



The Moscow Kremlin

Welcome reforms in Russia

Russia continues to reform its domestic financial market. The two stock exchanges RTS and Micex merge - a step which East Capital welcomes and has advocated the past few years. With one strong market place for stocks in Moscow a more liquid and transparent market is created.

Depository receipt quotas abolished

During the last week of June another step was taken in the right direction. President Medvedev informed that the 25% quotas for American and Global depository receipts, so called ADRs* and GDRs**, will be completely abolished. Until now, companies in Russia have had a system for trading local stocks as well as depository receipts, where trading prices have varied. There have not been any limitations on foreign ownership of local stocks; nonetheless many have chosen not to own stocks directly. As a result, depository receipts have traded with a

premium in the companies where the quotas have been met.

Buying local stocks successful

At East Capital we have not understood the logic in paying more for something that offers the exact same voting and dividend rights. Therefore we have in recent years bought a large amount of local shares since the discount has been - in our opinion - too great. One example is Magnit, in which we purchased a large block of stock during the financial crisis at a 40% discount, which we later sold when the discount was only 11%. Not only did we succeed in making a good trade through the reduction of the discount, the underlying stock also went up significantly. This resulted in a total return of 484% from 18 November 2008 to 15 January 2010.

Winner on shrinking discounts

Another good example is LSR, which has been one of the largest holdings in our Russian portfolio. LSR is a very interesting company based in St. Petersburg which has a large business within construction materials, as well as a significant construction business focused

on building multiple family residences in Moscow and St. Petersburg. When we invested in the company the discount for local shares was 40%. Before Medvedev's statement the discount was 12%, the following day it had shrunk to 6%, and today it is down to 4%. Also in the case of domestic stocks we have lobbied the authorities to make them understand how illogical the current system is and realize that there is a lot to gain by making it easier for foreign investors to invest in Russia.

Russian education a competitive advantage

Another interesting new aspect regarding Russia are the IT companies that have been listed on NASDAQ in the past six months, and which are building their businesses based on the high level of technological education in Russia. The high level of education is something that is often forgotten when comparing Russia to other emerging markets, and perhaps especially with regards to other BRIC countries.

The Internet companies Yandex and mail.ru are both large companies with market capitalizations of USD 11.7 billion and USD 7.2 billion respectively. As with most IT companies, valuations are currently somewhat too high for our taste. Nonetheless, we believe that there will be more companies entering the exciting IT sector and this will be an important part of the change in the view of Russian companies that we predict. There are a number of successful Russian entrepreneurs within fast growing sectors other than commodities. It is among these companies that East Capital finds many of the most interesting investments that contribute to the good long-term performance we have given our shareholders.

Peter Elam Håkansson
Written on flight AF 3226 (Air
France) between Paris and
Gothenburg



* American Depository Receipt (ADR) is a tradable security that represents the underlying stock in a non-American company traded in the US.

** Global Depository Receipt (GDR) is a certificate issued by a custodian institution for shares purchased in foreign companies and held in a custodial account.

Chinese equities remain in a holding pattern - but revenues and profits race ahead

In terms of share price appreciation, Chinese equities are mostly in negative territory year-to-date. The main reasons for this development are investor concerns about policy tightening in China due to overheating of the economy, combined with the growing debt problems in the EU and US. Regarding how the Chinese companies actually are performing in terms of operations and profit growth, the picture is much brighter.

In the first half of 2011 revenues for Chinese industrial companies rose by an astonishing 30 percent and profits by 29 percent year-on-year to 2.410 billion yuan (380 billion U.S. dollars), according to a recent survey by China's National Bureau of Statistics. The figures are derived from companies, listed and unlisted, with yearly sales of more than 20 million yuan in 39 industries. The bulk of the companies have yet to disclose their actual first half results, but this survey bodes very well for the upcoming reports of our portfolio holdings.

GWM performs strongly

One of our largest holdings, Great Wall Motor, last week confirmed the survey results by announcing a major positive profit warning. The consolidated profit during the first half of this year will increase by 80% year-on-year, mainly attributable to strong sales growth. Another noteworthy event in one of our portfolio holdings was the news that truck maker Sinotruk will add capacity by building a plant with an annual capacity of 400,000 trucks. Just to put this in perspective, this number of additional capacity that Sinotruk is building is of the same magnitude as the total annual produc-

tion of the world's largest truck maker today, Daimler AG.

US and EU in trouble

Meanwhile, in the US and EU the giant financial train crashes continue in slow motion. Debt ceilings are raised and aid packages are launched, but huge fiscal deficits in a number of large Western economies remain. Despite the near term aid packages for Greece, Portugal and Ireland, these countries will most likely default on their debt in the next few years. The focus of private bond investors has begun to shift to Spain and Italy, where yields will also rise and eventually risk getting out of control. The European Financial Stability Facility will suffice to bail out Greece, Portugal and Ireland - but not Spain and Italy.

Ten years ago, the thought of the US defaulting on its debt was unthinkable to most. Today it seems more a question of how many more years it will take. The US deficit that in January this year was projected by the Congressional Budget Office at USD 1.5 trillion, will instead turn into a USD 1.7 trillion or more deficit. In other words, in just one year, the US needs to finance incremental debt which is more than the amount that the Chinese have already lent to the US over many years.

China less risky than the West

So one strategic question for investors to rethink is whether China really is more risky than the US and EU to invest in. We have long argued that it is the other way around. For long term investors, China is less risky to invest in than in the EU and US. China continues to grow about three times faster than the West, the economic policy is prudent and long term oriented. China has huge public and private savings, a massive trade surplus and the currency appreciation will add to the returns for foreign investors. Speaking of currencies, in

late July, China's currency reached its strongest level in 17 years, at 6.44 yuan to the USD.

GE expands in China

As another illustration of Asia's growing importance, US giant General Electric announced it will relocate the headquarters of its global X-ray business to China. GE projects its health-care revenue in China will grow annually by 20% in the next five years from USD 1 billion in 2010. China's government has intensified its efforts to entice foreign companies to not only invest in manufacturing in China, but also to move research, product development and management functions to China. In this way, China can capture a larger share of the value chain and quicker gain access to foreign technology in order to bridge the technology gap with the foreign competitors.

While many investors take off for August vacation, we prepare for digging into the 1H reports of our holdings. I believe the earnings growth will confirm the strong preliminary numbers for the industry, and that should in turn provide good support for share prices.

Gustav Rhenman
Portfolio Manager



Market comments

Eastern Europe

Most equity markets continued to move south in July on the back of global macro. The Eurozone debt fears were replaced by concerns about the inability of American politicians to agree on a fiscal plan in order to increase the debt ceiling (they agreed just before the deadline in early August). All but a handful market in Eastern Europe lost ground as a result. A diverse group of frontier markets outperformed with Estonia and Slovakia being the two best markets in the region with 4.4% and 3.1% gains, partly as a rebound from the poor performance in June. The Serbian market dropped 6.8% and was among the worst markets for the second month in a row but is still one of the best markets year to date with a 20% gain. Of the larger markets, Russia continued to outperform noting a 3.1% gain while Turkey continued to underperform dropping 5.1% after the TRY depreciated 3.6%. Russia is holding up rather well due to its strong fundamentals whereas Turkey is being punished due to overheating concerns. The Central European markets, which have performed relatively well this year, were affected by the negative sentiment. The Polish and Czech markets dropped 3.8% and 4.2% respectively while Hungary was the worst markets of all dropping 7.1%.

East Asia

The Mainland equity market posted negative performance in July with CSI 300 Index declining 1.85%. The negative performance was mainly driven by concerns over the Mainland economy continuing to slow and the high inflation rate recorded in July. Hong Kong markets performed slightly better posting 1.59% gain. South Korean market gained 6.3% as Korean exports reached US\$ 51.4 billion, a record high, implying 27.3% year-on-year growth. The Taiwan market rebounded from its three month low and was up 2.25% as the country's second quarter GDP growth came in at 4.9% year-on-year, higher than the Bloomberg consensus estimate of 4.5%. Indonesian market was up an impressive 8.71% as the Bank Indonesia kept the benchmark rate unchanged at 6.75%. June inflation in Indonesia was 5.5%, within Bank Indonesia's target range of 4-6%, coming down from its peak of 7% year-on-year at the beginning of the year. The Thailand market was the best performing in the region as global investors chose to buy the nation's assets to a larger extent after Yingluck Shinawatra's Pheu Thai party won a majority on July 3.

Eastern European Funds	NAV (29.07.2011)			July (%)			2011 (%)		
Swedish registered	SEK	USD	EUR	SEK	USD	EUR	SEK	USD	EUR
East Capital Russian Fund	1440.28	2.6	3.2	2.5	4.0	-3.8	-2.7		
East Capital Baltic Fund	48.59	0.4	1.0	0.3	2.6	-5.1	-3.9		
East Capital Eastern European Fund	41.10	-0.7	-0.1	-0.8	1.3	-6.3	-5.2		
East Capital Balkan Fund	12.53	-5.3	-4.7	-5.4	-2.7	-10.0	-8.9		
East Capital Turkish Fund	8.56	-5.6	-5.1	-5.7	-11.1	-17.8	-16.8		
Luxembourg registered	USD	EUR	USD	EUR	USD	EUR	USD	EUR	
East Capital (Lux) Convergence EE Fund, Class A	64.58	58.51	-5.3	-4.8	-4.0	-11.2			
East Capital (Lux) Russian Fund, Class A	102.72	93.27	2.6	3.2	3.5	-4.3			
East Capital (Lux) Eastern European Fund, Class A	76.54	77.34	-0.8	-0.2	0.9	-6.8			
China Funds	NAV (29.07.2011)			July (%)			2011 (%)		
	EUR			EUR			EUR		
East Capital China East Asia Fund, Class C	206.48			1.0			-8.0		
East Capital China Fund, Class C	122.89			0.0			-9.5		

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