EMERGING MARKETS

BRAZIL: 3.0 STARS – ATTRACTIVE

- Manufacturing PMI at 52.3 in Apr 18, down from 53.4 in Mar 18
- Services PMI at 50.0 in Apr 18, down from 50.4 in Mar 18
- Composite PMI at 50.6 in Apr 18, down from 51.5 in Mar 18
- Retail sales rose 6.5% y-o-y in Mar 18, up from an upward-revised 1.5% y-o-y rise in Feb 18
- Industrial production rose 1.3% y-o-y in Mar 18, slowing from a downward-revised 2.4% y-o-y increase in Feb 18
- IPCA inflation came in at 2.8% y-o-y in Apr 18 as compared to a 2.7% y-o-y increase in Mar 18

RUSSIA: 3.5 STARS – VERY ATTRACTIVE

- Industrial production rose 1.3% y-o-y in Apr 18, down from 1.0% in Mar 18
- CPI rose 2.4% y-o-y in Apr 18 unchanged from Mar 18
- PPI came in at 7.5% y-o-y in Apr 18, rising from a 4.8% rise in Mar 18
- Real retail sales rose 2.4% y-o-y in Apr 18, up from a 2.0% increase in Mar 18

MARKET OUTLOOK

Brazilian corporations (as gauged by the Bovespa Index) as a whole saw earnings slight earnings upgrades over the month, as 2018's and 2019's estimates were raised 0.5% and 0.3% respectively (as of 25 May 2018). Year-to-date, revisions for 2018's and 2019's earnings estimates were 9.3% and 5.6% respectively. Earnings upgrades were driven by selected sectors and industries, while other sectors saw aggregate earnings downgrades. Among the financials, index heavyweight banks like Itau Unibanco saw slight EPS upgrades over the month. Among the materials sector, mining titan Vale once again continued to enjoy upgrades to its EPS estimate in May. Petroleo Brasileiro (Petrobras) also saw its estimated earnings revised higher, contributing to the energy sector's overall earnings upgrade over the month. On the other hand, Ambev, an index-heavyweight and the largest constituent in the consumer staples sector by market capitalisation, saw its EPS estimate for 2018 lowered over the month. However, sell-side analysts remain positive on Ambev's prospects as Brazil's economy continues to recover and consumption continues to improve. Over in Russia, Russian companies (as gauged by the constituents of the RTSI$ Index) saw their earnings estimates for 2018 and 2019 revised 3.8% and 3.2% respectively (as of 28 May 2018). This leaves year-to-date revisions for 2018's and 2019's earnings estimates at 14.1% and 11.1% respectively. The Rouble's (RUB) recent weakness following the Trump Administration's announcement of new sanctions on Russian entities in April drove earnings upgrades since then as corporations who derive most of their revenue from overseas are expected to see their earnings boosted after currency translation. Energy titans such as Gazprom, Novatek and Rosneft saw upgrades to their EPS in May, contributing to the market's overall earnings revisions. Among the materials sector, Novolipetsk Steel saw EPS upgrades while Magnitogorsk Iron & Steel Works saw downgrades over the month. Regarding the financials sector, Sberbank's EPS for 2018 remained unchanged from the previous month while VTB saw a bump up to its earnings estimates.

In terms of recently-released economic data for Brazil, industrial production slowed again, rising 1.3% year-on-year in March as compared to a prior downward-revised 2.4% year-on-year increase. However, retail sales surprised to the upside, registering a 6.5% year-on-year gain in March as compared to an upward-revised 1.5% gain in February. On a month-on-month basis, retail sales also beat consensus estimates. We think that the overall outlook for domestic consumption in Brazil remains bright as real incomes have been improving. Brazil's set of Markit PMIs decreased across the board in April, with the composite PMI coming in at 50.6, declining from a prior 51.5 reading. The decline in services' reading was lesser than its manufacturing counterpart, and came in exactly at the crucial 50.0 level. Going forward into the second half of the year, the upcoming general elections could introduce a level of uncertainty that could affect business confidence and foreign investor sentiment. Any adverse impact on sentiment could affect the recovery in capex and hiring in Brazil, which would weigh on overall growth this year. Over in Russia, economic data was strong in April, with industrial production coming in above expectations at a 1.3% year-on-year increase for the month of April, rising from a prior 1.0% year-on-year rise. Real retail sales also was robust, meeting the consensus forecast for a 2.4% year-on-year increase and increasing from a prior 2.0% year-on-year rise.

Inflation-adjusted wages and disposable income continue to register better-than-expected increases, suggesting that the current recovery in consumer purchasing power has been intact and that domestic consumption has been resilient despite the rise in geopolitical tensions between the US and Russia. While fundamentals are better as compared to the situation back in 2014 and 2015 following the annexation of the Crimea and the plunge in crude oil prices, It remains to be seen if the recent weakening of the Rouble and any possible decrease in business investment due to the spill over effects of sanctions will affect overall growth momentum.

A broad-based rebound in the USD in May pressured emerging markets around the world, with the Brazilian market seeing a -8.4% decline over the month in BRL terms (-10.9% in SGD terms). **We were cognisant of stretched valuations of Brazilian equities and have lowered its star ratings from a prior 3.0 Stars "Attractive" to 2.5 Stars "Neutral" in the middle of May to reflect this view.** We also note for the possibility of an increase in political uncertainty as the general elections in October approach, which could affect the recovery in capex and hiring and consequently weigh on overall growth in 2018. At current levels, the Brazilian equity market trades at 11.9X and 10.5X 2018's and 2019's estimated earnings, as compared to its fair PE ratio of 11.5X. In Russia, the equity market rebounded from April's wobbly trend, recording a 2.2% gain in SGD terms in May (as of 28 May 2018). Russian equities trade at 6.0X and 5.9X 2018's and 2019's estimated earnings, comparing favourably to its fair PE ratio of 7.0X. Geopolitical risks remain for the Russian market, and as such, direct exposure is only suitable for aggressive investors willing to stomach higher levels of volatility. **We believe that a star rating of 3.5 Stars "Attractive" continues to be warranted for Russia.**

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