

## Ten years on, Halloran still sees rich promise in Russia February 2008 Newsletter

**Supported back in 1997 by former employer CSFB and George Soros, veteran Russian investor Peter Halloran believes the country is at a very favourable point in its history**

Russia-focused hedge funds have come into vogue in the last couple of years, given the recent run of strong performance in emerging markets. But for one firm, hedge fund investing in Russia is far from a new concept.

Pharos Financial Group recently celebrated its 10-year anniversary, having debuted in October 1997 with its Pharos Russia Fund. The firm now manages about \$150 million - which the team ambitiously aims to take to \$1 billion over the next few years.

The Pharos Russia Fund has produced an annualised return of 33% over the past five years. It is a multi-sector Russia and former Soviet Union fund that invests in a diverse portfolio of liquid equities and can also short and use derivatives.



*Peter Halloran*

The fund produced a more subdued return of 9.6% last year, compared with nearly 37% in 2006, 65% in 2005 and 26% the year before that, owing to more difficult conditions in Russia's equity markets - although Peter Halloran, founder of Pharos, thinks the coming months should provide plenty of interesting opportunities.

The firm also runs two other funds, the Pharos Gas Investment Fund - which debuted in April 2004 and has produced an annualised return of nearly 49% - and the Pharos Small Cap Fund, which launched in November 2005 and which has generated an annualised return of about 23%.

Halloran, an American who has lived in Russia since 1995, has witnessed many dramatic changes in the economic and political landscape in Russia since he arrived then to run CSFB's Moscow brokerage business.

He got started while still on Wall Street, selling Russian privatisation vouchers to a group of risk-tolerant investors, who were very happy with the returns that the business provided.

On the back of high order flow for the vouchers, Halloran's team developed a large presence in Moscow, and CSFB eventually asked him to relocate and run the brokerage.

After running that for a few years, Halloran launched Pharos in 1997 with seed money from CSFB and Soros Fund Management. The timing - just before the Russian debt crisis of 1998 routed many Russia-focused funds - proved tricky, but also provided an unanticipated advantage.

"The markets had washed out, and Russian investment banks had exited, and so all those investors putting billions into Russia were left without any help," he said.

"We were local, and we knew the markets and most of the companies, so we ended up being hired as advisors on a number of large portfolios, including Soros."

Halloran set up Pharos to create an investment vehicle that could be completely opportunistic - investing in everything from fixed income to private equity.

Today, Halloran says Russia's prospects are better than ever. The currency is very strong, he says, while the economy continues to grow rapidly and valuations are highly compelling.

He believes that the risks most commonly associated with Russia - weak corporate governance and government stability - are overblown and that these have been overly discounted.

He says corporate governance issues have become more predictable - and thus more manageable - and that the country is politically more stable than many western investors give it credit for.

If anything, he says, the main threat to Russia right now is what is happening in the more developed western markets.

"The risk is more to do with the global situation and how it will impact this otherwise very favourable point in Russia's history," he says. "That would come from a couple of things - credit issues impacting Russia's ability to grow and impacting the economic cycle. If you have global growth slowing down, there will be risks to Russia."

The firm has recently revamped its portfolio management team and brought in several new hires, including consumer and telecoms analyst Kevin Dougherty from Deutsche Bank/UFG, a 10-year veteran of the Russian capital markets, and also hiring oil and gas analyst Nat Moser, who has 11 years' experience analysing the oil and gas sector in the region.