



Airbus A330
Turkish Airlines

Air travel in Turkey reflects the strong economic growth

At East Capital we are diligent travelers around Eastern Europe and Asia, and we use a large number of different airlines. Some do not leave an entirely positive impression, for example, various domestic flights in Russia on more or less known airlines. In contrast to these airlines, Aeroflot has developed very positively with a modern fleet of aircraft and

a good timetable, therefore we find ourselves only on exception flying other airlines (SAS included) to and from Moscow.

SAS has few direct flights to the East

It is interesting to see different airlines' strategies. As a Stockholm local I am astonished that SAS today, fourteen years after the start of East Capital, only flies directly from Stockholm to two destinations within the East Capital Investment Universe, which is what we call our investment area. These two destinations are

Moscow and St. Petersburg. Well, we should probably add that during the summer there are a few weekly flights to some destinations such as the Croatian cities Dubrovnik, Zagreb and Split as well as Budapest and Istanbul. Nonetheless, this does not assist business travelers, but merely Swedish summer tourists...

Turkish Airlines growing strongly

One airline, on the other hand, that has captured the robust growth in our investment region is Turkish Airlines. With its home base in Istanbul it is perfectly positioned halfway between Europe and Asia, and the number of passengers is increasing consistently. The airline's figures are impressive and the table below depicting the number of passengers makes for notable reading.

Turkish Airlines has, similar to Aeroflot, a young fleet of aircraft with an average age of 6.5 years, which is a huge advantage in terms of fuel consumption. If you also take into account the lower wages, the competition looks tough for more established airlines from Western Europe. The stock has also performed well in recent years and it is an established part of our Turkey Fund.

Competing with flight experience

The company's strongest competitive advantage, however, is the flight experience itself. Flight attendants are professional and friendly, and not least, you are served very good food and beverages on the flight (even in economy class).

The airline has worked extensively on meals and prioritizes more rather than less in this area, which really shows. The catering is handled by a company named Do&Co, which completed its IPO during the autumn of 2010. East Capital subscribed to a large part of the offering and remains a 3.6 percent shareholder. Do&Co is owned for the most part by the entrepreneur and enthusiast Attila Dogudan, who founded the company in 1981. It also manages the catering for Austrian Air and moreover has the high profile assignment

Turkish Airlines	2006	2007	2008	2009	2010	CAGR
Number of passengers (000)	16 947	19 636	22 597	25 102	29 119	
Annual growth	20%	16%	15%	11%	16%	16%

Left
Turkish Airlines shows an increased number of passengers and an impressive growth

of managing all of the catering worldwide for the Formula 1 competitions and ATP events. A very interesting combination!

With the aim of developing Istanbul into a strong transfer airport, Turkish Airlines also has very good assistance from the airport operator TAV, who manage a number of Turkey's airports. Currently the company is managing airports in other countries as well, both of Georgia's international airports, Tbilisi and Batumi for example.

Good outcome in Turkey's election

Turkey recently held elections and as expected the ruling AKP party won. AKP had hoped to gain a sole majority in order to be able to enforce a number of changes in the country's laws. Since it did not gain a majority, negotiations with the opposition party must take place. This may be deemed the best outcome in Turkey at the moment, since other parties than AKP will be able to influence these important changes.

Otherwise, Turkey continues to show strong growth and GDP figures for the first quarter reached a whopping 11% indicating an enormously strong underlying economy. This type of growth is in the same class as China! The figures are actually a little too good since the infrastructure currently in place is not capable of handling this growth, without there being a risk of the economy overheating. This has in turn led to a weaker stock market development in Turkey, and we expect 2011 to be a mediocre year for this market.

Peter Elam Håkansson
*Written on flight TK 2553
(Turkish Airlines) between
Dalaman and Istanbul*



Istanbul
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Forget talk of hard landing in China - growth easing as planned

Forget the talk about a hard landing in China. As we have pointed out in previous monthly letters, Chinese policy makers have taken timely and decisive tightening measures to achieve the results we now see. GDP growth is coming down from hyper-fast to just fast, running at slightly above a 9% growth rate for the first half of the year. Inflation will slow in the coming months says a confident Premier Wen, house price increases are moderating, and China's Purchasing Managers Index slowed yet again. This means that we will see the leaders in Beijing apply a less tight economic policy going forward, and this is good news for investors.

Outlook improve for China stocks

With less acute concerns about the mess in Greece, improving US economic data and first-half financial reports for Chinese companies just around the corner, the outlook for Chinese equities has improved significantly in the past two weeks. Judging from a number of monthly indicators and data points, the first-half financial reports should also be strong in many sectors. As an example, profits among Chinese industrial companies increased by 28% during the first five months of this year compared to the same period last year.

China announced new measures to promote domestic consumption, this time by slashing income taxation. The threshold for paying personal income tax will be raised from 2,000 RMB to 3,500 RMB per month. China's average monthly salary is 3,110 RMB, and after this

reform the portion of workers who need to pay personal income tax will fall from 28% to only 8%. This reform means 175 billion RMB less in tax revenues for the government but this is not a big issue, as the fiscal deficit runs at less than 2% of GDP. The tax revenue to GDP ratio in China was only 18% last year, so there is plenty of room to raise taxes should it be necessary to balance the budget. Compare that with Western nations currently struggling with deep deficits, despite tax to GDP ratios of 40% and higher.

Benefits from high-speed rail

On 30 June, China inaugurated its new high-speed rail line from Beijing to Shanghai. The 1,100 kilometre and USD 33bn project was completed one year ahead of schedule. China's unprecedented investments in a high-speed rail network have been met with scepticism by some foreign observers, but China points to the long-term benefits for the country's environment, employment and exports. An efficient high-speed rail network in China will also reduce the country's need for jet fuel and thus reliance on foreign oil.

On 1 July, China's Communist Party celebrated its 90th anniversary with the message that only it could have led the nation to become the world's second-largest economy. The celebrations include a new history book on the Party's achievements while in power, as well as numerous exhibitions and TV programs.

Thai election positive for equities

In Southeast Asia, the most significant recent event was the outcome of the national elections in Thailand. The ruling Democrat Party was defeated by the For Thai Party (PT), which is headed by Yingluck Shinawatra, the sister of exiled former leader Thaksin Shinawatra. The distrust and rivalry between Thailand's political groups remain intense and political unrest is frequent. In the near-term however, the election outcome should be positive for Thailand's equity market, as the PT-led new government is expected to pursue pro-growth

policies. PT has promised to cut the corporate income tax rate from the current 30% to 23% or lower, and to accelerate the nation's infrastructure build-out.

Gustav Rhenman
Portfolio Manager



Market comments

Eastern Europe

June was another turbulent month as the worries about Eurozone debt continued. The negative sentiment and the flight to (perceived) safety continued to have a negative impact on emerging market equities. The sentiment did, however, change towards the end of the month following progress on the rescues package for Greece. Most markets in Eastern Europe did end the month in negative territory, even though most markets started to show positive performance during the last week of the month. The Latvian market outperformed by gaining 7.6%. Neighbouring Lithuania also closed in black with a 0.3% gain. Russia was the only other market in positive territory with a 1% gain after a strong closing week. The Romanian and Turkish markets ended the month with small gains in local currency terms but as the currencies depreciated to the USD, they ended with 1.1% and 1.3% drops. Frontier Serbia and Ukraine dropped 12.4% and 7.8% respectively, while all other markets dropped a few percent.

East Asia

The mainland Chinese markets ended up 2.5% in June, posting a recovery from previous months of negative sentiment. In contrast, the Hong Kong market lost 4.8%. The negative market return in Hong Kong was triggered by fears of a Greek default, coupled with signs of slowing growth in the Chinese manufacturing sector. South Korea fell 2.0% in June following a rate hike in the beginning of the month. Taiwan was down 4.0% and reached a three-month low due to the exposure of Taiwan's stock market to European and US economies.

Indonesia gained 1.7% in June on the back of an expanding economy. The PMI index later published by ISM confirmed a higher-than-expected June reading of 55.3%, an increase of 1.8 percentage points compared with May. The Thai market fell 4.2%, possibly reflecting political uncertainty in the run up of the general election, and partly reflecting a further depreciation of the Thai Baht. The Philippines rose 1.0% with the major events being interest rates kept on hold despite mounting inflationary pressure. The country's sovereign debt rating was also raised to Ba2 by Moody's. Malaysia rose 1.4%. The Singapore market decreased 0.3%.

Industrial production figures have come down, which points to a likely slowdown in the yearly GDP figures for the second quarter of this year.

Eastern European Funds	NAV (30.06.2011)			June (%)			2011 (%)	
	SEK	USD	EUR	SEK	USD	EUR	SEK	EUR
Swedish registered								
East Capital Russian Fund	1405.45	-1.4	-1.8	1.1	1.4	-6.8	-5.0	
East Capital Baltic Fund	48.44	-3.1	-3.5	-0.6	2.2	-6.0	-4.2	
East Capital Eastern European Fund	41.42	-1.8	-2.1	0.7	1.9	-6.3	-4.5	
East Capital Balkan Fund	13.24	-4.7	-5.1	-2.3	2.7	-5.6	-3.8	
East Capital Turkish Fund	9.08	-1.7	-2.1	0.8	-5.8	-13.4	-11.8	
Luxembourg registered	USD	EUR	USD	EUR	USD	EUR		
East Capital (Lux) Convergence EE Fund, Class A	68.21	61.45	-2.6	-3.0		1.4	-6.8	
East Capital (Lux) Russian Fund, Class A	100.14	90.42	-1.6	-2.0		0.9	-7.2	
East Capital (Lux) Eastern European Fund, Class A	77.13	77.50	-1.9	-2.3		1.7	-6.6	
China Funds	NAV (30.06.2011)			June (%)		2011 (%)		
	EUR			EUR		EUR		
East Capital China East Asia Fund, Class C	204.45			-3.1			-8.9	
East Capital China Fund, Class C	122.95			-3.1			-9.5	

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