



## OPALESQUE EXCLUSIVES

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**Opalesque Exclusive: Russia Special: Oldest Russian hedge funds now focuses on fundamentals unlikely to be affected by crisis, Russia exposed to financial markets-contagion but economy is taking off, Western banks are building a presence in Russia, although raising funds is now difficult for the whole system, Emerging economies are the engines of growth**

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**Opalesque Exclusive: Oldest Russian hedge funds now focuses on fundamentals unlikely to be affected by crisis, Russia exposed to financial markets-contagion but economy is taking off**

[Benedicte Gravrand](#), Geneva: "We have the only Natural Gas Sector fund covering Russia and the CIS in the world," said Pharos' John Papesch to Opalesque. "Also, our Small Cap Fund is one of top performing funds to date with half of the volatility of our peer group. Now is the time to invest in Russia." So Opalesque talked to Pharos' portfolio manager about the funds and his take on Russia.

### **About Pharos and the three funds**

Pharos Financial Group, which has about \$150 million invested in Russia, is a specialist investor in Russia and the former Soviet Union (FSU) and runs three funds. It is one of the oldest Russian hedge funds around and employs a mixture of Russians and foreigners. Two Russian people will be joining the company in a couple of weeks. Pharos has been on the board of over 40 listed companies which gives the firm an intimate understanding of the market.

The **Pharos Russia Fund Ltd**, a Cayman-domiciled hedge fund, has been in existence since 1997, offers daily liquidity and is a multi-sector Russia and FSU fund. It has a diverse portfolio of liquid equities, and can short and use derivatives. The fund has a 31% annualized return over the past 5 years (-8.7% YTD to March est.)

The **Pharos Small Cap Fund** is Cayman-domiciled, it invests in undervalued second and third tier companies. Russia's strong economic growth, rapidly expanding domestic market and increasing financial market liquidity mean that many of these companies are the blue chips of the future. The fund since inception (2005) has a 21% annualized return (-8% YTD to March est.) The fund is up almost 8% MTD in April.

The **Pharos Gas Investment Fund**, Cayman-domiciled, is designed to take advantage of the transformation of the gas sector in Russia and Eurasia. The two key drivers are the dramatic increase in Russia's domestic gas prices from subsidized levels to market prices – estimated to increase 3 folds by 2011; and the rapidly increasing demand for natural gas across Eurasia. This is the only fund focused on this sector. It invests in listed equity and offers monthly liquidity. The fund since inception (2004) has a 45% annualized return (-6% YTD to March est.)

Two Pharos funds have ranked in the Top 15 Hedge Funds globally from Q1'05 to Q1'06 by Bloomberg (No.3 Pharos Gas Investment Fund; No.14 Pharos Russia Fund) and in the Top 10 by Eurohedge (No.3 Pharos Gas Investment Fund; No.6 Pharos Russia Fund).

Pharos announced plans to raise over \$1bln from Middle East countries to The Moscow Times last month. "There is tremendous interest" in Russian equities in the region, had said Pharos' Steve Kalnokyto to the paper. It also reported that Pharos may launch sharia-complaint funds to attract more Persian Gulf investors.

### **Fund management in Russia – not much use of the available hedging tools**

Peter Halloran, Pharos' CEO and a leading Russian investment expert, (an American, he has lived in Moscow since 1995 and speaks Russian) talked to Opalesque from his Moscow offices. Prior to founding Pharos Financial Group in 1997, Mr. Halloran was the principal contributor toward building the CS First Boston equity and fixed income brokerage businesses in Russia and the CIS.

"The fund management business in Russia has been developing on the back of the re-rating of the Russian story (which has been ongoing since 2000), which has encouraged long-only products with investment themes in Russian markets to develop. Long-biased and long-only products still dominate. The industry had an absence of derivative products. But that has changed in the last couple of years.

"It is a fairly deep market now; we have a dozen single securities where you can get (big markets), we have two indices that trade actively and one futures market as well. Shorting has always been available in the Russian market. All tools to run a true hedge fund product exist at this point but there are very few funds using them. We, however, use all those tools – we have been as much as 30% short at times and make full use of derivatives and the futures market which is different from 90% of the other funds."

## **Russia traded in sympathy with the global markets in Q1-2008**

When asked about the recent negative performance of the funds, Mr. Halloran admitted that they tuned in with the current global credit crisis. “Our next moves are that we will be well invested with underlying hedge against the volatile positions. We think that the fundamentals remain robust and companies across the board are fast-growing and getting cheaper. (...) We are quite mindful of the credit crisis. We are hedging out the biggest downside risks that could come from it and are focusing more on the fundamentals that we see – which are not likely to be impacted by the crisis as it has unfolded so far. The credit crisis has not materialised in the way that will sufficiently impact Russia and its commodities market.”

So there has not been much of a contagion in Russia. The economic growth-kind of contagion would affect Russia only if the crisis was very severe as Russia’s growth is insular and domestically driven. But Russia is definitely exposed to the financial markets kind of contagion.

The **Eureka** hedge Eastern Europe & Russia Hedge Fund Index returned -2.81% in March (est.) and -5.38% YTD (est.). It performed well in 2007, at +23.94%, and has had only positive years since launch in 2000.

When asked about his stance on the new leader, Mr. Halloran conceded that ‘politics here can be shrouded in mysteries.’ He pointed out that what is going on in Russian was far more positive than the Western commentators admit to. The arrival of Medvedev is a positive, as he is the youngest, most pro-western on the list of candidates. Corporate website: [Source](#)

See Dec-2007’s **Other Voices: Putin’s support of Medvedev as next President ‘hugely positive for markets’** from Pharos: [Source](#)

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