



Wermuth Asset Management GmbH

Press Release

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**Comments on President Medvedev's State of the Nation Address by Jochen Wermuth,
Founding Partner and Chief Investment Officer of Wermuth Asset Management GmbH:**

President Medvedev's State of the Nation Address is good news for Russia and foreign investors

In today's State of the Nation Address, President Medvedev outlined in essence how he will lead Russia from a "backward, drunk, corrupt and energy dependent country" – as he defined the current situation in his open letter on the internet "Go Russia" - into a brighter future.

For foreign investors this open and honest assessment of the problems Russia faces is a key first step for a better investment climate and for better living conditions. The measures proposed by President Medvedev are good news for Russia's economy in the medium term. Overall the State of the Nation Address was very honest and trust inspiring:

An honest assessment of reality and a call to action

President Medvedev, the majority of Russia's ruling elite and certainly most of the Russian people understand the challenges Russia faces. President Medvedev solicited comments on his draft speech on the internet and got some 20,000 often very clear and open ones. The result is an even more aggressive State of the Nation Address, reflecting greater courage to move ahead with reforms. The focus is to draw on Russia's huge human capital potential and to diversify further away from being just a natural resource producer. To achieve this, living and working in Russia must become more attractive. This requires a committed fight against corruption and strengthened democratic institutions. Having just returned from the 20 years celebration of the fall of the Berlin wall, President Medvedev reminded his fellow citizens of the sacrifices their parents and grandparents made to free Europe from fascism and called Russians to action to face its current challenges and to move ahead decisively at long last.

Stronger Democratic Institutions to fight Corruption and allow competition of political ideas

He stressed that Russia can only survive if it modernizes and that it can only be modernized in an environment of intellectual freedom where emancipated citizens are sure of their rights. He has already taken decisive measures to fight corruption. As a result officials and their relatives now publish their incomes and assets. Over 500 government officials and over 700 law enforcement agents have been convicted of corruption and imprisoned. Additionally, he now proposes measures to assure a free and fair competition of political ideas via fair elections : He proposes concrete measures such as access of all parties to election commissions and public buildings during election campaigns, and limits on the possibility of early voting to limit the potential to falsify election results which appeared to be rampant in regions like Moscow recently. These are very welcome steps in the right direction. They can be expected to occur only gradually, but the direction is clear: only strong democratic institutions and free media will in the end be able to overcome the cancer of corruption.

Foreign Relations: No more super power nostalgia but cooperation

Addressing a key problem with Russia's unfortunate image abroad as a potential aggressor given its occasionally longings for "super power status", he reminded his fellow citizens: "There is no point to blow up one's cheeks and pretend how great and important one is." Rather, he stressed, one should get to work on one's own problem and one should cooperate with one's partners and friends abroad. Russia needs good relations with foreign countries to attract foreign investments and it needs cooperation with foreigners to effectively modernize its economy. He stressed that Russia would continue to push for a multipolar world and welcomed the G20 process.

Energy Efficiency and Greenhouse Gas Emissions under the Kyoto Protocol

On the economic front, he stressed Russia's embarrassingly poor energy efficiency. By the most honest measures Russian energy consumption is three to five times as high per unit of GDP at current exchange rates than in Canada. Russia will be able to make huge progress once domestic electricity prices are freed and gas prices move to "net-back world market prices" (world market prices minus transport costs and tariffs)" and once it participates fully in the Kyoto protocol mechanism of "Joint Implementation" detailed instructions for which have just been signed by the Government. Improving energy efficiency also reduces greenhouse gas emissions dramatically. A long political fight has just ended with a huge victory for free markets and less possible interference for bureaucrats: Russia's Kyoto Protocol rules now allow an unlimited amount of "Emission Reduction Units" (ERUs) to be generated by energy and emission saving projects in Russia, while previously there had been plans to limit the amount of ERUs to be issued. As a result, Russia could hope for as much as Euro 10bn a year (!) in financing for energy and emission saving projects from the sale of ERUs. This is a great breakthrough for Russia and climate change.

Remaining Concerns

In spite of the encouraging words in the State of the Nation Address, serious concerns remain over the apparent election fraud in support of the party of power (United Russia) at elections a few weeks ago: By way of example, in a district where the opposition and his family voted, the officials recorded zero votes for the opposition! When exit polls predicted 45% for the party of power, they ended up with some 75% of the votes and some 97% (!) of the seats in Moscow parliament. The test for Medvedev will be the court investigations into these frauds. If the results will be corrected, Russia could move firmly ahead, like Prussia and Germany after the Mueller Arnold court case where a simple miller was able to claim damages from his aristocratic landlord, a case which stood at the beginning of judicial independence in Prussia and Germany.

Do the nice words matter?

Cynics have countered that words are cheap and that President Medvedev has no power anyway, so why bother to listen to him? The facts remain that former President Putin did not seek a third term in office even though he had sufficient support in the population, in the houses of parliament and among governors to change the constitution. His clear message to his people and the world was: The constitution and the rule of law are untouchable. All speculation that he is just pretending not to be in charge while he still is thus misses the point that he could have just stayed in charge had he chosen to. Instead, he supported Dmitry Medvedev, a lawyer without a secret service background, in his campaign for the Presidency of Russia, and jointly the President and the Prime Minister are leading the country into the future based on a realistic assessment of Russia's challenges and most importantly an understanding that only free markets and free competition of political ideas can address them.

The State of the Nation Address thus does matter and is very encouraging for foreign investors and good news for Russia.

Background information:

Jochen Wermuth, Chief Investment Officer of Wermuth Asset Management GmbH, is German and was:

- Head of the EU and World Bank financed Economic Expert Group under the Russian Ministry of Finance between 1993 and 1997, participated in IMF and World Bank loan negotiations
- Member of the management committee which set up Deutsche Bank Russia between 1997 and 1998 and head of debt origination, a capacity in which he raised \$8bn in debt for Russia
- Founder of Wermuth Asset Management GmbH and adviser to the Greater Europe Funds which have invested over \$1.5bn into Russian capital markets, real estate and private equity over ten years.

Wermuth Asset Management GmbH is the exclusive investment adviser to four investment vehicles with some \$300m in assets under management, specializing in value investing and friendly activism, fundamental bottom-up and macro economic analysis. Its regional focus is Eastern Europe, in particular Russia and the countries of the former Soviet Union (the "Greater Europe" area).

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