



Dome of Jabalieh, East of Kerman, Kerman Province, Central Iran

THIS MONTH

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Following three months of strong performance, the Tehran Stock Exchange cooled off a little during October. There was excessive supply of some stocks as some institutional investors were cashing out some of their holdings to participate in the consortium that purchased 20% of the market's largest listed company in its public offering.

Turquoise Iran Equity Fund

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The Turquoise Fund outperformed both market indices during October with the Fund unit index reaching 146.8 by the end of the month. A selection of data and charts regarding the performance of the Fund is provided in this section.

Country Overview

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The two major events during October which are covered in this section are the historic visit of Russian President Putin to Tehran and the unilateral sanctions announced by the government of the United States on two Iranian banks and organizations related to the Revolutionary Guards

Economy

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In this edition of the Economy section, the focus is on the problem of rising inflation, the reasons behind this rise, and the trendlines of inflation rates over the past months and years.

Iran Investment Monthly is produced by Turquoise Partners. Distributed electronically by exclusive subscription.

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After three months of consistent and strong growth, the Tehran Stock Exchange cooled down a little in October as sellers outpaced buyers on the market. One of the major reasons behind the rise in the supply of shares was the privatization of 20% of the National Iranian Copper Industries Company (NICIC) in September which was purchased by a consortium of domestic institutional investors all active in the market. Since the deadline for the down payment of that deal was set at the end of October, most of the members of the consortium had to exit other holdings to secure enough liquidity for the \$1.2 billion deal. This resulted in a volatile market at times during October when there was an excessive supply of some stocks on the market. Some key sectors are analyzed in more detail below:

Petrochemicals

The rising price of crude oil and petrochemical products on global markets coupled with the cancellation of the government decision to impose an export tariff on petrochemical goods had a positive impact on the listed petrochemical companies and once again created buying queues for their shares. There was also the announcement of an Initial Public Offering (IPO) of a methanol-producing company which added to the excitement about this sector. Fanavaran Petrochemical, with production capacity of one million tons of methanol per year, will be the first petroleum-related company to be privatized under the recent privatization scheme. The IPO of this company is expected to take place in the coming months. The top gainer in this sector during October was Khark Petrochemical with around a 30% rise in its share price. Khark also produces methanol and has significantly benefited from the recent rise in international methanol prices by around 100%.

Steel and Iron Ore

In mid-October one of the two listed iron ore companies, Golgohar, announced the sale of 280 thousands tons of iron ore on international markets for \$130 per ton. This is while this company had forecasted an average price of \$62 per ton for the sale of its products this year. This significant rise in the sell price of their iron ore means that the company will most probably double its revenues this year compared to its forecast. In fact the Iron Ore sector was the best performing one during the month of October with its index rising by around 30% to mark its all time high record. In the international arena, the largest global iron ore producers are in negotiations with consumers to raise their wholesale price for 2008. Rising demand from China, the decline in value of the US dollar as well as speculation on the rise of transport costs had left Iranian iron ore producers in a strong bargaining position for negotiating the domestic pricing of their products with the government.

For steel companies as well, October was a strong month thanks to rising prices of cold and hot rolled steel on the Tehran Metal Exchange. Meanwhile, the government offered another one percent of Mobarakeh Steel Complex on the market during October. The shares were sold at a price which was twice the IPO price when 5% of the company shares were first offered in March under the privatization scheme.

Copper and Zinc

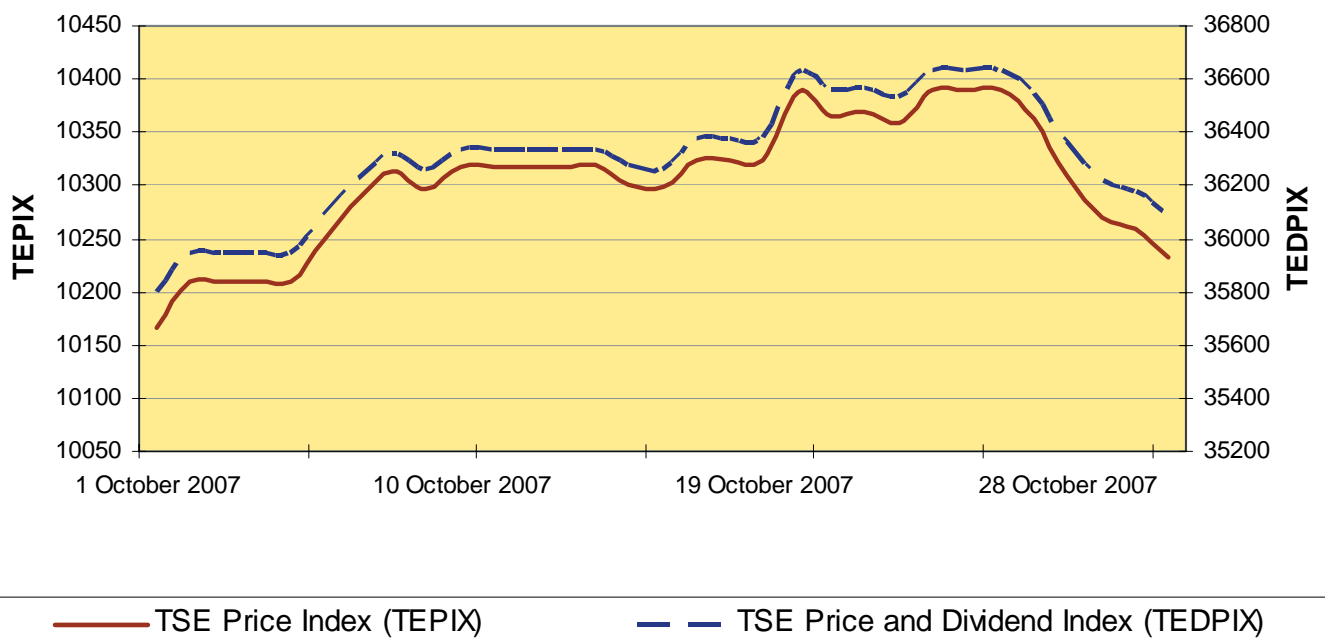
The copper and zinc sectors experienced a weak month. Falling global prices of these two commodities resulted in a heavy sell off of their shares on the TSE. The National Iranian Copper Industries Company (NICIC) which experienced a successful privatization and IPO in February and witnessed a return of over 150% is now under heavy selling pressure. As the largest listed company, NICIC's share price decline will have a significant negative impact on the market as a whole and its indices.

Auto Manufacturing

The auto manufacturing sector also had a weak month with most listed companies experiencing decline in their volume of trade. The largest companies in this sector, Iran Khodro and Saipa, are now trading at Price to Earning (PE) multiples as low as two. The main reasons behind the lack of interest in this sector are rising costs with little change in automobile prices, market saturation, and gasoline rationing. Prices of steel, labour and parts have all risen in the current Iranian year while the prices of finished vehicles remained mostly unchanged.

Overall the market witnessed an erratic but active month in October with the TSE Price and Dividend Index rising by 0.6 percent. This was recorded after three months of consistent growths of over 6 percent each month. The following chart demonstrates the performance of the two main market indices during the month.

Performance of TSE Indices (Oct 2007)



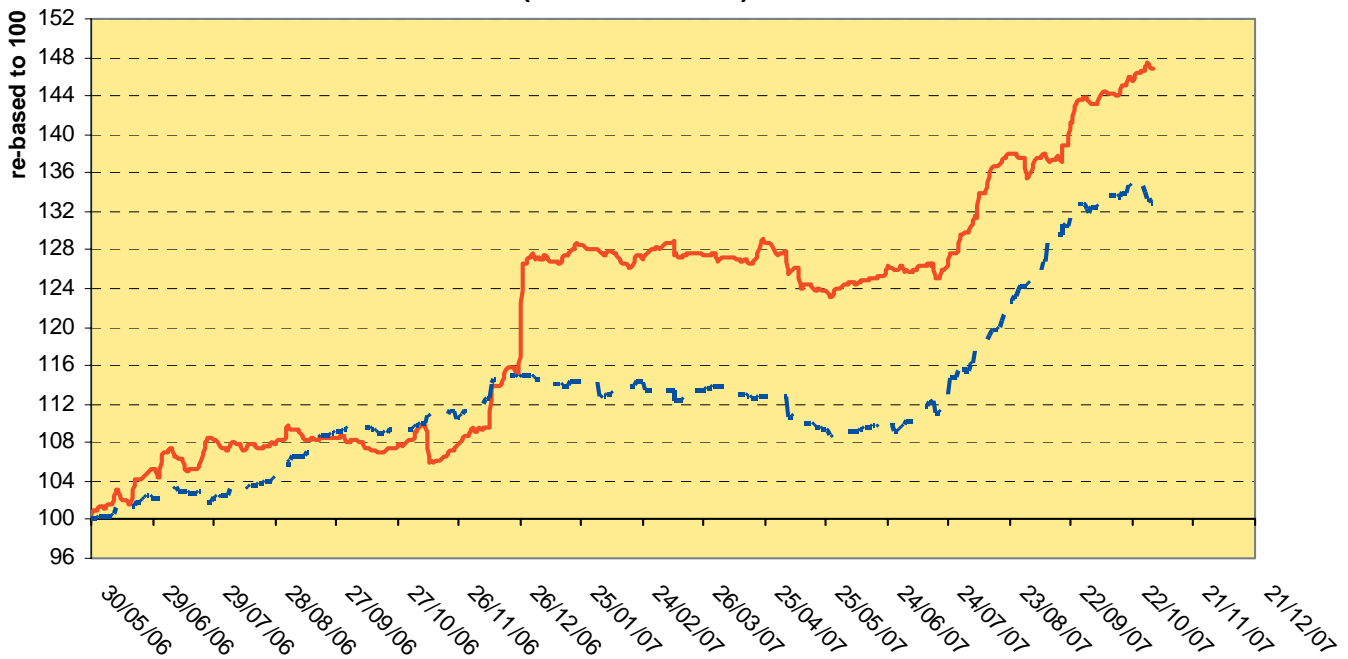
Investment Objective – The Turquoise Equity Fund seeks superior long-term capital growth by investing in the consumer and commodity potential of Iran, one of the most under-valued emerging markets in the world. Combining international experience with local expertise allows Turquoise to provide superior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

Monthly Report – The Net Asset Value (NAV) of the Turquoise Fund grew by approximately 2.3% during the month of October. The Fund’s unit index grew from 143.5 to 146.8 out-performing the benchmark, the TSE Price and Dividend Index (TEDPIX), which grew by around 0.6%. The TSE Price Index, (TEPIX) also grew by 0.6% during this month.

The Fund Investment Committee met regularly during the month and approved some adjustments to the portfolio which were implemented through the liquidation of some positions and the acquisition of others. More details on the Fund’s top holdings will be provided in the upcoming Monthly Performance Report.

The charts below demonstrate the performance of the Fund against the TEDPIX in local currency, and the Emerging Market index in USD as well as the overall performance of the Fund in USD, Euro and GBP. The performance table also provides the performance of the Fund in different time frames.

**Turquoise Portfolio vs. TSE Price & Div Index (TEDPIX)
(YEAR TO DATE)**



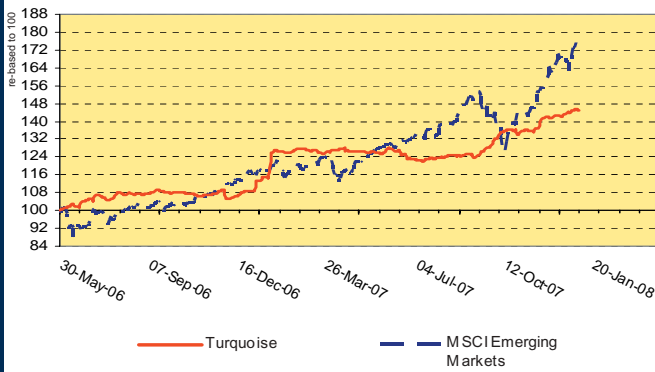
— Turquoise Iran Equity Fund — TSE Price & Div. Index

	1 Sep 07	1 Oct 07	1 Nov 07
Turquoise Fund	35.76 %	43.47 %	46.80 %
TEDPIX	24.39 %	31.80 %	32.87 %

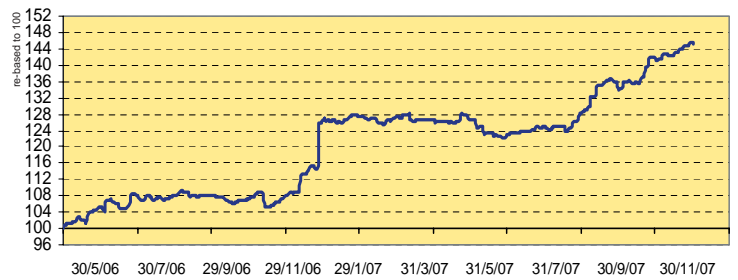
Performance

Period	Fund Return
Oct-07	2.32 %
Last 3 Months	13.01 %
Last 6 Months	15.22 %
Last 12 Months	35.46 %
Since Inception (30 May 06)	46.80 %

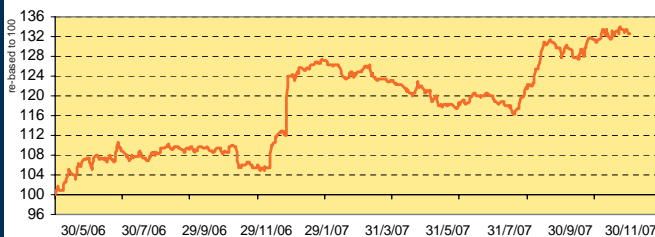
Turquoise Performance vs. MSCI Emerging Markets



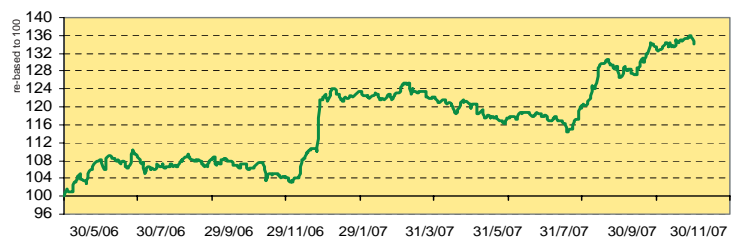
Turquoise Performance in US Dollar (US\$)



Turquoise Performance in Euro (€)



Turquoise Performance in British Pound Sterling (£)



Two major developments during the month of October have been the visit by Russian President Vladimir Putin to Tehran and the United States government's unilateral sanctions imposed on some of the major Iranian banks and companies affiliated to Iran's Revolutionary Guards Corps (IRGC).

After five decades without a state visit by a Russian or Soviet leader to Iran, President Putin made an official visit to the country in October to attend the Summit of the Caspian Littoral States. The Islamic Republic's relationship with the Soviet Union has been mostly frosty due to the Soviet Union's occupation of neighbouring Afghanistan and its support and sale of weaponry to Iraq during the eight-year Iran-Iraq war in the 1980s. However with the fall of the Soviet Union and after several visits by Iranian officials to Moscow, a new era of Russo-Iranian relations has gradually taken shape and developed to what President Ahmadinejad now calls, perhaps optimistically, "a natural alliance". The sincerity of the Russian government is, however, highly doubted in Iran by both the political elite and the general public due to unpleasant historical memories and the apparent Russian policy of playing it both ways when it comes to Iran's nuclear standoff. Although the Russians have supported Iran's pursuit of nuclear energy and have helped with the construction of Iran's first nuclear power plant at Bushehr, they have nonetheless been dragging their feet on sending nuclear fuel to Iran and giving a date for the completion of the Bushehr plant. They also went along with other UN Security Council members to impose two sets of sanctions on Iran for refusing to suspend its uranium enrichment program.

Overall both Putin and Ahmadinejad attempted to use this trip to their respective political advantage. Putin was able to demonstrate that Russia is independent in its foreign policy and would like to expand relations with Iran regardless of the West's opposition while Ahmadinejad secured the backing of the Caspian Littoral States for Iran's development of peaceful nuclear energy and also tried to make use of this event to prove that the West's plan to isolate Iran has failed. Both Ahmadinejad and Putin also proposed that no littoral state's territory should be used for military aggression against other states, which was approved by all parties at the summit. This was intended to counter reports that the United States is considering the use of Azerbaijan's territory to strike Iran in the event of a military conflict.

The US government meanwhile announced new unilateral sanctions on some of Iran's largest and best-known banks as well as a number of companies that are affiliated to the IRGC (Revolutionary Guards), a wing of the Iranian armed forces. The US also used the occasion to label the IRGC as a sponsor of terror. Three state-owned banks, Mellat, Saderat and Melli, were sanctioned this time along with Bank Sepah which was previously sanctioned by the US government. These banks were all accused by the United States of providing financial support to Iran's nuclear program and financing some of the groups that America considers terrorist organizations. Although America's unilateral sanctions against Iran are not a new development and have been in place in one form or another since 1979, what gives significance to this round of sanctions is the fact that this is the first time a section of a sovereign nation's armed forces was labelled as a "sponsor of terror". Also critical is that Bank Melli Iran is the largest and one of the oldest banks in Iran with which almost all Iranian families do some sort of business on a regular basis.

These new sets of sanctions, like the ones previously imposed by the United States and also the UN, will most probably make it even harder for Iranian businesses to secure financing or credit letters from foreign banks and will generally increase the cost of operation and trade for many Iranian companies. Although some European countries might follow suit and limit their business with the sanctioned entities, most analysts believe that the real impact of these sanctions will not be substantial for the following principal factors:

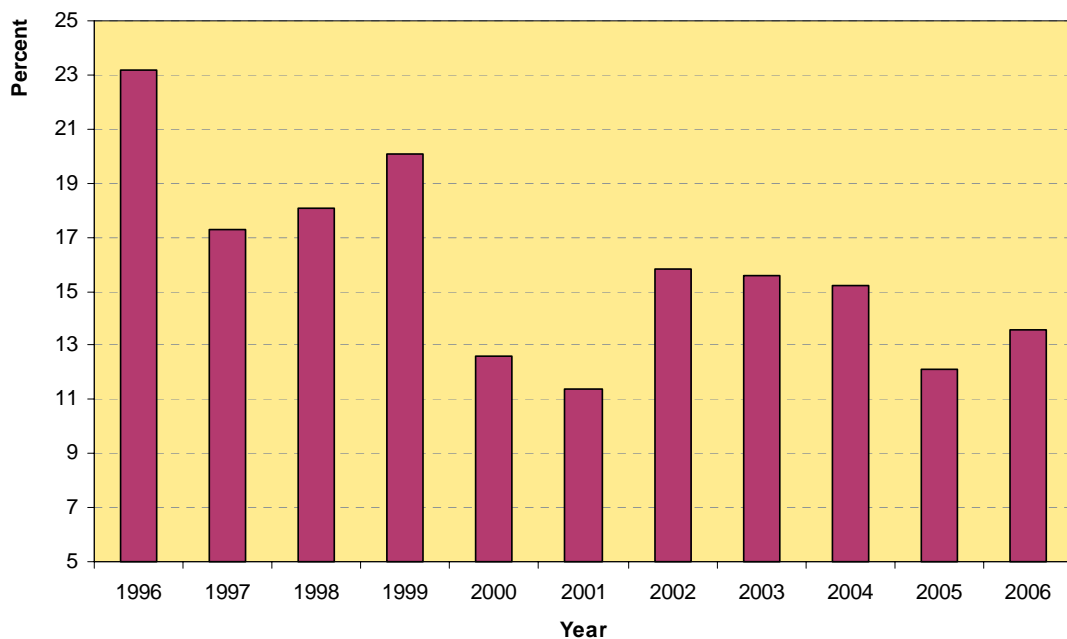
- Iran has already shifted most of its trade and business relations from West to East. Iran's trade with China last year stood at record level of \$15 billion. This figure is expected to reach \$20 billion this year making China Iran's largest trade partner.
- Iran has started to move its dealings away from the US dollar to other currencies such as the Euro and Yen leaving decreasing dependency on the US dollar. As announced recently by the Ministry of Petroleum, almost all crude oil exports of the country, which constitutes around 80% of foreign earnings, is currently sold in non-dollar currencies.
- Due to its significant market size and commercial opportunities, Iran is a lucrative market for some international banks that see the current sanctions as an opportunity to establish business here in the absence of competition from US and some of the European banks. A number of regional and Asian banks have already increased their business dealings with Iran.
- Many countries are opposed to this type of unilateral sanctions and will not abide by them. Russia and China, as well as the countries of the Non-Aligned Movement (NAM), have already condemned the move and emphasized the importance of negotiations rather than increased sanctions.

One of the main topics of discussion in the public sphere and one of the major concerns about the Iranian economy has for a long time been inflation levels in Iran that have remained relatively high for the past three decades. The recent rise of the inflation rate, which many economists blame on President Ahmadinejad's economic policies, has again raised some concerns for economists. These policies include increased expenditure of the crude oil windfall in the annual budget, providing cheap loans to Small and Medium-sized Enterprises (SMEs) as well as young couples, and imposing an interest rate cut on both the state-owned and privately-owned banks on an annual basis. In this edition of the Economy Page, a detailed analysis of the country's inflation problem is discussed.

According to annual reports published by the Central Bank of Iran, the country's Consumer Price Index (CPI) has consistently increased during the last ten years and has quadrupled from 1996 to 2006. This is while the annual rise in CPI, which demonstrates the 12-months inflation rate, has been volatile over the last ten years and has varied from the highest recorded rate of 23.2 percent in 1996 to the lowest rate of 11.4 in 2001.

The following chart shows the annual inflation rate recorded from 1996 to 2006. Please note that the figures are based on the Iranian calendar. For example 1996 figure corresponds to the Iranian year of 1375 which ended on 20 March 1997.

Inflation Rate 1996-2006

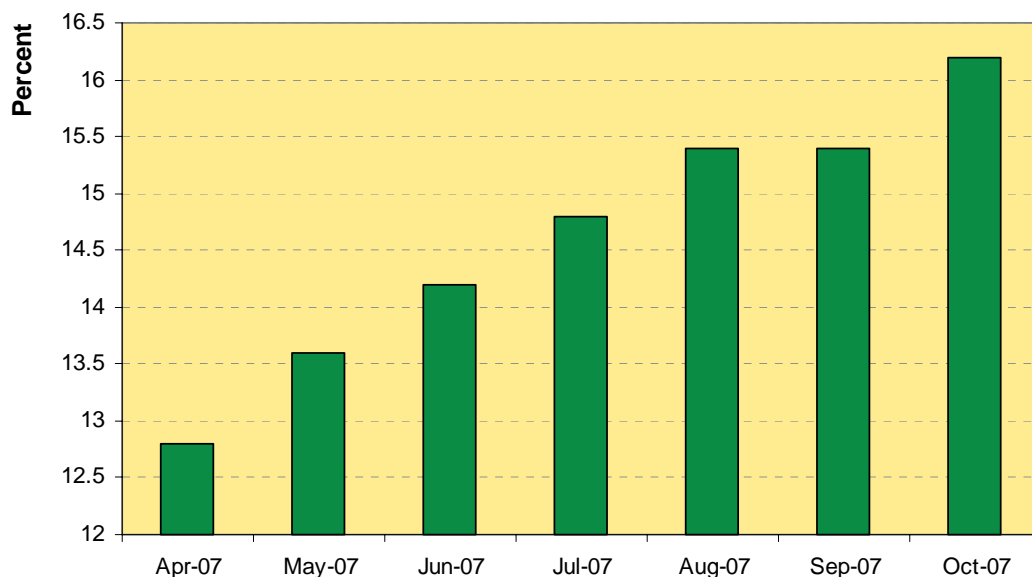


Analysts believe that the main reason behind the drop in inflation levels in the year 2005 and 2006 was a decision by Parliament and the Government to fix the prices of 12 vital commodities and services in this period. This policy was successful in reducing the inflation rate by around two percent but was inherently a short term solution to the long-term problem of the country's increasing levels of liquidity which is the real cause of the high inflation rate. This policy, which was opposed by the business community and manufacturers, was doomed to eventually fail as the cost of raw materials and labour was increasing and it was impossible to keep the price of goods at a fixed level without causing serious harm to businesses. This is the main reason why the inflation level this year bounced back and has been rising month on month since the beginning of the year. Many analysts believe that the real inflation rate is significantly higher than the one announced by the Central Bank and question the methods and the basket of goods that the Central Bank uses to calculate the CPI across the country. Considering that Iran's liquidity level has almost doubled over

the past two years (from \$80 billion in 2005 to \$150 billion in 2007), analysts believe that the real inflation rate should be around 25%. The Parliament's Research Centre announced a few months ago that the real inflation rate in fact is around 23%. The Central Bank, however, dismisses the claims and points out that it is the only credible source with sophisticated data collection methods that are implemented across the country for calculation of the CPI level and the inflation rate. The methods used by the Central Bank of Iran have been approved by the International Monetary Fund (IMF) and therefore data produced by the CBI is often referred to as the real inflation rate in the country.

Regardless of the methodology for calculation of the CPI, almost everyone agrees that the ever-increasing growth rate of Iran's liquidity levels is reaching alarming heights and the rising inflation rate is turning into a real economic problem. The following chart demonstrates the rising level of 12-month inflation on a month to month basis during the last few months since the beginning of the Iranian year (rough equivalence of Iranian calendar months):

12-month Inflation (monthly)



If this rising trend continues, analysts believe that the inflation rate by the end of the current Iranian year in March 2008 will reach around 18%.

The government has been trying to fight the rise of inflation by the mandatory pricing of some commodities and increased import of consumer goods while reducing the tariffs of some imports. Although sometimes successful as short-term solutions, these policies are proving largely ineffectual in combating rising inflation and could prove harmful in the long run since the dependency on imports increases. Another problem is that with little investment options available, most of the country's liquidity moves towards sectors in which neither a pricing mechanism nor imports are possible, such as the real estate sector in particular. The price of property has risen significantly in Iran over the past year by an average of around 30% across the country, while in places like Tehran this rise has been more than 50%, making the purchase of a small apartment unthinkable for many young couples.

Some analysts believe that the change of the Governor of the Central Bank a few months ago was aimed at keeping a tighter control on bank loans in order to contain the inflation rate from rising even further. It is yet to be seen whether this change could result in a reduction of the inflation rate in the months to come or not but according to the IMF's forecast, the inflation rate will reach 19% by the end of 2007 but will drop to 17.7 during 2008 which will still be amongst the highest rates in the world.

About Turquoise

Turquoise is a boutique investment bank based in Iran with offices in Tehran and London. 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 based both in Europe and in Iran enables Turquoise to benefit from coupling local knowledge and presence with global expertise.

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.

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