

Nuclear Deal Could Drive Foreign Investors to Iran Stocks

That Iran has a stock market surprises even some savvy investors

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TEHRAN—If Iran reaches a nuclear deal and sanctions are lifted, Western investors are likely to queue up to invest in the country.

The first stop for much of that money, at least initially, could be the Tehran Stock Exchange.

“Iran has a unique combination of frontier and developed characteristics that make it potentially compelling,” said Alison Graham, chief investment officer of New York-based frontier-markets investor Voltan Capital Management LLC. “It has a well-educated population, a large middle class, a substantial industrial base and has made progress in dismantling subsidies to get its macro house in order. At the same time, growth, valuations and potential investment upside are similar to frontier countries at a much earlier stage of development.”

While negotiators have kept the details of their work close to the vest, a deal is aimed at restraining Iran’s nuclear program in exchange for the gradual lifting of a variety of economic sanctions imposed on Iran individually by the U.S., European Union and United Nations. Representatives from various parties are currently meeting in Switzerland ahead of a Tuesday deadline to reach a deal on Tehran’s nuclear program.

The timing of when and how those sanctions would be removed is being heatedly discussed, but Iran has pushed hard to remove financial sanctions on its banking system, which are the main impediment to investing in the stock market.

That the Islamic republic has a stock market—much less one that has piqued the interest of hundreds of hedge funds and Western investors who have visited Iran in recent months—surprises many savvy investors.

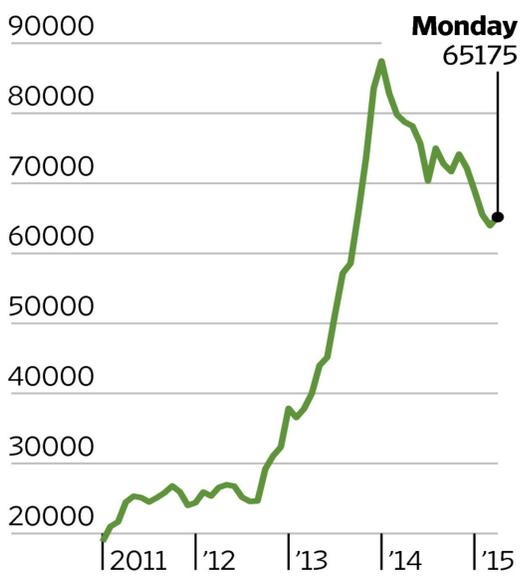
Before investing tens of millions of dollars in Iran starting in 2008, Juha Kojonen, head of Confido Capital OY in Helsinki, said, “I didn’t even know Iran had a stock market.”

The company, which manages about \$200 million, is one of just a handful of westerners with money still in the market.

Potential investors point to a plethora of administrative and infrastructure deficits that would need to be addressed before even a lifting of sanctions would spur large-scale Western investment: the lack of global custodians, for example, and dearth of meaningful corporate research.

Persian Potential

Tehran Stock Exchange



Note: Data are monthly
Source: CEIC

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Ms. Graham warns: “Anyone devoting substantial resources to potential Iranian investments at this point is getting ahead of himself.”

Currently, U.S., European and United Nations sanctions prevent Western investors from putting money

in the market and make it impossible for any with money still there to get it out.

It isn't clear how quickly things would change if the West and Iran cut a nuclear deal. But some Western fund managers are already planning. Financial-services companies in Tehran, which had kept a low profile for years, are hustling to keep up with the demand from Western investors wanting to visit and learn more.

Tehran's few Western-scale business hotels are consistently full, and the scant number of Western-oriented financial professionals can barely schedule them all in for tours and briefings.

"I'm meeting fund managers every day," said Reza Soltanzadeh, chief executive of Iran Industries Investment Co. in Tehran.

What they find housed in a dingy blue high-rise building adjacent to Tehran's furniture bazaar, is an equity market that, despite many quirks and potential pitfalls, already works better than many of the frontier and even emerging markets they invest in—with a potential upside that seemingly could far exceed them.

Many investors there on a recent day would welcome westerners with open arms.

"If there's a deal, everything would change for the better," said Ehsan Yousefazdei, a 28-year-old individual investor sitting in the gallery over the trading floor on a recent day. "With foreign investors, the market would really grow."

Only a handful of westerners have investments in Iran's stock market. Most of these were made in the mid-2000s before sanctions tightened. Those who decided not to withdraw their money found it stranded there. They can't add to it or take home their earnings, due to Western laws that have led all Western banks to sever ties with the Iranian banking system.

It has been a tumultuous, but not altogether unpleasant, ride, they say. Last year, Iran's stock market rocketed up, after the election of a new president, Hassan Rouhani, who has promised to open Iran back up to the world. Those gains were tempered by the collapse of Iran's currency last year and then by the drop in oil prices over the past nine months.

The exchange has shed more than a quarter of its total capitalization in the last year in rial terms. The damage has been worse in dollar terms, given the steep drop in the rial, falling by more than one-third to \$83 billion (2,800 billion rials).

The market has tumbled 5.5% so far this year.

Established in the 1970s and guided mostly by apolitical technocrats over the years, the bourse has navigated the Islamic revolution of 1979, a war with Iraq that shut the exchange down during much of the 1980s and then the turbulent era of international tightening sanctions and economic turmoil ushered in with the election of former president Mahmoud Ahmadinejad in 2005. During much of the last

decade, Western-oriented investment advisers slowly closed or learned to operate almost clandestinely to avoid the scrutiny of a government that became suspicious of westerners almost to the point of paranoia.

The market itself retained most of its original legal structure—designed to attract international, Western-oriented investors—and relatively tough corporate reporting requirements.

The Tehran Stock Exchange can be a sleepy affair on many days, as both men and women brokers sit in lines of desks around a board displaying prices. The exchange doesn't deal in derivatives or short or margin trading. Nor has the exchange aggressively pursued listing complicated Islamic finance instruments, as nearby Dubai has introduced on its markets.

The country launched a privatization program a decade ago that has, albeit fitfully, moved share ownership from companies directly controlled by the government into the hands of Iranian pension funds. Those pension funds are also controlled by government entities—leaving the bulk of the market still under government sway, a concern for some potential investors. But financial companies wooing future Western dollars argue that those funds are ultimately motivated by returns and likely to sell off poor performing shares in the coming years.

Large Western institutional investors would be ideal buyers for these blocks of shares, said Rouzbeh Pirouz, head of Turquoise Partners, a Tehran-based fund manager.

“When they come in, the sophistication of the market will increase dramatically,” he said. “They’re going to demand better management, better performance. They’re going to be better shareholders.”

Mr. Kojonen said he believes the protection provided to investors—including foreign investors—isn't up to the standards of fully developed markets but is significantly better than many places where his fund invests, such as Russia and some parts of Africa.

Mr. Kojonen said he and his investors would consider making new investments in the country if a strong political deal is reached and sanctions are lifted. But he also remains cautious. “Like any frontier market, there's a lot of work to be done,” he said.