GCC FOCUS

When will Dubai property prices rise?

PROPERTY PRICES ALL over the world have bottomed in 2009. The US Case — Schiller index, which tracks home prices in 20 American cities, bottomed in January 2009, though its recovery is fragile in an economy with an almost 10% jobless rate and anemic bank credit growth.

The National Building data shows that UK home prices have once again begun to rise, notably in London and the Home Countries. Commercial and residential prices in India, Singapore and Hong Kong have been on a roll in 2010, up as much as 20-30% in some locales.

The Beijing and Shanghai property bubble overheated to such a speculative degree that the Chinese Politburo publicly called for a correction and the Peoples Bank of China (PBOC) tightened monetary policy and regulations on bank mortgage lending property shares such as Lee Ka Shing promoted ARA Asset Management (symbol ARA in Singapore) have surged 56% since January 2010. Property was a winner asset class in Singapore in 2010, as I had argued in successive columns since early last year.

The Dubai property market does not reflect any of the investor exuberance that has lead to huge process rises in Singapore or China. Even though home prices have fallen by at least 50 per cent since the collapse of Lehman Brothers in September 2009, the volume of property transactions has plummeted in 2010. This makes it impossible to forecast a bottom for the market even though a UBS property analyst has publicly forecast that residential prices in Dubai will bottom at Dh600 a square foot, significantly below current levels.

A rule of thumb in distressed property investing is that markets rarely bottom until the foreclosure process is complete. This process has just begun in Dubai, with only 70-odd foreclosure cases filed under the Mortgage Law and no foreclosure auctions to date. It is also impossible for a sustainable rally in Dubai property prices as long as commercial banks slash credit lines and tighten restrictions on mortgage loan clients. The three month EIBOR, after all, is eight times higher than the 0.5% three month dollar LIBOR. Go go bank finance was the oxygen of the parabolic rise in home prices until 2008. This credit oxygen no longer exists to boost home prices and sales volumes.

There are a number of milestones that will suggest a bottom in residential property. Foreclosure auctions must happen and provide more realistic data on the prices actual buyers are willing to pay not, not current asking price that do not reflect market realities.

There is a glut of unsold apartments and villas that will be accentuated by at least 50,000 units in new deliveries. The rental market has not bottomed, as rents continue to fall. Distress sales by buyers in default need to end before prices bottom.

It is no coincidence that there were hardly any buyers in the last non-foreclosure auctions, when prices were set by the courts. Moreover, commercial banks cannot hold the thousands of units on their books after their ill fated foray into speculative development. A fall in EIBOR, successful foreclosure auctions, a surge in transactions, easier bank mortgage terms (8% mortgage rate are still among the highest on the planet, almost double the rate in Britain, the US or Singapore), fresh investor inflows and more realistic asking prices by property owners are needed for the market to stabilise and find a clearing level. Then and only then will home prices bottom in Dubai and begin to rise once again.

CURRENCIES

The bull and bear case for the Indian rupee

THIS YEAR WAS supposed to be the year of the Indian rupee. After all, the Sensex had doubled since its post-Lehman bear market low as foreign capital flows flooded Dalal Street, the Reserve Bank of India (RBI) turned hawkish on inflation and began to tighten monetary policy and Indian GDP growth accelerated to almost 9%.

However, the rupee has fallen by one per cent against the dollar as risk aversion triggered by the Greek sovereign debt crisis, the second worst performing currency in Asia after the South Korea.

What next for the Indian rupee?

The bullish case seems compelling enough. The RBI could be forced to raise the repurchase rate as high as 6% by this autumn as wholesale inflation has now reached double digits after the ruling Congress Party eased diesel fuel subsidies. The RBI hit the monetary brakes last week, India's inflation surge and successive RBI rate hikes will increase the rate differential with the US money markets, as Wall Street inflation indices soften and the prospect of Fed tightening is unthinkable in the short run.

As long as investor risk appetites remain benign towards the emerging markets, Dalal Street should remain a magnet for offshore fund investors. After all, net FII flows into Indian capital markets exceed 400 billion rupees or $8.5 billion in 2010 alone. One year option volatility on the rupee has plummeted 500 points to 10.4 per cent.

The IMF has raised its forecast for Indian GDP growth to 9.4 per cent from 8.8 per cent the Bretton Wood twin estimated only three months ago. Indian interest rates will rise for the fifth time in 2010 and it is entirely possible that ten-year Indian government debt will yield 8%, the highest among the BRIC nations by late summer.

All of the above suggests that the Indian rupee is cheap at 47 to the dollar and headed to 44 – 45 in the next six months.

However, it is never prudent to postulate only one scenario in the FX markets, whose myriad landmines make it among the most treacherous of money bazaars, as legions of ruined speculators will attest. India's economic juggernaut could be derailed by the current account deficit, which has soared to $13 billion in the second quarter 2010. A currency that depends on offshore fund inflows to bankroll a deteriorating current account deficit is inherently skating on thin ice.

Capital flows to Dalal Street are notoriously fickle in a world where Chinese property could crash by 30%, US housing is headed for a double dip and a European sovereign default is entirely plausible. Rate hikes will hit Indian growth metrics. The RBI is behind the curve on inflation. Industrial production has begun to fall.

India's growth rate is dependent on domestic consumption, which is highly sensitive to interest rate hikes. Oil prices at $80 and high food prices will not ameliorate imported inflation pressure. Economist estimate that only one fourth of the 10.6 wholesale inflation rate derives from domestic sources. India's states, some of whom are besieged by a Naxalite peasant revolt, communal riots and criminal political elite, have created a fiscal black hole by reckless borrowing. While Kashmir and relations with Pakistan are relatively stable, a singe act of terror of the Mumbai 26/11 magnitude could lead to tensions, even another catastrophic war.

I believe the Indian rupee will trade in a 48-44 band in the next twelve months. An economy with high growth, a closed capital account and rising inflation will, when all is said and done, be forced to revalue the rupee. At 48, the Indian rupee is a compelling buy.

STOCK PICK

When will Yahoo shares double?

THIS WAS A decade of heartbreak for Yahoo shareholders. The shares have lost 80% of their value since they peaked in the 2000 Silicon Valley gold rush and the world's first Internet portal now commands a value of only $20 billion on Wall Street, less than one twentieth Apple's $240 market cap.

Yahoo shares have fallen from 18 to below 14 since April alone, as CEO Carol Bartz, who once reinvented Autodesk, has failed to work her magic on Yahoo.

A decline in banner ads caused Yahoo once again miss sales forecasts. Google has totally outclassed Bing/Yahoo in search. Yahoo's Alibaba.com hopes were dashed by a bitter divorce in the Middle Kingdom's gorilla online market. Yahoo display advertising was hit more in a recession than performance based search ads or even broadcast TV.

Yahoo founder Jerry Yang blew a $47 billion hostile takeover/bear hug from the Evil Empire of Redmond (Mister Softee to the cognoscenti of NASDAQ, Microsoft to the wider world). Citigroup downgraded Yahoo shares. Surely investing in Yahoo is investment leprosy. Wrong. I believe Yahoo is at or near a historic bottom.

The sad sack Cinderella portal of 2010 is going to be, in my opinion, an investment Prince Charming of 2011. Yahoo (symbol YHOO) could well double in the next eighteen months to 26. Why?

One, Carol Bartz has restructured Yahoo with savage staff cutbacks, deal making on a global stage, critical new partnerships with Nokia and Facebook, reengineered its technology and product groups. Her strategy is working. Display advertising rose 19 per cent in the past quarter but Yahoo bears still savaged YHOO on NASDAQ.

Two, the search-display ad strategic alliance with Microsoft is progressing and Ad Center will launch well before the Christmas shopping seasons. Does Mr Market care? No way.

Three, Yahoo, despite its China setback, has targeted the world's emerging markets for growth — as the $164 million deal to buy Jordan (and DIC) based Maktoob.com demonstrates. Yahoo will create Arabic local media content in the age of Twitter and Facebook to redefine the MENA Internet market.

Yahoo CEO Carol Bartz

600M
The number of users worldwide

Yahoo's Singapore office is its gateway to Southeast Asia, its fastest online growth, impenetrated Internet market. Local content is often more credible than BBC or CNN global content, where royalties, licenses, mobile services and display ad revenues can sizzle. Yahoo, with content in 25 languages is truly the web portal for the human race. Yahoo's acquisition of an Aussie Totaltravel.com site fits with the local content theme. Yahoo owns a one third stake in Yahoo Japan.

Four, Yahoo has shed non-core assets to increase margins. It sold email tech unit Zimbra to VMware, Maven Networks and video editing tool firm Jumpcut. Yahoo sold Yahoo Jobs to Monster.com. Its operating margins will surge in 2011.

Five, Yahoo has rebranded Flickr, invested hugely in the mobile Internet markets, launched partnership deals with Facebook, Twitter and Nokia. Yahoo's advertising exchange Right Media is a credible, if minor, rival to Google's Doubleclick.

Six, Yahoo's home page was redesigned by Bartz's team with a similar layout as Google and MSN, with links to content and services to some of the hottest Websites on the Internet.

Yahoo's shear scale dazzles me, 600 million users worldwide, 10 billion ads displayed everyday. 100 billion email sent via Yahoo Mail. Collection of 50 petabyte (that is a 1,000 tera byte or 10 to the power of 12) of data every year. This franchise is a colossal, if scorned, crown jewel of the Internet.

Yahoo is in the Wall Street doghouse after the mediocre 2Q report. However, I doubt if Yahoo shares fall below 12 even in a worst case scenario. Yahoo is the cheapest large cap Net business listed on NASDAQ. Taking out its minority equity stakes in Yahoo Japan, and Alibaba, Yahoo trades at a mere 10 times forward earnings.

The board just approved a fabulous $3 billion share buyback and Yahoo has at least $10 billion in asset values and cash. This is not a poor, pitiable Cinderella, this is a hottie that will dazzle a fairy tale prince in the Internet palace ball. After all, Steve Ballmer was once willing to plonk $47 billion for Yahoo.

History does not repeat itself but it surely rhymes. If Bartz succeeds, Yahoo commands $40 billion. That, my friends, means I double my money in YAHOO sometime in 2011. Selling the January 13 put options has a stellar risk-reward calculus.

WALL STREET

The coming collapse in gold and silver

GOOD NEWS sandbagged the goldbugs in July. It is no coincidence spot gold tanked more than $100 from its late June $1266 high while the European bank shares index rose 16%, the Euro soared against the dollar above 1.30 and Spanish, Greek and Portuguese sovereign credit debt spreads compressed with a vengeance.

The conclusion is obvious. The moment the EU sanitised the health of the Eurozone banking system with its self serving stress tests, gold was toast as the fear premium built into prices was unwound. US corporate earnings also triggered a 8% rally in American equities and risk aversion indices such as the Chicago Volatility Index (VIX) plummeted in July. The Chinese yuan mini-reval also averted the risk of a protectionist backlash and the trade war with a Democratic US Senate in an election year. Above all, the Gaza flotilla incident and the North Korean sinking of a S. Korean warship did not lead to war and so eroded the geopolitical risk premium in the yellow metal.

The gold futures markets shows tangible evidence of panic liquidation by leveraged investors. Net long contracts on New York's COMEX have fallen big time (15% in July alone) and the gold ETF lost 30 metric tons, both the kiss of death for gold bulls. This was the real reason gold fell $22 in a single session in New York last week. After all, 30 metric tonnes is no less than one million troy ounce of gold. It is extremely unwise to bottom fish in a liquidation market, whatever the temptation to buy at lower prices or the sweet nothings whispered by Gold Souk brokers/sales guys. Any bounce is a dead Cheshire kitty bounce.

I believe gold is expensive relative to crude oil, jewellery demand in India will soften as RBI interest rates bite into consumer spending, that Chinese reserve buying gold has long peaked, that even Treasury bonds do not incorporate such a high degree of unwarranted risk aversion.

> Investors will scramble to dump silver as prices fall

This is a time for a paradigm U-turn for bullish gold lambs lest they not be fleeced into the slaughterhouse. When gold goes nasty, there is no bottom. I recommend using any bounce to $1,210 to aggressively sell gold for a $980-1020 target by Christmas. This is the year Auric Goldfinger rolls over and dies.

Silver is a psychotic precious metal, gold's hyper-volatile stepsister. Silver prices rose from $5 to $20 in the last eight years, the biggest rally since Nelson Bunker Hunt masterminded the Epic Silver Squeeze in 1980. Massive mine production in Indonesia, Russia, China and Peru (mainly as a by product of nickel and zinc) has created a silver glut at the same time that digital cameras have killed photography demand and fabrication offtake has been whacked by the fall in global industrial production.

The only reason silver prices did not collapse was due to an epic speculative buying spree by hedge funds and epic growth in the silver ETF, which soaked up physical supply and locked it into bank vaults. Central banks, who sold 2,400 tonnes of silver, saw no point in dumping reserves into rising markets. After all, to quote Lord Keynes, markets can stay irrational a lot longer than you can stay solvent — and nothing defies leveraged irrational exuberance more than the silver futures market.

But now the bullish virtuous cycle will become a bearish vicious cycle. Central banks and ETF investors will scramble to dump silver as prices fall. Quelle horreur, but moi crystal glass greets Santa Claus with $12 silver.

MARKET VIEW

Exclusive interview with **Peter Halloran**, Founder and CEO of one of the world's leading specialists Russia fund managers

Russia: The world's winner market?

WHAT IS THE outlook for the Russian stock market in 2H 2010?

The Russian stock market is poised to be one of the best performing in the world in the 2H 2010 if global recovery continues. Russian companies are posting strong financial results, the market is trading at historically low valuations compared to Emerging Market peers, and the government's huge fiscal reserves gives it protection against sovereign worries that are holding back markets in Europe and North America.

What are the sectors/themes that will outperform in 2H 2010?

We are very bullish on the Residential Real Estate sector. The market bottomed in September 2009, and prices and monthly sales volumes have been steadily increasing since then. June was the highest sales month on record.

Banks have recently launched new mortgage products at attractive borrowing terms, which will allow a much wider group of buyers to enter the market, further supporting residential real estate. Currently 75% of residential real estate deals are 100% cash purchases, so the potential effect on demand from mortgages is massive.

We are also bullish on select companies in the mining sector, as iron ore, copper and platinum/palladium prices are poised to rebound in the 2H 2010 as Chinese de-stocking appears to have ended, which should push up those commodity prices.

Why does Russia trade at a huge valuation discount to MS EM index or the other three BRIC's?

Russia trades at a big discount to the other BRICs largely because its economy is one of the most sensitive to global growth, and investors fled the market amidst the 2008-9 crisis. Russia is historically one of the highest volatility markets in the world, and is set up to be one of the best performing markets if global growth does not relapse into recession.

> Russia historically is one of the most volatile markets in the world and is set up to become one of the best performing

The Russian market is currently trading at a 35% discount to EM as a whole, which is as cheap as it has ever been, even as we expect up to 40% CAGR net income growth over the next three years.

How can investors best benefit from Russia's consumer economy?

We are playing the consumer theme through retail chains, banks — which will benefit from an exponential increase in consumer lending, which is virtually nonexistent right now — and residential real estate developers. The retail sector is very fragmented, with the top 10 food retailers accounting for only 11% of the market and modern retail outlets only accounting for 44% of overall sales, so there is huge growth and consolidation potential for the sector leaders that we are invested in.

What are the major risks to your outlook for Russian equities?

The major risks to our outlook for Russian equities are a second phase to the global crisis, such as we almost had in Europe in May, or a collapse in the oil price below $40/bbl.

What is the USP of Pharos as a Russia specialist fund manager?

Pharos has been the best performing Russia fund due to our combination of superior stock picking ability and our rigorous risk management practices. Alone amongst Russia focused funds, we use hedges to protect against tail risk, so that we provide the Russia upside at the same time that we are protected against market meltdowns.

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