EMERGING MARKETS

BRAZIL – 4.0 STARS (VERY ATTRACTIVE)

- Economic activity index grew 0.6% m-o-m in Dec 11 following an upward-revised 1.3% increase in Nov 11
- Industrial production grew by 0.9% m-o-m in Dec 11, up from a 0.2% growth rate in Nov 11
- PMI Manufacturing rose to 50.6 in Jan 12, up from 49.1 in Dec 11
- IPCA inflation decelerated to 6.2% y-o-y in Jan 12, down from 6.5% y-o-y in Dec 11
- Retail Sales grew 6.7% y-o-y in Dec 11, following 6.8% growth in Nov 11
- FGV consumer confidence rose to 119.4 in Feb 12 from 116.0 in Jan 12
- Unemployment rate rose to 5.5% in Jan 12 after falling to 4.7% in Dec 11

MARKET OUTLOOK

Brazil's economic activity began to reverse its slide as the government's attempts to boost economic activity appeared to be reaping dividends. Industrial production rose more than expected, growing by 1.30% on a month-on-month basis in February, beating estimates of a 0.60% growth rate, after an upward-revised fall of -1.50% in January. On a year-on-year basis, industrial production slid by -3.90%, beating estimates of a -5.80% slide and improving from January's upward revised rate of -2.90%. Further, positives can be found for the Brazilian market's industrial outlook. The Manufacturing Purchasing Manager index, which signaled contractions throughout 2H 2011, has now turned expansionary, spending 3 months at above-50 levels. Assuming ceteris paribus, we expect to see industrial production rebound in the latter half of the year.

Retail sales have continued to remain robust, posting growth of 9.60% on a year-on-year basis in February 7.30% after growing an upward-revised 7.80% in January. On a month-on-month basis, retail sales fell slightly by -0.50% in February, after growing an upward-revised 3.30% in January 12. Retail sales have been a key driver in keeping the Brazilian economy humming despite the slowdown in the global economy and the steep decline in industrial production.

Inflation has continued its fall into the government's target of 4.5% (plus/minus 2%), registering a year-on-year rate of 5.24% in March after falling to 5.85% in February, a 6th consecutive month of moderating inflation. With global commodity prices beginning to rise again as a result of tensions in the Gulf, inflation in Brazil could rise in 2H 2012 thanks in part to a relatively low-base effect, potentially complicating the Brazilian central bank's attempt to stoke growth and cool inflation.

Worries of a potential credit bubble have partially eased this month in Brazil as credit loan defaults amongst consumers fell for the first time since December 2010. The default rate amongst consumers fell to 7.4% in March, down from 7.6% in February while the rate for corporate defaults remained at 4.1%. Loans outstanding grew 1.70% on a month-on-month basis as banks lowered their lending rates due in part to the cutting of the Selic rate by another 75 basis points. This resulted in the average lending rate on consumer loans declining from 45.4% in February to 44.2% in March, and the rate on corporate loans falling from 28.6% in February to 27.7% in March. Despite having declining lending rates, we believe that the acceptable default rates coupled with the increase in loans as well as the term of the loans are still in the favour of the Brazilian financial sector.

For the month of April, the Bovespa index lost -4.2% (in local currency terms, as of 30 April 2012). At present price levels (61,820.26 as at 30 April), valuations remain extremely positive for Brazilian equities as they trade at a forward PE ratio of 10.4X and 9.1X based on 2012 and 2013 projected earnings, representing potential upside of 26% by 2013.