ADDISON WIGGIN
THE Apogee ADVISORY
[ap-uh-jee] Investment Ideas from 30,000 Feet

Beyond Coffee and Cocaine

Forget everything you've ever heard about Colombia… because if you don't, you'll regret missing out 10 years from now

"So this bar," you see, "was opened by the fellow you'll be meeting tomorrow."

We'd barely had time to get checked into our hotel in Medellín when we were off to our first appointment — drinks and dinner with the international director of a major brokerage and investment bank in Colombia. The firm handles 30% of the volume on the country's $200 billion stock exchange.

"There's another one down the street opened by one of his friends. And that one across the way? Still another friend owns that one."

We thought we were being told an amusing story about how a bunch of bars in one district of the city happened to be owned by the same bunch of guys. It turns out to be a microcosm of how enterprise works in this dynamic country.

Think Colombia and you probably think of one of two things: coffee or drugs. Juan Valdez or Pablo Escobar.

Coffee is, indeed, the country's No. 2 export. You might be surprised to learn what's No. 1. More about that inside this issue.

As for Escobar, he's been dead for 17 years, shot under circumstances that are still a subject of vigorous debate. The violent crime that tore the country apart for two decades is largely a thing of the past, for reasons we'll also get into. (On a side note, we hear Juan Valdez is still looking just as youthful as he always has. We can't confirm for sure. We didn't get a chance to see him on our trip.)

In this issue, you'll also learn about the three catalysts about to take this already-growing economy to a whole new level — and the $53 billion wild card that could deliver an added boost.

Finally, we'll dig in to two opportunities — easily accessed for U.S. investors — that'll give you direct access to one of the world's great unsung growth stories.

But before we get to any of that, let's tackle the question everyone asks…

In this Issue

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“Aren’t You Afraid!?!?”

“Why are you going *there!?*” was a common question people gave asked me when I told them I was going to Colombia. “Stay safe, my friend,” read an email from a friend who actually knows a thing or two about Latin America.

A typical American’s perceptions of Colombia begin and end with one word: “violence.”

That only increased our determination to go… to see if the perception of conventional wisdom was anywhere near reality.

It was not. We spent a week in Bogotá and Medellín. At no time were we accompanied by armed guards. And at no time did we feel unsafe.

But the legacy left by decades of violence was unmistakable: In nearly every office building we visited, we were fingerprinted and our laptop serial numbers logged on the way in and out. Leaving the country to come home, security at the Medellín airport checked our passports no less than seven times… and we were patted down twice.

Colombia’s infamous cocaine trade, which begat larger-than-life figures like Escobar, emerged in the late 1970s and grew throughout the ’80s and ’90s. At first, Colombia’s role was as middleman, taking raw coca from Peru and refining it to powder before sending to the United States and other points north.

One U.S. president after another tried to stanch the flow, to no effect. “Under pressure from Washington,” explains Independent Institute scholar Álvaro Vargas Llosa, “coca cultivation shifted from Peru and Bolivia to Colombia in the 1990s. When Colombia turned the screws, it shifted back to Peru, where the area under cultivation has increased by 70% and production has tripled.”

As a result of Washington’s intervention, Colombia

Country Profile: Colombia

Population: 45.6 million — about the size of California, Oregon and Washington combined. More than one in six Colombians — 8.8 million — live in the capital, Bogotá.

Area: 441,000 square miles — roughly half the size of the United States east of the Mississippi

GDP: $430 billion — about the same as Virginia

Heritage Foundation rating of economic freedom: 68.0. Colombia ranks No. 45 among 179 countries. For comparison, Hong Kong ranks No. 1, with a rating of 89.7

Gini coefficient: 58.5. This is a measure of wealth disparity among the population. By comparison, the United States hit a record high of 47.0 in 2006, when the financial sector was at its peak of paper wealth and influence

Freedom House rating of political rights: Partly Free

Freedom House rating of civil liberties: Partly Free

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became the No. 3 recipient of U.S. foreign aid by 2000, after Israel and Egypt. The "war on terror" has pushed it down the list since, but Colombia still collected aid totaling $895 million in 2009.

Drugs also become the financing vehicle of choice for Colombia's left-wing guerrilla groups, chief among them the Revolutionary Armed Forces of Colombia, which goes by its Spanish acronym FARC.

The result was a free-for-all of violence. "Across the street there," our host continued to tell us over dinner, "a bomb went off 17 years ago. It killed three of my best friends." Nearly everyone we met in Colombia has a story like that.

Starting in 2002, the administration of President Álvaro Uribe took a gloves-off policy toward the FARC and other outlawed groups. It has been undeniably effective.

UNDENIABLY EFFECTIVE

Crimes committed in Colombia, 2000–2010

Crime	2000	2005	2010*
Homicides	27,943	18,363	15,560
Kidnappings	3,572	800	264
Highway robberies	3,260	716	397
Bank robberies	412	91	62
Pipeline attacks	215	155	27

*annualized based on first ten months of the year

Source: Colombian National Defense Ministry

For every American friend who asked us about "the violence" before we left, we met an executive in Colombia who said "the security situation" is vastly improved. The FARC is a shadow of its former self, chased back to the most remote rural regions. While we were there, the FARC kidnapped 23 oil workers near the Venezuelan border. Within 24 hours, one hostage escaped and the military swooped in to free all but one of the others.

It wasn't pretty, this improvement in "the security situation." Our contacts in Colombia freely spoke of the role played by the CIA and the Israeli intelligence agency Mossad. Not one of them spoke of Colombia's homegrown right-wing paramilitaries.

The "paras," as they're known, came together in the late 1990s to counter the FARC and the other guerrilla groups under the umbrella AUC. Like the FARC, it was branded a terrorist group by the U.S. State Department and funded much of its operations with drug money.

Uribe's government reached a peace agreement with the AUC; tens of thousands of its members demobilized in 2006. But critics say some of them held onto their weapons and now operate as criminal gangs, under names like the Black Eagles.

We saw no sign of the Black Eagles or the FARC or anyone else — although the occasional soldier in combat fatigues with an automatic weapon was hard to ignore.

So we carried on the business we intended to carry on in Colombia. We sought an answer to the question: What's the opportunity here?

Why Colombia? Why Now?

Three Reasons Colombia Is "Like Chile 15 Years Ago"… and a $53 Billion Wild Card

We had the chance to think about this question a lot as we were shuttled from one appointment to the next on the streets of Bogotá. We had a driver skilled in the fine art of bobbing and weaving through traffic that moved at breakneck speed when it wasn't at an absolute standstill.

Bogotá is choked with cars, trucks and motorcycles. Auto sales grew 41% last year. Colombians are getting access to consumer, auto and mortgage credit for the first time in their lives. Yes, it might end in tears as it did in the United States… but at this stage in the cycle, it's one of the best markers of growth an investor can look for.

"Colombia is like Chile 15 years ago," we were told more than once. Or we were told, "Colombia is like Brazil 10 years ago."

Brazil is up 365% in the last 10 years. Chile is up 370% in the last 15. We like those precedents.

But is there reason to believe Colombia can pull it off? Absolutely. Three reasons, in fact. And a $53 billion wild card… but we'll get to that in a bit:

- **Investment-grade credit rating:** While we were there, Standard & Poor's upgraded Colombian government bonds to investment grade. Moody's and Fitch will likely follow in the months ahead.

Investment grade opens up Colombian debt to entire classes of institutional investors — bond funds, pensions and so on — that wouldn't touch it otherwise. It sends a signal to investors worldwide that Colombia has "arrived"

- **Pending stock exchange merger:** Colombia's stock exchange, the Bolsa de Valores de Colombia, joins forces on May 30 with its counterparts in Peru and Chile. The combined exchange, known as MILA or the Integrated Latin American Market, will be the region's second largest by market cap, after Brazil's Bovespa.

  Similar mergers have held out great promise: After the merger of Scandinavian stock exchanges into the Nasdaq Nordic, Norway's stock market rose tenfold

- **U.S.-Colombia trade agreement:** Forged between the Bush and Uribe administrations in 2006, this will lower a host of trade barriers, to the benefit of both countries. The textile maker we met on the outskirts of Medellín, for example, will be able to get U.S. cotton cheaper… and he'll be able to sell his products in the U.S. market at a competitive price.

  This one is less of a sure thing… but during April, Uribe's successor, Juan Manuel Santos, ventured to Washington to tweak the agreement with President Obama, who pronounced himself satisfied with the result.

That's a huge shift for Obama. Up to now, he'd dragged his heels on the deal in deference to U.S. labor leaders, who pointed to a history of violence against Colombian labor leaders. The issue was a red herring, "never as serious as he contended," according to *The Washington Post* editorial page.

Regardless, the final agreement still might not satisfy Congressional Democrats. Republicans, meanwhile, might insist on passing the agreement as a package deal, along with a much larger trade agreement for South Korea.

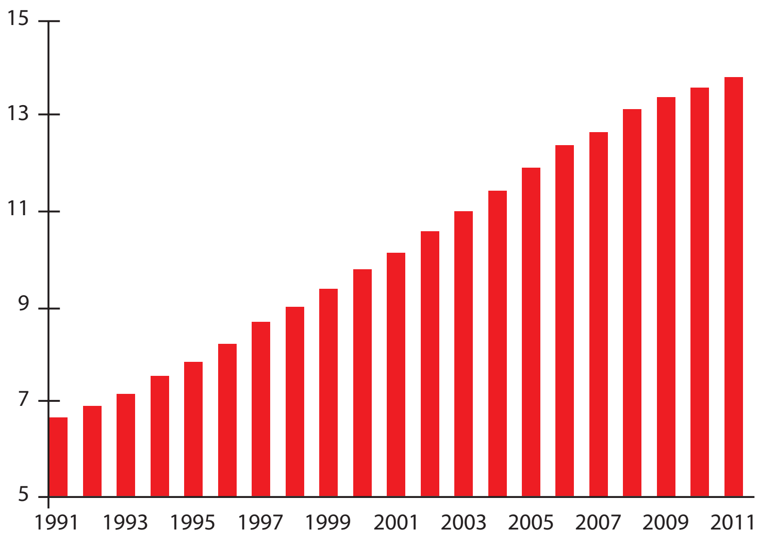
But Colombia's doing fine even without the deal. The macro indicators are the envy of many far-more-developed countries:

- **Growing economy:** Colombian GDP grew 4.3% in 2010. The central bank forecasts 5.5% in 2011, so even if that turns out to be wildly optimistic, we have a healthy growth story here
- **Inflation under control, more or less:** At an annualized 3.2% in March, the cost of living is rising, but it's right in the central bank's target range of 2–4%. And with a rising Colombian peso, the cost of imports is stable, or even falling
- **Unemployment is stable:** At 13.2%, the benchmark urban unemployment rate remains stubbornly high. But President Santos is pushing for revisions to Colombia's labor laws to make it easier for small businesses to hire.

A decade ago, barely 9 million Colombians could call themselves middle class. Now 13 million can — well over a quarter of the population.

ESSENTIAL INDICATOR: A GROWING MIDDLE CLASS

Growth of Colombia's middle class, 1991–2011



Source: Foreign Agricultural Service, U.S. Dept. of Agriculture

And as that number grows, a $53 billion lump of money is going to accelerate the growth of Colombia's stock market.

Here's another key aspect in which Colombia is "like Chile 15 years ago." You might already know how Chile allows its workers to plow their payroll taxes into an individual retirement account — a "privatized" Social Security in which the worker has a part in choosing how to invest the funds.

Colombia has the same thing — a $53 billion pool known as the "multifunds." Until August 2010, Colombian workers had little choice about how to invest that money: Everyone was put into a "moderate risk" allocation of stocks and bonds.

That's changed now. In addition to the "moderate" portfolio, workers who are closer to retirement can choose a conservative model that leans more toward bonds. Younger workers willing to step out on the risk curve can choose a more-aggressive model tilted toward stocks.

So far, 89% of assets remain invested in the "moderate" allocation. But as workers become more comfortable with the new choices, they're liable to start investing more aggressively… and plowing more money into the Colombian stock market. Here again, Chile was a trendsetter — along with Peru.

With 80% of Colombia's population under age 50, we're talking about a lot of people entering the stock market for the first time.

So… we know Colombians are going to invest in their own future. How can you come along for the ride?

Made in Japan, Perfected in Colombia

A Business Model Found All Over This ETF

You can learn a lot about Colombia's stock market by looking at the top 10 holdings of a Colombian-oriented exchange-traded fund. Here's the lineup of the one that's been around longest, the Global X/InterBolsa FTSE Colombia 20 (NYSEArca:GXG):

A GLIMPSE INTO COLOMBIA'S STOCK MARKET VIA AN ETF

Top 10 Holdings of Global X/InterBolsa FTSE Colombia 20

Company	Sector	% of total holdings
Ecopetrol	Oil and gas	12.65
Pacific Rubiales	Oil and gas	10.47
Bancolombia	Finance	10.24
Grupo Aval	Finance	6.96
Grupo Inversiones Suramericana	Diversified	6.45
Almacenes Exito	Retail	5.14
Inversiones Argos	Cement	4.96
Interconexion Electrica	Power generation	4.85
ISAGEN	Power generation	4.84
Sociedad de Inversiones de Energia	Oil and gas	4.79

Holdings as of April 11, 2011; top ten holdings equal 71.35%

As you can probably suss out from the fund's name, GXG tracks the performance of the FTSE Colombia 20 Index. Of its 20 holdings, the top 10 make up 71%. And we met with people from six of those top 10.

No, there's not much diversification among sectors. There's a lot of energy and a lot of financial. But right now, that's pretty much what the country's all about.

Colombia is a minor player in world oil production — it comes in at No. 27 on a list of the world's top-producing nations, on par with Egypt and India. But within Colombia, oil is huge — making up 41% of the country's exports last year.

Thus, two oil companies top the list. Ecopetrol is a government-owned firm that's tiptoeing hesitantly into the rough-and-tumble world of global exploration and production. But it's a giant within Colombia, with a market cap of $85 billion — pretty impressive in the face of a globe-spanning operator like Chevron, at $217 billion.

Right behind Ecopetrol is the privately held, Toronto-listed Pacific Rubiales. This is a company that's firing on all cylinders. Four years ago, you could pick up shares for less than a dime each. Now it's a shade below $30.

Way to Go, Hugo: Venezuela's Loss, Colombia's Gain

Colombia's oil production in 2012 will likely double the 2009 figure. And a lot of the credit goes to the caudillo next door, Venezuela's Hugo Chavez.

Under Chavez's mismanagement, Venezuela's oil production has fallen 30% since 1996. In recent years, Chavez fired thousands of knowledgeable geologists, engineers and other specialists… replacing them with political hacks.

Where did all those qualified people go? Many of them ended up in Colombia. And it's not just raw talent they bring to the table. Colombia's oil riches lie in the Llanos basin, in the east of the country — right on Venezuela's border. So they also know the regional geology, and how best to coax the oil out of the ground.

Finance's dominance shows up in No. 3 Bancolombia and No. 4 Grupo Aval. Aval has a hand in real estate and telecommunications, but it owns controlling stakes in three major banks.

If you're resisting the notion of banks, don't. Colombia's banking sector plays it conservative. The country had its own housing bubble in the late 1990s. Unlike U.S. banks, the Colombians learned their lesson.

The One Hang-up We Have About GXG… and Why We Can Live With It

Don't get us wrong. We like Colombia, so we like GXG. It's just that we'd like it a lot more if the No. 1 holding, at nearly 13% of the total, were something other than the state-owned oil company Ecopetrol.

Ecopetrol is a fossil within a dynamic Colombian economy. It carries a heavy legacy from the mid-20th century, when governments throughout Latin America brought oil production under state control. Think Pemex in Mexico or PDVSA in Venezuela.

The Uribe regime restructured the company in 2003 to give management more autonomy. An IPO followed in 2007, and a NYSE listing in 2008 (ticker symbol EC). But 90% of the company remains state held. Three of the nine directors are cabinet officials. The firm's headquarters reminded us more of a government bureaucracy than a dynamic producer of a modern economy's lifeblood.

Sure enough, Ecopetrol drilled 19 new wells last year and most of them were dry.

But Ecopetrol's dominance of GXG isn't a deal-killer.

In early April, Ecopetrol's refining subsidiary Reficar secured a $2.84 billion loan from the U.S. Export-Import Bank. The money will help expand and upgrade a refinery complex in Cartagena.

And this loan comes in addition to $880 million in additional financing Ecopetrol has secured from the Ex-Im Bank since last December. That's $3.72 billion of U.S. taxpayer money getting pumped into a company with a market cap of $85 billion.

In other words, Ecopetrol could keep drilling dry wells for some time… and it's still going to have a nice flow of money coming in straight from Washington, D.C.

You might as well reclaim a little bit of the taxes you paid for that and grab shares of GXG.

Here's something that you can't tell just from looking at the list — the almost-incestuous nature of who controls Colombia's major companies. Like a soap opera, it's hard to keep track of who's in bed with whom. For instance, No. 4-ranked Aval owns Banco de Bogotá — which owns a stake in No. 13 Corporacion Financiera Colombiana.

But for interlocking relationships, no one holds a candle to No. 5-ranked Grupo de Inversiones Suramericana — a $10.3 billion holding company.

Try to wrap your mind around this. It owns:

- 29% of No. 3 Bancolombia…
- 37% of No. 7 Inversiones Argos…
- and 38% of No. 12 Grupo Nutresa, a food maker.

Suramericana also owns a major insurer. And its AFP Proteccion unit is one of six firms authorized by the Colombian government to handle the $53 billion in multifunds. (Aval controls one of the others, Porvenir.)

Indeed, Suramericana amounts to a Latin American version of a Japanese *keiretsu*.

The *keiretsus* were a defensive measure taken by Japan's surviving industrial families after World War II. Gen. Douglas MacArthur, who ran the U.S. postwar occupation force, moved to break up many Japanese companies.

The families who owned them didn't fight back. Instead, they used their considerable capital to buy shares in each others' firms; each keiretsu had a bank at its center. Thus is Bank of Tokyo-Mitsubishi intimately tied to everything from Mitsubishi Motors to Nikon to Kirin Brewery.

In Colombia, *keiretsu* came about during a stock market slump more than 30 years ago. With interlocking family ownerships, hostile takeovers became difficult, if not impossible, no matter how low the share price.

Suramericana is actually traded on the Pink Sheets in the United States. But don't bother. It is very thinly traded, and its overall performance the last two years neatly tracks GXG.

GXG gives you broad exposure to everything about the Colombian economy — a booming energy sector, a well-managed finance sector, the smarts and connections of the keiretsu and a potential $53 billion pool of money destined to drive up the Colombian stock market for years to come.

How to Make the Most of a Rising Latin American Star.

Pick up some shares of the Global X/InterBolsa FTSE Colombia 20 (NYSEArca:GXG). It's been trading for a little over two years. There's a new competitor from the Van Eck fund family, and if it had a history longer than six weeks, we'd take a good look at it. For now, stick with GXG.

Banking the Way It Used to Be?

A Taste of It Right Now in Colombia

Colombians don't deal with banks the way you and I do.

Only 5% of the adult population has a checking account. By far, the more popular choice is a savings account — 56% of Colombian adults have one — with a debit card linked to it.

As mentioned earlier, Colombia had its own housing bubble a little over a decade ago. People took out 10–15-year adjustable mortgages and got burned badly when rates reset.

These days, mortgage holders go for fixed rates. They put down a minimum down payment of 30%. The term is no more than 10 years. And most of them pay off the loan in seven or eight.

Yes, the banks do package up the mortgages into mortgage-backed securities. But in Colombia, that's mostly a tax-avoidance mechanism. The interest on those securities is tax free, so the banks often end up owning the very mortgages they securitize.

All of this is a roundabout way of saying Colombian banks are pretty conservative. In a typical U.S. bank, 4–5% of loans are 90 days past due. In Colombia, a bank starts to worry if 3% of loans are even 30 days past due. And "leverage" is a dirty word.

The banking leader in Colombia is **Bancolombia (NYSE:CIB)**. From a distance, its headquarters building in Medellín looks as if someone dropped a cruise ship in a valley surrounded by mountains. The thing's huge — 800,000 square feet, where 4,000 people work every day. We nearly ran out of breath walking it.

Bancolombia is listed on the NYSE. Its assets have grown 19-fold in the last 15 years. So has its market cap.

It has 6.8 million savings accounts, and 82% of those have debit cards linked to them. In a country where only 16% of adults have a credit card, that's a lot of fees one company can generate.

It has 923 branches in 663 cities and towns — including extensive operations in El Salvador and smaller operations in Peru, Panama, Puerto Rico and even Miami.

For size, scope and ease for American investors, Bancolombia is the obvious choice.

How to make the most of Colombia's growing financial sector

Buy shares of **Bancolombia (NYSE:CIB)** from any discount or full-service broker. But don't jump in all at once. Shares are near all-time highs right now, so you might consider averaging into this well-managed bank over the next few months.

I could go on and on about Colombia, of course. But I've run out of paper in this month's issue. If you're planning on coming to our Investment Symposium in Vancouver (see below), stop by and say hi. I can share more tales from the trip over a nice glass of red wine.

If all goes as planned, next month, I'll be showing you a little-known (and highly controversial!) way to keep your gold away from the U.S. government. You won't want to miss it.

In the meantime, I want to thank you for your subscription to *Apogee Advisory*. Your subscription fees allow me to continue my passion — traveling the world in search of unique investment opportunities, meeting interesting insiders and sharing their stories with you.

Cheers,

Addison Wiggin