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A BETTER BRI'IC

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The acronym BRIC (Brazil, Russia, India and China) was coined by Jim O'Neill of Goldman Sachs in 2001 and became a symbol of the shift in economic power from the G7 countries to the developing world. Over the years other clever acronyms followed including MIST, E7, the Next Eleven, etc. These acronyms represent a willingness to look beyond the developed world for faster economic growth, more favorable demographics and the potential for more attractive investment returns. Now, though, it's time for a change. In the interest of keeping it simple, we suggest changing the familiar acronym BRIC to BRI'IC by adding Indonesia.

Most investors don't realize that Indonesia is the 4th most populous country in the world and has enormous under developed natural resources, including oil/gas, coal, tin and rubber. Indonesia's economy is well-balanced, with a large consumption component and limited reliance on exports to the developed world. Impressively, retail sales in Indonesia doubled from 2009 to 2012 (yes, doubled in three years) which we attribute to an improving unemployment rate, favorable demographics, strong growth in wages and high consumer confidence. Meanwhile, developed markets struggle with high unemployment, an aging workforce, stagnant wages, and low consumer confidence. It's no wonder retail sales in the US and Europe is a stark contrast to Indonesia, struggling to grow ~1% year over year.

In the past two months, while the rating agencies were busy downgrading most European countries and financial institutions, Fitch and Moody's actually upgraded Indonesia's sovereign debt ratings to investment grade, the first time Indonesia has achieved such a rating since the 1997 Asian Financial Crisis.

ACHIEVING AN INVESTMENT GRADE RATING WILL SUPPORT ASSET PRICES FOR AT LEAST TWO IMPORTANT REASONS:

First, the upgrades demonstrate the strength of the underlying economic fundamentals in Indonesia. With debt to GDP at 27%, GDP growth forecast of approximately +6% and inflation running at the lower end of the central bank target of +4-6%, Indonesia's economy is one of the strongest in the world. Indonesia also has large foreign exchange reserves (US\$110b), a strong banking system, government bond yields near all time lows, consumer confidence near all time highs, and retail sales/industrial production at 20-year highs.

Second, investment grade ratings should result in lower cost of capital, which supports growth in the public and private sectors. After under spending for much of the past 15 years, Indonesia needs significant infrastructure development. We expect spending to accelerate and broaden, as the government recognizes the positive correlation between proper infrastructure and economic growth. Additionally, we anticipate that a strong corporate bond market will partially offset the likely slowdown in credit availability from European banks.

Indonesia still has many risks, including corporate governance, inefficient subsidies and sluggish infrastructure spending programs. However, we consider the Fitch and Moody's sovereign debt upgrades indicative of Indonesia's progress since the Asian Financial Crisis and emergence as an important global economy.

While the G7 countries celebrate 1-2% GDP growth (partially reflective of massive quantitative easing), the Indonesian economy appears well positioned to continue its impressive fundamental growth with little fanfare. At some point, global investors will begin to focus on the many opportunities emerging from one of the strongest economies in the world. And let's go ahead and add that extra 'I' in BRIIC.