Risks and Revelations

By Derek Sambrook, FIB(SA), TEP,
Managing Director, Trust Services, S.A.,
Panama

Last month's column (The President and the Dancer – Issue 266) featured tangos and waltzes, both with one partner, Argentina, whose future has suddenly brightened after Mauricio Macri was elected its president at the end of last year. President Obama danced the more complex tango and China the more measured waltz.

Both are welcome partners for two different reasons: President Macri wants to break with the past and reverse the hostile mood towards the United States of America which I have written about already and, at the same time, build on the firm foundations already existing with China. After all, China is Argentina's second trading partner after Brazil. In 2014 some 7% of exports went to China and 16% of total imports came from there. Argentina and China have been economic partners for over 20 years and signed a Bilateral Investment Treaty in 1992. What really cemented the relationship, however, was when China, in 2004, provided the country with a USD20 billion funding package. In last month's column I also wrote about the lifeline thrown to Argentina by China when it was battling with creditors over its USD95 billion default back in 2001 and which was, at that time, the biggest sovereign default ever.

Following President Obama's trip, the sale of USD16.5 billion of bonds was four times oversubscribed; I had previously wondered in last month's column just how big investors' appetites might be, given the country's dismal track record with debt. Is it faith in a new Argentina or the desperate search for yield? It was, in fact, this desperate search for yield by bankers and investors that made Latin America attractive in the 19th century (Argentina gained independence from Spain in 1816). Britain's current account surplus at the time had created a surfeit of savings, the outcome of which was enormous exports of capital. The idea was that the monies would be used to develop the infrastructure of new independent countries, and Latin America was a natural lure.

Unfortunately, the Bank of England then raised interest rates which led to a market panic. Now it is the US holding the reins of monetary policy but unlike the gunboat diplomacy of the day, which could sometimes enforce debt contracts, investors in large creditor countries are no longer cushioned against risk by that possibility and which led to the UK invading Egypt in 1882 and Istanbul in 1876 when Turkey defaulted.

Although Cicero was of the opinion that "Nature has planted in our minds an insatiable desire to see the truth", circumstances can lead us to do so with one eye shut, just the environment in which the fraudster thrives; not surprisingly, the past rubs shoulders with the present because the fraud, often with the aid of skilful publicity, is a constant, whether it is a country that doesn't exist ("Bubble, Bubble, Toil and Trouble" – Issue 240) or turns matchmaking into artful manipulation ("The Silence of the Shams" – Issue 248).

Since 2009 investors have reacted to low returns and loose monetary conditions. First there was a move out of traditional conservative investments into corporate bonds and shares which paid good dividends; but with returns falling even further, greater gambles are being taken. Consider insurers who have to deliver guaranteed income returns for pensions, when very low or negative interest rates are all that is on offer. The volume of high yield, non-investment grade bonds, including leveraged loans and collateralised loan obligations which have been issued over the past four years, comes to about USD3.5 trillion whereas the amount of loans outstanding in 2007 in the case of subprime mortgage loans was some USD1.3 trillion. What's more, many of these loans have the minimum of protection for lenders; in fact, some allow interest to be paid in the form of IOUs instead of cash.

Would higher returns compensate for loss of capital in the long-run? Obviously, emerging markets, not just in Latin America, present very real dangers. No one could have avoided the amount of publicity and number of articles featuring "the new dawn of opportunities" in Africa. Take Mozambique, a country I visited often in my youth where I enjoyed its fine beaches and the most delicious prawns. Investors were attracted by one government USD850 million loan, offering an interest rate of 8.5%. The funds were to be used for a tuna fishing venture but serious allegations were subsequently made that this was not the reality. Since then the situation has only worsened.

To add to the mix, Mozambique is one of the poorest countries on the planet and because much of the debt is denominated in US dollars, should US rates go higher and the dollar's value increase, so will the debt servicing costs. Not alone, the country is captive to the fate of future US rates which appear as steady as a seesaw during America's year of political angst and animosity.

So one can see why Argentinean bonds might appeal and the country may be entering calmer waters, although in politics leaders are always hostage to events. President Dilma Rousseff in Brazil knows all about this, as do investors, after the country's oil company, Petrobras, issued 100-year bonds in June 2015 with a yield of 8.45 per cent. These bonds were thought to be as secure as 30-year ones, based on present value mathematics which sees the principal as a small component of return. In the second-half of 2015, however, low commodity prices began to bite, high debt levels raised concerns and then the Petrobras corruption scandal exploded. Within three months of issuance the bonds had lost approximately 30 per cent of their value.

President Macri, despite the brighter outlook, is now under scrutiny because, along with his father and brother, he was a director of a company in the Bahamas incorporated in 1998 but dissolved in 2009. These details have been revealed by the International Consortium of Investigative Journalists after the purloining of the confidential records of Mossack Fonseca, a law firm based in Panama; thus the appellation, "Panama Papers". President Macri's spokesman, Ivan Pavlosky, has stated that the president never declared the company in his asset declarations when he was mayor of Buenos Aires because he had neither capital participation, nor shares, in the company.

Like so many others named, but who can't be blamed, he will be part of the collateral damage not protected by the Universal Declaration of Human Rights which was drafted by representatives from different legal and cultural backgrounds around the world and which was proclaimed in 1948 by the United Nations General Assembly in Paris. Journalists zealously (and rightly) protect their sources, but not the innocent, who will find little comfort from these two sentences in the declaration: "No one shall be subjected to arbitrary interference with his privacy, family, home or correspondence, nor to attacks upon his honour and reputation. Everyone has the right to the protection of the law against such interference or attacks". Spare a thought then for those who went offshore because of the risks they ran from the unstable conditions at home, in some instances exposing their families and themselves, for example, to possible extortion and kidnapping.

Populist revolt against the rich is nothing new; as regular readers will appreciate, I lean heavily on history when negotiating my travels through the present. But the most famous point of reference in modern history must surely be America's Robber Barons. Just as today's rich individuals have attracted the wrath of people, so did a number of entrepreneurs who were instrumental in leading America's move from an agricultural society into one dominated by industry. When the US entered the First World War, John D. Rockefeller had become the country's first billionaire. He once controlled 80% of the world's oil supply, just as today Google (itself under intense tax scrutiny) has 90% of the search market in Europe and about 67% in the US. President Theodore Roosevelt spoke of the "criminal rich", an epithet once more heard today. Louis Brandeis, a famous Supreme Court judge at the time, said that democracy "cannot endure" when large concentrations of wealth are in the hands of the few. The early part of the 20th century found 40% of American manufacturing assets held in trusts and holding companies.

The Panama Papers' revelations have been carefully orchestrated and much like a symphony, they have several movements we have yet to hear. Pursue the men who are criminals, yes; but have regard for those who are not and whose honour and reputation have been questioned. I think President Macri would agree.

www.trustservices.net

European Magazine Services Ltd, 12-16 Castle Lane, Belfast BT1 5AF, United Kingdom • Tel: +44 (0) 28 9032 8777 • Web: www.offshoreinvestment.com

PUBLISHER AND CEO
Barry C Bingham
barry@offshoreinvestment.com

EDITORIAL DIRECTOR
Jenny L McDonough
editorial@offshoreinvestment.com

SALES DIRECTOR
Deborah Maclaren
advertising@offshoreinvestment.com

FINANCIAL DIRECTOR
Rosalind A Maguire
accounts@offshoreinvestment.com

MEDIA MANAGER
Gillian M Abernethy
administration@offshoreinvestment.com

CONFERENCE
Emily Anderson
conference@offshoreinvestment.com

SUBSCRIPTIONS
Laura Simpson
subscriptions@offshoreinvestment.com

DESIGN
Dave Johnston
administration@offshoreinvestment.com

PRODUCTION
Gillian Devenney
administration@offshoreinvestment.com

THE SALES TEAM +44 (0)203 004 7201

Account Managers

Paul Robertshaw
PaulRobertshaw@offshoreinvestment.com

Anne Mead-Green
AnneMead-Green@offshoreinvestment.com

ISSN 0954-0628 US PS 002-273.

Printed by Pensord Press Limited, Pontllanfraith, Blackwood, Wales, UK. *Offshore Investment* has tried to ensure that all information contained within this publication is accurate, however, the publisher would emphasise that he cannot accept responsibility for any mistakes or omissions. No legal or investment instruction is intended. The opinions expressed are strictly those of the authors. *Offshore Investment* **USPS 002-273** is published monthly except July and December by Offshore Investment, 12-16 Castle Lane, Belfast BT1 5AF, United Kingdom. The 2015 US annual subscription price is 960.00. Airfreight and mailing in the USA by agent named Air Business Ltd, c/o Worldnet Shipping Inc., 156-15, 146th Avenue, 2nd Floor, Jamaica, NY 11434, USA.

US POSTMASTER: Send address changes to Offshore Investment, c/o Worldnet Shipping Inc., 156-15, 146th Avenue, 2nd Floor, Jamaica, NY 11434, USA. Subscription records are maintained at European Magazine Services Ltd, 12-16 Castle Lane, Belfast BT1 5AF, United Kingdom. Air Business Ltd is acting as our mailing agent.