unlisted securities, can reduce such risks.

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DEFENCE INDUSTRY

# Weapon makers look overseas

AP, *Washington*

Foreign governments looking to kick the tires of fighter jets and cargo planes at this week's air show in Paris will likely hear a clear message from US defence contractors: We need your business now more than ever.

AP

**In this Aug 15, 2008 file photo, a US C-17 military cargo plane, the type to be stationed permanently at a NATO air base at Papa, northwest of Budapest, Hungary, sits on the runway to be shown to local journalists. With the US looking to cut defence costs in 2009, and rethinking the way it fights wars, many contractors need overseas buyers to take the big, pricey weapons that the Pentagon no longer wants or needs fewer of.**

With the United States looking to cut defence costs and rethinking the way it fights wars, many defence companies are looking for international buyers to take the big, pricey weapons that the Pentagon no longer wants or needs fewer of. US contractors are chasing some lucrative deals, but could also face some legal and political hurdles as they hawk weapons overseas.

Boeing Co and Lockheed Martin Corp are competing to sell fighter planes to countries such as India and Brazil. Boeing is trying to spark international interest in its C-17 cargo plane. Middle Eastern nations fearful of threats from Iran are bulking up on missile defence equipment from Lockheed and Raytheon Co.

"This is a world market right now," says Chris Chadwick, Boeing's president of military aircraft.

Globalisation is nothing new for many US industries, which often use overseas operations and sales to tap into fast-growing areas like China and as a hedge against domestic downturns. Some of the nation's biggest manufacturers, companies like Caterpillar and General Electric, make more than half of their sales overseas.

But the defence industry is closely tethered to one primary buyer - the US government. It has been a lucrative relationship. Defence spending is up more than 40 percent over the past eight years, fuelled in part by spending on wars in Iraq and Afghanistan. Much of the money flowed to defence contractors that supply the Pentagon with everything from warships to bullets.

Overseas arms sales represent a relatively small segment of defence contractor sales. But many are turning to the global markets for growth now that the appetite for big and expensive weapons is waning in the United States. The push is helped by countries worried about security threats from nations such as North Korea and Iran. Many European allies need to upgrade their aging equipment, and are turning to US companies as likely suppliers.

However, budgets for big weapons are getting tighter as costs like personnel expenses eat up more Pentagon resources. Defence Secretary Robert Gates proposes spending more money on tools like unmanned drones to fight insurgencies instead of big and pricey equipment like $140 million apiece for F-22 fighters jets meant for more conventional wars.

In the 2008 fiscal year, the military spent $164 billion to buy weapons. For the 2010 fiscal year, the Pentagon proposes spending only $131 billion, though that number will probably grow when Congress adds weapons spending as it reviews the budget.

Big defence companies would take a hit. Lockheed will have to shut down its assembly line at its big Marietta, Ga. plant, putting thousands of jobs at risk. Boeing, which gets 80 percent of its defence unit sales from the Pentagon, could stop selling the $276 million C-17.

"There is a softness in the home market right now," said Richard Aboulafia, an aerospace analyst with the Teal Group.

That could grant some new life to programs that would be cut under the Pentagon's new budget.

The F-22 program is slated to end at 187 planes for the U.S. Air Force, far fewer than originally envisioned. Japan and Australia are considered potential sources of new sales, but federal law barring export of the technologically sensitive plane would have to be overturned. The prospects of that remain unclear.

Congress put eight more C-17s back into the budget. Boeing wants to make 16 per year and hopes to cover the shortfall overseas. It recently cut a deal to make four for the United Arab Emirates. The contractor is also trying to persuade foreign governments to buy the F-18 instead of the F-35, made by a team led by Lockheed.

Defence companies will display their jets, engines, missiles, pilotless drones and other hardware for several days this week at an airfield outside Paris. The show is one of the biggest that brings together contractors and militaries from around the globe to broker weapons deals.

New markets have emerged. Iraq wants to buy Lockheed fighter jets, Boeing helicopters and Abrams tanks made by General Dynamics Corp. to rebuild its military. The nation was the second largest potential buyer of US military equipment last year, behind Israel, according to a March report by the Arms Control Association, a Washington think tank.

The Pentagon notified Congress it planned to sell $74.5 billion worth of US military equipment to 25 countries in 2008, nearly double its proposed arms sales from 2007. Iraq accounted for $18.7 billion of that total.

Congress must approve weapons sales to foreign governments that are negotiated between US contractors and foreign countries through the Defence Department. Not all notifications lead to sales and they cover mostly large purchases, but Congress has never moved to block a sale once it was formally notified.