

## Q&A: Russia Hedge Fund Manager Sees Eastern Promises

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The U.S. subprime crisis and global equity sell-offs have investors scrambling to reposition their portfolios in search of better returns elsewhere. But investors need not despair.

FINalternatives recently talked to Peter Halloran, CEO and portfolio manager at Pharos Financial Group, about opportunities in Russia and what effect, if any, the impending U.S. recession might have on his portfolio. Halloran manages US\$130 million in three Russia-focused hedge funds: Pharos Russia Fund; Pharos Gas Investment Fund and the Pharos Small Cap Fund.



**FIN:** This has been a wild week for the global equities markets. How did your funds perform amid the madness?

**Halloran:** We run a hedge/stop portfolio so we've avoided about half of the losses here. We perform on the downside quite nicely, and when the other markets came back we took a lot of the hedge off earlier this week so it's going pretty well for us all things considered.

Russia held out for the first week or so for the year and then swung on last week to correlate heavily. Now, it is retracing back to the upside along with the rest of the world.

**FIN:** So your investors haven't come close to hitting the panic button yet.

**Halloran:** We haven't had any panic calls from investors, partly because it is not a Russian issue. Anyone who has a problem with us has a bigger problem with their German or French positions. We post our numbers every day and it looks strong relative to the sell-off.

**FIN:** What's your take on the current sell-off and how it will affect Russia?

**Halloran:** Globally, there's still going to be a lot of credit issues that are going to take time to work out. But take it forward six to nine months, and the U.S. would have gotten through most of this slowdown. The problem isn't an overvalued or bubble market; it's a credit market with liquidity issues, which has led to quick sell-offs.

It would have some effect depending on how deep the recession is, but the impact will be completely indirect so long as oil prices stay above US\$50 per barrel. The Russian growth story remains intact and the economy certainly benefits a lot from oil, but at the same time the growth is coming from domestic revitalization. It's been about economic policies leading to domestic growth and that won't be interrupted. So the earnings and EBITDA growth numbers that we would model out in our companies aren't going to be impinged that much by a U.S. recession.

**FIN:** Are there still buying opportunities in Russia, and, if so, where?

**Halloran:** I think so. The Russian economy is not under pressure and the currency is incredibly strong. You've got markets trading at a multiple of below 10 on earnings and the companies that we buy are growing at 20% to 40%.

We like infrastructure and other suppliers to the infrastructure story, such as coal as a source of energy because we think the Russian market has become a domestic story. We're less positive on oil stocks but extremely positive on gas stocks.

**FIN:** While all three funds had good returns last year, those numbers weren't anywhere near your 2006 numbers, when they were up between 37% and 53%. How do you explain the big performance gap between the two years?

**Halloran:** The market environment was very different from '06 to '07, which was a more difficult year. Last year, the market made a big move in a short period when the global credit crisis was coming upon us. We had pulled back from the market and it made a 10% move that we missed. The global credit crisis I was worried about in September is actually hitting now but for that we would've been up 20%.

**FIN:** What are you doing to take your funds to the next level?

**Halloran:** We've just embarked upon marketing these products, and we're targeting US\$1 billion for the Russia fund, US\$250 million for the small-cap fund, and for the gas sector fund we're looking to cap out at US\$200 million. This is a function of liquidity, which goes up every six months, so those numbers may change.

We're also looking at different sectors that may have room for specialty products in and our natural gas fund is an example of that type of thematic fund.