



# INVESTORS BULLISH ON THE ISTANBUL STOCK EXCHANGE

Will the Istanbul Stock Exchange, the eighth-largest stock exchange among developing countries, climb even higher?

BY MERVE KARA

Since 2001, when Goldman Sachs Asset Management Chairman Jim O'Neil coined the term "BRICs" for the largest emerging markets, international mutual funds have pumped \$70 billion of funds into Brazil, India, China, and Russia—the BRIC countries. These countries' capital markets income in the Standard & Poor's 500 Index roughly quadrupled over the past decade. O'Neill's prediction that the BRIC economies would exhibit healthier growth than those of the G-7 countries seemed more or less confirmed until recently, when their performance fell below expectations, such that current reports by Goldman Sachs—the originator of the term "BRIC"—say the golden age of BRIC is over. In a report published by Goldman Sachs last December, titled "The BRICs 10 Years On: Halfway through the Great Transformation," it is stated that the peak potential growth rates for all of the BRIC economies have been left behind. Goldman Sachs economists updated their long-term growth projections in the report, according to which BRICs are still set to join the largest economies in the world but the N-11 and other EM should also become significant global players.

This year, Jim O'Neill has been helping to popularize an acronym for a new group of nations that seem likely to replace BRIC for many investors: MIST, or Mexico, Indonesia, South Korea, and Turkey, the four biggest markets in the Goldman Sachs N-11 Equity Fund (GSYAX). Launched in February 2011, this fund has grown 12% this year, while Goldman Sachs' BRIC fund gained just 1.5%. Of the four MIST countries, Turkey and Mexico are the most attractive at the moment, O'Neill was paraphrased as saying in a related article published August 6 by Bloomberg. Positive expectations for the economy of Turkey, one of the most promising members of MIST, reflected upon the stock market with an incredible performance despite the heavy effects of the crisis still being felt in the global economy: since July, Turkey has been passing through a period in which records in the stock market are being broken one after the other.

Garnering a credit rating upgrade on June 20 by Moody's to Ba1, one level below investment grade, was important as it provides Turkey with means for lower-cost international financing and loans. Measures implemented to control Turkey's more sensitive parameters, such as its current account deficit, play a role in the upgrade and are expected to bring in the long term more sustainable growth and economic stability. It is important to note that Turkish stocks rallied after the government cut its fiscal deficit to 1.3% of GDP in 2011 from 3.6% in 2010. The increase in direct investment, an important instrument for the quality financing of the current account deficit, can especially increase from-scratch "greenfield" investments.



The ISE ranks 20th among world stock exchanges in terms of trading volume and 32nd in terms of market value, according to the World Federation of Exchanges. The Market Trends Report prepared jointly by the Investor Relations Association of Turkey (TÜYİD) and the Central Registry Agency (MKG) in June demonstrates the recent positive performance of the stock market and foreign investors' positive contribution to market value. According to the report, a performance increase of 8% on the Turkish lira and 11% on the US dollar has been observed over the first five months of this year. While just 7,683 of the total 1.1 million investors were foreign, they account for a 19% share of transaction volume and 62% share in market value. TÜYİD President Funda Güngör Akpınar states that interest in the ISE has increased significantly especially since June. Comparing the ISE's performance over the first six months of the year to global markets, Turkey exhibits relatively very good performance and its rate of growth on the dollar since the New Year has surpassed 20%, she says. Data from the Cambridge,

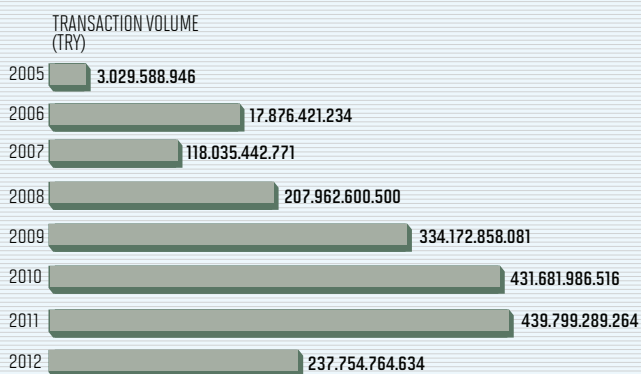
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Massachusetts-based research firm EPFR Global supports this viewpoint—according to EPFR Global, investors added a net \$104 million this year to funds focused on Turkey.

"It can be easily said that Turkey's economy is remarkably stable compared to its neighbors in the euro zone and Middle East, which has been an important feature to attract foreign investors," says Philipp Reuter, Turkey Director of international research and consulting company Frost & Sullivan. The additional costs imposed by the crisis and instability in currency exchange rates in neighbor-

## RAPID GROWTH OVER EIGHT YEARS

Annual transaction volume increase for TurkoDEX since its foundation in 2004.



Data: TURKOEX

ing countries and beyond, as emphasized by Reuter, incited the private sector in Turkey—SMEs in particular—to adopt a more active approach to public offerings, another important source of financing. A total of 27 initial public offerings took place in 2011, while over just the first months of 2012 there were 19. The increase in public offerings and higher transaction volumes are expected to continue through the end of the year, and they are quite significant with respect to increasing market players' sense of trust by deepening Turkey's capital markets, reducing fluctuation, and therefore reducing risk premium. Attila Köksal, President of the Association of Capital Market Intermediary Institutions of Turkey, which launched a campaign to encourage public offerings by signing a protocol of cooperation in 2008 with TOBB, SPK, and the ISE to better inform companies about capital markets and public offerings, states that there are 13 companies that have applied to be listed on the market as of mid July, and he adds, "We can expect the public offering trend observed in the first half of the year to continue in the second half. But the international economic conjuncture will be an important factor in public offerings."

Turkey is one of the countries least affected by the crisis in 2008 and 2009.

Thanks to the past bitter experiences of the '90s, Turkey has managed to develop better financial policies to regulate the investment and banking environment, which also gives birth to opportunities via market liberalization. According to Philipp Reuter, this current business environment drives the regional geographic expansion plans for Turkish companies which is likely to be expected to boost their M&A

activities in global markets. "We are expecting the volume of M&A activities to increase in the following two years, which will create a better awareness for the investment society. So this will cause the number of public offerings to increase more between 2013 and 2016," he adds.

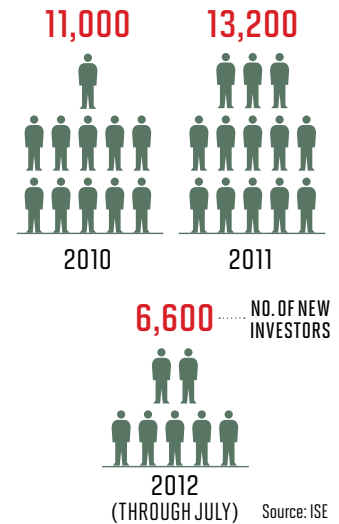
Together with the ISE, TurkDEX—the Turkish Derivative Exchange—is exhibiting vibrant, buzzing performance. The exchange celebrated its eighth year this past February. The exchange's transaction volume of TRY 423 billion in 2010 increased by 2% in 2011, but because

the number of transactions increased 16%, TurkDEX maintained its position among world derivative exchanges. TurkDEX is expected to grow 4% in 2012.

Turkey's high-trending markets continue to instill hope in many investors. Thanks to this victory of sound measures like technology policy, Public offerings, and product diversification, Turkey seems likely to continue to climb within MIST, the new favorites of the world economy.

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<b>FUNDA GÜNEŞ AKPINAR</b>	<b>ATTILA KÖKSAL, CFA – PRESIDENT</b>	<b>PHILIPP REUTER</b>
<b>President, the Investor Relations Association of Turkey (TUYİD)</b>	<b>Association of Capital Market Intermediary Institutions of Turkey (TSPAKB)</b>	<b>Director, Frost &amp; Sullivan</b>
<p>When this interest in the ISE is examined in terms of contribution to international direct investment, it can be said to be critical in terms of the expansion of the investor base and therefore Turkey's recognition. The development of capital markets is a significant promotion tool for many countries that will invest in Turkey. Several companies making portfolio investments can also be active in private equities. An international fund entering as a stock market investor today could, with knowledge of the economy of Turkey and the operation of its markets, bring its direct investments to our country, too. The ISE's positive performance is another door opening on to Turkey for investors in this respect.</p>	<p>Turkey is a country that has been under watch by global capital for quite some time. Especially in recent years, Turkey has never had a hard time drawing sources of capital from abroad. On the capital side, it is expected that both strategic and portfolio investors (private equity funds especially) will continue to be interested in Turkey. Since the start of 2010, the number of stock market investors in Turkey grew 9% to reach 1.1 million. Although there is no definite data that can measure the effect of public offerings on the number of investors, it is known that the public offerings made recently have gained new investors for the ISE.</p>	<p>Unlike the US or EU, Turkey is very promising for investors. Even if the expansionary policy of US central bank had a positive impact for a while during 2010, fluctuation continued in 2011 and still does. Additionally, the uncertainty of Greece and the falling ratings of European banks are strengthening Turkey's position to receive foreign investments. Hence, in Q1 2012, foreign investors purchased almost \$1 billion in stock. The vast majority of foreign investors are from the US, which accounts for a 20% share, and we expect this number to increase alongside uncertainty in the European economy. Additionally, the venture capital inflows have been affected positively due to intense activities by the ISE depending on its offer of an additional exit option through public listing of a company, exit option through public listing of a company.</p>



## ISE CONNECTS TO EAST ASIA

Mr. Nihat Gümüş, advisor to the chairman of the ISE, spoke to The Turkish Perspective magazine about the recent performance of the exchange in Turkey

BY MERVE KARA

### **What do you think about the ISE's performance over the past year, in terms of the contribution made to drawing international investors?**

The market value of companies listed on the ISE had increased by the end of 2010 to more than three times the figure attained by the end of 2008, reaching approximately \$307 billion. Our market value fell in 2011 due to global liquidity conditions and obvious issues that emerged in Europe, but in 2012 it recovered and again attained levels of \$260 billion in the first seven months.

This performance, taking place in a time when the North Atlantic crisis still affects the world, reflects the behavior

of nonresident international investors in our exchange. Nonresidents' net purchases in the stock market over the first six months of 2012 totaled approximately \$2.8 billion. These nonresidents' share in total transaction volume has shot back up to levels of 18-19% in the first six months of 2012. These figures indicate that the position of nonresident international investors in the ISE has risen with their performance over the past year.

**2012 has been a very fruitful year in terms of public offerings in the stock market. What is your assessment of this situation? Do you expect this trend to continue?**

The public offering campaign that started in 2010 with the initiative of all actors in the capital market, our exchange and Capital Markets Board above all, started to show its effects from the first year onward. The shares of 23 of our companies were offered to the public in 2010, and of 27 in 2011. In the first half of 2012, this figure reached 19. As the outcome of these public offerings, we have provided our companies with TRY 420 million in resources. We will conduct three more public offerings before July is over. And in light of the existing applications, it is possible to say that this trend will continue to increase. Another matter we will be focusing on in relation to public offerings is to make public offerings widespread especially among Turkish companies that rank in the top 500 and 1,000 companies listed by ISO. We will be working intensely next year both to introduce large companies [in Turkey] to the exchange and to increase the public offerings of already listed large companies.

### **What kind of activity has the large number of public offerings created in the stock market? How will this draw small- and medium-scale investors?**

Since the public offering campaign began in 2010, the transaction volume of our stock exchange rose from \$316 billion in the previous year to \$425 billion. The year 2011 ended with a transaction volume of roughly the same level. Looking at the first seven months of 2012, one sees that the volume has maintained its levels.

As is known, approximately three-fourths of the total transaction volume on our exchange is accounted to individual investors. Therefore, another indicator one must keep in sight is the increase in the number of investors. The number of investors opening investing accounts and participating in public offerings for the first time has increased consistently since 2010.

**Do you expect the rise in the stock market that followed Turkey's credit rating increase to continue?**  
International credit rating agencies'

evaluations of countries, institutions, and financial products became one of the most important topics on the agenda after the 2007 financial crisis. One of the most serious criticisms concerning these evaluations has been that the models on which they are based are built to an extremely large degree upon historical data and do not reflect the future-facing potential and risks carried by an economy. Generally, I agree with these assessments. The evaluations conducted by credit rating agencies in time become built on top of an assumption of constancy and are unable to capture the structural transformations and breakdowns undergone by an economy over time. For this reason, the credit rating of Turkey, which should have long been raised to “investment worthy” by virtue of the country’s structural reforms, macro-economic performance, and finance sector strength over the past ten years, only came to the stage before this level in recent months. As another outcome of the extreme reliance of the models on historical data, the fact that the rating of Italy, whose economic condition is clearly dire, is still A- while Turkey’s is still at BB+ can be shown as an example. But the markets are moving ahead of the rating agencies. While the treasury of Turkey was able to secure a 30-year loan with 5–6% interest, Italy’s loan rates are clear to see.

To return to your question, the increase in credit ratings can of course be said to positively influence the amount of investment in companies listed on our exchange. But the truly significant effect will be seen when Turkey possesses an “investment worthy” credit rating. My expectation is that Turkey’s rating will rise to this level as of next year.

**Can you provide some information about the ISE’s process of incorporation? How will this situation contribute to the development of the exchange?**

Historically, in many countries in the world, exchanges were established as cooperative-like structures formed generally with the participation of their members. But since the 1990s, there

has been a rising trend for exchanges to turn into profit-focused corporations with public offerings. Examining the examples of the exchanges of Stockholm, Italy, and Australia, and the exchanges of Korea and Brazil, which were incorporated in the second half of the 2000s, significant increases in their market values were observed following incorporation. If the new Capital Markets Code is fully ratified in the General Council of the Grand National Assembly of Turkey in October, we expect to complete this process by the end of the year.



*There is no reason for our exchange not to strengthen its leadership in its region and become one of the world’s distinguished exchanges*

**Can you discuss the work you have done to increase the ISE’s international competitiveness and depth?**

In order to survive and develop in this competitive environment, we as the ISE believe that we must first secure vertical and horizontal consolidation internally. In this way, we are aiming

to create a technological platform on which resident investors both local and international can buy and sell many products over one trading and storage account. Also in this scope, we are engaged in an effort to establish regional partnerships by making agreements with exchanges in our region, many of which are members of the European Federation of Exchanges over which we currently preside anyway. With memorandums of understanding and protocols we signed with the exchanges of South Korea, Macedonia, Morocco, Bosnia, and Egypt, we have started projects to make it possible to mutually connect these exchanges. Also in the coming term, we aim to make such agreements with exchanges in our region and in East Asia.

**Where do you predict the ISE will be among global markets for the next five years? What data supports your predictions?**

As of 2011, our exchange ranked eighth among World Federation of Exchanges-member developing markets in terms of stock market transaction volume with a figure of roughly \$500 billion. In terms of volume, and hence liquidity, our exchange is a leader in the region. But we must raise the market value of our companies in the stock exchange. I think this is a viable—surpassable, in fact—target under normal conditions. The Turkish banking industry has accomplished this, after all: growing roughly fourfold over the past eight to ten years, our banking industry has come to its level today.

Macroeconomic indicators like the structural reforms that took place after 2002, the reduction of public pressure on usable funds, our high performance in growth, low inflation, and our strong banking industry show that capital markets are next line. With the needed technological policies and the expansion of public offerings and product diversity, and with activities to inform investors, the value of our exchange will rise to levels in proportion with our national income. There is no reason for our exchange not to strengthen its leadership in its region and become one of the world’s distinguished exchanges.