EMERGING MARKETS

BRAZIL: 3.5 STARS – ATTRACTIVE

- Manufacturing PMI stood at 50.0 in Jul 17, down from 50.5 in Jun 17
- Services PMI came in at 48.8 in Jul 17, up from 47.4 in Jun 17
- Composite PMI was recorded at 49.4 in Jul 17, up from 48.5 in Jun 17
- Retail sales rose by 3.0% y-o-y in Jun 17, up from a 2.6% y-o-y increase in May 17
- Industrial production rose 0.5% y-o-y in Jun 17 after a 4.1% y-o-y increase in May 17
- IPCA inflation came in at 2.7% y-o-y in Jul 17, easing from a 3.0% y-o-y increase in Jun 17
- Selic rate at 9.25% as of 28 August 2017

RUSSIA: 4.0 STARS – VERY ATTRACTIVE

- Russia's GDP grew 2.5% y-o-y in 2Q 17 (advance estimates), up from 0.5% y-o-y in 1Q 17
- Industrial production grew 1.1% y-o-y in Jul 17, down from a 3.5% expansion in Jun 17
- CPI came in at 3.9% y-o-y in Jul 17, down from 4.4% y-o-y in Jun 17
- PPI came in at 1.8% y-o-y in Jul 17, easing from a 2.9% increase in Jun 17
- Retail sales at 1.0% y-o-y in Jul 17, down from a 1.2% increase in Jun 17
- CBR rate at 9.00% as of 28 August 2017

MARKET OUTLOOK

Through the course of August as of 28 August 2017, the 2017 and 2018 earnings estimates of Brazilian companies were revised downwards by -1.6% and -2.2% respectively. As of 28 August 2017, the earnings of Brazilian companies are expected to grow 30.0% and 11.4% in the whole of 2017 and 2018 respectively. Iron ore mining giant Vale SA was amongst companies in the Bovespa index that saw the largest earnings upgrades over the month amid a surge in optimism surrounding the company's corporate governance. In mid-August, the company had reached its minimum threshold for preference share conversion to ordinary shares and such a conversion would enable the company to dismantle Valepar SA, the controlling shareholder group consisting Brazilian state pension funds. This move is perceived to result in notable improvement in the company's vulnerability to government manipulation. From a sector perspective, Brazil's pulp and paper industry also saw some of the greatest upward revisions in earnings over the month, resulting in the notable upward revision in the materials sector as a whole; while the country's heavy-weight financials and consumer staples sectors saw mixed earnings revisions over the month.

Month-to-date as of 28 August 2017, the 2017 and 2018 earnings estimates of Russian corporations were revised upwards by 2.4% and 2.5% respectively. As of 28 August 2017, the earnings of Russian companies are expected to grow 4.7% in the whole of 2017 and grow 12.4% in the whole of 2018. From a sector perspective, the heavy-weight financials sector saw some of the largest earnings upgrades while the materials sector dominated earnings downgrades over the month. Meanwhile, the energy sector saw mixed earnings revisions over the month. Companies such as oil & gas industry steel pipe provider TMK PJSC as well as provider of crude oil pipeline transportation Transneft PJSC saw the largest month-to-date earnings upgrades in the sector, while oil & gas producers Surgutneftegas OJSC and Novatek PJSC saw the largest earnings downgrades amongst companies in the energy sector. Looking ahead, however, it would be unsurprising that supply side issues in the global oil industry as well as greater US shale oil production contribute to a prolonged and volatile oil price recovery, presenting risks to the earnings of Russian oil companies. Additionally, comparatively low oil production in the near term on the back of Russia's ongoing oil production cut agreement with OPEC add to the risks facing Russian oil companies' earnings.

In South America, Brazil's industrial production rose 0.5% year-on-year in June, surpassing expectations for a -0.1% decline and expanding for the second consecutive month. Brazil's growth in industrial production in June is the highest growth rate since late 2013, with the exception of the high growth of 4.1% seen in May 2017. The country's manufacturing PMI stood at 50.0 in July, down from the 50.5 reading in June and 52.0 reading in May, signalling a slowdown in manufacturing expansion in the recent months. Nonetheless, several indicators had continued to suggest continued progression in the economy's road to recovery. The country's unemployment rate had started to dip since April 2017 and retail sales had exited contractionary territory in April as well. July's consumer price inflation had extended its downward trend to reach 2.7% year-on-year, down from prior month's 3.0% year-on-year, giving consumers better bang for their buck. The above bodes well for the economy's household consumption, which contributes to around 60% of the country's GDP. Additionally, the continued easing of the country's inflation would likely continue to give rise to good room for further monetary policy easing, which would likely in turn provide support to the country's economic growth. According to recent central bank surveys of around 100 economists, expectations are for the economy's interest rate, which currently stands at 9.25%, to reach 7.50% by the end of this year and for the country's GDP to grow 0.34% for the whole of this year, up from -3.6% in 2016.

Thus far the Russian economy, which had fallen into a recession in 2014, has shown good economic progress, with its 4Q 16 and 1Q 17 GDP growth coming in at 0.3% and 0.5% year-on-year respectively and its 2Q 2017 GDP clocking an even higher growth rate of 2.5% year-on-year. The economy's labour market has continued to strengthen, as consumer price inflation continued to tick downwards (3.9% year-on-year in July, down from 4.4% year-on-year in June) and the country's unemployment rate had fallen since the beginning of the year, although it had remained at 5.1% in June and July. Consequently, real wages and retail sales extended their overall upward trends. The strengthening labour market bodes well for household consumption over the coming quarters, which contributes to around half of Russia's GDP. Additionally, the lower inflation rates would likely create greater room for further interest rate cuts. At this juncture, expectations are for the country's key rate, which currently stands at 9.00%, to fall to 8.25% and 7.10% by the end of 2017 and 2018 respectively. Industrial production had grown a smaller 1.1% year-on-year in July compared to its notable 3.5% expansion in June. Nonetheless, overall, industrial production remains relatively resilient as it has registered positive growth since February 2016 (when excluding February 2017's contraction). While there are signs that the pace of expansion in the country's manufacturing and services sectors may come in at levels lower than their highs in the beginning of the year, as per consensus forecasts, the Russian economy is still expected to grow 1.4% for the whole of 2017, up from -0.2% in 2016.

Over the course of August, as of 28 August 2017, the Bovespa Index has risen 7.7% in local currency terms and currently trades at estimated PE ratios of 13.7X and 12.3X for 2017 and 2018 respectively as compared to its fair PE ratio of 11.5X. While **we retain Brazil's star rating at 3.5 Stars "Attractive", we are keeping an eye on overall valuations should there be continued gains in stock prices without overall improving fundamentals**. On the other hand, the Russian equity market rose 6.1% in RUB terms month-to-date (as of 28 August 2017), trading at estimated PE ratios of 6.7X and 6.0X for 2017 and 2018 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 as well as continued low oil production in the near term on the back of the ongoing on the oil production cut agreement present risks to the earnings prospects of Russian oil companies. As of 23 August 2017, the market's forecasted annualised total return (by end-2019) has dipped to 16.6% from 19.3% as of early-March 2017. Thus, **we lowered Russia's star ratings a notch from 4.0 Stars "Very Attractive" to 3.5 Stars "Attractive" on the back of notable oil uncertainties.**

RECOMMENDED FUND:
EASTSPRING INVESTMENT GLOBAL EMERGING MARKETS FUND