



Enter Dragon, Smoking

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T&B – Enter Dragon, Smoking...

I sometimes think that God in creating man somewhat overestimated his ability.

Oscar Wilde

T&B is delighted at the response to our challenge to the Western narrative regarding the recent Moscow protests which, not without a touch of irony, we dubbed “The Facebook Revolution”. Indeed, we have not been quite so counter-current and controversial since we took aim at the murderous thug Khodorkovsky and his numerous Western shills who so conveniently forgot what they themselves had been writing about him – until, that is, their masters gave a sharp tug on their leash, having suddenly concluded that the “vicious oligarch” was in fact a hero for democracy, (i.e. favourable to Western interests) and thus, that the recent past was to be promptly re-written.

While roughly 75% of our feedback has been positive, we have had some interesting discussions with a couple of knowledgeable and well-informed correspondents who argued that we were missing the deeper political significance to the middle-class revolt; we shall discuss their views – and our response – below. There are a few others – perhaps less worthy of rebuttal – who apparently believe

that being broadly favourable to the Putin government somehow disqualifies one from expressing any political views at all; apparently this applies to Russia alone – they do not seem to consider those favourable to, say, Obama or Merkel to be similarly discredited.

What we here need to address are a couple of personal comments from Russian readers who, for some odd reason, suspect that our support for the Putin presidency has something to do with his uniquely favourable influence upon our personal finances – perhaps they should think about this statement for just a minute...

Were our views on Russia politics to be predicated solely upon our personal financial interests, it should be obvious that we would be down on our knees praying for a return of the enthusiastically pro-Western governments of the late 1990s, leading to a renewed wave of foreign hot money inflows which we would be well-positioned to trade (even 1997 was a great year – if, that is, one got out in time!) In the short-run at least, finance is a game of perceptions – with Western perceptions a major determinant for Russian market performance. While in our view the Putin government offers the best long-term perspectives, from a trader's perspective, a return of Medvedev to the Presidency would have sparked a nice little rally, while a Prokhorov presidency would, at least initially, be manna from heaven!¹

We prefer the devil we do know, and, quite frankly, there are some things money just can't buy; T&B would rather undergo dental surgery than to see a replay of the late 1990s.

¹ *Albeit about as likely as T&B being elected to Holy Synod! Russia is simply not ready for a Berlusconi, and at least Berlusconi had been a very successful – as opposed to lucky – businessman.*

Christmas- (Heterodox) -Greetings

Thank you Vladimir Vladimirovich!

*Not otherwise known for our excessive modesty, T&B has been heard to boast of combining most of the biblical vices in a single person. That said, there is at least one vice that we find truly loathsome – **ingratitude**.*

Indeed, were some of the upper-class Moscow liberals we know – who cease stuffing themselves with European delicacies in this Christmas season only long enough to bemoan how terrible everything is in Russia – to have even a modicum of decency, they might at least acknowledge the fact that they owe their current well-being almost entirely to Vladimir Putin. While they may sincerely believe it time for him to step down (a defensible view, although one which we will argue against), their refusal to at least acknowledge our profound debt of gratitude suggests those vices which gives the human race such a filthy reputation amidst the animal kingdom.

T&B's personal story is closely tied up with the Putin decade – and unlike a few of our Russian friends of “the 1%” who are somewhat critical of our views, T&B has no other home – no residence abroad, nothing to return to in our native France; intentionally or otherwise, our fate is tied to that of Russia. The claim that “we can always leave if things get dodgy” applies equally to a large segment of the Russian nomenclatura – many of whom, like us, have no conceivable desire to do so...

Readers of *The Missing Chapter*, and indeed anyone living in Moscow following the crisis of August 1998, will remember the well-intentioned admonitions of our Western friends that we should bail out of Russia without undue delay; under the best of circumstances, it was to remain an absolute financial backwater for the next couple of decades; under the worst – was headed for civil unrest, social breakdown, economic crisis, and a possible breakup into its geographical moieties. Perhaps our choice was irrational – some combination of Moscow's great weather, cheap prices, friendly people, light-touch bureaucracy and easy traffic – but we choose to throw in our lot with that of the locals.

In retrospect we would like to think it was foresight – perhaps it was nothing more than stubbornness – but having fallen in love with

Russia (an affair, which after 14 years, has not yet grown entirely cold) and being disinclined to double back upon our own footsteps, we waited with considerable fear and trepidation to see whether Russia could right herself based on her own resources, making fools of the nay-sayers...In the event, fate proved kind indeed.

Those who did not know the Russia of the 1990s can hardly imagine the degree of dysfunctionality – the Federal budget was one of the great works of Russian fiction, the central bank a sieve, long-term planning ran to perhaps 15 days, the commodity businesses were little more than organized theft, social welfare a shambles. The country was plunged into poverty, bled white by the oligarchs – while a handful of people grew incredibly rich, the general level was one of appalling misery. What a difference a decade makes!

Success has a Hundred Fathers (Failure is an Orphan)

In some circles one hears it asserted that the recovery was solely due to the oil price, and that “*anyone could have done it*” – what tripe! Looking back at the media coverage at the beginning of the Putin presidency, the press was almost unanimous in asserting that, like Yeltsin before him, the new president would be nothing more than a puppet, unable to control the predatory oligarchs and their allies, the thuggish regional governors. Russia was ungovernable, doomed to demographic collapse and decay. The important matter was for the West to prepare for the coming collapse, seeking to limit and ring-fence the damage...
Ha! Fools!

What a difference a decade makes... by crushing the oligarchs as a political force and neutering the regional potentates, Putin retook Russia. There have been some very real weaknesses in governance – but viewed from 35,000 feet, the Putin decade has clearly been the most successful in Russian History. The accession of Vladimir Putin proved to be a godsend, not because matters could not theoretically have been better (things could always be better... or, for that matter, far worse) but because, given the realities on the ground and the then-conceivable alternatives, we are

hard-pressed to imagine a better outcome, at least within the realm of the probable.

While we would dismiss much of the foreign commentary outright as essentially corrupt (the Western *Kommentariat* generally refrains from biting the hand that feeds it – and the supine Russia of the Yeltsin years was so much easier for Washington and Brussels to deal with than is Putin's more assertive version), we are struck by the fact that the social classes which have benefited the most tend to be most critical. There is a local tendency to measure any current government not against any other plausible regime given Russia's unique history and sociology, but rather, against some hypothetical reign of the Holy Spirit. Paradoxically, both in Moscow and especially in the regions, those who are still struggling to get by are generally most favourable to the Putin government, recognizing that life has always been tough here, but that the situation, and their own lives – have improved dramatically since the 1990s. Unlike their European peers, they expect little of the government, devoid of that sense of entitlement which is now causing such havoc in Europe.

Not surprisingly, Putin has not solved all of the millennial ills of Russia – corruption and administrative callousness have not been reversed; Russia remains afflicted with bad roads and fools; the approach to social problems such as drug-abuse and AIDS seems more appropriate to the 19th Century. And yet, we have witnessed a myriad of events we would never have imagined possible – investment grade ratings, the resurrection of Russia as an agricultural powerhouse, the emergence of true banks (rather than the *bank-like entities* of yesteryear), a fully functional labour market, and, indeed, the emergence of the increasingly assertive middle class which gave rise to the recent protests.

T&B has been particularly gratified to witness Russia's development into a major regional power², willing and able to defend her own

² *The desire to exploit and dominate one's neighbours is apparently deeply coded within the human genome, and given that it is totally unrealistic to imagine that the beneficiaries of the current system would sacrifice their own narrow interests in order to cede power to some hypothetical international government, the next-best option is pluralism – if there are to be tigers, there be not one but several tigers. T&B would no more like to live in a world*

interests on the global stage. As regards foreign policy at least, the Medvedev interval is now closed; Russian policy will no longer seek to appease Washington and to curry favour with the broader West. Instead – much like the policies of the other BRICs – Russian diplomacy will seek to further Russia's own secular interests, at times in collaboration with – at other times in opposition to – the policies of the other powers.

This success was due very much to one man – whom T&B would class among the handful of men who – whatever their failings – can be seen as the saviours of their countries. The claim that “*anyone could have done it given the oil prices*” is mendacious. Under the Yeltsin governments, no finite oil price would have been of much help since the proceeds of oil exports were simply stolen and stashed abroad by the oligarchs. The banning of offshore trading vehicles and petroleum export duties – so fiercely opposed by Khodorkovsky, started Russia down the road to solvency. Whatever the shortcomings of the new governing class – and they are both deep and numerous – they have shown at least some modicum of civic sense as witnessed by the resurgence of Russian Forex reserves, balanced budgets and fiscal probity at a time when most of the G7 is faced with the threat of financial collapse.

Much Ado about Very Little – the Facebook Revolution (FBR) heads for the Beach

T&B has broken with the Western narrative to express a note of irony regarding the Moscow street protests after the Duma elections. While we fully understand the motivation for the tame foreign media in making the most of the rallies, we were bewildered by some of our brighter peers, who also appeared to be taking the protests quite seriously indeed. Always alert to the possibility that we might simply be wrong, T&B has discussed and debated the matter with several of them; while we have perhaps become more acutely aware of the long-term weaknesses of the current political system erected around Vladimir Putin, we remain

entirely dominated by Russia, China or the UK than in one under the sole command of America – members of the US nomenclatura are far too skillful at convincing themselves that whatever is beneficial to their personal interests is equally beneficial to those of a broader swath of mankind...

deeply unconvinced by the contention that Putin has outlived his usefulness, or especially, that the Putin system was in any way threatened by the fun in the streets.

Thus far, our conclusions seem to have been borne out by events: as far we can determine, this is the first time in recorded history that a mighty revolutionary wave has stopped in its tracks to enjoy a long, leisurely Winter vacation, while promising to be back sometime soon – and even more fearsome than before. Certainly, in November 1917 had the Bolsheviks departed St. Petersburg for a few weeks on the beach in Bali, the history of the 20th Century would have been profoundly different.

A decade or so ago, debating against those lamenting Russia's turn away from Yeltsin-era "democracy", T&B argued that, if Putin was successful, Russia would inevitably develop an assertive middle-class which naturally created political institutions in its own image, leading to a gradual evolution towards a boring, European social-democratic model.

We were right, and we were wrong – if there is any significance to the recent protests, it is to demonstrate the emergence of a Russian middle-class seeking a larger share of the pie as well as the trappings of Western political democracy. Where we have not yet been vindicated is in our expectation that this rising middle-class would create meaningful and representative political institutions, able to advance their own economic interests.

The current Russian opposition could be most charitably described as "*pathetic*". Certainly, while the Dec 24 demonstration managed to assemble an estimated 75,000 people, they could agree on very little other than the fact that they were unhappy. Besides the core of Westernizing liberals, there were substantial contingents of leftists, nationalists, anarchists, syndicalists and assorted hangers on. Several of the speakers, including Ksenia Sobchak (Russia's answer to Paris Hilton) and Alexei Kudrin were booed off the stage – several others, from Prokhorov to Gorbachev, wisely declined to address the crowd. The most popular speaker was without a doubt Alexei Navalny, a self-appointed anti-corruption crusader who is widely rumoured to be working for any one of several mutually incompatible employers. Having repeatedly watched YouTube footage of Navalny working the

crowd very professionally – a role for which nothing in his past experience had prepared him – T&B, a veteran of numerous political protest movements, could reasonably conclude that he had received some high-level training in public speaking and political agitation. We would note that his previous endeavours were partially sponsored by the National Endowment for Democracy, a Washington front organization³ which had been heavily involved in the Orange Revolution (*Google: Navalny National Endowment for Democracy*).

Alexei Kudrin – whom we had seen as at least a moderately competent technocrat – indeed, whom once upon a time we had hoped would be Putin's next Prime Minister, surprisingly proposed his assistance in mediating with the Kremlin so as "to avoid bloodshed" (whose blood was not to be shed he did not say...); apparently neither the protestors nor the Kremlin had much desire to discuss, and Kudrin was roundly booed for his pains.

Through Western Eyes

Western coverage of Russia's Duma elections has conveniently neglected a few inconvenient truths:

- The elections were a stinging defeat for Medvedev and the Medvedev Westernizing political line. The reader will note that the new Duma, with a substantially increased Communist representation (20%), is substantially more hostile to the West than was its predecessor; like the French parties of the moderate right, Vladimir Putin is under considerable popular pressure to take a harder line on immigration, so as to avoid being outflanked by the Nationalists.

- The claim that the Communists did well solely because of the protest vote is patently absurd – those wishing to vote for the liberal alternative had the option of voting for the Yabloko candidate; those who voted Communist or LDPR (hard-line nationalists) did so for the simple reason that they preferred the policies of those parties.

³ *While the reader may find nothing objectionable about the US backing a Russian political operative, we would invite him to reflect on the likely reaction in the US were it to become known that an important political player was being funded by the Kremlin! At the very least, his political career would be drastically foreshortened....*

- There was, indeed, electoral fraud – and badly executed fraud, at that. There has been electoral fraud in every Russian election since the fall of the USSR, and the extent of this fraud, estimated at an average of approximately 5% (see Karlin), was substantially less than in previous elections, in particular, the 1996 vote which returned Yeltsin to the Kremlin (Zyuganov was almost certainly the real winner – but there appears to have been a broad agreement to discretely look elsewhere, pretending not to notice).

Is Moscow Burning, oh Dragon?

We are besieged with questions by readers: With all the prattle in the Western press, surely something must be afoot in Moscow? What on earth is Prokhorov doing running in an election he knows he cannot conceivably win? What was Kudrin thinking when he took the mike at the demonstration? For whom is Navalny fronting?

In fact, as so often in Russia, there is less here than meets the eye⁴; on the other hand, as regards the question of individual motivations, we must admit to some considerable bewilderment.

- While Zhirinovskiy and Zyuganov are running for president because that is what they do for a living – both manage flourishing political businesses (and would likely be horrified if they thought themselves to be in any real danger of winning the Presidency), on the other hand, the Prokhorov candidacy is theatre of the absurd – his televised debate with

Much Ado about No One

In the early part of the last decade, the new US Ambassador to Russia, McFaul, then at Stanford University, assured T&B in an e-mail exchange that “The Russians were so afraid of China that they would beg for a military alliance with Washington – under whatever terms the US chose to impose”. Since that time, Russia has been busily building bridges to Beijing, drawing progressively further from Washington. Apparently, career progress in the Obama administration is contingent not upon getting it even remotely right, but rather, upon remaining ideologically-correct.

Zyuganov, the old Communist apparachnik, was hilarious; the oligarch came across as defensive and frankly dim-witted, getting sliced to pieces by Zyuganov’s well-honed rhetoric.

Prokhorov’s most recent campaign pledge is to introduce a single global currency **for the entire world**, based upon the Rouble and the Euro... need we say more? What he seeks to gain from this charade, we cannot even guess (and no, the Kremlin is not behind it – they have their own opposition candidate in Mironov!)

- As an apolitical technocrat, Kudrin appeared as a credible replacement for Medvedev – until, that is, he stepped onto the platform at Bolotnaya Ploshad and totally trashed his own credibility. What he hoped to gain from this appearance is equally unclear.

- As regards Navalny, his surprisingly rabid nationalism (“Russia for Russians”) and political opportunism are widely believed to be encouraged by a foreign power with a not-entirely-benign view of the Putin presidency. Certainly, in 2007-2008 he was sponsored by the US-based “National Endowment for Democracy”, which was also proud of its role in promoting the Orange Revolution and other attempts at regime-change (i.e. coups) in the CIS; see e.g.

<http://www.prisonplanet.com/the-shady-national-endowment-for-democracy-the-prime-agenda-of-‘whoever’-is-next-us-president.html>

Putin 2.0?

Where the Plot Thickens....

Perhaps the greatest danger for the strategist is not of getting it wrong – but of getting it right.

Having made a controversial call early on and been repeatedly proved right, there is the danger that one becomes wedded to a position, failing to detect the danger signs when the situation

⁴ *The reader will note that, if Austrian economists have predicted seven out of the last two recessions, then since 2000, the pundits have predicted 15 of the last zero political crises in Russia – from the arrest of Khodorkovsky to the demonstrations against reform of social payments, the Orange Revolution in Ukraine to protests against automobile taxation, the constantly predicted rebellions have been conspicuous for their absence.*

changes. Thus, T&B was an early and enthusiastic supporter of Vladimir Putin; even before he assumed the presidency, we were deeply impressed by his mission statement "*Russia at the Turn of the Millennium*". The ensuing years have been kind – VVP indeed proved to be the best leader of the past several centuries in a country not otherwise famous for good governance. *But – more than a decade later – is our initial call still valid?*

Our enthusiasm does not blind us to the failings of the Russian political system, the greatest of which being the lack of any mechanism allowing for the replacement of individuals while maintaining political continuity⁵; contrast this with China, where the Communist Party has worked out a highly effective system of co-option, whereby the numerous factional and regional interests contribute to the selection of consensus candidates. Later in 2012, the entire Politburo, along with the heads of the Party and the Government, is to be renewed. The choice of replacements will be highly "democratic" in the sense of reflecting the various factions and currents within the Party. Contrast this with Russia where, 12 years after Yeltsin, there are still no true political parties and indeed, no heir-apparent to Putin; the political system thus remains highly dependent upon one man (whom, despite all signs to the contrary, we have reason to believe merely mortal...).

While it is often asserted that the Kremlin is to blame for the absence of a credible liberal opposition, this allegation seems a bit too convenient, and precious little evidence has been adduced for it. We would note that, years before the advent of Vladimir Putin, the liberal parties repeatedly failed to forth an even vaguely-credible candidate (possibly excepting Anatoly Chubais); indeed, the fact that a country which has produced some of the world's greatest mathematicians, writers and thinkers could do no better than the profoundly stupid Nemtsov, the 50 year-old political virgin Yavlinsky, and the smart but hopelessly narcissistic Khakamada remains an enduring mystery.

A second explanation for the missing opposition would simply be that, despite the angry remonstrations of a thin sliver of the Moscow middle-class, Russia is simply not a liberal country – in our travels around Russia, we have certainly heard some bitter complaints – what one does not hear are anguished calls

for liberalization and reintroduction of the Westernizing model of the 1990s.

We would, however, prefer an alternate explanation: the psychological failure of historical Russian liberalism. The tragic outcome the Russian 19th Century was essentially a function of the failure of Tsarist absolutism to gradually evolve towards true constitutional monarchy and moderate liberalisation. The inflexibility of the opposition was as much to blame as was the stupidity of the monarchy. The liberals, totally unwilling to seek any working compromise with a Tsarist power they held to be morally reprehensible, withdrew instead into a comfortable opposition to everyone and everything, thus abandoning the field to the ultramontaine Right and the radical Left – the S.D. and Kadets, ultimately giving rise to the Bolsheviks and 70 years of a noble experiment gone horribly wrong.

For now, we shall take a pragmatic stance. The great danger for long-standing political leaders is that, after an excellent start, they become increasingly isolated, surrounding themselves with yes-men and hearing no criticism until the roof beams come crashing down about their heads. Having recently seen a spectacle one will never witness in the West – Vladimir Putin spending several hours – without notes and without aides – taking unscreened questions, several of them fiercely hostile, at the VTB conference, we can affirm that he has not yet lost his edge, and certainly gets to hear his fair share of criticism. Furthermore, at present there simply is no even half-way credible replacement candidate.

The existence of the Facebook protests confirms the validity of our assumption that a middle-class political consciousness and representative institutions will ultimately evolve – although whether or not T&B will recognize the sea change when it finally arrives – or will instead remain wedded to our first love, only time will tell!

⁵ With thanks to Vlad Sobell for having made this point very forcefully in private correspondence.

T&B in the Trenches

We have recently had some lively arguments with a couple of our more insightful peers, several of whom have challenged our constructive reading on the next Putin Presidency, claiming that Putin has lost the confidence of the “elite”, that his mandate from the Russian people is irreparably compromised, and that the political system is discredited. We disagree on all counts.

- “The Elite” is a shifting and poorly defined concept, and many of those who consider themselves to be charter members of the elect may be faintly delusional. More fundamentally though, the Russian intelligentsia enjoys nothing more than sitting in the kitchen bemoaning how terrible the world is – yet when push comes to shove, we suspect that absent any attractive alternatives (how many of them would actually wish to live under a Zhirinovskiy or a Zyuganov government?) this elite, functionally defined as those with something to lose, would be happy enough to continue living comfortable, well-fed, morally pristine dissident lives.
- Putin’s poll ratings fell sharply in the aftermath of the clumsy, poorly managed presidential swap with Medvedev; indeed, we found the entire Medvedev presidency to be slightly farcical. That said, this is not the first time Putin’s rating has fallen only to rebound, and he is now recovering in all of the published polls; to paraphrase Mark Twain, reports of his recent death may have been greatly overstated.
- The political system is indeed nothing to write home about... On the other hand, for as long as it can continue to deliver the bacon, those expecting a “coloured revolution” in Russia will continue to look like chimps.

The Scorecard

T&B is frequently criticised for our excessive optimism vis-a-vis Russia, and for ignoring the bad to highlight the good. As in our last

appearance in Paris traffic court – we plead guilty, but with an explanation:

Having been an expatriate most of our lives, we can assert that to thrive in a foreign country, it is best to be a bit in love with it, and love always includes an irrational element.

Having lived in Russia since 1997, we can confirm that any resemblance between this country and Paradise is purely fortuitous. We are neither delusional nor knowingly dishonest – we have been on the wrong side of a “zakuplen” (paid-for) court decision,⁶ struggled heroically with obstreperous and totally irrational Russian consulates for our annual visa renewal, have more than once been compelled to pay substantial “administrative fees” (not otherwise called for by the legislation) to chinovniki, and have taken some painful losses due to the unique Russian system of good bank (yours)/bad bank (mine) Rouble bond restructurings (thank you, Troika!). Although on the street level we find that matters have improved greatly since the 1990s⁷, there is still a long way to go.

The essential point here is that T&B writes primarily for a foreign audience which, since the end of the Yeltsin years, has been systematically misled, lied to and brainwashed by the deeply corrupt Western press and the self-interested political Kommentariat. We assume that most of our readers have already received a double-portion of bad news, spun as negatively as possible, and T&B thus seeks to re-establish some balance.

We began life as a financial publication aimed at foreign fund managers doing business with one of those investment banks crazy enough to hire us; since the 1998 crisis, any investor following T&B’s trading advice has been long the world’s best-performing major financial market, presumably making a small fortune in the process; meanwhile, those cleaving to the views of the uniquely evil Edward Lucas (The Economist) would presumably have been short this market, and would be now bankrupt.

⁶ *Albeit, paid for by a Dutch executive of a major foreign consumer goods firm.*

⁷ *When no foreigner dared to go out without his passport for fear of being shaken down by the police – we have not been stopped for at least the past 5 years – and we recently received a traffic ticket – rather than a demand for a bribe – for a minor offence.*

Unlike politics, finance ultimately has a hard reality check.

As regards the successes and failures of Putin's Russia, as we argue below, it is insane to judge by the same standards one would apply to Sweden or Switzerland, countries with a long history of stable governance, civil society, and a well-regulated capitalist system. President Putin must be judged in terms of the situation he found when he assumed the presidency of a country which after centuries of absolutism, followed first by a 70-year failed experiment in German idealism, then a misguided attempt to adopt Western politico-economic models which proved to be grotesquely unsuited to the local situation, was seriously threatened with dissolution, impotence and failure – politically neutered, unable to feed its population, and with the writ of the central government largely ignored in the provinces.

Anyone who has lived in Russia this past decade has witnessed a transformation, which could be fairly described as “almost-miraculous” – but one which, at best, is still only half-finished. While Russia is now middle-income, stable, and politically assertive – with eminently sustainable public finances, no substantial sovereign debt, falling inflation, low unemployment, and moderate but steady economic growth – equally, governance remains very poor, corruption a chronic problem, while the political system is weak, unable to properly transmit feedback from the grass-roots to the top, and highly dependent upon a handful of individuals. In short, twenty years after the collapse of the USSR, Russia remains a work-in-progress.

While unstinting in our praise for Putin, we do not go quite as far as to attribute infallibility, and can identify a number of weaknesses and some serious political missteps – the most serious of which was his attempt to appease the West by stepping down from the Russian presidency, appointing Medvedev in his place, this at a time when he could have swept to victory had he called a referendum to annul constitutional term limits⁸.

⁸ As we argued at the time – and would argue still – constitutions are not engraved in stone, and are susceptible to modification. The American constitution has been amended 27 times, with another five or six amendments still pending (indeed, US presidential term limits were

The Medvedev manoeuvre was a failure, achieving the worst of both worlds – while Mr Putin may have genuinely believed that there was at least some chance that Medvedev would succeed and could eventually assume genuine control, the impression given – both in Russia and abroad – was of a transparent attempt by Putin to maintain control⁹, complying with the letter of the law while evading its intent. It played very poorly in Russia where Medvedev has no real political constituency, and unlike Putin, never incarnated the way the Russians wished to see themselves; meanwhile, it created false hopes in a West desperate to see its own models applied in Russia.

The Georgian crisis, quickly followed by the American financial meltdown at the beginning of the Medvedev presidency compelled Putin to retain personal control for the first 18 months; when Medvedev was finally allowed to stretch his wings, he made a shambles of it, and is widely mocked for a series of meaningless domestic policy initiatives, followed by a disastrous foray into foreign policy due to a childlike faith in the good intentions of the Atlantic Alliance. To summarize:

In the Line of Fire – Bullet Points

Politics

- Russia is now widely respected – not, of course, in the sunset countries of the West, but where it counts – in the rising new powers, in particular of Asia. During recent travel in China, Indonesia and in the Dragons, we heard little else but praise for Vladimir Putin. Likewise in Latin America, he is quite popular among the chattering classes.
- Although it may displease *FT* and *Economist* journalists obsessed with the Facebook generation, Russia has

introduced by a constitutional amendment following the FDR presidency); our native France is on its Fifth Republic. Most constitutions will have mechanisms for modification, and provided that these procedures are followed, then modification is by definition “constitutional”.

⁹ If this was indeed the case, and Putin intended to give his creature a chance to prove himself, then almost certainly, the Medvedev presidency was one of the unsung casualties of the NATO Libyan operation – his disastrous foray into foreign policy having sealed his fate.

- seen substantially less social disorder than have numerous European countries... and for good reason.
- The new Eurasian Union of Belarus, Kazakhstan and Russia allowing free circulation of goods, capital and labour is likely to be extended to Ukraine, giving Russia a sphere of influence capable of seeing off the repeated attempts at political domination by the US/EU. The “coloured revolutions” proved a complete failure, and Russia is once again the predominant economic and political power in her immediate neighbourhood – while this may displease some in the West, it is hardly surprising that most Russians find it to their liking.
 - Russia has largely won the gas-pipeline wars. As we have argued for nearly a decade (and was asserted by journalist John Helmer in the early 2000s) Nabucco is a pipe-dream, not a pipe-line. North Stream is now pumping, and Turkey has just signed on for the South Stream pipeline – probably the last nail in the Nabucco coffin.
 - After more than a decade of discussions, Russia has been admitted into the WTO on reasonably favourable negotiated terms.
 - The Georgian incursion into Ossetia was seen off by Russia, and the separation of Abkhazia and Ossetia from Georgia has now been tacitly accepted by all but the Georgians, nevertheless compelled to cede to Western pressure and lift their threatened veto of Russian WTO accession.
 - Some of the most troglodytic and obstructive and deeply corrupt political holdovers from the 1990s – the likes of Tatarstan’s Mintimer Shaimiev and Moscow’s Yuri Luzkhov have finally gotten the silver stake. None too soon, but at least they are gone.
 - The systematic hostility of the Eastern European EU bloc – in particular Poland and the Baltic Republics has waned as the European economic crisis bites. A solvent and fast-growing Russia suddenly seems quite appealing as an economic partner...

- Russia’s tactical alliance with China – grindingly slow and hesitant to begin with – is now very much a reality; China is Russia’s largest trading partner, and Sino-Russian global foreign policy is increasingly well integrated. The ESPO oil pipeline is now pumping and the two giants are now settling their trade in Roubles and Renminbi, not in dollars.
- Growth and prosperity – previously confined to Moscow alone – have spread throughout the larger Russian cities, and to some of the smaller cities. The statement that “50 km outside of Moscow it’s still the Soviet Union” is both true and misleading. The outskirts of Moscow are indeed grim – but in Ekaterinburg, St. Pete, Novosibirsk, Kazan and numerous other cities, there a minor renaissance is underway.

Economics

- Russia is now largely a (lower) middle-class country. Poverty levels have plunged, demography has stabilized, real unemployment is less than half that of the US, France or the UK, while the Gini ratio is slightly more equal than that of the United States (albeit, no great accomplishment).
- Russia, during Soviet times the world’s largest grain importer, is now one of the world’s largest agricultural exporters. The agricultural sector is seeing double-digit annual growth.
- The Russian Rouble is now fairly stable, with an exchange rate largely determined by the market.
- Inflation has been on a steadily declining path since 2000, and this year will likely drop below 6%.
- Russian banking – a misnomer in 2000 – has now improved to the point where Sberbank and VTB could recently borrow at rates better than their American or European TBF (Too Big to Fail) peers.
- Russian sovereign CDS recently traded inside of France, intraday... *plus ca change...*

- The share of hydrocarbons in the Russian GDP has decreased by half – to about 25%. Russia is now a major exporter of a wide variety of raw and semi-finished commodities.
- Russia has gone from bankrupt to holding the world's third-largest Forex reserves. It is now investment-grade rated, and can boast the world's best-performing major debt and equity markets since 1999.
- Rather than the previous pattern which saw Russian financial markets crash-and-burn each time the West got into trouble (last seen in 2008), during the 2011 bear market Russia performed on a par with the European and emerging equity markets.
- Finally – after 15 years of trying – Russia will this year have a single depository and a unified RTS-MICEX stock exchange... the Rouble bond market is next to be reformed.
- While Russian equities still trade at a substantial discount to other emerging markets, this is not the case for Russian fixed income, which is now keenly priced.
- With a flat tax of 13% on income, the Russian tax system favours the accumulation of private capital.
- Thanks to customs concessions facilitating JVs and start-ups by Western automobile makers, Russia now produces cars a sane person might actually wish to own; although the Putin administration was heavily criticised for spending heavily to save the Tagliotti and other car plants, in doing so it preserved a major segment of Russia's non-oil economy.

The glass is, of course, half-full or half-empty, depending upon one's perspective. After a very difficult first millennium, the transformation and modernization of Russia is very much a work-in-progress – among the weak points:

- The Russian economy is – and almost certainly will remain – heavily commodity-centric. With Chinese manufacturing expertise having blocked the traditional pathway to gradual industrialisation, Russia is most unlikely to become a major

producer of consumer goods anytime soon. Efforts should continue to be focused on moving up the commodity value-added chain.

- As widely reported, corruption, and poor governance remain major problems, the widespread perception of corruption being as damaging as the corruption itself.
- As in every emerging market, from Mexico to China to Indonesia, a substantial portion of the wealthiest segment of society wishes to park their wives, children and financial assets abroad – not surprising, as the richest countries tend to be far more agreeable to live in than do the poorer ones.
- While vastly overestimated (due to Russian companies buying productive assets abroad, as well as to European bank subsidiaries pumping Russian deposits back to their deeply distressed home offices) capital flight remains a chronic problem.
- Technological innovation is lagging, and there is little attempt to integrate the university research establishment with private business. Perhaps the pilot projects at Skolkovo will help.
- Corporate governance is patchy at best. While we no longer see the egregious corporate malfeasance widespread during the 1990s, more moderate abuse is still common. While a few Russian blue-chips show world-class governance and transparency, further down the food-chain the story is distinctly mixed.
- Although efforts have been made to improve the infrastructure, results are spotty at best. While much of the coverage in the press is misleading¹⁰, the road network is, at worst, distinctly third-world, the rail-system has improved to perhaps the level of Europe in the 1960s, and while Moscow has better airports than

¹⁰ By way of example: for how long has the reader been warned about the imminent collapse of the Russian electric power grid? Since 1995, perhaps? Since that time, there have been numerous major power outages – in the most advanced Western countries including the United States – but none of any note in Russia.

London, many of the regional hubs are an embarrassment. Port infrastructure is creaky, public transport (ex the superb but largely Stalin-era Moscow metro) requires massive investment, and hospitals and schools are in need of upgrade. Beijing is currently constructing ten metro lines simultaneously; Moscow is struggling to build that many stations (although, in fairness, to do so in Paris is expected to take several decades, Brussels has given up even trying, while the US cities apparently consider spending on public transport to be a case of creeping socialism)

- Capital investment in industrial plant has been very uneven. While the oil and metals industries have seen vast improvements (aluminium production now being world-class, as are the best steel mills), and cellular communications and internet infrastructure are on a par with Europe, there has been very insufficient Capex in manufacture and non-financial services.

In short, we cleave to our view that Russia cannot possibly hope to match China, but fortunately, is more dynamic and flexible than its distressed European neighbours. The situation has improved vastly since the 1990s, and we fully expect it to continue to improve – but at that uniquely Russian pace. Patience is to be seen as a vital commodity...

Journalism – the World’s Second Oldest Profession

*T&B is repeatedly amazed at the indignation evoked by any criticism of the press – not just from journalists, but also from civilians. One reader wrote us angrily denying that Western journalists took cash envelopes in return for negative coverage of Russia – needless to say, we **never suggested** that they did. The problem is not the “honest corruption” still widespread in certain Russian media – a set fee for a service, pretty much in the open – but rather, the far more pernicious and secretive system of corruption developed in the West: networks of influence, financial ownership of media, exchange of favours, manipulation by government-funded NGOs and foundations, ideologically-driven manipulation, and raw political pressure.*

While it would be absurd to suggest that Western hacks receive the occasional kickback in return for bent coverage, what some of them do take is a modest monthly pay-cheque in return for slavishly towing the party line. Those doubting this allegation should ask themselves how long would FT “journalist” Charles Clover keep his job were he to change his mind and to start writing flattering articles about Vladimir Putin¹¹? Would Julia Ioffe manage to sell a single story were she to provide some historical and sociological perspective on WHY Putin remains overwhelmingly popular in Russia? After all, when it comes to Russia, fairness and balance seem so dull, as well as requiring such long-winded explanations; guns and girls sell paper far better!

There are, of course, some honourable exceptions – long-serving journalists, several of whom are employed by the wires and US newspapers, and who, in private, come across as strikingly well-informed and balanced, critical but constructive. After a couple of drinks, they tend to complain bitterly about their frustration at seeing their dispatches mangled by the editors, the manipulation of their media by corporate interests, as well as at the wilful

¹¹ *In a recent article about Russia – Mafia state, Clover adduced no evidence whatsoever, beyond citing the Wikileaks claim that a US diplomat had called it one (as if this were a criterion) Instead, he simply repeated the allegation time and time again – with an assortment of colourful and largely irrelevant stories filling out his hatchet job.*

dishonesty of some of their more complacent and politically attuned peers.

The level-zero of the press is the sophomoric, almost pathetic *Moscow Times*. Considered in the 1990s to be the best English language newspaper in a non-English speaking country, it was plundered of its best journalists by the mainstream media, manipulated by its owners, and now flounders about in search of a justification for its continued existence. Their headline writers do not know the difference between “Tack” and “Tact”, the editors struggle with basic English, and they fill their pages with breathless editorials authored by

hysterical predictions of imminent collapse continue to be dutifully reprinted by the MT which – after more than a decade – still hasn’t realized that it’s nonsense...

Oddly enough, the *Wall Street Journal* has become one of the few useful mainstream Western sources on Russia. Not that they are remotely pro-Russian (much less Pro-Putin), but simply they do a reasonably professional job of it, with the occasional well-researched investigative story and even some attempt at balance and fairness. This, of course, goes so far only – one of the bases of modern thought-control is the careful filtering of what news makes it onto the page; while pouncing on any

bit of bad news, the *WSJ* tends to overlook the good (checking their website, there are some 15 unhappy stories – and not a single positive one; one would have to assume that nothing good ever happens in Russia...)

We pirate Western news websites (one would certainly not wish to give money to these people!) of course not solely for their irritation value, but in the hope of learning something useful – while we find ourselves disagreeing with much of the *WSJ* coverage, at least we are not continually outraged at the political bias and outright dishonesty which has become the trademark of the British press – the intellectually corrupt *FT* and *The Economist*.

Truth for Sale...

While, at least during the post-Stalin period – in their heart of hearts – any educated Soviet citizen knew that he was being served a pack of half-truths and lies in his daily *Pravda*, we are amazed by the childlike faith most Westerners have in their press, which – despite its tedious exercises in self-congratulation – is no less bent

and propagandistic.

T&B’s repeated expressions of bewilderment at the trust educated Westerners have in their media are not disingenuous – we are sincerely

Browderized

T&B was recently contacted by an investigative reporter researching the Browder/Hermitage/Magnitsky story for a major US financial publication. We spent several hours on the telephone outlining Browder’s ugly history – from his abuse of offshore structures to get around Russian legislation in the 1990s, to his participation in a number of “Russian style” deals, and his controversial restructuring of his fund in the aftermath of the 1998 crisis. We cited his questionable business practices, his self-serving hypocrisy, and especially, his amazingly skilful manipulation of the Western media. In particular, we noted that the claims of tax evasion levelled against him (which he denies) were for abuse of a series of offshore tax vehicles predating the purported theft of several of his other offshore companies by corrupt Russian functionaries.

We certainly did NOT seek to defend the criminal misconduct of those immediately responsible for the death of Mr Magnitsky. But the fact that one’s enemies are indeed evil does not signify that the person is himself not equally so. Magnitsky was used by both parties.

Several of our peers – some of whom once worked for Browder and who are still employed in the financial industry – supported our version of the event, though preferring to remain anonymous.

Before the article could be published, Browder’s attorney had threatened the publication with all manner of legal actions. Although all statements could be substantiated, the publishers correctly figured that it would cost a fortune in legal fees and management time to defend themselves in court, and chose to gut the article. Only our remarks regarding Browder’s very mediocre trading performance once exiled from the only market where he had useful information sources remained in the final version.

With no one to threaten the media when they print lies about the Russian State, Western readers will continue to receive a biased and one-sided view; Browder’s press agency and spin continue to be reprinted word-per-word in the Western media, even when the individual journalists complain bitterly of his manipulation. There is some small compensation in the fact that one of the most self-interested people we have ever encountered in the not-otherwise-disinterested world of finance will have gained nothing from his crusade.

professional dissidents who survive largely on hand-outs from the US NGOs, and must thus demonstrate some public impact to justify their fees – the likes of Latynina, who has warned of Putin’s “final fatal mistake” literally every week for the past 12 years. Her

amazed by the cognitive dissonance at work here. Everyone knows that we were egregiously lied to in the run-up to the invasion of Iraq – no one even bothers to deny it any longer; journalists and editors happily reprinted the lies of the Bush and Blair administrations, knowing full-well they were false. While the American press loves to take credit for the end of the Vietnam War, they conveniently forget that for most of the preceding decades, while millions of Asians were being slaughtered, they allowed themselves to be manipulated by the Pentagon, reprinting disinformation without any hint of critical assessment.

In what is perhaps the best illustration of the willingness of the press to serve the geopolitical interests of its masters, while the relatively small and peaceful demonstrations in Russia got round-the-clock coverage, there was initially hardly a mention of the slaughter of an estimated seventy¹² strikers involved in a protest against Kazmunaigas in the Kazakh city of Zhanaozen. This relative silence was perhaps not unrelated to the fact that Kazmunaigas' main partner is the US oil major Conoco, and that Washington and Brussels are both desperately seeking to keep Kazakhstan from moving too closely into the Russian orbit, as well as terrified that an Islamist uprising could destabilize yet another major oil producer.

¹² The official death toll reported by the government was 15 – local estimates range from 70 to upwards of 100, including women, children and bystanders

Looking back in history the press has always been the handmaiden of the power elite. Everyone knows Orson Wells' *Citizen Kane*, every educated person is aware of the genesis of the Spanish-American War. Why then does anyone imagine that it is suddenly different today?

Quite the opposite, there has been substantial consolidation of the media, with an increasing share of the US/UK press owned outright by right-wing financial interests. Does anyone seriously believe that they put the truth before the pecuniary interests of their owners? (*If so, we have a bridge for you – at a real bargain*

price... and just for you... but don't tell anyone, or they'll want it too...)

Of Talking Rocks And Stoned Ambassadors

During the height of the Litvinenko story a subplot briefly hit the wires when Russia accused the British of using fake rocks fitted with high-tech radio transmitters to run their captive NGOs in Russia. Needless to say, the Western press had a great time poking fun at these *wildly improbable stories, intended to distract attention from the real issues* – the West, of course, would never indulge in such skulduggery.

A few years later and the UK has just

admitted that the story was true as reported. We are certainly not surprised – Russia obviously engages in espionage too; simply, when the Russians get caught at it they are less sanctimoniously hypocritical. What is extraordinary, on the other hand, are the double standards applied in the press. There

One of the most extraordinary stories we have come across in recent years was recently published in a Miami newspaper, <http://www.miaminewtimes.com/2011-11-17/news/russian-billionaires-battle-for-fisher-island/>. A must-read, it documents how Boris Berezovsky almost certainly poisoned his friend the Georgian oligarch (and Saakashvili opponent) Arkady Patarkatsishvili, then drugged and kidnapped Emanuel Zeltser, the lawyer managing the Patarkatsishvili estate, who was shipped unconscious to Belarus in Berezovsky's private jet where he was beaten, enduring a series of torture sessions followed by a 16-month period of imprisonment under grim conditions, ending only with the personal intervention of no less than Hilary Clinton (Zeltser is a US citizen). A John LeCarre novel, but in real life.

This seems highly relevant to the Litvinenko case, given that the one person who stood to gain from the polonium poisoning of Litvinenko was Berezovsky. Litvinenko had worked for Berezovsky since his defection from Russia, but having long ago told all that he knew, and notoriously difficult to control, he was no longer useful; while the ex-oligarch was reportedly trying to cut him loose, this was not proving as easy as hoped for, and Litvinenko was causing problems by free-lancing for various shady interests.

From day one the entire affaire was stage-managed by Goldfarb, a Berezovsky henchman, who also released posthumously Litvinenko's moving, poetic death bed letter blaming Vladimir Putin for his poisoning – a letter drafted in beautiful, flowing prose, but purportedly written by a man who could hardly speak enough English to order a beer – even when healthy – and who was then at death's door (how odd that no one in the Western press thought to challenge them on such an obvious implausibility). Of course, anything which fits with the "Putin Eats Babies" line suits the interests of the British political establishment – which will happily sell political asylum to Eastern-European gangsters, provided they are wealthy enough to feather a few British nests.

have been warnings that Putin would use the British admission to clamp down on NGOs; one would certainly hope that he does precisely that! Is it conceivable that the UK would allow dozens of Kremlin-funded political organizations to function unmolested in London? Would the FBI tolerate covert Russian funding of the US political establishment?¹³

While the American Neocons were proud to take credit for the “coloured revolutions” in the ex-Soviet space, Putin’s angry assertion that the US – in particular Mrs Clinton – was interfering in Russian internal affairs by trying to foment protests was airily dismissed.

In fact, what is quite extraordinary is that any sane person should have the slightest doubt that Washington is doing whatever it can to influence the Russian political process – interference in the affairs of rivals is simply what empires do... The US spends untold billions on the CIA, as well as funding numerous public, semi-public and covert operations. The private sector spends hundreds of millions – probably billions – more on a vast network of NGOs, think tanks, and political initiatives. Considering the fact that Putin’s Russia increasingly constitutes a major stumbling block for American foreign policy, to imagine that a large part of this spending is not directed towards securing regime change in Russia would be naïve in the extreme.

The return of Vladimir Putin to the Russian presidency and the demise of the Medvedev foreign policy line seal the demise of the misnamed “reset,” signalling a more assertive Russian foreign policy – anathema to the US. In collaboration with China, Russia has blocked UN Security Council action on Iran and Syria, frustrating attempts of by the West to resolve the matter by aerial bombardment. Having learned the lessons from Medvedev’s abstention on Libya, Russia is now being quite assertive in its attempt to block foreign-sponsored regime change in Syria. Meanwhile, the newly-created Eurasian customs union is successfully federating Russia, Kazakhstan and Belarus, countering attempts to draw the ex-Soviet states out of the Russian orbit; although Ukrainian politics are famously unpredictable, there is at least an even chance that Ukraine will be the next to join.

¹³ or, for that matter, would the US ambassador to the UK begin his term of office by throwing an open house for “Occupy London”? What a fool... McFool!

Making it Easy

The conduct of European foreign policy has been about as competent as could be expected of a bus with 27 drivers. Whilst given the spreading sovereign debt crisis, the EU clearly does not have the financial means for a successful Eastern policy (salvaging the Ukrainian economy would be an unaffordable luxury), their ideological bent has rendered a bad situation far worse – indeed, had they actually wished to assist Russia in drawing Belarus back into the fold, they would have acted no differently. Led by Poland, the EU antagonized President Lukashenko by seeking to intervene in Belarusian politics, leaving him no choice but to throw in his lot with Russia – from which he had long sought to maintain a safe distance. Rebuffed by Europe, Belarus sold its pipeline infrastructure to Gazprom, entering into a formal customs union in return for a hefty discount on Russian gas – this may well constitute a first step towards Yeltsin’s dream of drawing Belarus back into the Russian Federation.

Building upon its previous failure, the EU then proceeded to cut short discussions with the Yanukovich government over the question of Tymoshenko’s imprisonment on corruption charges. Whatever the rights and the wrongs of the Tymoshenko case¹⁴, on precisely which legal grounds the EU considered it had the right to dictate Ukrainian court decisions is not entirely clear (the motivation is clear enough – Tymoshenko was strongly favourable to Western interests, and one cannot be taken seriously as a neo-imperialist power if unable to protect one’s local allies); the ultimate effect was simply to push Ukraine towards Russia.

For its part, the Yanukovich government has managed to antagonize both of Ukraine’s potential saviours – Russia and the EU/US/IMF; the former demands the sale of the gas pipeline and Ukraine’s entry into the customs union in return for a decrease in gas prices, the latter, a politically disastrous 35% hike in gas tariffs as well as further austerity in return for a bailout. The Ukrainians are typically taking it right down to the wire, and we cannot predict the outcome with any certainty.

¹⁴ Tymoshenko had stolen billions, paid a large bribe to the Ukrainian prime minister Lazarenko – for which he served a long prison term in the US – but may well not have been guilty of the charges for which she was actually prosecuted.

How to Trade it – The Bear Smiles...

*This, the Winter of Our Contentment –
Perhaps a Warm Spring to Follow –
But Beware the ~~Bear~~ Bear...*

Interviewed recently on RBC television, T&B was asked whether we presently favoured the Russian or Asian markets. We could only reply that it made precious little difference – depending upon one's time zone, personal proclivities, and astrological sign one could play the risk-on scenario via Russian stocks, Venezuelan bonds, Italian banks, Shanghai equities... or, for that matter, pork-bellies and Brazilian Real. The market now moves as an amorphous lump; thus, if the party does continue, we would expect only the "safest" assets¹⁵ – yen, dollar, US treasury and Bunds – to underperform. As noted in a previous issue, global financial markets have become a casino where all of the tables have been shut down except for the roulette... and the numbers have been off the wheel, too. Basically, you can bet on either red or black: risk-on or risk-off. Rien ne va plus!

Given the extreme pessimism with which the financial world entered the New Year, the market was overdue for a bounce; the excuse was provided first by the ECB (turning on the taps), then by the Fed (promising free cheese for as far as the eye can see).

Now that the Europeans have joined the Americans in massive monetary creation (the US via outright Fed purchase of government debt, the Europeans by ECB LBTO lending to the commercial banks which they employ the ECB cash to fund risk-free carry-trades on EU sovereign debt) the game will certainly last for another few innings. We are highly sceptical of any purported economic "green shoots", which strike us as artificial in the extreme, driven solely by continued credit expansion. Note that the US has a structural deficit estimated at 7.5% and a current budget deficit of nearly 10%; the European blended deficit is a more modest 6%, mostly cyclical; alas, there are several notorious outliers with clearly

¹⁵ Yes, agreed – fundamentally, there is nothing remotely "safe" about any of these other than the Bunds... but the market has decreed them the risk-off trade, and woe betide the trader who ignores that convention...

unsustainable debt dynamics. Both blocs are being kept out of outright recession by accelerating monetization alone – never a comforting thought.

Vitality, neither the EU nor the US can roll over maturing debt under market conditions, and have thus resorted to overt monetization (despite the obviously unsustainable debt dynamics, the UST yield curve was flattened last year by massive Fed buying; European sovereign bonds have latterly joined the party, with yields coming in by as much as 50%). Not at all inclined to bet against the central banks, T&B would currently tend to befriend the trend.

Of course, until and unless the laws of gravity are repealed, there is ultimately going to be a choice between massive fiscal drag or outright monetization with a severely inflationary outcome. But that is for later – and we get paid for making money now. Our best guess is that we will have a happy first two quarters of 2012, followed by a renewed storm in late Spring... if so, just remember to sell in May and go away.

Lever me up, Scotty!

Having happily sheltered in the emerging markets corporate fixed income space for the past six months, T&B is currently adopting a slightly more risk-friendly stance. Our preferred Axis-of-Evil (AOE) bond trade – Venezuela (PdVSA) / Cuba (serviced) / Belarus / Russia (private banks) – has worked out nicely indeed, with some of our assets up as much as 15 points (plus carry) since the October bottom. Argentina GDP warrants, arguably also associate members of the AOE, yielded about 60% last year, but still offer considerable value on a multi-year horizon.

As risk comes back into fashion and everyman and his dog reaches for yield, we would expect most of these assets to gain a further 5-6 points over the next couple of months. That said, as yields fall back into the single-digit range, some bonds will be getting back into overvalued territory, and we would be alert for opportunities to exit before the next swipe of the bear's paw (as noted, probably in Q3).

We would now be looking to sell US dollars, buying Asian and commodity- currencies, equities (especially China, India), Russian roubles, commodities and emerging markets equities – in particular, Russia and China.

Fixed Income

Our beloved PdVSA (Petroleos de Venezuela – *Viva Chavez!*) bonds are up as much as 15 points from their October lows, with some trading at or above their highs of the past five years. We are disinclined to chase them much above here. Belarus is surging back, and we would expect the bonds (now at 91, after seeing the low 70s) to enjoy further strength as Russia executes a successful buyout of her Western neighbour.

Russian bank bonds still offer free money – a good half-dozen points of yield pick-up with literally zero default risk. Our favourites remain RUSB (Russian Standard), Promsvyaz, and Alfa, to which we might add BOM, and for the truly adventurous, TCS. *Your friendly VTB*

salesman will be able to guide you as regards relative value along the curve.

Elsewhere, the excitement is to be had in the more exotic neighbouring regions – Ukraine and Kazakh banks (we must here add a health-warning – something along the lines of “*Don’t try this at home!*” The yields are juicy but there are some very substantial risks).

Ukraine – *often described as a joke which gets funnier each time you tell it* – Ukraine is facing an unsustainable fiscal squeeze and has fallen squarely between two stools, managing to simultaneously antagonize both Russia and the EU. Given their unsustainable debt/current account/currency dynamics, we would assume that, in extremis, they will either agree a bailout with the IMF (requiring a 35% increase in domestic gas prices in the run-up to an election which is looking increasingly difficult for Yanukovich), or they will agree to a Belarus-type deal with Russia, ceding control of the gas pipeline system (a wasting asset, as competing routes – Nord Stream and soon South Stream¹⁶ – render it less critical for

¹⁶ *T&B has argued for most of the past decade that Nabucco was a pipe-dream not a pipeline – economic nonsense in the absence of a Transcaspian pipeline (vetoed by Russia and Iran). We have been amazed at their ability to keep the*

Russian export volumes), in return for a knock-down price on Russian gas imports.

Of course, this being Ukraine, there is also the possibility that they will dither until the markets lose patience and carry them out; all Ukrainian financial assets currently include a substantial

sovereign risk premium. While we still like some of the dollar bonds, we would certainly not hold any local currency.

By far our preferred Ukrainian trade was Alfa Ukraine 2012 (restructured) – alas, this bond is now almost completely amortized, trading above par, and maturing later this year. This leaves Metinvest, in our view a credit substantially better than the sovereign which would be rated investment-grade

were it not for the sovereign-ceiling effect; financial ratios are conservative, its sole vulnerability being its exposure to global steel prices.

For the truly adventurous, a few of the Ukrainian banks are offering yields in the range of 15%, but with commensurate risk. Our bet had been on Privatbank – which recently scared the hell out of us with some typically controversial corporate governance actions – but it is now recovering nicely; once Privatbank pays off its \$500m Feb 12 maturity, the 15s and 16s should enjoy a sharp bounce; Ukreximbank is probably the safer alternative. *For further information – have a word with our friends at Dragon Capital, Kiev or with VTB, Moscow.*

As regards Kazakhstan, we think that the banking sector bonds offer substantial upside for moderate risk – the subordinated debt of KKB, ATF and BCCRD have been our preferred picks. ATF has performed poorly – the parent company, Unicredito Italia, receiving

dream alive for as long as they have – but we reiterate our view that not a single molecule of gas will ever flow through it. Turkey’s recent agreement to allow the construction of Gazprom’s South Stream is probably the last nail in the coffin of what was always intended as a political luxury project that Europe currently cannot possibly afford.

much unwanted attention as its share-price crumbled in the wake of the deeply discounted rights issue needed to repair its capital levels. That said, absent a European meltdown, we do not see any meaningful risk of failure of Unicredito – which is TBF (Too Big to Fail) in Italy. Furthermore, as a stand-alone credit, ATF is holding reasonably steady and should continue to gradually amortize its NPL load.

Credit metrics of KKB and BCCRD are slowly improving – not at the pace which could have been expected with oil at \$110 and the growing Chinese involvement in the Kazakh economy, but we see very limited default risk. *The première Kazakh broker Visor Capital monitors these assets very closely, and can provide further detail as well as good execution.*

Currencies

Those currencies which were worst beaten up during the extreme risk-off phase are now likely to outperform – NZD, AUD, BRL, KRW, RBL, etc. Which one you choose seems almost irrelevant – perhaps a basket approach would be best. Absent any further surprises out of Europe (always a risky proposition) the Euro should continue to strengthen – but we can find more attractive alternatives.

Our top currency recommendation, indeed out top trade, remains what it has been for the past year – **long Chinese RMB**. We are increasingly enthusiastic about this call, which has performed remarkably well this year, RMB being essentially the sole major currency to have appreciated against the USD. As China liberalizes its currency regime preliminary to its assuming control over the entire visible universe, the NDF market, which until recently charged a premium of as much as 2.5% to buy RMB forward one year, is now actually offering forward RMB at a discount¹⁷. Properly leveraged (6-1), assuming a 5% currency appreciation this year (mid-way between the bullish 6% and the bearish 4% calls), this trade should yield somewhere in the vicinity of 30% cash-on-cash. Best of all though, we see precious limited downside – while the Renminbi might conceivably fail to appreciate, we are hard-pressed to envision a scenario where it would devalue outright.

¹⁷ We recently picked up one year RMB for a client account at 1.5% below spot, corresponding to some portion of the interest rate differential between USD and RMB – i.e. the RMB is now pricing as an adult currency.

Equities

While we admit that the highest-beta assets will likely outperform early in the year, our Russian equity positioning remains “conservative,” heavily biased toward “virtual fixed-income” e.g. the preferred shares of TNK-BP and Bashneft, with perhaps a side-order of Tatneft Prefs. But, according to our good friend John Quinn of Deutsche Bank Moscow, we have been missing the best – Surgut Prefs, which DB expect to yield in the vicinity of 15%, offering both yield and capital appreciation; furthermore, according to Mr Quinn, even that baying hound Transneft may well become something resembling a public company, paying proper dividends and showing concern for investor relations. *For further information, readers are invited to contact the source...*

Commodities

“Risk-on” means what it says. Precious metals are likely to surge on pleasure-principal monetary policy, and even if Soros is right about gold being “the ultimate bubble,” one make a great deal of money on bubbles provided you remember to get out in time...

Uranium has been one of the worst-performing industrial metals – this was not improved by Fukushima. At some point – though probably not this year – demand will further outstrip production, and prices will surge.

If the current flight **from** quality continues, then we would expect financial investors to come crowding back into the commodity space, with predictable consequences. We like energy and think some of the agriculturals are in for a strong bounce, but remain wary of the volatility. The PGMs, Palladium especially, are likely to see insufficient supply in the face of growing demand.

Where could we be wrong?

We could be jumping the gun here, and have limited certainty as regards our bullish call – but at some point one simply must get up and dance.

Having once badly underestimated the Europeans’ ability to screw things up, we are cautious about falling through the same ice twice – and if tomorrow morning the reader learns that the Germans have blocked further LTRO loans, have decided to reintroduce the

Deutschemark or even to reoccupy the Sudeten, then it's game up – and don't blame T&B! Equally, were the US to suddenly stop talking about a balanced budget and actually attempt to implement one, we would not want to be anywhere near the risk assets. For now, all of these scenarios appear most unlikely

And please don't miss the appendix by Sergey Lukyanenko, overleaf.

Happy Trading!

T&B

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*For a taste of Paradise,
after the -20 C Moscow Weather...*

Appendix

Years ago, when people asked us which – besides T&B – was the best Western source on Russia, we would modestly answer that, unfortunately, there were none – the MT was brain-dead, the mainstream Western press was dishonest – substantially worse than useless – and so you would just have to continue reading T&B... no longer!

Thanks to the blogosphere, there is a wealth of independent, decorrelated and lucid commentary available – among the best is Anatoly Karlin's oddly named Sublime Oblivion: www.sublimeoblivion.com Anatoly recently posted his translation of Lukyanenko's recent declaration of support for VVP – helping to debunk the myth that – tacit Akunin et al – the entire Russian intelligentsia is anti-Putin. We found that Sergey made many of the same points that we have – perhaps T&B circulates more widely than we had thought...

We have slightly edited the translation for clarity and punctuation (the original Russian text can be found on the web).

Translation Sergey Lukyanenko – I Will Vote For Putin

Posted on January 23, 2012 by [AK](#)

I Will Vote For Putin

I didn't really want to, but in the end I had to comment since every so often, agitated young people would log onto my LJ (Live Journal) blog, demanding to know: "Where were you during the Meetings (for Free Elections)? At home? That means you voted for the swindlers and thieves! Are you not ashamed of yourself? Your friends Kaganov, Eksler, Bykov were out there, making rhetorical history and laughing and waving placards... How could you look them in the eyes now? If everything in your life is fine, you'd be for Putin, right? You consider this regime to be ideal? What, you mean to say, that we don't have anyone else qualified to be President?"

So an explanation is warranted.

I voted for the Communists. I did it with a pinched nose, for today's Communist Party has no relation to communists, to the people, and unfortunately, even to politics in general. In the past I voted for the Union of Right Forces, but with equal amounts of horror and aversion. But the defining weirdness of my thoroughly anti-democratic and anti-liberal conscience consists of my belief in everyone's right to think differently. And I want the Parliament to have representatives of the right, and the left, and centrists, and swindlers and thieves too, as they too make up a considerable share of our society – why bother denying this? As our most ardent supporters of democracy insist on denying others the right to their own opinion, I will sing my own song and do everything I can to make "a thousand flowers bloom."

I am mostly satisfied with the result (of the Duma elections) – yes, of course there were violations -yeah, as if they didn't exist earlier... You remember how Yeltsin won? Nothing bothered you back then! But the Duma did become more diverse. And I, by the way, don't call for my political opponents to be hanged in the squares, stripped of their rights and exiled to Magadan. Unlike you, my dear liberals...

And the fact that Leo, Alex, and Dima went to the Meetings does not in the slightest interfere with my appreciation of their books. More power to them. And I consider them sane people too.

I am always touched by the argument: "Well, life is good for you – so that's why you support the

current regime?" This is usually said in an outraged and aggressive tone. I mean, how could this be – why are those people, who don't dislike the government, why are they not protesting against it? The binomial theory! The great mystery of the universe! The great Russian pastime – cutting off one's nose to spite one's face! Yes, I will actually vote for the current government, as long as I believe that it is right for me. And you will vote against it, as long as you believe that it is bad for you. And this is all right and proper. Is this not the very democracy that you want?

So moving on, does this mean I consider the current regime ideal?

What a profoundly intellectual challenge! I do not consider the sausage that I buy in a supermarket to be ideal. I don't consider my books to be ideal. I consider our entire world to be far from ideal. So what should I do then – refrain from eating, from writing books, and from living in general? If you are not the Dark Lord, you will always find mistakes in the universe. We have no shortage of fools – both in power and under their power. We have many swindlers, thieves, idlers, and rascals. But here is one crucial detail – these people are everywhere, in all spheres of life. And their percentage among construction workers, medics, and politicians is broadly similar.

The world isn't perfect, you know? People neither. Have you forgotten how thirty years ago, the entire country voted in unison for the Block of Communists and Non-Party Members. I remember. Have you forgotten, how twenty years ago schoolboys dreamed of becoming hitmen, and schoolgirls – whores? Better by far that they dream of becoming bureaucrats! Satellites are falling, the Bulava can't take off? And did you know how many satellites burned up on their way to orbit under the USSR, and how many unsuccessful missile launches there were before things got it right? You say the country is dying out? Just look at the charts – at how life expectancy has improved in the past few years. Few births? Look at the figures for Europe. Problems with immigrants? Take a walk in London or Paris (which, by the way, is now possible, as was not the case under the USSR).

Do you want the level of democracy they have in Switzerland or the UK? Learn a bit of history, people. How many years did they spend building their modern democracies and modern relations of people to the state? How many people perished in the process? Yes, it would be wonderful to wave a magic wand and... but I don't have one. I'm afraid Putin doesn't have one either. There, in Tajikistan yesterday they banned... Father Frost (Santa Claus)! As a socially and religiously alien element. We aren't in Tajikistan, you say? In some respects, we are. At least as regards our attitudes towards differing viewpoints. The entire LJ blogosphere constantly demonstrates this.

Not long ago, I was still wondering who to vote for in the Presidential elections. And, you know what, you guys helped me make my choice – with your meetings, provocative placards and loud slogans. I will vote for Putin.

Because we really do NOT have another politician, capable of leading the country.

Because the slogans of everyone else are either naked populism, or facsimiles of Putin's slogans, or an unorganized and chaotic set of contradictory promises.

Because the "opposition leaders" plaster each other with obscenities, and would tear each other apart if the current government were to fall. Do you expect Krylov to get along with Yavlinsky? The liberals to make friends with Communists and Nationalists? My friends, this isn't even funny... All the current protesting opposition marches under the banner of destruction and mutual hatred... and holds your life cheap, to boot...

Because Zyuganov would flee to Switzerland in panic if you were to vote him in.
Because Mironov, though a good man, is not a national leader.

Because Nemtsov – well, that’s not even funny.
Because Zhirinovskiy – ‘twould be fun, if the country had a “Save Game” button.
Because Prokhorov is a businessman, and a country can’t be managed like a mining company.
Because Navalny is a person, who works for another country. Not for ours.
Because there is no other. He hasn’t appeared yet.

So is Putin responsible for all that? That he hasn’t raised a successor?

But you didn’t like Medvedev either. “Too liberal”; “too scheming”; “iPhone President”; “innovation”, this and that...

Putin, by the way, was put forwards by Yeltsin. You don’t like the result? So what do you want, that Putin himself could put forward someone, whom you consider worthy? Well then it would be but a continuation of Putin’s policies.

The opposition, in your opinion, should be raised by the acting regime? Don’t take the mickey... Politics aren’t the Olympic Games. Politicians grow notwithstanding the current government. And let them grow, and good luck to them. Let Navalny and Chirikova organize a party, write a program and come to power.

What, they wouldn’t be allowed to? LOL. United Russia had its share of the vote inflated, but probably by not more than 5 percent. United Russia is the party off the majority, that is a fact. So what if they got a few percentage points less – they’d have joined a coalition with Fair Russia. And as if that’d have made a great difference to the political picture in Russia...

Here are transparent ballot boxes, web cams at the elections, parties of 500 people... the mass media are controlled? Again, LOL. There are opposition media everywhere. Do you want to have the first word on TV? Then work for it, fight for it. If you get the majority – you’ll have this all. And if not – well, my apologies...

You have the right to vote. And to monitor the vote. And it’s entirely possible, that on that day – I too will go have a look. So that you, my passionate and fiery friends, don’t flood the streets with your bulletins. Because whenever one or the other side says that it’s all pure and white, that is precisely the side I don’t trust.

... And about what is happening now in the world, how one country after another is ruined in the name of democracy and maintaining the status quo, I won’t even talk about that. Either you see it and understand it, or you are naive beyond all measure. And over the next several years, while the world is undergoing this HUGE crisis, I want to see a leader in power who is capable of bold moves. And ready to defend our country.

So I will go and vote for Putin. For the next six years he has my trust on credit. And you go and vote for your candidates. This is what is called democracy.

But magic wands and a free lunch don’t exist in this world.

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Like cats and horses, markets – whether emerging or emerged, are apt to do as they damned well choose, and a considerable measure of luck is required to come out in one piece. Exercise caution in all things. Good Luck!

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