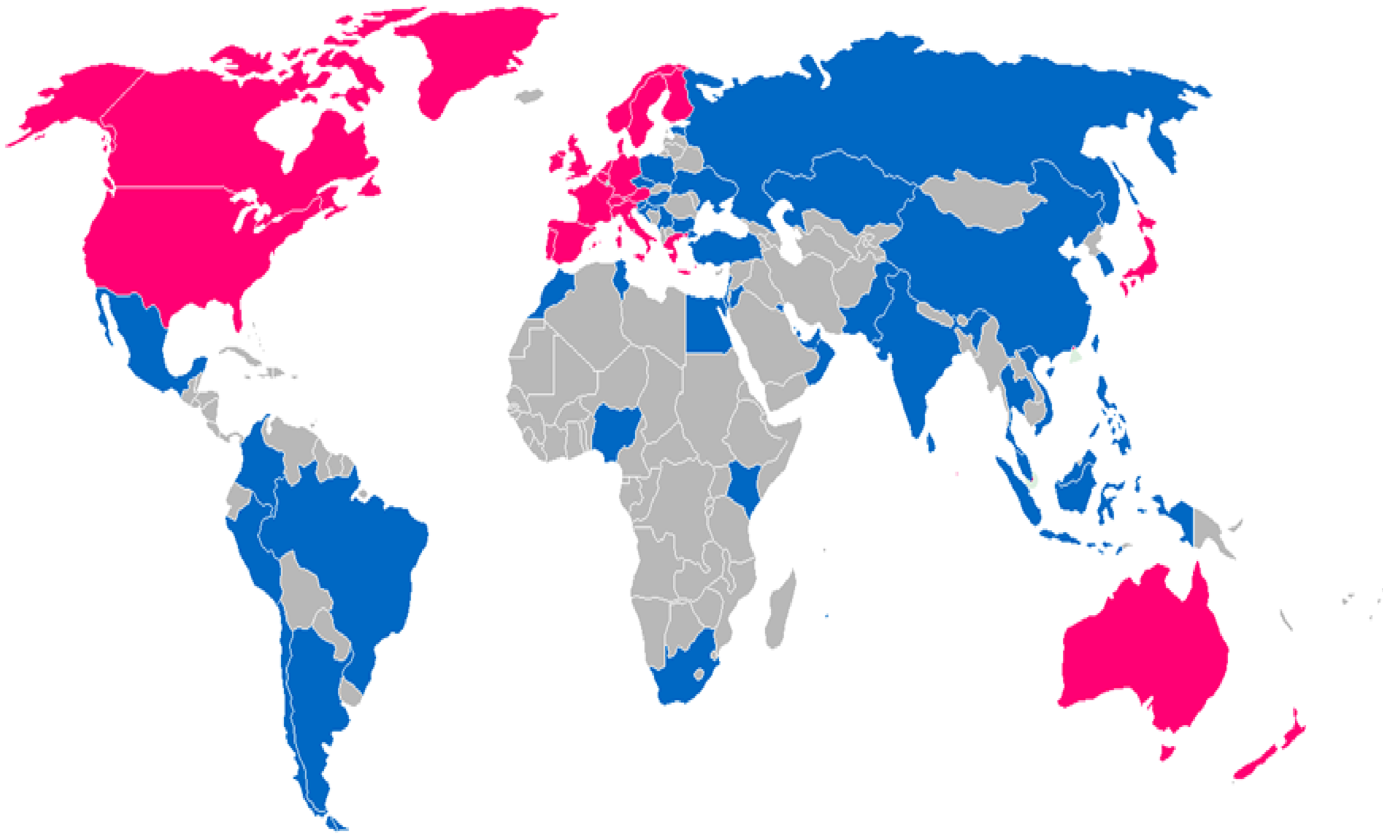
futurefund

Future Fund and Emerging Markets



Latin America Infrastructure Forum

Let's start with what EM we currently own?
We break this down into asset class and geography.

EM - LatAm

- Chart 1 shows EM exposures we can classify. As at 30 April 2017 the majority of our EM exposure is in Listed Equities, with Debt and Private Equity rounding out the top 3. EM infrastructure is currently a small exposure (less than 1% of our EM exposure).
- Chart 2 displays the EM exposure in Chart 1 via country. China makes up 30%, with our top 4 EM countries (China, Taiwan, India and Brazil) make up greater than 60%.
- For LatAm we estimate to have over $2.8bn of exposure, with Brazil and Mexico being around $2.5bn.

Chart 1 – EM by asset class: 30 April 2017

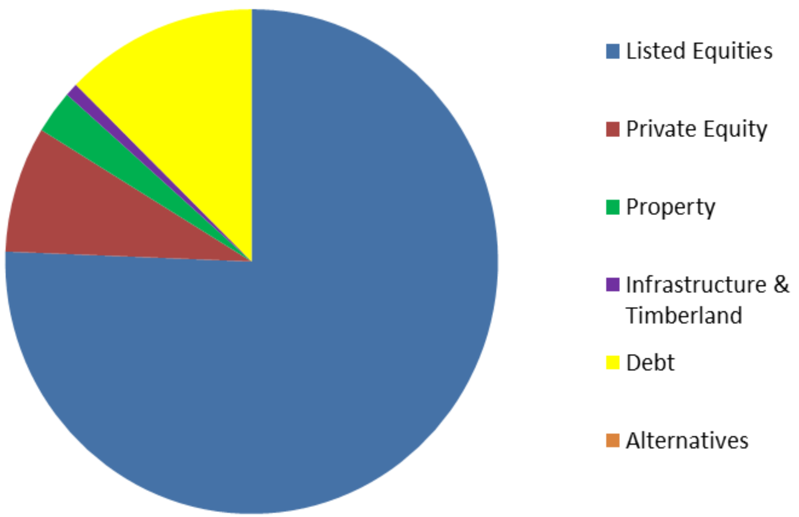
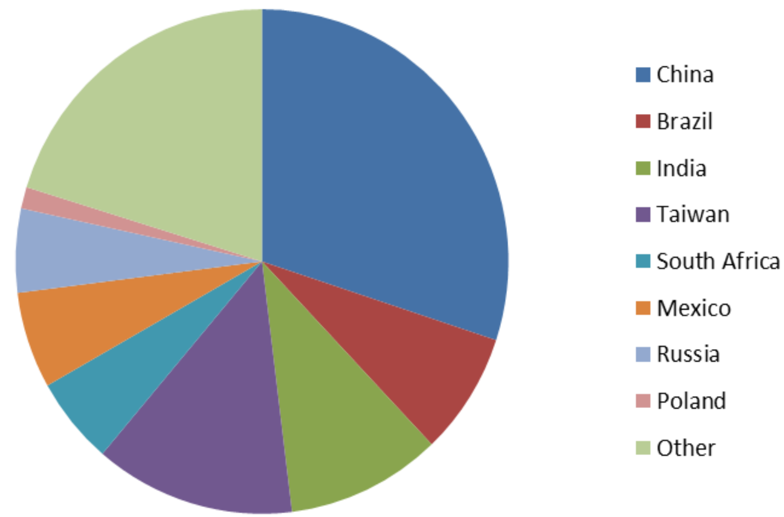


Chart 2 – EM by geography: 30 April 2017



When considering investments in EM, a range of risk variables have been identified that can affect the value of the asset and associated returns.

EM - LatAm

- When investing, understanding the risk-return trade-off is key.
- This is particularly important for long duration assets.
  - Complexity increases when assessing assets in EM, due to general unfamiliarity.
- An EM risk-return framework has been trialled to create a higher quality conversation about the risk-return trade-off.
- This assesses the specific opportunity against 11 risk variables. They are:
  - Vulnerabilities;
  - **Sovereign Environment**;
  - Barriers to Entry;
  - Growth;
  - Economic and Regulatory cycles;
  - Operational Risk;
  - Leverage;
  - Governance;
  - Purchase price and terms;
  - Liquidity/Illiquidity; and
  - Inflation
- Each variable is assessed against the asset's or the transaction's characteristics to determine whether a premium is required against each particular risk variable.
- This approach avoids the need to impose a separate generic "sovereign risk premium" for EM.

I consider "Sovereign Environment" the most critical risk variable.
To better understand this risk variable we dissect it into core components.

EM - LatAm

- The "Sovereign Environment" captures specific regulations that impact the functioning of the asset, as well as the sovereign framework that assets operate within (e.g., rule of law, corruption, political stability) and broader policy risk (e.g., are existing regulations stable?).
    - This is a critical risk variable to analyse as it is mostly out of control of the investor.
- To better understand "Sovereign Environment", we review institutional metrics that focus on core components.
    - Rule of Law.
    - Corruption.
    - Political Stability.
    - Regulatory Quality.
    - Government Effectiveness
    - Taxation.
- I will now do a quick review of "Sovereign Environment" for LatAm.

We use the World Bank's WGI as a metric that helps us better understand "Sovereign Environment". First in aggregate…

- The WGI in aggregate (Charts 3 and 4) highlights:
  - The **level** of aggregate governance surrounding LatAm is lower when compared to DM.
  - In aggregate, some of LatAm has regressed over the past 6 and 19 years on governance arrangements (below the 45 degree sloped blue line). Over more recent years, Brazil and Mexico are the two that have displayed a negative **rate of change.**

Chart 3 – WGI: 2015 vs 1996

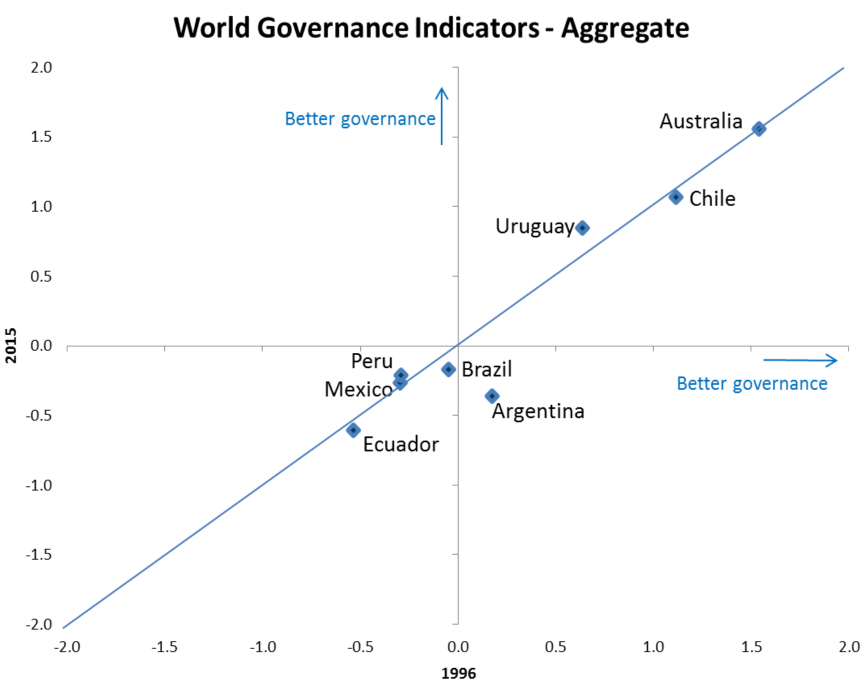
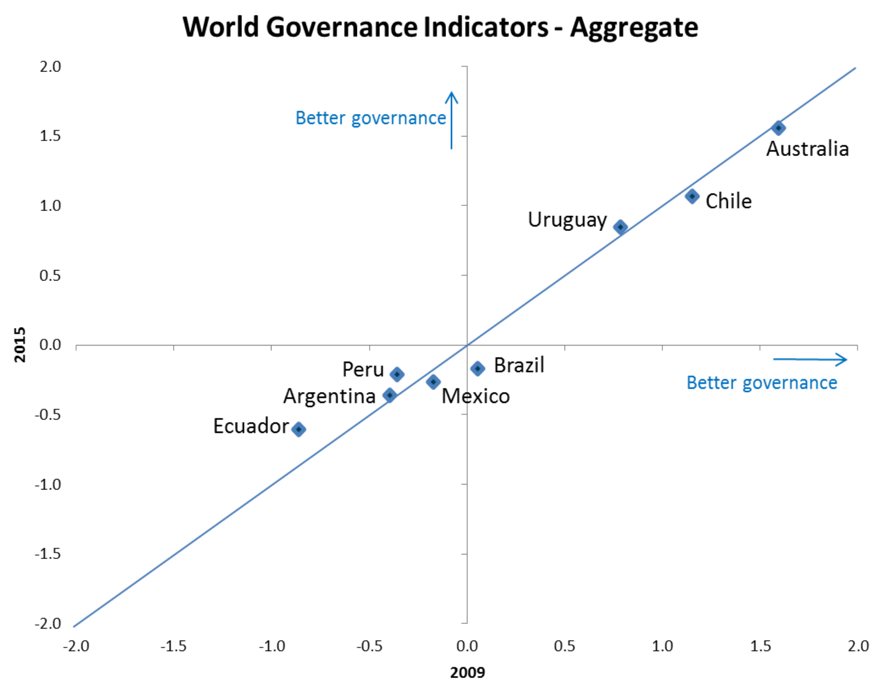


Chart 4 – WGI: 2015 vs 2009



…then on specific components.
For this presentation we will quickly look at two components: Rule of Law and Political Stability.

EM - LatAm

- Rule of Law captures the quality of contract enforcement, property rights, the court system and policing (Chart 5).
- Political Stability measures perceptions of the likelihood of political instability and/or politically motivated violence including terrorism (Chart 6).

Chart 5 – Rule of Law: 2015 vs 1996

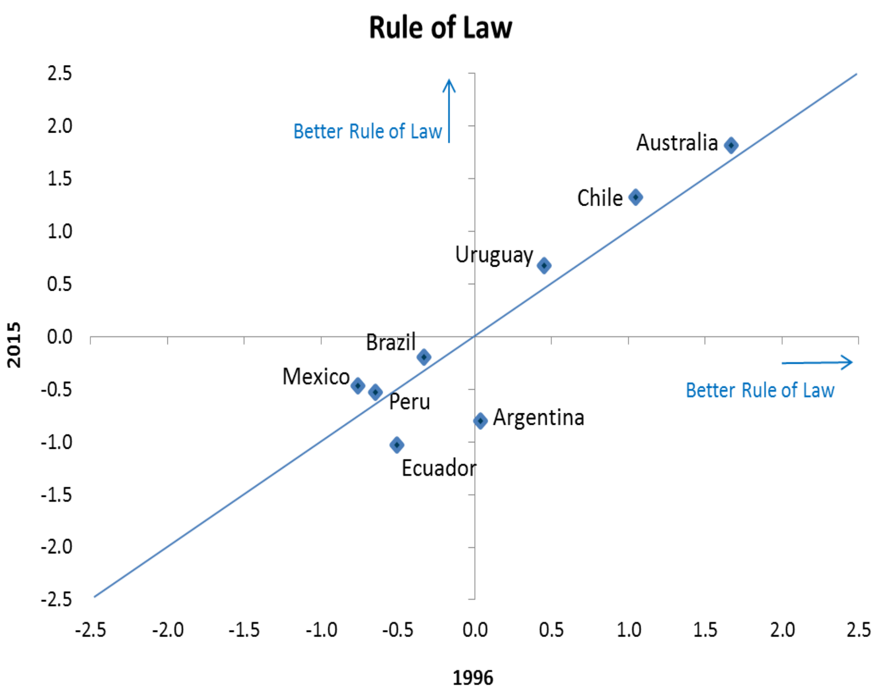
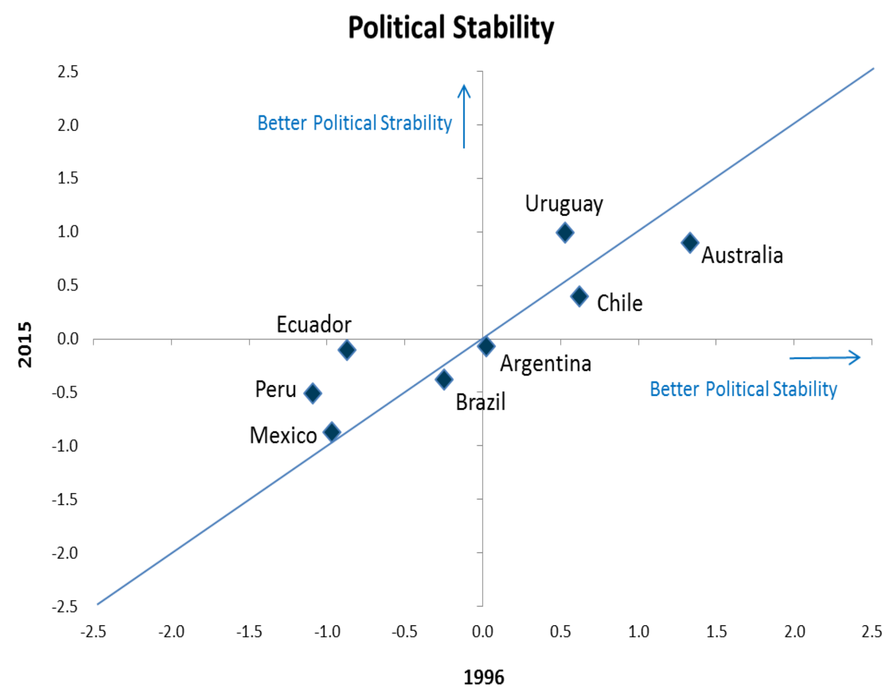


Chart 6 – Political Stability: 2015 vs 1996



In conclusion, when reviewing LatAm against "Sovereign Environment", we believe seeking a risk premium is appropriate.

EM - LatAm

- Reviewing the aggregate results across institutional metrics we make some general observations:
  - LatAm institutions, governance, and regulatory standards lag DM standards.
  - Some large LatAm nations have not improved their sovereign environment over recent, or many, years.
  - The re-rating of LatAm has to a large degree played out in macro-economic/balance sheet strength; it is yet to materialise in notable improvements in institutional strength/governance standards.
  - There are exceptions; Uruguay and Chile being the obvious two.
- We conclude that when investing in long duration LatAm assets we either seek a risk premium to compensate us for this additional risk or look to address this risk through the transaction documentation.
- We remain interested in LatAm infrastructure assets, provided we can get comfortable with the risk-return trade off. To date, this has proved elusive for us.
- Note these metrics are backward looking and have lags attached - they are helpful in telling the story so far but are far from perfect indicators of what is to come. Plans for institutional and sovereign governance reform is a key factor to watch for.