



Changing the way Emerging Europe investments are done.....

In 2009, whether you looked at the different assets categories or individual investments the same themes kept popping-up; (a) Mid-cap stocks did better than the larger ones (b) owning Technology and Energy (as well as other commodity stocks) was a must and (c) Emerging Markets were on fire. Equities moved higher as investors began to close the book on the financial crisis of the past and began to think about the prospects of 2010 and beyond. Overall, World stocks rose 26.98% (US and Europe 23.45% and 31.24% respectively) with Emerging Markets 74.50%.

These numbers were quite strong, and in our view are explained and/or direct results of the following themes: (I) after the panic (of '08 and early '09), when the entire global financial systems seemed to be in peril, investors began to breathe a sigh of relief when world governments appeared to provide a baseline of stability. (II), with that in mind, investors dove back into the areas that they were previously invested and had fled just few months earlier. And (III), Emerging economies showed strength and overall stability than those of US and Europe. At the end, these strong gains are the direct reflection of the longer-term story of Emerging Market's global importance and still enormous growth potential.

### Emerging Europe

The 2009 ongoing improvement in investors risk appetite, coupled with overall Emerging market's recovery, which outpaced the expectation, was positive for Emerging Europe. In Russia, the dollar-denominated RTS stock index soared 128.62% this year, led higher by the oil and gas sector. In Poland, the WIG20 index rose 38.62%, while the Czech Republic's PX index surged 35.22%. In Hungary, the Budapest Stock Exchange's benchmark BUX stock index rose 73.40%.

From a regional standpoint, Emerging Europe saw an overall strong performance versus other Emerging market regions (see Table1). With one of the world's best educated populations sitting on some of the worlds best natural resources, we believe, this trend will continue.

Despite a strong showing, Russia still remains one of the most appealing plays on Global recovery. The price of oil is high, the Ruble is strong, the country has added over \$60 billion in foreign reserves and interest rates are coming down. Furthermore, Russian stocks remain some of the cheapest (see Table 2), which we see as unjustified giving 30% plus EPS growth prospects for 2010. Also let's not overlook, the only EU member state with positive GDP growth in 2009, Poland. The most recent macro data was surprisingly strong, pushing the growth estimates for 4Q and the whole 2009, to 2.7% and 1.6% respectively. These showings alone, should improve the unemployment outlook (not today but in coming months) and by and large public finance picture.

Overall we prefer Emerging European markets, as many companies in this region showed faster growth and better profitability than their other Global counterparts, yet still selling at lower valuations. In 2010, higher growth, improved balance sheets and still low valuations should provide a unique opportunity for Emerging Europe and investors. Certainly the Global growth trend may weigh on these nations in the near term, but the fundamentals, especially those that are commodity-based, will remain strong going forward.

### Looking Ahead

For all the negativity in 2009, about the state of the Global economies - large deficits, little growth, dysfunctional banks, and inept governmental responses the bottom line is that in the past twelve months there has been a remarkable up-swing in the capital markets and investors' confidence.

Meanwhile an extraordinary change in all the countries budgetary and overall global financial systems took place. “We are not cured yet, but the patient is going home” type of the feeling.

The good news about 2010 is that the world is emerging from recession and the economic picture is and will become clearer. The question remains; what will the landscape look like? Here are some of our thoughts and/or what we expect:

- **Emerging Markets** – will be central to just about every global issue in the coming years.
- **Developed Markets** -rich countries troubled by debt and high unemployment still are facing a long hard road to recovery.
- **Risk** - will continue to be redefined (return to sensible risk management).
- **Private Equity** - will shift to long-term funding (older model).
- **Banks** – those too-big to fail are breathing easier and are poised for a comeback.
- **Inflation** - the risks remain muted globally (at least for now)
- **Commodities** – higher

We see all these factors are beneficial to our EE focus. Overall, Emerging countries have a better fiscal and debt outlook than advanced economies which are mired in huge deficits and growing debt levels.

On the U.S. side, even though the market was up over 23% for the year, the major issues of deleveraging, availability of credit, government’s push toward regulation and threat of terrorism (yes, we haven’t heard this for a while) may act as a catalyst to lock potential gains for stocks, at least in the near term.

Consequently we expect non-US markets to keep outpacing US equities, as the strong showings of Global stocks has restored some attractiveness and appetite for these markets. One thing is for sure, that 2010 promises to be another testing year as fiscal and monetary stimulus in many of the world’s major economies begins to wane.

### **Eastern Capital Fund Ltd.**

The year was challenging, and will be remembered by investors as a year of recovery from the worldwide collapse of 2008. Clearly, some markets recovered faster than others, as the global economic slowdown was more marked in the US and Europe, than in Emerging Markets. The turning point came in March, when relentless selling on most markets subsided and renewed hopes of a recovery started to spread to investors. Commodity prices stabilized and recovered, thus lifting Fund’s shares particular in the spring.

The EC Fund ended the year with an NAV of \$31.12 per share or up 97.96%. The Fund produced a greater return than its benchmark, the MSCI EM Europe Index; the fund’s long-term showings are also superior (see Table 3). In addition, the fund’s volatility has not been overwhelming; its risk score is about average for the category.

As the Emerging economies continue to be the engine that drives worldwide growth, in our opinion this will benefit the Fund and our investors. We will maintain our overweight positions in Energy,

Natural Resource, Financials and Services producers with an increasing diversification away from the former Soviet Union and into global operators with a specific focus on Emerging Markets. In particular, we are keen on a number of companies which offer a combination of good governance, (through a listing in NY or London, for example), quality resource assets and strong growth potential.

We would like to take this time, and thank you for your confidence and your support. The best is yet to come!

*M.G. Kaminski and Robert Lada  
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**Table 1 - Emerging Europe versus other Emerging Markets.**

	<b>4Q</b>	<b>2009</b>
<b>MSCI EM Europe</b>	<b>9.29%</b>	<b>81.06%</b>
<b>MSCI Asia</b>	<b>6.65%</b>	<b>70.31%</b>
<b>MSCI Latin America</b>	<b>11.59%</b>	<b>98.14%</b>
<b>MSCI South Africa</b>	<b>8.86%</b>	<b>53.39%</b>

Data as of 12/31/09

**Table 2 – Russia’s valuations and the rest of the BRIC.**

	<b>2009E</b>	<b>2010E</b>
<b>Russia</b>	<b>11.3x</b>	<b>8.6X</b>
<b>Brazil</b>	<b>15.8x</b>	<b>12.7x</b>
<b>India</b>	<b>20.7x</b>	<b>17.0x</b>
<b>China</b>	<b>17.5x</b>	<b>14.3x</b>

Data as of 11/10/09

**Table 3 – Performance for Eastern Capital Fund and the MSCI EM Europe Index.**

	<b>2009</b>	<b>5 Year Ann.</b>	<b>10 Year Ann.</b>
<b>Eastern Capital Fund</b>	<b>97.96%</b>	<b>4.85%</b>	<b>12.78%</b>
<b>MSCI EM Europe</b>	<b>81.06%</b>	<b>7.39%</b>	<b>6.50%</b>

Data as of 12/31/09

Data Sources: MSCI, JP Morgan Securities (Asia Pacific) Ltd., Bloomberg.