EMERGING MARKETS

BRAZIL: 3.0 STARS – ATTRACTIVE

- Manufacturing PMI stood at 50.9 in Sep 17, unchanged from Aug 17
- Services PMI came in at 50.7 in Sep 17, up from 49.0 in Aug 17
- Composite PMI was recorded at 51.1 in Sep 17, up from 49.6 in Aug 17
- Retail sales rose by 3.6% y-o-y in Aug 17, up from a 3.1%y-o-y increase in Jul 17
- Industrial production rose 4.0% y-o-y in Aug 17 improving from a 2.9% y-o-y increase in Jul 17
- IPCA inflation came in at 2.54% y-o-y in Sep 17, rising from a 2.46% y-o-y increase in Aug 17
- Selic rate at 7.50% as of 25 October 2017

RUSSIA: 3.5 STARS – VERY ATTRACTIVE

- Industrial production grew 0.9% y-o-y in Sep 17, down from a 1.5% expansion in Aug 17
- CPI came in at 3.0% y-o-y in Sep 17, down from 3.3% y-o-y in Aug17
- PPI came in at 6.8% y-o-y in Sep 17, up from a 4.7% increase in Aug17
- Retail sales at 3.1% y-o-y in Sep 17, up from a 1.9% increase in Aug 17
- CBR rate at 8.25% as of 27 October 2017

MARKET OUTLOOK

Through the course of October as of 30 October 2017, the earnings estimates of Brazilian companies for the years 2017, 2018 and 2019 were revised upwards slightly by 0.6%, 0.8% and 1.6% respectively. For the whole of 2017, 2018, and 2019, the earnings of Brazilian corporations are expected to grow 31.7%, 12.7% and 21.3% respectively. Over the month, the materials sector dominated earnings upgrades in the market, with steel makers Usinas Siderurgicas de Minas Gerais SA and Metalurgica Gerdau SA as well as pulp and paper companies Fibria Celulose SA and Klabin SA seeing some of the greatest earnings upgrades. Meanwhile, companies from the consumer staples sector such as Ambev SA and BRF SA as well as several utilities companies were met with some of the greatest earnings downgrades. Over in the land of the Tsars, little was changed with regards to the earnings estimates of Russian corporations over the month (2017 and 2018 earnings estimates as of 30 October 2017 were on par with that at the end of September). The 2019 earnings estimates of Russian companies were downgraded slightly by -0.6% over the course of October. As of 30 October 2017, the earnings of Russian corporations are expected to grow 3.8%, 11.9% and 5.7% for 2017, 2018 and 2019 respectively. Similar to that witnessed in its emerging market peers, Brazil, several companies (primarily steel makers) from the materials sector were seen at the top of the table in terms of earnings upgrades, while companies like Magnit PJSC and DIXY Group PJSC from the consumer staples sector saw the largest earnings downgrades. Meanwhile, earnings revisions were mixed over in Russia's dominant energy sector although oil prices edged up by 4.8% over the month to USD 54.15 per barrel (as of 30 October 2017) amid renewed hopes that the OPEC will continue its efforts in balancing the demand and supply in the oil market.

In Latin America's largest economy, economic data released over the month such as PMI data, retail sales, unemployment rate and industrial production, to name a few, continued to suggest progress towards economic recovery. For the first time in 13 months, Brazil's inflation ticked upwards in September 2017 to 2.54% year-on-year, up from prior month's 2.46%. The figure was also higher than consensus expectations of a 2.47% increase in prices. Although the latest inflation figure suggests a possible slowdown or bottoming out of the decline in inflation, inflation is likely to remain in line with, or below, the central bank's target of 4.5% inflation target for the next two years. In its October monetary policy meeting, the Copom has expressed that its expectations are for inflation to "stand around 3.3% for 2017, 4.3% for 2018, and 4.2% for 2019". Nonetheless, the Copom, had unanimously decided to embark on the slowdown of its monetary easing cycle (an intention they had announced in their September meeting), and had slashed rates by a smaller -75 basis points rather than -100 basis points as they had done so in the previous four consecutive meetings. On the 26 October 2017, the Selic rate was cut to 7.50%. Additionally, the central bank had expressed that "regarding the next meeting", it views a "moderate reduction of the pace of easing as appropriate". This would mean further rate cuts at -50 or -25 basis points in the upcoming Copom meetings.

Over in Russia, economic progress seems broadly on path to recovery. Consumption, which contributes to around 50% of the economy's GDP, has continued to improve. Retail sales had extended its uptrend as it rose 3.6% year-on-year in August up from a prior 3.1% in July, while consumer prices continued to head south and came in at a low, in recent history, of 3.0% year-on-year in September, thus providing support to consumption appetites. Services PMI had continued to head up and had registered a 55.2 reading, suggesting continued expansion in the services sector. Meanwhile, while industrial production and manufacturing PMI continued to signal expansion in the manufacturing sector, both have continued to come in at levels lower than that seen in the first half of this year. Nonetheless, industrial production has largely remained in positive territory since February 2016, signalling some underlying resilience. While there are signs that the rate of expansion in Russia's manufacturing sector has slowed, particularly in the mining cluster of the manufacturing sector, current expectations are for industrial production to grow 2.0% in 2017 and 2.1% in 2018, up from 0.4% in 2016. In its October meeting, the Russian central bank had slashed its key rate by -25 basis points to 8.25% for the fifth time this year, as widely expected. Nonetheless, the bank had guided that temporary factors played a role in the recent decline in inflation and that given the "balance of risks for inflation", its ongoing transition from moderately tight to neutral monetary policy would be "gradual". The bank had left open the option of further rate cuts in the coming meetings.

Over the course of September, as of 30 October 2017, the Bovespa Index has risen 0.7% in local currency terms and currently trades at estimated PE ratios of 14.3X, 12.7X and 10.5X for 2017, 2018 and 2019 respectively as compared to its fair PE ratio of 11.5X. In recent times, the valuations of Brazilian equities have rallied on the back of increased optimism surrounding the government's planned reforms and privatisations, although revisions in earnings estimates have remained flattish or slight. In mid-October, we **lowered Brazil's star rating a notch from 3.5 Stars "Attractive" to 3.0 Stars "Attractive" given the reduced upside potential of Brazilian equities due to their strong rally in valuations but flattish earnings revisions**. On the other hand, the Russian equity market dipped -1.1% in RUB terms month-to-date (as of 30 October 2017), trading at estimated PE ratios of 7.2X, 6.4X and 6.0X for 2017, 2018 and 2019 respectively relative to its 7.0X fair PE ratio. While Russia's good progress to economic recovery would likely continue to provide support to the aggregate earnings of Russian companies, structural headwinds facing oil prices coupled with the country's continued low oil production in the near term (in view of the ongoing oil production cut agreement with OPEC) presents risks to the earnings of oil companies. At this juncture, **we believe that a star rating of 3.5 Stars "Attractive" remains warranted for the market.**

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