

Truth and Beauty (light)

(... and Russian Finance)

Sakhalin, Mon Amour

Fear and Trembling	1	Georgia - On my Mind	6
Cycling Through Russia	2	Russian Response - Of House Flies and Howitzers	6
Sakhalin , Mon Amour	3	The Assassinations - Down a Gun Barrel - darkly	7
Shell shock	5	A parting shot - eXile-ing Newsweek	9

Fear and Trembling

Once again, there is a whiff of panic in the autumn air – Investor opinion as regards Russia is being afflicted by one of its periodic phases of very Bad Vibes. A series of totally unrelated events, some tragic, i.e. the assassinations; others readily justifiable or at least understandable – the revision of the Sakhalin deals and Russia's snapping back at Georgia, once again combine to destroy that warm, fuzzy feeling that Russia usually inspires in the West. Needless to say, with their accustomed benevolence towards all things Russian, the international press is milking them for all they are worth!

Given that T&B sees itself, at least occasionally, as primarily a financial publication, we are disinclined to waste further time in abstract discussions with the baying pack of Russophobes. From the investment standpoint, we would simply remind our readers that taking out a subscription to The Economist may well have been the worst investment of many careers... In 1997, you would have been warned of the impending collapse in oil prices, in 1998 of the catastrophic breakup of the Russian Federation – while every subsequent issue of The Economist has warned of a veritable *pot-pouri* of impending catastrophes... In the meantime, of course, oil prices have more than quintupled, the Russian equity market has soared 30-fold, while Russian GDP has exploded to almost one trillion dollars...this unparalleled history of failure has apparently taught them precisely nothing – we now find them shrieking about Russian “fascism”...as in, how dare those uppity Russians succeed when we mandated that they should fail!

Similarly, the totally corrupt Anders Aslund – he who brought discredit upon the Carnegie Endowment by soliciting secret “contributions” from Yukos – little more than bribes for his PR services, is now calling for a resumption of the Cold War... Somehow, with enemies like these, one gets the sneaking suspicion that Russia must be doing something right...

As during previous periods of dismay – those following the Serbian bust-up, the Yukos follies, the terrorist outrages, Putin's restoration of the power vertical in the regions, the Ukrainian imbroglio, etc. – the current round of Western agonizing about Russia will soon enough exhaust itself.

Russia is neither the *Shining City on the Hill* nor the *Heart of Darkness* – what it is is a thriving, challenging, dynamic country, offering enormous opportunities – investors had best do their own due diligence – not relying upon deeply-biased Western pundits with comically-bad track records.

Back in the real world, each passing week brings further confirmation of Russia's reinforced Asian strategy, thundering growth in Russia's regions (where real estate prices are now going ballistic), and the huge new inflows of capital, both domestic and foreign. While industrial output growth remains tepid, overall growth is impressive – nearer to 7% again this year. Major reforms are underway (most recently, RAO UES) and the badly degraded infrastructure is finally being rebuilt. As acknowledged by Vladimir Putin himself – corruption remains a serious problem...but it has certainly not prevented Russia from enjoying eight consecutive years of the fastest growth in the Western hemisphere. The dogs bark – the caravan passes.

Cycling Through Russia

Since October 1998, in his various incarnations, T&B has been selling Russia to the foreigners. As sentiment tends to be cyclical, it has, at times, been a bit of a slog.

Just six weeks after the crash – as Head of Fixed Income for a large, temperamental German bank (retribution for something we did in our last lives?) and having just heard from Finance Minister Misha Kasyanov that he felt a “fiduciary duty” to the European *dedushki* and *babushki* (i.e. grandmothers and grandfathers) who owned Russian Eurobonds, and thus, that Russia would never default on her external debt¹ – we set off manfully to Switzerland to peddle some cheap assets.

In Geneva, of course, when we were received at all, we were let in via the service entrance – like purveyors of fine cannabis, a few clients were interested, but for God's sake, not in public! In the end, a couple of old mates, admiring our perseverance and figuring that “*at these levels, how much can we lose?*” did us a favour, taking a few million Russia 28s off our hands at about 20 cents on the dollar – thus keeping us, at least temporarily, in a job. In the event, their kindness was very adequately rewarded – with a compounding total return of about 1700% over the following 6 years.

Needless to say, we have learned to be not just counter-cyclical but alert – having ridden the Russian roller-coaster for the past decade, we have observed that each time one of our peers announces that Russia is finally becoming boringly predictable – it is time to fasten the old seat-belts – for we are just about to hit some turbulence!

In recent years, the periods of maximum bearishness have generally offered the best buying opportunities – though alas, investors are now growing increasingly skeptical about what they read in the press, no longer dumping their Russian assets in a blind panic each time the Economist and its ilk announces the end of the world. Nothing illustrates this skepticism better than the fact that, despite all the bad press, over the first 9 months of 2006 total foreign investment hit a record \$27bn, with FDI increasing by a whopping 43.6% Y-o-Y... and all the rest is just literature.

Enjoying the Crumbs

What was initially little more than a leap of faith as regards Russia's ability to fulfill her huge potential has gradually been comforted by the unremitting stream of excellent macro-economic numbers, slowly improving corporate governance and the vital – if still incomplete – advent of political stability. There have been set-backs, and there is much we would find to criticize, but this is somewhat beside the point. Foreigners, we are merely guests at this feast – a Russian feast, conducted in keeping with the national experience and the mysterious Russian soul. Not necessarily the way T&B would have chosen – certainly not the way her self-appointed advisors and oh-so-deeply-concerned well-wishers in the West would have mandated – simply, the Russian way.

Russia is not quite “The West” – equally, it is not really part of Asia. Russia shares certain aspects of each, but with her own unique identity – understanding this simple fact is apparently quite a challenge for many Western commentators. Perhaps there would have been fewer misunderstandings were the Russians to have Asian features, or perhaps long ears and blue skin – then the Westerners would have instinctively accepted that there were certain fundamental differences – as they accept them in the Chinese.

Enough philosophy! We shall here attempt to shine what little light we can upon the three stories which have most shaken our peer-group: foreign participation in Russian oil (i.e. Sakhalin and Shtockman), the turbulence with Georgia, and the assassinations.

¹ Translation: default on my own Eurobonds? Are you crazy? Now that I've bought my size – and it is going to feed the next five generations of Kasyanovs – now is the time to get your clients in!

SAKHALIN, MON AMOUR

Characteristically, T&B finds ourselves in the difficult position of trying to explain an obstreperous and newly assertive Russia to a deeply biased and badly misinformed West. In the end, our position remains descriptive – not prescriptive. We shall leave the impotent diatribes to others. Indeed, we are to equal measures amused by the hypocritical moralizing of the oil companies – certainly the most rapacious beasts in the global jungle; bored with the tendentious Western press coverage (hoping that any investor who actually believes what he reads in *The Economist* gets what he deserves); and just about to give up any residual hope that the Russian government will ever learn to communicate its positions in a transparent, coherent, and at least half-coordinated fashion. They have that unique knack of making themselves look like villains even when distributing Christmas candy to orphans!

While the oil majors are doing quite nicely on their Russian investments, it is very much a seller's market, and some revision in their attitudes will be called for. Those who have played the game (BP, Conoco) are printing money. The others shall be faced with the stark choice between doing it the Russian way, or not doing it at all. Russia now has ample technical means of developing her own on-shore resources, and can buy in the necessary services to develop of the remainder. She can easily dispense with foreign money, expertise and advice – and, as shown by the recent shock decision on Schtockman, is increasingly doing just that.

Through a Barrel, Darkly

*We have recently been peppered with questions as regards the profound significance of the Sakhalin dispute, and what it means for foreign non-strategic investors in Russia. As is typically the case, the answer is, in fact – **precious little**. Russia is reclaiming control over what she sees as her strategic assets, but that is not news – and she is doing so with typical tact, spin-management, and clarity...*

Those companies which negotiated deals in the 1990s that were a bit too good should by now understand that a “too-good” deal in Russia is, in fact, not good at all. Crooked or incompetent agreements from the 1990s are no longer grandfathered, and talking tough with the Russians will invariably evoke a Stalingrad-style defense. Once again, like oil business everywhere, in Russia it is all about the balance of power, not about abstract issues.

A Brief Digression – Our Oil/ Your Sands

How did “Our Oil” get under Their Sands?

Bumper sticker, Berkeley, California

With the exceptions of Norway and Russia itself, none of the current major oil exporting countries initially owned or developed its own major fields; development work was done by foreign oil companies acting in the interests of their own shareholders and governments – the host countries had neither the money nor the technology to develop their own assets, and since oil was a buyer's market, they were at the mercy of the oil majors, and could always be slapped into line by the threat of boycotts.

With the rise in OPEC, these countries rapidly grew wealthier, and could increasingly manage their industries without allowing direct foreign ownership. With varying degrees of compensation and negotiation, they eventually expropriated the foreigners. The first country to do so was Mexico, when in 1938 Lazaro Cardenas nationalized US holdings, forming the state oil company Pemex. Since the Mexican constitution unambiguously defines sub-soil resources as the property of the nation, and given the huge domestic popularity of this nationalistic move, the takeover was initially done without compensation. This triggered an aggressive response from the oil companies, with the US government briefly boycotting Mexican oil exports. The boycott was soon lifted in return for a token payment of \$27M, when the imminent European war caused Washington to become concerned about stability of supply.

Mexico remained very much the exception, as new oil provinces were opened up by the Seven Sisters in the Middle East, Venezuela, Iran and Asia. Oil was cheap and plentiful, deals were as often as not corrupt, and until the beginning of the 1970s, the producing countries extracted limited benefits and no political leverage.

The 1973 Israeli-Arab war galvanized OPEC. The first oil shock hit the West hard, demonstrating its vulnerability, as prices soared and country after country began to assert ownership of their subsoil resources. By the end of the decade, essentially all of the major producers – not just in the Middle East, but also in Latin America and Asia – had reclaimed ownership (while foreign companies have, in a few cases, been allowed back in, they have returned as operators – not as owners – and have been subject to the occasional bout of retroactive taxation and other vexations).

Russia, of course, fell outside of this development. While oil deposits in Southern Russia had been exploited from late in the 19th Century, the great Samatlor and various Siberian fields were developed by Soviet engineers, and the USSR became increasingly dependent upon oil exports to fund its dysfunctional economy. The slide in oil prices arguably contributed far more than Afghanistan or Star Wars to its final collapse.

With the breakup of the Soviet Union, Russian oil exports plunged, as political and economic disorganization led to a halt not just in exploration but also in basic maintenance, as well as to widespread theft and asset stripping. By the early 1990s, the politico-economic situation in Russia had deteriorated to the point that there was no domestic capital or infrastructure to support exploratory drilling – even onshore, much less in a very challenging deep-water environment. It was in this context that the Production-sharing agreements (PSAs) were signed.

PSAs are generally the preferred means used by oil companies for undertaking high-risk exploration projects in third-world free-fire zones, where the political and taxation environment is uncertain at best.

The rich but very challenging oil and gas-fields on Sakhalin Island and offshore Sakhalin were the targets for the first Russian PSAs. The first one to be negotiated was Sakhalin-2, currently 55% owned by Shell, 45% by two Japanese trading companies; it was followed a year later by Sakhalin-1, with Exxon as lead investor. From the Russian standpoint, Sakhalin-2 provides a text-book example of how not to structure a PSA. Indeed, looking at the terms of Sakhalin-2, essentially unprecedented in the global oil industry, the only real question is whether it was an example of simple incompetence on the part of the Yeltsin-era Russian natural resources ministry, or whether it was a case of outright corruption.²

In a recent review of the PSA terms, without speculating on the reasons, Alfa Bank Research showed just how far the Sakhalin-2 project deviated from industry standards:

- Though Sakhalin is geographically challenging there was no exploration risk. Extensive initial exploration had already been carried out, fields were mapped, and the oil was in place. Neither of the consortia assumed the risk of coming up empty-handed.
- Sub-standard royalties and tax rates.

But most extraordinarily:

- No time limit – PSAs ordinarily run 20 years. Sakhalin-2 is set for an initial 25 years, but renewable at the sole initiative of the company by 5-year increments *ad infinitum!*
- No cap on costs – the Russian State was to receive no profit oil whatsoever until after all costs are recovered AND a 17.5% IRR is achieved by the company. In other words, Russia would see no revenues until Shell was deeply in the black, regardless of how well or how poorly they performed – and whether or not any attempt was made to control costs.

² We will remind the presumably outraged reader that, while they may have refined it, it was certainly not Russia to invent corruption, a quick review of the history of the oil majors in the developing world provides a wealth of examples of corrupt practices – though frequently the sole means of getting business done in some of the places where oil is to be found.

Shell Shock

Shell might well have gotten away with what, given the subsequent rise in oil prices, must be counted among the oil deals of the century – had they not run into The Mother of all Cost Overruns.

Apparently, when Shell recently realized that they had a serious problem on their hands, rather than come clean, they decided to trade their way out of at least part of the problem by offering an asset swap to Gazprom – which agreed to trade 50% of its Zapolyarnoye gas-field in Siberia for 25% of Sakhalin-2. Unfortunately, during the negotiations, Shell somehow forgot to inform Gazprom that their Sakhalin project was running just a bit over budget... by about **\$11 billion dollars** – and still counting.

What precisely Shell was thinking about, or how they expected Gazprom to react, one can only guess. In the event, Gazprom was distinctly not amused, promptly breaking off negotiations and presumably calling on its parent company – Russia Inc. – to deal with the miscreants.

After the typical Russian flurry of contradictory and confused statements, most recently by Khristenko, and the delightful spectacle of two Russian bureaucracies actually suing each other in Sakhalin court, the intervention of numerous ministries and bureaucracies, and the general fog of peace, we are finally getting some clarity – Mr. Gref himself has stated that Russia has no intentions of accepting a \$11bn cost overrun at its sole expense. The same applies to Sakhalin-1, where Exxon is reporting cost-overruns of “only” \$5bn.

While Shell is being reasonably discrete, Exxon’s response has been both characteristically robust – and profoundly disingenuous. Both companies are arguing “sanctity of contract.” If it goes to arbitration Russia’s response will presumably be that the massive cost overruns and delays have nullified the contracts. More fundamentally though, even were the oil companies to win, in fact, they lose. Whether or not the playing field is level – Russia owns the stadium and can stop play at the time of their choosing. Cash-rich and unconstrained by NPV calculations, the government can afford to block these projects indefinitely on ecological or operational grounds – effectively starving the oil companies into acquiescence. Furthermore, simply barring the recalcitrant ones from soliciting any new business in Russia should convince them of the virtues of negotiations..

Shell, in particular, will simply not be able to do business here without coming to terms with the State – either they will have to swallow some of the cost overruns, or to give up a larger stake in the project. At present, the reality is that no major Russian hydrocarbons projects will go ahead without a state company holding at least a blocking minority stake; like it or not, the Western firms would do well to negotiate the best deal they can get (and given the huge rise in oil prices since the early 90s – assuming that NPV analyses for Sakhalin were carried out for oil prices in the low ‘teens – the Sakhalin investments will certainly be among their best...though perhaps not quite as massively as they had hoped).

Back to the Future

In some ways, the situation is reminiscent of the government’s struggle with Menatep³ – where the Russian State was totally justified in breaking the control of a criminal organization exerting an unacceptable degree of corrupt influence over the Russian policy-making process, in particular in the Duma. Alas, rather than being frank and open about it, arresting the Yukos boys for bribery, theft and murder, they ham-handedly sought to conceal the real issue under a cover of routine law enforcement and tax claims – perhaps judicially valid, but certainly highly selective. While the State was finally successful in dismantling the Menatep empire, the PR damage was both massive and largely unnecessary...and we have yet to understand what the Yukos minorities did to deserve their sad fate.

Afterword – Schtockman – I did it My-y-y-y Way!

The approach of Western oil companies and governments to the Sakhalin discussions has been typically counterproductive: warning the Russians that, if they did not play by their playbook, Western oil companies would refuse to invest in Russia. The effect was what could have been

³ ironically, it was Mikhail Khodorkovsky himself who led the successful fight to ban further PSAs – rightfully arguing that these contracts created an unlevel playing field biased against Russian operators...

predicted – the Western oil companies will now participate, if at all, as subcontractors. Russia has far less to lose – even if her reserves are developed somewhat more slowly than would have otherwise been the case, this will simply drive up international oil prices...while providing a longer earnings stream to the next generation of Russians.

GEORGIA – ON MY MIND

Once again, like in the Ukrainian imbroglio, at least part of the origins of this conflict lie to the West, in particular Washington, characteristically delighted to support any leader in Russia's neighbourhood who happens to be anti-Russian – regardless of his competence or democratic credentials.

Those who knew the USSR cynically note that Georgia's independence from Russia is the first recorded instance of the master seeking freedom from his slave! Indeed, Georgia, a Christian enclave in the Caucasus, which had cleaved to Russia for protection during her early history, was to become a highly privileged region of the Soviet Union – with a living standard well above that of Russia itself. While there is no denying a strong nationalist urge which was firmly suppressed during the Soviet period, Georgia has given Russia some of the greatest artists, dancers (N. Tsiskaridze, Nina Ananashvili), and politicians (Stalin, Beria). The breakup of the Soviet Union was a catastrophe for the Georgian economy, which never recovered, becoming one of the poorest and most disorderly of the ex-Soviet states and losing substantial territory to separatist movements.

In fact, Georgia's recent provocative arrest of four Russians on some poorly-defined charges of espionage had nothing to do with some sudden desire to become any more independent from Russia than she already is. Such independence has already proved a major threat to their economic viability. Certainly, as Russia continues to close down her military bases, no one was threatening Georgian independence.

Instead, Saakashvili needed to provoke a crisis because of the impending resolution of the status of Kosovo. If Kosovo is allowed to choose independence from Serbia – and there appears to be nothing short of brute force which can prevent it – then there is no conceivable reason to deprive Abkhazia and South Ossetia, already de facto independent, of the same right to secession. Aware that time was working against him, Saakashvili apparently decided that his only option was to create a crisis, expecting the arrest of a group of Russians on doubtful charges of espionage would provoke a violent – preferably a military – Russian response, thus dragging in his American backers. In fact, this was a major tactical blunder – he had totally failed to reckon with...North Korea!

According to the Associated Press –

The U.N. Security Council unanimously adopted a resolution Friday that extends the mandate of a U.N. observer mission in Georgia and urges the former Soviet republic to avoid threatening steps in the Russian-backed breakaway region of Abkhazia...

and further

...Russia's U.N. Ambassador Vitaly Churkin told reporters the main purpose of the resolution is to bring peace to the region.

"It is mostly a resolution calling all the parties to the conflict to go back to (the) negotiating table to work out their difficulties and differences amicably," he said, stressing Russia's "important part in trying to settle that long-standing conflict."

The United States had opposed the Russian draft but U.S. Ambassador John Bolton said an agreement was reached during a conversation between Lavrov and Secretary of State Condoleezza Rice.

T&B leaves it to our readers to guess what could possibly have led to this most unexpected about-face!

Russian Response – Of House Flies and Howitzers

While quite fortunately falling short of a military strike, Russia's response to outright provocation was typically heavy-handed. Georgia is economically dependent upon Russia, both for energy and for

markets. Russia promptly cut off road, rail and postal communications, banned Georgian exports of mineral water, wine and food products, closed down a number of Georgian casinos for supposed mafia infiltration, and most significantly, banned financial transfers, a potentially devastating step since Georgia's main source of revenue is remittances from guest workers in Russia – i.e. thus far, power politics red in tooth and claw – but not entirely at odds with US policy towards those who would challenge it: Iran, Cuba or Venezuela.

Unfortunately, in a typically Russian fashion, the reaction spun out of control at the local level. In a surge of misguided patriotism (always a dangerous emotion) overzealous local authorities began to round up illegal immigrants – some of whom have lived in Moscow for years. People of Georgian extraction were harassed by the police, small businesses were shuttered, and life was made generally miserable for totally innocent bystanders. Markets controlled by the Georgian mafia, as well as Georgian casinos and businesses were raided (apparently, it took 15 years for the Moscow police to figure out that something was not quite kosher at the Krystal Casino).

The reaction of the Russian press has been most encouraging. The papers have been almost uniformly critical of the injustices being done to ordinary, hard-working Georgians – every bit as much a part of the Moscow ecosystem as are the Slavs. The Muscovites have generally expressed solidarity, often helping their Georgian neighbours to evade the controls. The closing of several of Moscow's favorite Georgian restaurants has been met with anger and derision towards the authorities. Probably as a result, Kremlin sources have made a number of public statements sharply critical of these excessive local initiatives.

As we go to press, while the repression has become more selective, economic pressure is not being slackened. Saakashvili appears to have miscalculated; having recently gotten a sharp warning as regards the limits to US support given the Americans' other political priorities, he finds that he has painted himself into a corner and cannot back down without losing face – dangerous for a man in his position. At best, he, or his electorate, will gradually come to understand that antagonizing the major regional power – in the absence of any viable alternatives – is not wise policy. In any event, given the parlous global situation as regards North Korea and Iran, and the United States' sudden need for cooperation from Russia and China in the Security Council, there appears to be little danger of a sharp deterioration in Great Power relations on the back of the Georgian problem.

THE ASSASSINATIONS – DOWN A GUN BARREL – DARKLY

This is a painful one – we are both horrified by the recent killings and sickened by the deeply dishonest way this story has been twisted in some of the Western media, always delighted for a chance to tell the world how dreadful Russia really is.

During the early 1990s, execution-style murders were commonplace in Moscow; as the decade progressed and the new owners of Soviet property gradually consolidated their control, things quieted down very considerably; by the end of the decade, business disputes were almost invariably settled in court rather than with automatic weapons.

That said, while in terms of street crime Moscow is far safer than London or Paris, there is no shortage of trained killers – frequently veterans of Afghanistan or Chechnya, with little to lose and excellent technique. Law enforcement is weak and frequently corrupt, and in criminal circles, there is still a tendency to use extreme means in the settlement of disputes.

Three high profile killings are generally cited abroad: Central Banker Andrei Kozlov, Forbes journalist Paul Klebnikov, and most recently, Russian journalist Anna Politkovskaya.

In point of fact, considering the possible motives, we would note that two of the victims had one factor in common, two of the others a very different factor: Mr. Klebnikov and Andrei Kozlov were fervent supporters of President Putin (Mrs. Politkovskaya was, of course, an outspoken critic). The death of the first two was thus a direct challenge to the Kremlin. On the other hand, two of the victims had dangerously antagonized one or the other of the Chechen factions – Paul, the anti-Russian warlords; Mrs. Politkovskaya, the Kremlin-backed Kadyrov faction. Those in Russia who have effectively attacked any of the Chechen warlords have generally lived short and eventful lives.

In typical fashion, much of the foreign coverage has involved a crude amalgamation of the three killings, which are somehow then laid at the doorstep of President Putin – as if Russia had been a sharing and caring place – until the Wolf arrived:

Perhaps the most notorious murder, however, was that of Paul Khlebnikov (sic), the editor of the Russian edition of the US business magazine Forbes. His punishment for exposing the wealth of Russia's business elite was a bullet in the back of the head. While no one has ever proffered any evidence that directly links Putin to the murders, few believe they were anything other than Kremlin-inspired.

The Telegraph, London

Yet it is quite possible, without performing any detective work, to say what is ultimately responsible for these deaths: It is the climate of brutality that has flourished under Mr. Putin. A former KGB agent himself, he inherited an imperfect democracy and systematically undermined its institutions.

The Washington Post

The Telegraph is either ignorant – intentionally lying – or both. Paul Klebnikov was an enthusiastic supporter of President Putin. To claim that Mr. Putin would have ordered/inspired the murder of the foreign journalist most supportive of the Kremlin is not just slanderous but patently nonsensical. The equally absurd claim that Paul was murdered for publishing the Forbes Richest List, rather than for his very critical writings about the Chechen rebels, suggests that they did not even bother to follow the investigation – hardly surprising; these would-be Russia experts could not even get the correct spelling of Mr. Klebnikov's name...

As for the Post, their fact checking is a bit better, though we are awed at the shamelessness of a newspaper which championed the illegal invasion of Iraq – complete with fraudulent WMD dossiers and 650,000 dead (including hundreds of reporters) in drawing snap moral judgments... In fact, the “climate of brutality” in Russia dates back to the 10th century – Russia remains a tough place, though it is certainly far gentler today than it was in the 1990s.

More to the point, **No one** we have spoken to in Moscow – pro-Putin or anti-Putin, believes that anyone in the Kremlin “inspired the killings”. Though desperately brave and deeply committed to her work, Mrs. Politkovskaya was virtually unknown outside of a small circle of Moscow intelligentsia and was, at the most, a minor irritant to the Kremlin – of which there are far more prominent examples. In fact, most of the local speculation – always wild – centers around exiled oligarch Boris Berezovsky, who is believed to be increasingly desperate to retain some relevance in Russia, and is widely believed to have used means both fair and foul in the past. Anecdotally, he was engaged in a long and ultimately successful (under totally unbalanced UK libel law) lawsuit against Forbes and Mr. Klebnikov, who had branded him the *Godfather of the Kremlin*.

These rumours, of course, remain totally unsubstantiated. The most obvious explanation is that Mrs. Politkovskaya's investigative reporting had created some troublesome legal problems for a Chechen faction which has typically required no encouragement towards mayhem.

There is much to criticize. Russian law enforcement is desperately in need of reform. The new Chechen government, a warlord faction allied with Moscow, was supported as a Chechen solution to an otherwise-intractable Chechen problem – the means it employs are precisely those used over the past decade by the Chechen insurgency, those wonderful folk who brought you Beslan.

While it is easy to criticize the Kremlin for using these hard men to settle the issue, those who would criticize Putin for using Chechen factions to fight Chechen wars must also explain how else this war – which until recently had been widely predicted to threaten the end of a unitary Russian state – could have been won. Or, for that matter, how the victory of a Taliban-style regime in an independent Chechnya would have been greeted in the West.

Afterword – as we go to press, we encounter another tendentious and manipulative misuse of the murders in an otherwise well-researched and powerful article in the Wall Street Journal – tracing the ownership of Megafon to Telecoms Minister Leonid Reiman. Most unfortunate, as this is precisely the sort of journalism which can have real impact, revealing abuses to the public eye. The WSJ did some diligent, hard-hitting investigative work – why, then, must they systematically discredit it with their inability to refrain from imparting their personal biases, disguised as objective reporting?

But as the Kremlin during the Putin years has tightened its grip over economic and political life, problems have worsened, say some officials and business leaders...

“Some” business leaders, of course, will say quite the opposite – some may think the WSJ is a Bushite plot or, for that matter, is written by Martians! In journalese, “some” is a term generally employed either as a cover for sloppy research, or more often, as a pseudo-objective way to allow the journalist to slip in his own views – unchallenged and unchallengeable. So far, pretty much par for the course – but what follows seems manipulative and offensive:

...Some who have pushed for change in Russia have left the country in the face of growing pressure. Some who stayed to fight have paid a heavy price. Last month, a central-bank official who led a drive to clean up the banking system was gunned down in an apparent contract hit.

And what does this have to do with the theme? Why do they use it here? In an article credibly accusing one of Mr. Putin’s close associates of corruption – for the casual reader, the implication is that somehow, “Putin’s Russia” is to blame for the murder of Mr. Kozlov – in fact, a long time personal friend and ally of Vladimir Putin, who has sworn to avenge his death.

Since the WSJ seems intent upon providing a ready-made interpretation rather than allowing the reader to reach his own conclusions, they might have added a final sentence:

While some have argued that Russia has become a one-party state, and that no one dares to challenge the Kremlin or those most closely aligned with it, the fact that the Alfa Group has aggressively taken on a long-standing associate of Mr. Putin’s, both in the international courts and in the Western press, suggests a far greater degree of pluralism than is usually attributed... (our prose – certainly not theirs!)

A parting shot – eXile-ing Newsweek

Our recent rant about the dishonest and apparently corrupt⁴ coverage of Russia in Newsweek has, as expected, proved delightfully controversial. We have received much mail; most of it surprisingly supportive, though there have been one or two irate notes from journalists complaining that we should let them get on with their jobs....

In fact, we suggest that the right to criticize should come as a package with the ability to accept – indeed to welcome – criticism. We have great respect for the majority of Western journalists who, while many of them disagree with our general take on Russia, endeavor to remain objective and balanced. Instead, it is those few who blatantly and dishonestly misuse the freedoms they are afforded to knowingly mislead their readers whom we shall continue to skewer.

A reporter who, living in Russia and thus knowing both sides of the story, writes the sort of totally unbalanced garbage we read in Newsweek – simply because Newsweek belongs to the Washington Post and the faction now in control at the Post is vehemently anti-Russian, deserves to be regarded as a member of the world’s oldest profession. Again, we would challenge the reader to find us an example of such slander as regards any major country in the world, other than Russia.

The best retort – to a subsequent Newsweek article on “Why Russia was Really Weak” – was written by Mark Ames and ran in Moscow’s notorious The eXile. Never had we expected to cite this publication, bathroom reading for generations of Moscow expats, by comparison with which T&B is politically correct, carefully balanced, and tightly edited...yet increasingly – like the little boy who shouted out that the emperor had no clothes – The eXile writers are the only ones to attack the accepted wisdom. For those not offended by a bit of hostile hyperbole – as well as generous use of the Anglo-Saxon – the article, some of which we would take strong exception to, is not to be missed!

http://www.exile.ru/2006-September-22/feature_story.html

⁴ “corrupt” not, of course, in the sense of well-stuffed envelopes, but instead, corrupt in terms of their willfully misinforming in an attempt to further the politico-economic interests of the financial entity controlling the publication.

And reload, just one last time:

Welcome In Russia – Please Do not Leave Your Common Sense Unattended

T&B has just finished a long phone conversation with a major West Coast US fund – just returned safely home after a death-defying expedition into the Heart of Darkness. After almost a week in a top Moscow hotel, and a series of meetings with foreign analysts and your standard Russian conspiracy buffs, they came away with a clear understanding of the Russian political context – something T&B has struggled to make sense of over almost a decade.

Among the pearls they brought back with them was the information that Vladimir Putin would not run for a third term, had \$14bn stashed away for his retirement, and was intentionally maintaining political instability while preparing his withdrawal from the Russian scene (sic). Surprisingly, they had witnessed neither whale harnessed to pull ships, nor bears with the heads of men....

T&B will be the first to admit that we do not have even a clue as regards what, if anything, might be on Mr. Putin's personal accounts; quite frankly, if we did, we would certainly not be telling it to a bunch of ex-surfers... Indeed, it is a particularly safe assumption in Russia that those who talk about such matters simply do not know – and those few who may actually know something, certainly do not say...

We would not bother mentioning this one (and no, these gentlemen are not potential clients...) except that we hear similarly wild and wooly theories with amazing regularity. Surprisingly, the investors in question were smart, experience guys, conversant with the macros of a dozen or so emerging economies, and with quite a decent track record. When they talk Brazil or Viet-Nam, they are cautious, skeptical, and reasonably well-informed. But, when it comes to Russia – Lord, Lord...

Ladies and Gentlemen, Welcome in Russia! Please come visit us to Moscow – but we are giving just one word advice: Aeroflot carry-on baggage allowance is generous. So there is absolutely no need to leave your common sense at home – Russia has great story tellers; so it is more vital here than even passport or toothbrush...please not to forget it.

Happy flying!

T&B

T&B WISHES TO REMIND OUR READERS THAT THEY ARE WELCOME - INDEED ENCOURAGED - TO FORWARD THIS PUBLICATION TO ANY INTERESTED PARTY.

TO SUBSCRIBE, PLEASE DROP A NOTE TO ERIC@NIKITSKYFUND.COM. THE AUTHOR CAN BE REACHED AT KRAUS@RUNBOX.COM. WE WELCOME READER COMMENTARY AND ENDEAVOUR TO REPLY WHERE APPROPRIATE.

BACK ISSUES CAN BE FREELY DOWNLOADED FROM WWW.NIKITSKYFUND.COM.

This message is provided for informational purposes and neither the information nor any opinion expressed herein constitutes an offer, or an invitation to make an offer, to buy or sell any investment funds, securities or any options, futures or other derivatives related to such securities.

Investment in emerging markets bears a high degree of risk, and is not suitable for all investors. This report is based upon information we believe to be reliable, however it is provided solely as an intellectual exercise, and no investment decisions whatsoever should be based upon it, in full or in part. In particular, investing in securities, including Emerging Markets securities involves a great deal of risk and investors should perform their own due diligence before investing.

Past performance is not necessarily a guide to future performance. Some investments may be subject to sudden and large falls in value and on realization customers may receive less than they invested or may be required to pay more.

Changes in foreign exchange rates, interest rates, or other financial parameters may have an adverse effect on the price, value or needs of customers. We would recommend that investors take financial advice as to the implications, including taxation, of investing in any financial product.

Some investments may not be readily realizable and valuing the investment and identifying the risk to which customers are exposed may be difficult to quantify.

The author or any fund he advises may from time to time have long or short positions in any assets discussed, or derivatives thereof.

Although the Nikitsky Fund is a sponsor of T&B, its trading policy is totally independent of this publication, and it should not be assumed that it is positioned in a fashion in keeping with the market views expressed herein.

Like cats and horses, markets are apt to do as they damned-well choose, and a considerable measure of luck is required to come out in one piece. Exercise caution in all things. Good Luck!