The Investcorp Newsletter

INVESTCORP

THE REVIEW

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Welcome

Investcorp has begun its new fiscal year the same way we ended 2015, with us remaining focused on executing deals where we see significant value creation potential for our investors and shareholders. While Investcorp is going through a period of transition in order to better position the Firm for the future, some things will never change. Investcorp has its foundations in the complete alignment of our interests with that of our shareholders and investors, a commitment to always delivering the very highest possible level of client service via a high-touch model and always attracting and retaining star talent.

Over the course of our fiscal year 2015, we deployed $1 billion in Corporate Investment and Real Estate deals across all our key markets in the Middle East and North Africa, Europe and the United States. Meanwhile, the Firm generating $1.5 billion in total proceeds from successful realizations in 2015 demonstrated our ability to maximize value through exits and complemented our buy-side activity. Taking a step back and looking at the six-year period to FY15, total realization proceeds totalled $7.5 billion with total capital deployed in new and add-on investments over this period hitting $4.3 billion.

When you consider the global economic backdrop we have been operating in over the past few years, Investcorp's ability to deliver consistently strong returns is a testament to our commitment to our investors and shareholders.

Since the start of FY16, we have acquired a portfolio of eight residential properties in the metropolitan areas of Las Vegas, Denver, Chicago, Atlanta and Dallas for approximately $400 million. All eight properties are well-occupied rental properties situated in major and growing U.S. markets, offering solid rent growth potential. On the Corporate Investment side, we have added POC, a revolutionary manufacturer of skiing and cycling helmets, gear and accessories, to our portfolio. POC is a deal I am particularly excited about and one that continues our long history of involvement with consumer sporting businesses, which started with Riva Boats in 1984, followed by Helly Hansen, Dainese, AGV and now POC.

While we have no plans to slow down and are actively monitoring a number of situations across a range our markets, we will always analyse every detail of a deal in order to ensure maximum value creation.

Away from investment activity, we have further strengthened the backbone of Investcorp by moving one step closer to opening our office in Doha, having received approval from the regulator. This builds on our existing presence in Bahrain, Riyadh and Abu Dhabi, and allows us to provide an even better service to our investors and shareholders in Qatar.

These are exciting times for Investcorp and while we are sure to see some changes, the Firm's unwavering commitment and dedication to its clients will forever remain.

Mohammed Al-Shroogi
Co-Chief Executive Officer

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The way forward

As I began to write this letter, it dawned upon me just how fast my first few months as Executive Chairman of Investcorp have passed and I can honestly say that I have thoroughly enjoyed every moment.

Without the foresight of Nemir Kirdar more than three decades ago to create a Firm that would bridge the Gulf and the West, Investcorp would not be where it is today. It is with the deepest respect that I thank Nemir for leading this company since 1982, and we owe a great deal to his years of dedicated service to the Firm.

Investcorp is an institution that has ambitions. It wants to grow and add more services on offer for its investors. All without losing its focus on client service.

We have set ambitious goals for the Firm and have developed a clear strategy to help us achieve them:

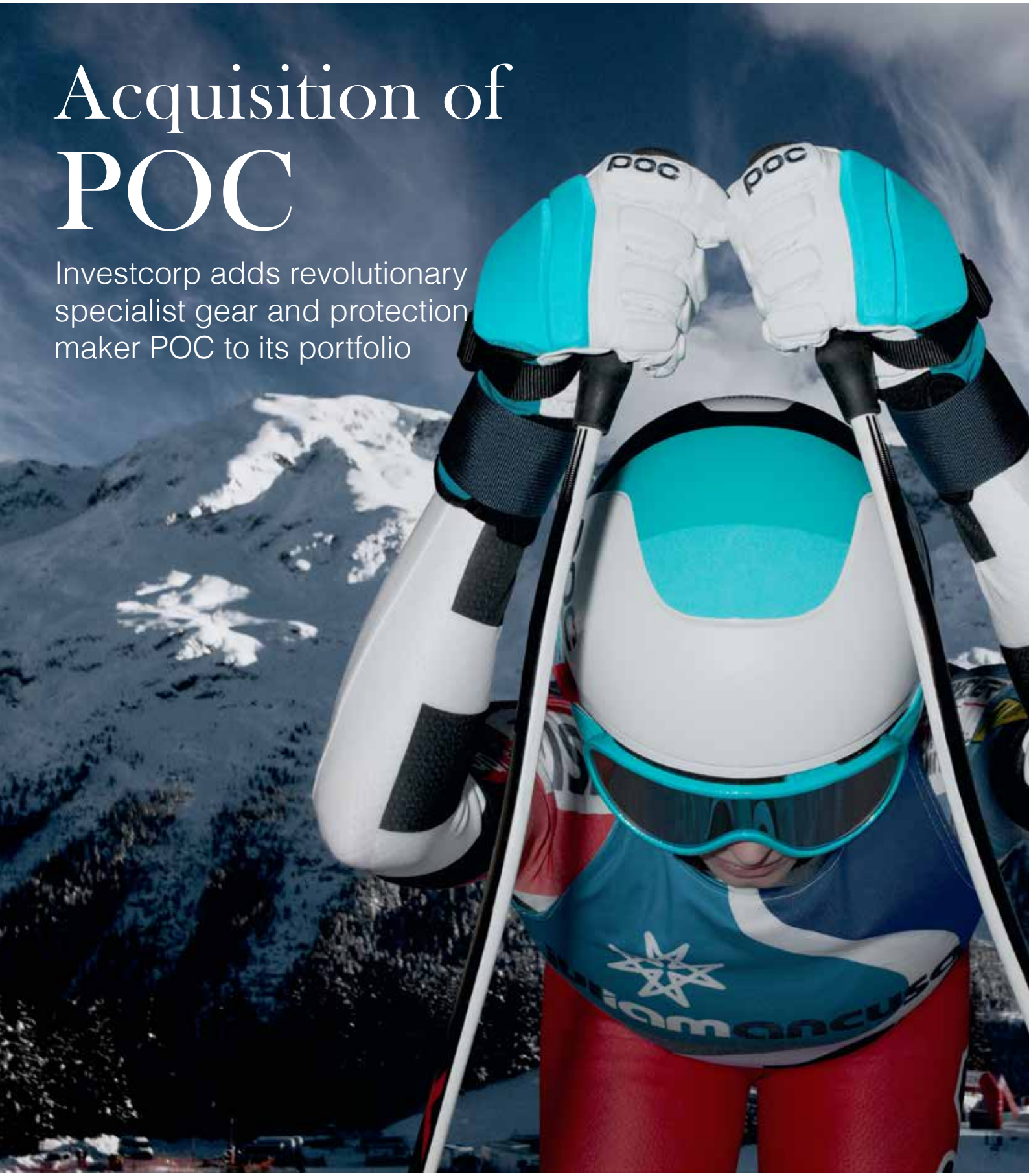
- We want to grow our Assets under Management by more than 100% over the medium term, helping our clients to grow their wealth in a disciplined way whilst effectively managing their risk.
- To always maintain and build very close relationships with our investors and shareholders. We will always provide them with the very highest possible level of service.
- To keep on carrying out the most thorough due diligence and delivering the best possible return on investment for our investors and shareholders.
- We will continue to invest in our people and attract international star talent, growing our headcount capability across our business lines around the world.
- We will seek to leverage and maximise the huge depth of skills, relationships, resources and market knowledge that already exist around the Firm and that give us edge over our competitors to reinforce our role as the region's bridge between the Gulf and exciting investment opportunities in international markets.
- We will strive to innovate our product set to enable our investors to access alternative investment opportunities allowing them to create diversified portfolios across multiple markets delivering attractive returns.

I am truly excited about the road ahead for Investcorp. We have a strong platform, an incredibly talented team and a clear vision - but there is no question about the level of hard work required. I can assure you, my commitment to this Firm is unwavering and I am confident we can achieve our goals.

Mohammed Al Ardhi
Executive Chairman

Acquisition of POC

Investcorp adds revolutionary specialist gear and protection maker POC to its portfolio



On 8 October 2015, POC, a revolutionary manufacturer of skiing and cycling helmets, gear and accessories, was added to the Investcorp portfolio. POC was acquired for a total consideration of $65 million from outdoor equipment maker Black Diamond, Inc.

Investcorp has continued its long history of involvement with consumer sporting businesses in Europe, both apparel and gear, with Riva Boats, its first European investment in 1984, followed by Helly Hansen, Dainese, AGV and most recently, POC.

Established in 2004 and headquartered in Sweden, POC's quest is to provide athletes and consumers with the highest standard of personal protection. POC's line of products includes helmets, body armour, goggles, eyewear, gloves and other gear, which are currently sold across 27 countries worldwide. Through technical collaboration with partners such as Volvo and Ericsson, POC is pioneering innovative safety concepts.

The company also collaborates with leading sportsmen and women as it strives to be at the forefront of technical advancements including the American World Cup alpine ski-racer and Olympic gold medallist, Julia Mancuso, who collaborated with POC to develop a signature collection. Collaborations with leading road bike teams, such as Team Cannondale-Garmin and Team Stolting, ensure POC is at the vanguard of developing products famed for safety, comfort and aerodynamics for the rapidly growing road bike market.

This acquisition came almost a year after Investcorp acquired the specialist gear and protection maker Dainese, the most recognized and respected brand for safety and quality in motorcycle and other dynamic sports markets. There are synergies between the two businesses that will be explored in the future.

Mohammed Al-Shroogi, Investcorp's Co-CEO, said: "POC is one of the fastest growing, dynamic and innovative companies in the sports gear and protection sectors. Its cross generational reach, intrinsic focus on technical innovation and commitment to safety, make it the perfect fit for our portfolio. Leveraging our sector expertise, experience of working with high quality brands and industry connections, we believe Investcorp is well placed to further support POC's already impressive growth trajectory."

Stefan Ytterborn, POC's founder, said, "We are delighted to be partnering with Investcorp in the next stage of our development. I am confident that with their support we will continue to grow sales, increase penetration into new markets and drive forward innovation, while not deviating from our ultimate mission of doing the best we can to possibly save lives and reduce consequences of accidents for gravity sports athletes and cyclists."

poc

NDT Corrosion
Control Services joins Investcorp's Saudi portfolio

Saudi Arabia's largest industrial testing services company

In July, Investcorp completed the acquisition of a majority stake in NDT Corrosion Control Services Co, the largest testing services company for the industrial sector in Saudi Arabia. Investcorp acquired the stake in NDT CCS from the Al Shuwayer Group, which founded the company in 1975 and retains a minority stake alongside Investcorp.

NDT CCS, which also has operations in the UAE and licences to operate in Kuwait and Qatar, provides non-destructive testing ("NDT") services for a range of industrial sectors including oil and gas, petrochemicals, mining, nuclear and utilities. NDT involves the evaluation and testing of pipes, valves, oil platforms and other key industrial components and identifying faults, cracks or defects without causing damage. NDT CCS provides a broad range of NDT services to a large blue chip customer base, which

Investcorp's fifth acquisition in Saudi Arabia and the second in the Testing Inspection and Certification sector

includes Saudi ARAMCO, SABIC, Ma'aden, Saipem and Hyundai Heavy Industries.

Mohammed Al-Shroogi, Investcorp's Co-CEO, said: "NDT CCS has firmly established itself as Saudi Arabia's market leader in the NDT industry. We believe that the company is well-positioned to solidify its leading position and gain a greater market share in a sizable, growing and fragmented industry. Investcorp will support the company to grow its existing business in the UAE as well as expand into Kuwait and Qatar. Investcorp will seek to leverage its previously successful experience with Moody International, a global provider of inspection services and international certifications. Investcorp acquired Moody International in 2007 and successfully sold it in 2011. As is the case with other corporate investments across the Gulf, Investcorp is the first institutional owner of NDT CCS and we believe we are well positioned to unlock the company's potential, optimize its operations and drive its next phase of growth."

James Tanner, Head of Corporate Investment – MENA and Managing Director at Investcorp, commented: "NDT CCS benefits from having the largest number of skilled technicians together with a broad service offering. The company has been successful in securing a healthy mix of projects and maintenance contracts, which we believe positions it favourably to help achieve sustainable and profitable long-term growth. We are excited about partnering with the Al Shuwayer Group and capitalizing on the strong demand fundamentals that are supported by an aging infrastructure base and high safety requirements by asset owners."

Mishal S. Al-Ardi, CEO of Al Shuwayer Group and shareholder, said: "Investcorp is the ideal partner to help support the growth of NDT CCS. It has an extensive track-record of successfully investing in the GCC and has specific industry experience through its investment in Moody International. I am looking forward to working closely with our new partners to bring NDT CCS to new markets as well as broaden our service offerings."

ndt CCS NDT CCS
NDT Corrosion Control Services Co.

Georg Jensen
continues to extend its reach

Over the past few months, Georg Jensen has continued its expansion in key markets around the world. In October, the Danish design and luxury brand held a private pre-opening event for its new flagship outlet in London's Mount Street, ahead of the official VIP opening that is taking place later this month. The opening of the flagship store in Mount Street comes as Georg Jensen decided to relocate its flagship store from Bond Street, its home for 80 years.

In September, Georg Jensen opened its much-anticipated House of Georg Jensen in the heart of Beijing, China. The House includes a Georg Jensen museum, a retail outlet, lounge, a restaurant and a hall for dinners, art events and exhibitions. During the event, Georg Jensen introduced the latest holloware set designed by world-renowned Apple iPhone and Apple Watch designer Marc Neusson.

In May, Georg Jensen's CEO David Chu was honored to welcome Frederik, Crown Prince of Denmark, and Mary, Crown Princess of Denmark, to the opening of Georg Jensen's first flagship Store in Munich.

GEORG JENSEN

Corporate Investments

Fitness Time partners with FC Barcelona

Fitness Time has become the official partner of FC Barcelona in the Kingdom of Saudi Arabia and the UAE. It has the exclusive rights to launch the Kids Football Academy and Barcelona Football School, FCB Escola, in both countries, under the supervision of Spanish trainers accredited by FC Barcelona. The agreement also allows for a yearly delegation of children to visit Barcelona and train in its facilities.

A signing ceremony was held at the Rafal Kempinski Hotel in Riyadh. Javier Faus, Vice President of FC Barcelona, and Laurent Colette, Chief Marketing and Commercial Officer of FC Barcelona, represented the football club. Fitness Time's Chairman of the Board and Managing Director Abdul Mohsen Al Haqbani and Chief Operations Officer Fahad Al Haqbani attended on behalf of Fitness Time.

The signing of this partnership comes as Fitness Times opened its first gym in Dubai at Al Mamzar. The state-of-the-art facility, spreading across 4,828 square meters, encompasses the latest fitness equipment, classes and amenities.

Investcorp and BDI held the third GCC Board Directors Institute Chairman Summit

Investcorp and the GCC Board Directors Institute ('BDI') held the third Chairman Summit in Riyadh on 14 September 2015. Featuring three panel discussions, the Summit hosted over 60 Chairpersons and CEOs of regional leading organisations.

In his opening remarks, Mohammed Al Shroogi, Co-CEO of Investcorp and Chairman of BDI, emphasised the importance of instilling world-class standards of corporate governance and board effectiveness in the GCC in order to make a strong impact on economies and societies in the region.

Mr. Al Shroogi talked about the growing role BDI has been playing in promoting professional directorship and effective boards across the region. He explained that, "these two areas are key components of good corporate governance, which, once achieved, translates into strong market confidence and better access to capital, both domestic and foreign, allowing companies to invest and create jobs, and in turn stimulate the growth of the wider economy."

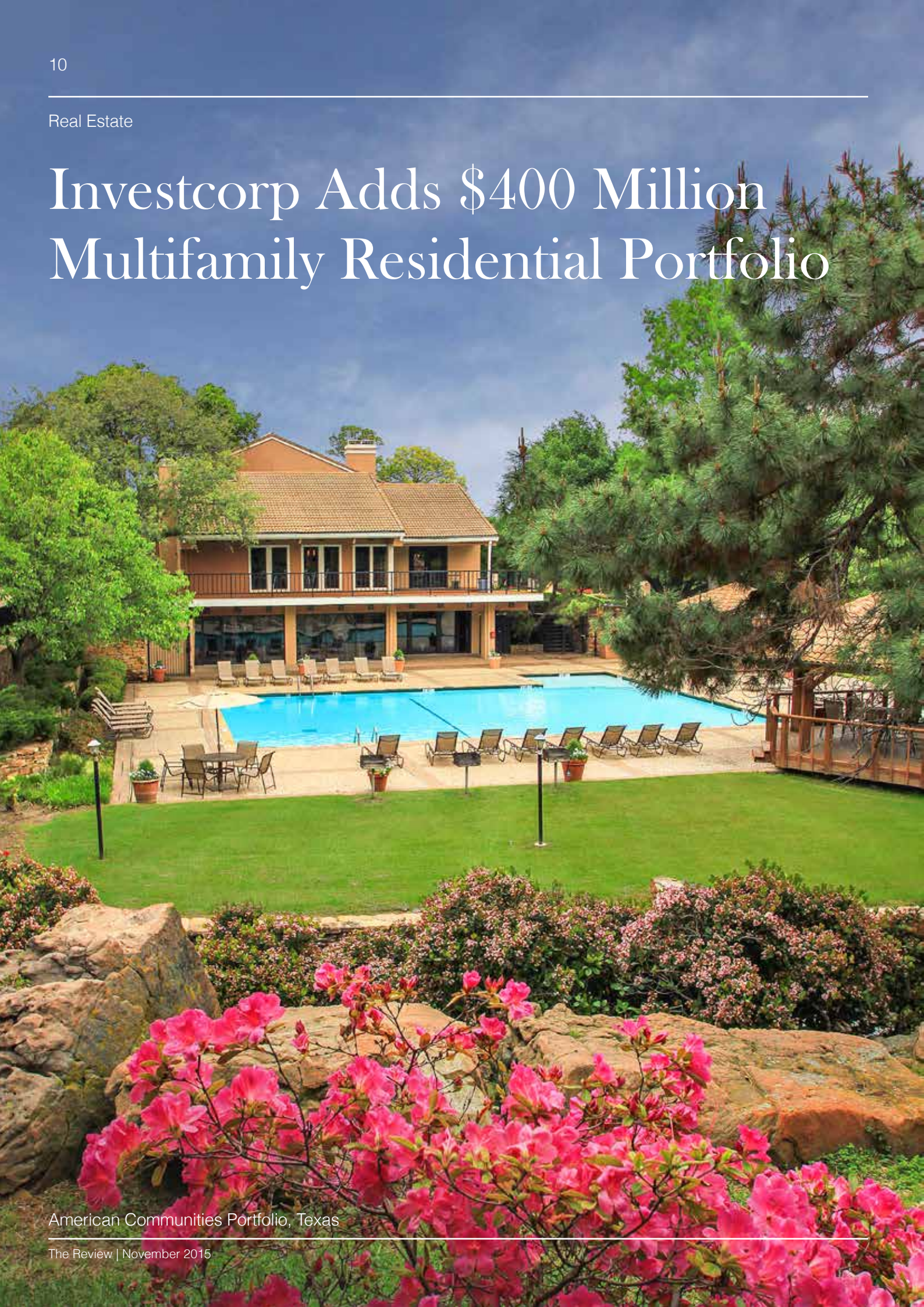
On Investcorp's involvement in BDI, he commented that, "BDI's vision and role in the GCC aligns very closely with what we aim to do at Investcorp, as both a listed company and an investor in growing economies across the region and around the world. Our objective revolves around maximising value creation, and ensuring a strong board of directors is in place is an important part of this process."

The Summit focused on three topics; (1) the importance of public trust to a company's success, (2) the chairman's role in enhancing board effectiveness and (3) the board's role in leading companies through change. In his welcoming speech, Mr. Al Shroogi talked about the significance of these three issues in the context of the current regional and international economic conditions and the challenges companies face as they seek investment and avenues for growth.

He continued to say that, "In light of the uncertainty we are currently seeing in the markets, regionally and internationally, being a chairman is increasingly requiring a lot of commitment and hard work, in addition to both formal and informal engagement with management. Most importantly, the chairman's role should complement the board's part in leading companies through change and providing guidance in the development and execution of a strategic plan."

Mohammed Al Shroogi: "Professional directorship and effective Boards are significant components of good corporate governance"

Investcorp Adds $400 Million Multifamily Residential Portfolio



American Communities Portfolio, Texas

Investcorp announced the acquisition of a portfolio of eight residential properties in the metropolitan areas of Las Vegas, Denver, Chicago, Atlanta and Dallas for approximately $400 million in October. The transactions took the Firm's total real estate acquisitions past $1 billion over the last 12 months, in the continuation of a highly active period of investment for the company's real estate group.

The properties were acquired through joint ventures with several local and regional operating partners. They total more than 3.2 million square feet with approximately 3,400 multifamily units. Currently, the average occupancy rate is approximately 96 percent. All eight properties are well-occupied rental properties situated in major and growing U.S. markets, demonstrating solid rent growth potential. Investcorp intends to add value to the portfolio through renovation and capital expenditure, a strategy that the Firm has successfully executed in previous multifamily investments.

"In an environment in which the U.S. homeownership rate has dropped to a 50-year low, these acquisitions affirm our confidence in the attractiveness of investing in high-quality multifamily rental properties in major U.S. markets. We believe this fact, combined with the solid demographic and employment fundamentals in these areas should assist in driving the upside potential of these investments," said Herb Myers, Managing Director, Real Estate Investment at Investcorp.

The acquired properties are:

- **Solis at Flamingo, Las Vegas, Nevada:** This garden style, for-rent multifamily property is located in close proximity to three major employment drivers that have spurred population growth in the area: the Las Vegas Strip, the University of Nevada, Las Vegas, and McCarran International Airport. Additionally, there are various major construction projects underway in the surrounding area, totalling approximately $8 billion.
- **The Reserve at Hoffman Estates, Chicago, Illinois:** This property, located within the upscale Hoffman Estates/Schaumberg suburb, is a desirable community in the Chicago Metro area. This area is known for its numerous retail centres and corporate and industrial companies, representing the largest concentration of business outside of the city of Chicago.
- **Rosemont Vinings Ridge, Atlanta, Georgia:** This for-rent apartment complex is located in the growing Cumberland/Galleria submarket in Atlanta, the business capital of the Southeastern region of the U.S. and a global business hub. The area has benefited from over 250 recent corporate locations and over $2 billion in public and private revitalization projects, including a new baseball stadium for the Atlanta Braves. It is also in close proximity to major retail centres, public parks, quality schools as well as major thoroughfares, providing connectivity throughout Atlanta.
- **American Communities Portfolio, Irving and Plano, Texas:** These garden style multifamily apartment properties are located in Irving and Plano, two dynamic and growing Dallas submarkets. Since 2005, the area has seen significant employment growth of over 20 percent, well above the national average, and enjoys a diversified economy in technology, communications, healthcare and manufacturing.
- **Cherry Creek Club, Denver, Colorado:** A for-rent multifamily property located within Denver's thriving and diverse Glendale/Cherry Creek submarket and in close proximity to Denver's two major office areas, Downtown Denver and Southeast Denver, which are home to several high growth employment sectors such as healthcare, IT and energy.

In addition to strong momentum behind acquisitions, significant realizations have also been made, such as: the sale of multifamily properties in Houston and Dallas, an industrial property in Connecticut, office buildings in Northern California and hotels in Pittsburgh and Boston.

Solis at Flamingo, Las Vegas

The Reserve at Hoffman Estates, Illinois

Rosemont Vinings Ridge, Georgia

Cherry Creek Club, Colorado

New building by Zaha Hadid unveiled at Oxford University's Middle East Centre

The Oxford University building created by Zaha Hadid was unveiled and named the Investcorp Building. St Antony's College commissioned the building to expand and make space for its Middle East Centre. The Investcorp Building spans two Victorian buildings on Woodstock Road in the grounds of the college.

Her Highness Sheikha Moza bint Nasser of Qatar was the keynote speaker for the unveiling of the new building. Sheikha Moza is chair of the Qatar Foundation, an education development and scientific research organisation, as well as the UNESCO Special Envoy for Basic and Higher Education since 2003.

Nemir Kirdar, Chairman of Investcorp, commented, "From the outset, Investcorp's mission has been broader than effecting mere financial transactions. We have also made it our goal to promote higher education and cross-cultural understanding. Oxford's Middle East Centre was established to become a bridge between the West and the Middle East, and Investcorp could not be more proud to do our part to further this worthy cause."

The new building doubles the space available for the Middle East Centre's expanding library and archive, providing almost 1,200 square metres of additional floor space and a new 118-seat lecture theatre. The Middle East Centre holds Oxford University's primary collection on the modern Middle East, an excellent collection of private papers and historic photographs used by scholars and researchers with an interest in the region. The Investcorp Building's lecture theatre will allow the Middle East Centre to expand its popular programme of seminars, lectures and debates - much of which is open to both the University and the public.

Dame Zaha Hadid said, "The work of the Middle East Centre contributes to the global discourse and greater understanding of the region. The new Investcorp Building connects disparate buildings within the college, defining a series of generous spaces for the centre's renowned archive, library and seminar programmes; allowing the Middle East Centre to expand its commitment as a forum of research, understanding and open debate."

Nemir Kirdar appointed Founding Chairman of the Advisory Board of the Middle East Centre at Oxford University

Appointment coincided with the unveiling of the Investcorp Building at Oxford University's Middle East Centre

Nemir Kirdar was appointed as Founding Chairman of the Advisory Board of the Middle East Centre at St Antony's College at Oxford University on 7 June 2015.

The principal remit of the Advisory Board is to enable the Middle East Centre to fulfil its mission to serve as a bridge between the Middle East and the West and to preserve its position as the Western world's pre-eminent centre for the study of the modern Middle East.

Mr. Kirdar said, "I am deeply honoured by the opportunity to serve the Middle East Centre in this capacity and to help advance its mission of fostering dialogue and understanding of the Middle East region. In addition to the financial bridge Investcorp creates for our clients between the Middle East and the West, we have long held the view that providing a conduit for cross-cultural understanding is core to our mission. The Middle East Centre at St Antony's College will provide an educational bridge of this kind, and we are immensely proud to serve this cause."

Mr. Kirdar's appointment coincided with the unveiling and naming of the Investcorp Building at Oxford University's Middle East Centre. The Middle East Centre's bold new headquarters spans two Victorian buildings on Woodstock Road in the grounds of St Antony's College, and was designed by world-renowned architect, Zaha Hadid.

Farewell

A farewell to Mike Merritt

Ramzi AbdelJaber steps up as Chief Administrative Officer

Mike Merritt

Leadership team strengthened with appointment of Timothy Mattar as head of PRM

Last month, one of Investcorp's longest serving professionals, Mike Merritt, retired from his leadership position at the Firm. Mike, who co-founded Investcorp in 1982, has agreed to remain in an advisory capacity going forward. Ramzi AbdelJaber, who has had a long and distinguished career at Investcorp for over 11 years, succeeds Mike as Chief Administrative Officer, subject to Central Bank of Bahrain approval. Ramzi has over two decades of business building, strategy consulting, and senior management experience, with a particular focus on the financial services sector.

Investcorp bids a warm farewell to Mike, whose expertise and dedication to the Firm and its culture are equal to none.

This is not the first time Mike has retired but he tells us it will be the last. Mike returned to Investcorp five years ago after his first retirement in 1996 and has led the corporate review and improvements in Human Resources, Compensation, Corporate Communications, Information Technology and Administration. He has also played an important role in guiding the PRM fundraising strategy, recruitment efforts and office expansion. Mike helped reinforce the original Investcorp culture within the Firm. Investcorp is in Mike's DNA.

We wish Mike, who will always be part of the Investcorp family, the best of luck in his retirement.

In other news, the Investcorp leadership team has been further strengthened by the appointment of Timothy Mattar as head of Placement and Relationship Management (PRM). Timothy has been with Investcorp for 20 years and has held a number of country head positions for the PRM team across the GCC and has worked in every Gulf market where we operate.

Ramzi AbdelJaber

Timothy Mattar

Tony Robinson appointed as new CFO

Tony Robinson became Investcorp's Chief Financial Officer on 1 July 2015. He took over from Rishi Kapoor, who recently became Co-Chief Executive Officer alongside Mohammed Al-Shroogi.

Mr Robinson was with Investcorp for 14 years until 2008. He rejoined the Firm from Bahrain Mumtalakat Holding Co., where he was responsible for the finance and treasury functions as Chief Financial Officer. He has over 25 years of experience across Australia, the UK and Bahrain. He holds a Master of Taxation and a Master of Finance from Curtin University of Technology in Australia. He also holds a Bachelor of Business (Accounting) from the Western Australia Institute of Technology University. He is a Chartered Accountant.

Investcorp's Chairman, Nemir Kirdar, said, "We are pleased with Tony's decision to rejoin Investcorp as Chief Financial Officer. His deep knowledge of the Firm will ensure a smooth transition of leadership. At the same time, Tony will bring a fresh perspective based on the experience he gained from working with a large sovereign investment institution."

Mr. Kapoor remarked, "This is an exciting time for Investcorp as we position the Firm to continue on its growth trajectory and its journey that started in 1982. Having Tony, who knows the Firm well, as CFO will help us move forward smoothly and ensure that Investcorp continues to uphold its standards of best-in-class financial management and reporting. With his diversified experience, expertise and commitment, I know he will be a valuable asset to our team."

Tony Robinson

On his new appointment, Mr. Robinson noted that, "Investcorp has been growing from strength to strength, adapting to the changing business environment and evolving its business model while maintaining its vision to be the bridge between GCC investors and investment opportunities in the west. I am honoured to be re-joining Investcorp, and I look forward to working with the leadership team as we steer the Firm through its next phase of growth."

David Tayeh joins Investcorp as Head of Corporate Investment in North America

On 1 September 2015, David Tayeh joined Investcorp as the head of its Corporate Investment business in North America. Mr. Tayeh joined from CVC Capital Partners, where he was a Partner and led private equity deals that focused on collaborating with management to create long-term value. He is responsible for the strategy and management of the Corporate Investment team focused on investment opportunities for North American-headquartered companies with leading positions in their industry and strong records of accomplishment.

Mohammed Al-Shroogi, Investcorp's Co-CEO, said, "I am pleased to welcome David back to Investcorp as we grow our Corporate Investment business in North America. David has extensive experience and will provide real depth in the market. I look forward to working with him and I am confident he will bring energy, value and leadership to the team."

Mr. Tayeh said, "I'm excited to re-join Investcorp, an established leader with a long track record in the middle market. Investcorp is poised for growth, and I look forward to building on that momentum and the opportunity to work with a strong and motivated team of partners and colleagues."

Mr. Tayeh joined Investcorp with 20-plus years of industry experience. David was previously a member of the Investcorp Corporate Investment team for over 10 years, and was the Senior Vice President and Chief Financial Officer of Jostens, Inc., a former Investcorp portfolio company. He holds a BA degree in Politics, Economics, Rhetoric and Law from the University of Chicago and an MBA from the Wharton School of Business at the University of Pennsylvania.

David Tayeh

Guest Feature

CHINA: Is It Time to De-Risk?

Dr. Hani Khalil Findakly

I made a brief visit to China in late September and found the economic situation far more serious than expected from reading the press and the punditry. Here are my summary observations:

1. Economic growth for the coming two years is closer to 3-4% than the 7% market consensus. Important measures, such as electricity consumption, freight and bank loans (the three constituents of the "Li Keqiang Index" are flat. A contributing factor to slower growth is public sector investments, which contributed to 45% of GDP past growth, is slowing down considerably. The reason is that when the economy grows in double digits, public investment is effective; but not when the economy is growing at 3%-4%.

2. China's revised national accounting method. China's GDP may actually be 18% higher, or $1.5 trillion, than is currently reported, from revisions from the transition from the Soviet-era Materials Production System in 1992. Meanwhile, the process of transforming China's economy from investment-led to consumption-led focus is much slower than expected. The reasons are complex, but two primary factors hamper the pace of transition: consumption is more income-elastic than price-elastic, so slower income growth slows consumption; and growth in services (e.g., education, healthcare) is lagging. While consumption is robust at 46.9% of GDP, growth will be sluggish.

3. Central bank policy is as confused as that of the US Federal Reserve. Zhou Xiaochuan, Governor of the People's Bank of China gets high marks for his management of monetary policy, but the missteps on August 11 that caused an effective devaluation of about 3% jolted global markets and more can be at risk if China's exchange rate policy remains uncertain.

4. Best guess for the mini-devaluation in August is the desire of China to internationalize its currency, by first having the RmB added to the IMF basket of Special Drawing Rights, which now appears likely. China has a broader agenda to address the imbalance in China's role in international organizations, where China has a disproportionately smaller share than indicated by its economic role, ultimately aiming to internationalize the RmB.

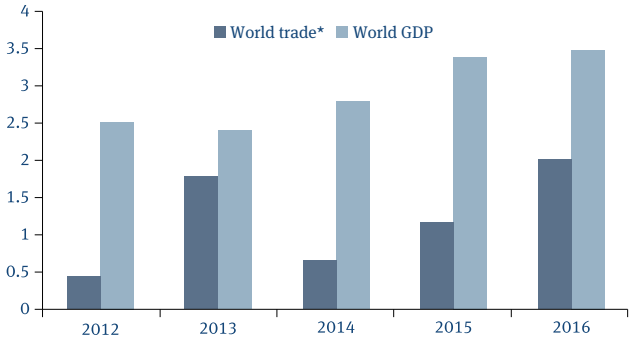
5. In responding to recent market turmoil, China's arguably clumsy moves to support the market and to stabilize the RmB resulted in a massive loss of an estimated $240 billion of foreign exchange reserves China's control over the domestic exchnage rate markets (CNY) is almost total as it can print or withdraw close to infinite amounts of RmB. But their control over the off-shore market (CNH) is more limited and indirect (through the state-woned banks). As a result, the spread between the two markets tend to widen on speculative moves, as it has been recently as spread widened to the highest level in 5 years.

6. The Federal Reserve decision to delay raising interest rates may have bought China (and other emerging markets) time to stabilize their markets. But the window may be short. If indeed the Fed decides to raise rates later this year, it is doubtful that China will opt to continue hemorrhaging reserves by keeping the Yuan stable. Against a 25% devaluation of the Euro and 50% devaluation of the Yen, China is unlikely to let its competitiveness stagnate. China's problem is compounded by a U.S. Dollar that lifts the effective exchange rate of the Yuan. That China needs to devalue its currency is not in question as it may have been a year ago. Instead, debate may center on the timing, pace, and amount of devaluation. It is reasonable to expect a series of gradual devaluations that could amount to 20% over two years, reversing part of its 35% appreciation in the past several years.

7. Debt is a problem for China, as it is globally. Overall domestic debt in China, at about $28 trillion, is over 280% of GDP (two-thirds of which are household and non-financial debt), having nearly quadrupled since 2007, far outpacing GDP growth during the period. Part of the Central Government reforms is to streamline both financial and non-financial state-owned enterprises (SOEs) that add up to a mind-boggling 155,000 companies. Of these, only about 100 are of strategic national interest and will be fully protected. During my visit, a number of high profile entities were raided and senior members were arrested on charges of corruption and

World trade and GDP growth

% per annum change in GDP/trade



Souce: World Bank (GDP) and Delta Economics (Trade data)
* World trade measured in dollars – at current prices 2012-13, constant prices 2014-16

malfeasance. An increasing number of "shadow market" financial entities are coming under strain and some are flooding outright.

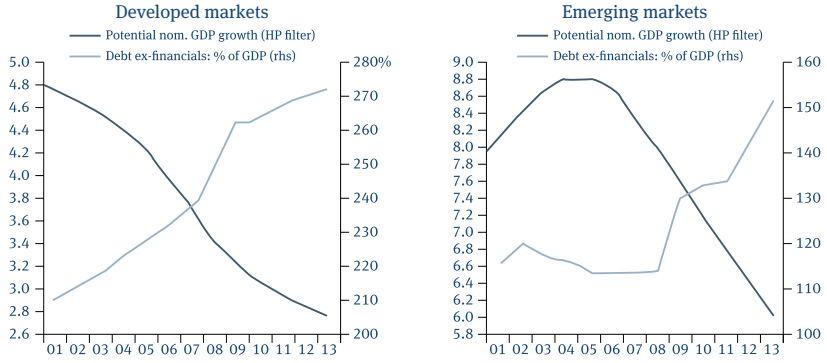
8. Beyond the pressures on SOEs, a growing number of private factories are shuttering down or consolidating. Anecdotal evidence of an onset of reverse migration of workers from big cities back to smaller towns suggests that 10 million workers have already made such moves, reversing a three-decade long trend. Demographics caused by the one-child policy was beginning to bite into China's labor market creating shortages and wage increases.

9. China's slowdown is bad news for Europe, Japan, South Korea, and for commodity and energy producers. Germany's heavy export-dependency, especially in capital goods, is particularly vulnerable. Emerging countries will also feel more pain.

10. Financial deleveraging can become painful for China, but may spread across globally: U.S. non-financial debt has grown by about 130% since 2007 while GDP grew by only 23%. At over $200 trillion, global debt now exceeds 300% of Global GDP, and is well over the levels preceding the two most recent market crises in 2000 and 2007. The chart below illustrrates the degree of exposure of highly indebted countries, such as Brazil, Russia, Nigeria, Indonesia, Turkey, etc.

12. Finally, some thoughtful scholars are becoming wary of potential for conflicts in Asia that may be aggravated by the slow-down in trade and growth. Already, nationalism is high in Japan, China and S. Korea,

Slowing growth; rising debt: this can't end well!



*Note that potential nominal rates are smoothed for cyclical fluctuation

Dr. Hani Khalil Findakly

Dr. Hani Khalil Findakly is a Director of Saudi Economic and Development Holding Co. and SEDCO Capital. Dr. Findakly served as President and Chief Executive Officer of Potomac Babson Inc. from 1990 to 1999 and Potomac Capital. From 1986 to 1990, Dr. Findakly held senior management positions on Wall Street including Director and Chairman of Dillon Read Capital Management and Vice-Chairman of the Clinton Group.

He was the Managing Director of global risk management at PaineWebber, Inc and Head of the International Division at Drexel Burnham Lambert, where he had overall responsibility for managing the Drexel's international subsidiaries in the US, Europe, and Asia.

Dr. Findakly served as Director of the Investment Department and Chief Investment Officer at the World Bank, where he worked from 1975 to 1986. From 1972 to 1975, he served on the MIT's School of Engineering and the Center for Policy Alternatives faculty, where he did research and teaching in the field of decision theory and systems analysis. In 1973, Dr. Findakly was an OAS Visiting Associate Professor at the Catholic University in Rio de Janeiro, Brazil. He has advised many governments, central banks, and international institutions in the fields of portfolio management, capital markets, and risk management. Dr. Findakly was the Vice Chairman of The Family Office Co. BSC.

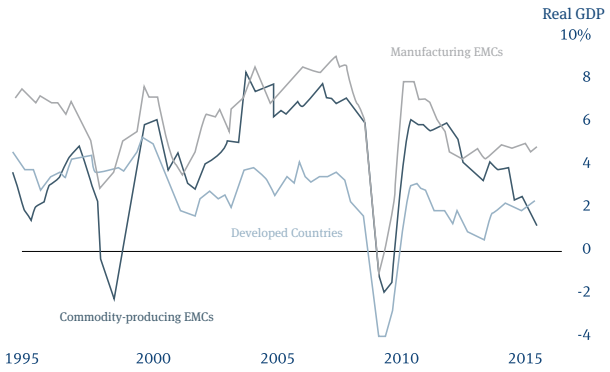
He served as a Director of TAIB Bank B.S.C. (c) since November 8, 2007 and had been a Non- Executive Director of SEDCO since 2003. He obtained a Doctor of Science on Decision Theory in 1972 and Master of Science in 1971 in Computer Simulation from the Massachusetts Institute of Technology (MIT). Dr. Findakly graduated from the Baghdad University with B. Sc. Magna Cum Laude, in Civil Engineering in 1966.

all of which have unusually strong leadership. The issues of the South China Sea (engulfing Vietnam, the Philippines, Malaysia, Indonesia and Taiwan) in territorial claims, and the East China Sea (Japan and S. Korea) have dragged the US into the conflict, as demonstrated by the relatively cool reception in Washington for President Xi Jinping on his first state visit as President of China.

Message: I am reminded that the Mandarin character for crisis is the same as opportunity. China has enormous resources to deal with its transition. These include over $3 trillion of foreign reserves; a monetary buffer that gives considerable leeway for lowering interest rates; a healthy central government balance sheet that gives it options for fiscal stimulus; flexibility on foreign exchange policy; and, importantly, political latitude for quick decision-making, unlike the case in the West. Nonetheless, it is evident that the transformation process will be more protracted than generally assumed, with potential consequences for the global economy. Over the medium-to-long term, China faces two fundamental choices: a gradual, but bumpy transition and reform of its economy; or a Schumpetrian-style "creative destruction" that would transform its economy more effectively and rebuild it on more solid ground in the same manner it embarked on its path-breaking economy over the past three decades. Given the risks, both social and political and Chinese Confucian proclivity to social harmony, China may opt for incremental change. Meanwhile, the risk for markets is that China's slowdown and slowing global trade will be transmitted through the financial markets.

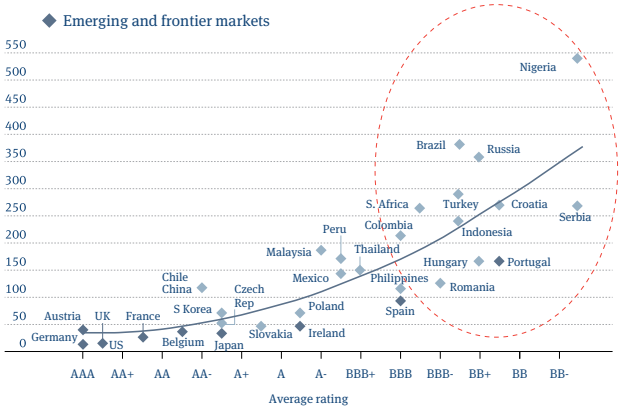
Time to "De-Risk"?

Where is the locomotive?

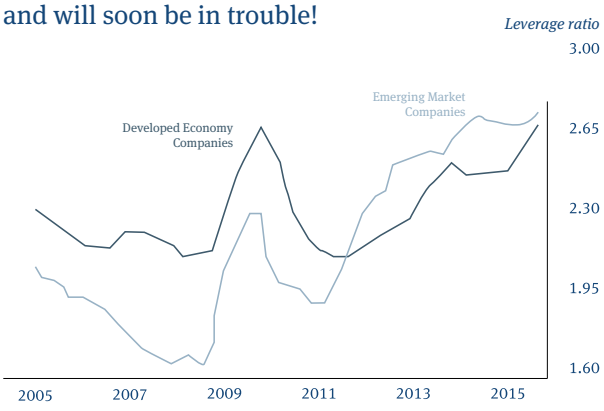


Next at risk: the market view

5-year credit default swap v average rating at S&P and Moody's



Emerging market companies are over leveraged and will soon be in trouble!



Souce: BIS

Global macro outlook

Rebecca Hellerstein

Q3 2015 has been marked by elevated levels of market volatility. The slowdown in the Chinese economy and uncertainty regarding a Fed "Lift-off" kept investors' anxiety elevated. These past few months have also further reinforced perceptions of a global slowdown. The evidence of a contraction can be seen in the global PMI numbers, which uniformly diminished across both EM and DM economies.

Global equity markets saw periods of sharp market sell-offs. Chinese equity markets in particular have been unstable despite the government's ongoing policy measures—neither a halt to short-selling and IPOs nor increased government spending, bench-mark rate cuts, or a currency devaluation— have been able to completely restore investors' confidence.

The issues with China have negatively affected EM markets with credit spreads widening relative to DM credit over the past quarter. As Chinese equities tumbled, EM equities in general followed suit. EM FX also did not fare well, especially with the additional pressures from a robust US labor market and US Dollar. With China being one of the largest commodity importers, its slowdown has had a marked impact on commodity-driven currencies and energy producers. Specifically, oil prices continued to trend downward, dipping below $40/bbl in late August, a 6 ½-year low. Falling commodity prices are creating negative feedback loops, generating additional pressure on EM economies.

The Fed, convinced that China's economic slowdown would keep inflation low, ultimately decided to not raise rates at its much-anticipated September FOMC meeting. While the decision may have relieved the markets of some short-term volatility, it has raised long-term concerns regarding the strength of the global economy and the Fed's ability to react to global weakness.

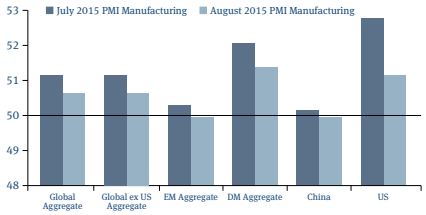
Q4 2015 may not prove any better for EM markets, particularly due to weak commodity prices. An overabundant supply— especially from growing production in the Middle East , slowing demand growth, a strengthening dollar, and volatility in Asian FX markets should continue to be headwinds to commodity prices and EM growth over the upcoming months. The markets are also pricing in a December rate hike and such a prospect will heavily weigh on investors' minds, making us bearish on commodities.

Equities may bounce back in Q4, recovering from the market-sell off, especially in Europe and Japan. It is too early to call a definitive end to the global bull market, although downside risk is substantive. Globally, financials appear to be on an upswing. While Q3 was the hiccup with equity markets overreacting to China›s problems, Q4 should be the recovery and rebound. In FX, the USD is the clear winner with the US labor markets beginning to look more healthy and robust. Rates and Credit prospects still look unattractive, suffering from the slowing global growth and a likely year-end Fed rate hike.

Regionally, the US is poised to do well over the next few months with its strengthening labor market, improved spending data, and strong investment numbers. In Europe, good fundamentals should continue to drive a healthy pace of growth. Although downside risks to Euro-area growth have grown moderately in Q3 over the uncertainty in China, as a result of low commodity prices and a tumble in EM FX, the recovery in Europe should continue to be steady in Q4. Exposure to final demand in Asia is not incredibly high for the Euro-area; domestic demand is the crucial economic engine in the region. With easing financial conditions and an accommodating fiscal policy combined with low energy prices and steady corporate performance, the Euro-area is not likely to suffer a pronounced slowdown due to contagion from China's economic problems.

Global manufacturing PMI aggregate down in August

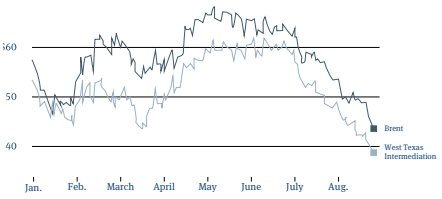
August PMIs inch lower across the board



Source: Haver Analytics, Goldman Sachs Global Investment Research

Oil Prices Have Plummeted

Price per barrel of crude oil



Source: Bloomberg

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