

Russia set to outperform EM peers in 2010, driven by economic recovery, superior earnings growth and closing of valuation gap vs EM peers

- **Efficient crisis management**

68% of companies reported better than expected earnings as of 1H 2009 vs 10% worse than expected. This was mainly due to companies' ability to manage costs efficiently when the economy contracted. This fuels profit growth and we expect this to continue in 2010.

- **Economic recovery underestimated**

IMF recently increased 2010e GDP growth to 1.5%. East Capital expects Russia's next year's growth to be as much as 4-5% and the consensus is continuously being upgraded.

- **Very attractive valuation**

Russia is the lowest valued market in Global Emerging Markets (GEM) with a 2010 P/E of ~8 to be compared to GEM average of 14.1, BRIC average 14.3. The current valuation for Russia implies that investors are greatly underestimating Russia's ability to grow.

- **Unjustified discount**

Russia is now trading with an unjustified large discount on 2010e P/E; >45% to EM peers, and ~50% to BRIC peers. We expect the discount to contract from current levels.

- **Earnings growth and operational leverage**

Given the companies ability to reduce and keep costs down in an efficient way together with an economic recovery, we are positive on the earnings growth for Russian companies. Available consensus numbers suggest Russian EPS growth to be among the highest in the GEM space for 2010 (consensus on Russian EPS growth for 2010 is 39% vs 29% and 28% for GEM and BRIC peers respectively).

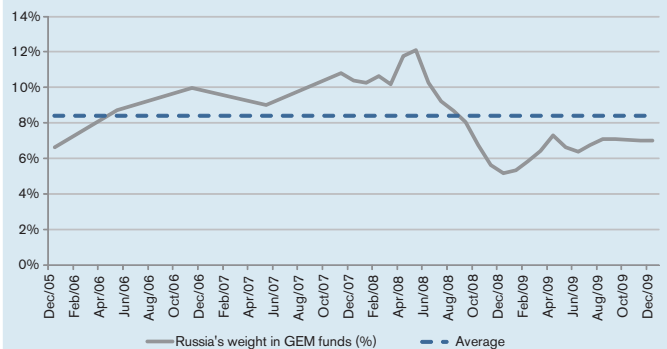
- **Flows and room for surprises**

During 2009 emerging markets have seen net flows of approximately 80bn USD, of which some 90% were allocated to Asia (China) and LatAm (Brazil). These markets are crowded and expectations are high, meaning room for negative news is low. On the other side of this is Russia, with very little flows in comparison where any positive development and news will add to investor attention and attract flows.

- **From underweight to flavour of 2010?**

Russia has been off the radar screen for strategic allocations. However, investors are now starting to increase their weighting to Russian equities on the back of strong fundamentals, which will help trigger the market to perform and narrow the valuation gap.

Investors are starting to increase Russia weighting



- More than 95% of analyst ratings on Russian stocks are “buy” or “hold” – the highest level since Bloomberg began tracking data in 1997
- Russia is the most overweight recommendation by investment strategists in emerging markets
- East Capital currently has a historic high weighting to Russian equities in the East Capital Eastern European fund.
- **Risk premium and investor perception**
In the light of the more favourable macro economic outlook, strong corporate earnings and a positive political development we consider the risk premium for Russian investments to be exaggerated and expect it to decrease. We argue investors have failed to revise their outlook in line with Russia's economic recovery and maintain an overly cautious view based on the events taken place in 2008 with plummeting commodity prices, increased political tensions and worries over the Ruble. Hence, with a more positive news flow we expect Russia to be the market to benefit the most from increased risk appetite and shift in investor perception.

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