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CASE STUDIES

"Case Studies" presents a case pertinent to contemporary issues and events in investment management. Insightful and provocative questions are posed at the end of each case to challenge the reader. Each case is an invitation to the critical thinking and pragmatic problem solving that are so fundamental to the practice of investment management.

Jack L. Treynor, Senior Editor

GLOBAL INVESTING

Since Tom Phillips had taken over management of Global Fund, he hadn't seen many investment opportunities. But here he was in Macedonia, responding to a call from an American who had been one of the leaders in developing the capital. Skopje wasn't Kuala Lumpur or Dubai, but Tom had to admit that the new office buildings improved its appearance.

The American developer had put millions of dollars into the project. But now, as he had explained to Tom, he wanted to diversify. And he was so eager that he was offering a deal that was unusually attractive. The developer pointed out that demand for office space depended on the local prosperity. He added that because of the constant influx of Albanians into Macedonia, Tom didn't need to worry about local demand. It seemed to be precisely the kind of diversification Tom's American clients were looking for.

Occupancy rates seemed satisfactory. But in order to judge whether the rents would justify the dollar asking price, Tom had to translate from dinars to dollars. As the following tables show, Macedonia has

(1) a managed currency and
(2) a large trade deficit.

Exhibit A Trade Balance, Macedonia.

Year	Exports	Percent of GDP	Imports	Percent of GDP	GDP
2003	95.2	38	138.0	55	251.5
2004	106.8	40	160.4	60	265.3
2005	128.1	45	177.6	62	286.6
2006	149.7	48	201.5	67	310.9
2007	189.3	53	256.1	72	354.3

2009 IMF Yearbook

Exhibit B Real Effective Exchange Rate.

2001	2002	2003	2004	2005	2006	2007	2008
102.25	101.70	103.60	102.55	100.00	99.73	100.00	104.62

When a country is striving to maintain a stable value for its currency, it will often hoard reserves of foreign currency. If necessary to defend that hoard, it will impose exchange controls—limits on conversion from its currency into foreign currency. "Within many countries, bureaucratic regulation … is accepted as a means to balance international payments and receipts …"[1]

When a foreigner makes a local investment that generates its reward in local currency, he will often want to exchange it for his own currency. In attempting to translate dinars into dollars, has the developer run up against bureaucratic controls?

Presumably the local bureaucrats would have been more cooperative if the developer's investment had generated foreign currency. But how could one tell in advance whether an investment would improve the country's trade balance?

Questions

Why is the developer eager to sell to an American?

Will products that are culture-specific, perishable or too expensive to transport improve the country's trade balance?

How about investments in office buildings? Other kinds of real estate? Retail chains? Services?

Did the developer's investment improve Macedonia's trade balance?

Would the investment give Tom's American clients what they want from Global Fund?

Is diversification a sufficient justification for investing in a foreign country?

In his continuing search for global investment opportunities, what lessons should Tom learn from this experience?

Note

[1] The International Money Game, Robert Z. Aliber, Basic Books, 1973.