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TURQUOISE PARTNERS

The White Bridge, Ahwaz

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This month, the Tehran Stock Exchange (TSE) showed the first signs of a recovery following a two-month slump, with the market's main index growing 1.6% in Rial terms on the month. Analysts cited the main reason for this turnaround in investor sentiment as being the recent reduction in political uncertainty following the country enduring a challenging period of political turbulence and emerging relatively unscathed. Investor confidence seems to be on the rebound, with savvy investors focusing more on company fundamentals and rather less on the risks associated with the investment climate. The steep 50% devaluation of the Rial by this Iranian calendar year has given domestic companies a new lease of life and granted them a healthy competitive advantage over importers, who in stark comparison now seem unable to compete with Iranian companies. Investors now eagerly await Quarter 3 earnings reports, due in January 2012, for confirmation that the devalued Rial has lifted earni ngs in line with analysts' expectations. If one takes a closer look at the TSE's historic performance following steep devaluation of the domestic currency, then one might reasonably expect the market to deliver a strong performance in the coming weeks. Indeed, the two best past periods of performance on the TSE both followed a steep devaluation in the Rial and analysts expect a similar outcome now.

We shall now examine in greater detail several individual sectors of the market:

TILES & CERAMICS:

At times of economic recession, investors typically favour stocks in smaller companies, in the hope of realising short-term gains from price movements. This resulted in the tiles and ceramics sector, which makes up just 1% of the total market capitalisation of the Exchange, being the TSE's best performing sector this month. The sector grew by an astonishing 41%, delivering what proved to be its best ever monthly performance. Historical data shows us that the average PE for this sector at 4.5 was always below the average for the market as a whole. However, following the sector's tremendous performance this month, its PE surpassed the market average PE at 6.5. There are two key reasons behind the gains in this sector this month: firstly, the recovery in the construction sector where levels of new real estate construction reached their highest level in the last three years and, secondly, the sharp devaluation in the Rial which resulted in revenues from export countries such as Iraq rising significantly. One can however still attribute some degree of speculation to this sector's growth, above and beyond the reasons cited above.

PETROCHEMICALS:

When examining the larger sectors of the market, the petrochemicals sector was amongst the best performers this month. Indeed, the first signs of a rebound in the broader market came from this sector and much of this can be explained by the fact that these companies' revenues are denominated in dollars and Euros, resulting in them benefitting from the weak Rial. The largest listed consumer of naphta-based feedstock, Arak Petrochemicals, made a positive earnings adjustment of 30%, resulting in a 20% leap in the share price of this company. Analysts now await earnings reports from gas-orientated companies whose cost bases are fixed, leading investors to expect significantly higher profits announcements. The market embraced such news wholeheartedly this month.

Khark Petrochemicals (the Middle East's third largest methanol producer) and Pardis Petrochemicals (the Middle East's largest urea producer) stocks grew by 13% and 3.6% respectively.

REAL ESTATE CONSTRUCTION:

This sector was the month's second best performer, delivering strong growth of 18.1%. When amalgamated with the tiles and ceramics sector, these two sectors were largely responsible for the bulk of the market's recovery this month. Prior to December, with a PE of 4.2, this sector was amongst the cheapest stocks of the market. This month's performance brought the sector's PE up to 4.7, still leaving the sector attractive to investors seeking stocks with further room for growth. The surge in construction activity combined with the 30% rise in house prices in 2011 (based on unofficial statistics) were the main factors behind this sector's strong performance. Despite this positive news, it is worth mentioning that companies in this sector continue to be plagued by a lack of adequate liquidity.

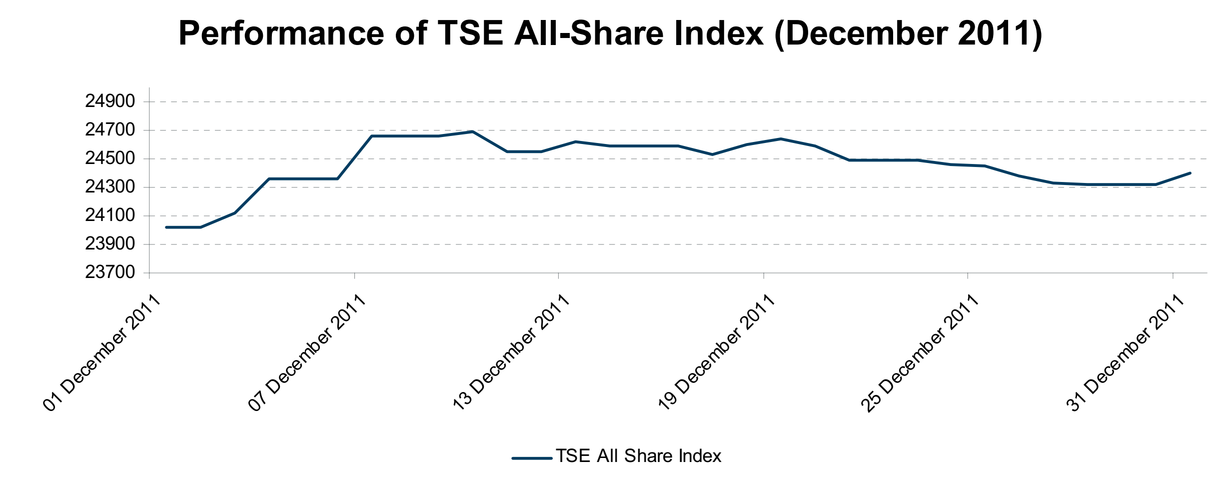
OTC:

The OTC market ended 2011 on a high note, following what has been a particularly strong year for the Farabourse (OTC) overall when compared to the TSE. In December, the OTC saw both a new listing and a bond issuance. Maroon Petrochemicals, the largest petrochemicals company by market capitalisation, was IPO'd this month, with 3% listed on the OTC. This company was established with a market capitalisation of $5.7 billion (based on official exchange rates). Maroon's profits were $920 million (based on official exchange rates) and the company was listed with a PE of 6. Some analysts viewed this stock as being overpriced based on its value, set at a 4 times the replacement value. In the bond market this month, Butane Group, a family-owned private manufacturing company and household name synonymous for producing water heaters and white goods, issued $17.7 million worth (at official rates) of 4 year bonds, generating a 17% annual yield. Demand overwhelmed the market, with the bond being over 40-times oversubscribed, aptly demonstrating the market's strong interest in fixed-income securities.

SUBSIDY REFORM PLAN:

This month marked the first anniversary of the Iranian government's bold subsidy reform plan, which saw state subsidies on fuel, utilities and other items being rapidly phased out. The government, following several undelivered promises of handouts to industry, answered their prayers by announcing that they would no longer intervene in industry pricing, with the exception of the automotive sector. This came as welcome news to Iran's ailing domestic manufacturing industry, which has wrangled with the government over this issue for some time now, and allows companies to adjust their pricing in line with consumer demand.

Overall, the month of December was a period in which the TSE began a steady recovery with growth of 1.6% and a total value of trades of $988 million (at official rates). One would expect this upward trend to continue into next month, following the release of Q3 earning reports due in mid-January, which are expected to show strong corporate earnings and buoy the market further.



Market Statistics	
Average P/E	6.6
Trade Volume ($ Billion)	1.0
Trade Value Monthly Change (%)	-0.9
Market Cap ($ Billion)	108

Top 5 Traded by Value

Rank	Company Name	Turnover Value ($million)	% of Total Turnover
1	Tidewater Middle East Co.	212	21
2	Informatics Services Corporation	54	6
3	Pasargad Bank	54	6
4	Parsian Bank	30	3
5	SADRA	22	2

Top 5 Companies by Market Cap

Rank	Name of Company	Market Cap ($Million)	% of Total MC
1	Telecommunications Co. of Iran	17,464	16
2	National Iranian Copper Industries Co.	12,845	12
3	Isfahan Mobarakeh Steel Co.	6,793	6
4	Pasargad Bank	5,990	6
5	Ghadir Investment Co.	4,634	4

Rate of US$ vs. IRR (www.cbi.ir)
December 2011: US$ 1 = IRR 11,164

Iran's threatened closure of the Strait of Hormuz

This month tensions in the Persian Gulf increased following Iran's threatened closure of the strategic Strait of Hormuz over a planned embargo of Iranian oil. As part of a ten-day series of military exercises, Iran undertook a drill designed to simulate closure of the strait and test fired a series of missiles designed to showcase the strength of the country's navy in the Persian Gulf.

A potential closure of the Strait of Hormuz by Iran tops the list of global energy security nightmares. About one third of all sea-borne oil and roughly 90 percent of all Persian Gulf oil leaves the region on tankers that must pass through this narrow waterway opposite the Iranian coast and land pipelines do not provide sufficient alternative export routes. Extended closure of the strait would remove roughly a quarter of the world's oil from the market, causing a supply shock of the type not seen since the glory days of OPEC. Brent crude oil futures jumped nearly a dollar to over $109 a barrel after the Iranian threat, but analysts saw this is as being only temporary. Some analysts say Iran would think hard about sealing off the strait as it could suffer just as much economically as Western crude importers.

Industry sources said that Saudi Arabia and other Gulf OPEC states were ready to replace Iranian oil if further sanctions halted Iranian crude exports to Europe. The Iranian oil minister, Rostam Qasemi, had said that Saudi Arabia had promised not to replace Iranian crude if sanctions were imposed. Gulf delegates from OPEC said an Iranian threat to close the strait would harm Tehran as well as the major regional producers that also use the world's most vital oil export channel.

Tensions were further elevated by the head of Iran's army warning the US against sending an aircraft carrier back to the Persian Gulf after it passed through the Strait of Hormuz a week ago.

The USS John C. Stennis, which Iran said it spotted during naval exercises, passed eastward through the Strait of Hormuz on 27th December on a routine voyage and was operating in the northern Arabian Sea.

US Signs Iran Sanctions Bill

This month, President Barack Obama signed into law a defence funding bill that imposes sanctions on financial institutions dealing with Iran's Central Bank, while allowing for exemptions to avoid upsetting energy markets.

The sanctions target both private and government-controlled banks - including central banks - and take hold after a two- to six-month warning period, depending on the transactions. The measures meant to punish Iran for its nuclear programme, were contained in a $662 billion defence bill, which officials said Obama signed despite concerns that it could complicate his bid to build an international front against Tehran. The sanctions require foreign firms to make a choice between doing business with Tehran's oil and financial sectors or central bank or the US economy and financial sector.

Foreign central banks which deal with the Iranian central bank on oil transactions could also face similar restrictions under the new law, which has sparked fears of damage to US ties with nations such as Russia and China.

Under the law, the President can move to exempt institutions in a country that has significantly reduced its dealings with Iran and in situations where a waiver is in the U.S. national security interest or otherwise necessary for energy market stability. He would need to notify Congress and waivers would be temporary, but could be extended. Sanctioned institutions would be frozen out of U.S. financial markets.

Analysts saw the implementation of this law as being a timed and phased approach to avoid repercussions to the oil market. Iran's Central Bank is the main conduit for Tehran's oil revenues. Obama signed the bill shortly after Iran signalled it was ready for fresh talks on its disputed nuclear program.

Iran Builds Homes in Venezuela

Iran has signed a $1bn agreement with Venezuela to help build about 10,000 homes in the South American country. The Foreign Ministry was quoted in a statement as saying that the new apartments would house some 45,000 people.

President Hugo Chavez has developed close ties to Tehran, and an Iranian company previously helped build public housing complexes in Venezuela. The deal is a part of President Chavez's Vivienda Venezuela project, the socialist leader's plan to build 2 million housing units for the country's poor over the next seven years. Mr Chavez has made the project one of his top priorities ahead of next year's presidential election.

To meet its housing deficit, Venezuela is working with companies from China, Iran, Turkey and Belarus for construction and financing as Venezuela confronts a severe housing shortage.

Housing Minister Ricardo Molina announced the agreement with Iran and said the homes will be constructed in the states of Yaracuy, Lara and Carabobo over the next 18 months.

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Rial Hits Record Low

This month, the Iranian Rial, at unofficial rates, plunged almost 30% to a record low against the US dollar amid concerns over the impact of international sanctions and speculation that the government is devaluing the Rial to help narrow a massive budget deficit.

The unofficial Rial vs. US Dollar rate underwent severe fluctuations this month, eventually settling at 17,000 Rials at the end of the period.

Over the past decade, Iran's Central Bank, which channels more than 90 per cent of hard currency into the local market, has employed a managed float system to support a single rate against hard currencies, notably the US Dollar.

Usually when the Rial shows signs of weakening, the bank pumps foreign currency into the market to intervene. However, sometimes the authorities choose to weaken the national currency intentionally by withholding the supply of hard currency to earn more Rial-denominated income, usually at times when the government faces a budget deficit.

The managed float mechanism has not functioned properly for much of this year. The Central Bank's adoption of a multiple-rate system has also been unsuccessful in restoring stability to the market and foiling the impact of international sanctions aimed at Tehran's nuclear programme. Sanctions have caused the cost of financial transactions to increase, by forcing them to go through numerous back channels, and have hit foreign currency markets by reducing the supply of hard currency.

There are also domestic dynamics at play. Local media have accused the government of President Ahmadinejad of engineering a deliberate devaluation to boost the Rial value of its oil income in the final months of the fiscal year to March. Economists and parliamentarians have predicted this year's budget deficit could be as high as $30bn, or 7% of the country's GDP.

The government is due to present its budget bill to Parliament soon and some analysts believe the government is allowing the Rial to weaken to reset the official exchange rate to the dollar in the budget, which has traditionally sat around the 10,000 mark. Iran's Economy and Finance Minister strongly denied any such intention.

The reasons for this devaluation may be found in four serious immediate threats to Iran's economy: impending political tension and power struggles between the Ahmadinejad camp and the principalist camp in the upcoming Parliamentary elections, which may generate administrative and political instability; US and international financial sanctions that have made international financial transactions with Iran extremely difficult; heightened military tension with the US; and the consequences of alleged economic and financial mismanagement and inappropriate monetary and fiscal policies of the ninth and tenth governments.

Reflecting possible concerns about liquidity and the flight of hard currency, the Central Bank of Iran (CBI) over the past few months has restricted cash withdrawals and allows those travelling outside the country to take with them only $2,000 a year. For foreign investors, Iran's 2002 Foreign Investment Promotion and Protection Act (FIPPA) continues to provide reassurance by guaranteeing foreign currency at official rates and repatriation of investment and profits in hard currency at official exchange rates.

The most radical step came on 26th January 2012 when the CBI's Governor Mahmoud Bahmani announced that it would be fixing the official rate of the Rial against the Dollar at 12,260 Rials from 28th January and seek to meet all demand for foreign currency through banks. The CBI's plans to devalue the Rial at official rates are aimed at reducing the unofficial market's influence in undermining the currency.

One day earlier, President Ahmadinejad took the momentous decision to liberalise the mechanism by which bank interest rates are set, granting banks the authority to raise interest rates to up to 21%. The move was a reversal of his earlier opposition to the decision by Iran's Money and Credit Council that would have boosted the interest rates to a level above the inflation rate. Economists said such a step was crucial to absorbing market liquidity and buoying the rial.

Following the announcement of the raise in interest rates, the currency markets significantly calmed and the Rial was trading at 17,000 Rials to the dollar. Many analysts foresee the new single foreign currency rate due to come into implementation on 28th January combined with the new elevated bank interest rates as being two hugely positive measures that will bring calm to the market and stability to Iran's economy, whilst restoring Iranians' faith in their currency.

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Iran Temporarily Halts Imports from UAE

This month Iran took the surprise step of temporarily halting imports from the United Arab Emirates, in a show of anger against the Arab state's support of US and EU sanctions against Iran and the UAE's cooperation with the US and EU states in maintaining stability in the global energy market if Iranian oil were to be embargoed.

Iran's Minister for Industry, Mines and Trade ordered a temporary stop to the import register offers from the UAE, a move later confirmed by Iran's ambassador to Abu Dhabi.

Iran is the main destination of exports and re-exports from the UAE, which has gained over $12 billion of income from exporting goods to Iran over the last eight months. Iran's action was deemed to have had a noticeable impact on the UAE economy. Analysts see the cutting of trade relations as being more harmful to the UAE, given that the Arab state's exports to Iran are of a magnitude four times greater than its imports from Iran. The value of trade between the UAE and Iran over the last eight months stands at over $15 billion, of which around $12 billion were the UAE's exports to Iran. Losing the lucrative Iranian market would therefore have detrimental effects on the UAE's economy.

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Tehran Stock Exchange Ends 2011 on a High

The Tehran Stock Exchange (TSE) ended 2011 on a high note, with significant growth in its main index of 29.5% from the end of 2010.

The number of trades increased by 60% in comparison to 2010 and transactions exceeded the 4.2 million mark. Value of trading also witnessed a healthy 7.3% growth and exceeded 211,000 billion Rials. The only area that suffered a decline was the trading volume which fell 29% to 68 billion traded shares.

2011 was a good year for IPOs with six new companies listing on the TSE. These included two banks, two petrochemical companies, a steel manufacturer and an electronics company which raised the total number of TSE listed companies to 347 at the end of December 2011.

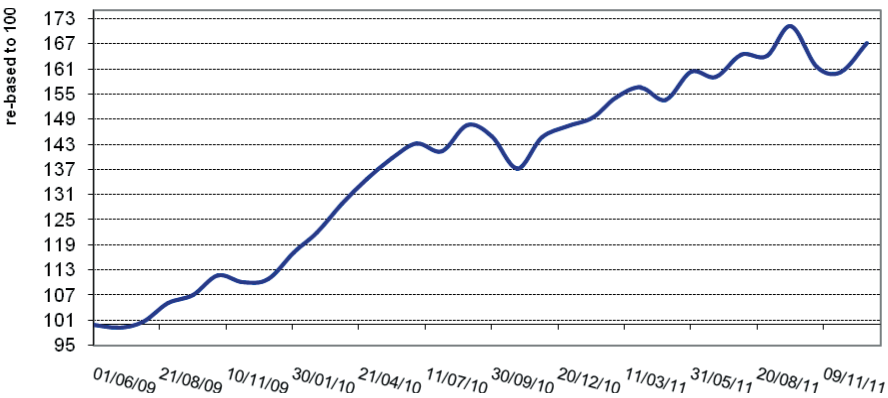
In the TSE's derivatives market, over 13,200 single stock futures contracts were traded in 2011 with a value of over 510 billion Rials. This represents phenomenal growth given that this market is still in its infancy having only been launched in mid-2010. The Securities and Exchange Organisation (SEO) is currently considering establishing a stock options market on the TSE.

Investment Objective – The Turquoise Equity Investments seeks superior long-term capital growth by investing in the consumer and commodity potential of Iran, one of the most undervalued emerging markets in the world. Turquoise combines international experience with local expertise in investing in equities listed on the Tehran Stock Exchange (TSE) and other Iranian-based securities. The goal is to provide superior returns, with greater diversification and lower volatility.

Class A — *NAV = 167.0*

Vehicle Domicile	Management Fee	Currency
British Virgin Islands	2.0% p.a	Euro (€)
Launch Date	**Carried Interest**	**Minimum Investment**
01 June 2009	20% (High Water Mark Applies)	€100,000

Class A Performance (Euro) - As at 31st December 2011



Period	Portfolio Return
Last Month	4.2 %
Last 3 Months	- 2.5 %
Last 6 Months	5.0 %
Last 12 Months	13.3 %
Since Inception (01 June 09)	67.0 %

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About Turquoise

Turquoise is a boutique investment firm based in Iran. Turquoise creates financial products and offers financial services to select clients and investors who are interested in the Iranian market. Having a qualified and diverse management team with a wealth of international expertise enables Turquoise to benefit from coupling a network of global expertise with an enviable reputation for local knowledge, professionalism and integrity.

Turquoise publishes this electronic newsletter, *Iran Investment Monthly*, with the aim of keeping its recipients updated on the latest macroeconomic developments in Iran, providing an in-depth analysis of the Tehran Stock Exchange as well as introducing new financial products and private equity opportunities to potential investors.

Iran Investment Monthly is distributed exclusively amongst Iran analysts and potential investors who have worked closely or have been in contact with Turquoise Partners. Subscription to this newsletter is by referral only or through an online request sent to: *info@turquoisepartners.com*

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