ECOGNOSIS ADVISORY LTD

From the Greek: ΟΙΚΟΝΟΜΙΚΗ ΓΝΩΣΙΣ (Ekonomiki Gnosis, Knowledge of Economics). Ecognosis is a global financial, economic advisory and information service, covering economic and financial developments, equities, fixed income, forex, commodities and other assets. Econotes is a research publication available free on our internet site and to the public in Hong Kong. It is not a solicitation for business and neither does it contain investment suggestions on specific and named securities including any buy, sell or hold advice. It is written by Dr. Andrew F. Freris based on 47 years of market experience which includes senior positions with GT Capital, Salomon Brothers, Bank of America and BNP Paribas as well as senior academic posts with universities in London and in Hong Kong

8/F, 2 Exchange Square, 8 Connaught Place, Central, Hong Kong. Tel: 852 3167 4591, Mob 852 9738 0944
Email: afreris@ecognosisadvisory.com Website: www.ecognosisadvisory.com

ECONOTE No. 36 **30/5/2015**

Lest we forget the BRICs (or BRT ?): Read on….

Summary	Investment Conclusions
The acronym BRIC was irrelevant as the economies covered, Brazil, Russia, India and China, were as different as to resemble more of an alphabet soup than similar economic units.The aim of examining economies together is to draw investment conclusions.We look here at Brazil and Russia because they are commodities-dependent economies with unique domestic and external problems, and we add Turkey as it,too, has economic and political problems. Brazil is deeply mired in scandals and low commodity prices. Russia has survived low oil prices and the Ukraine better than expected and Turkey is in the cusp of important political developments.	While the external balances of Brazil and of Russia stay impacted by weak commodity prices, it follows that the “scissors” of weaker currency and the difficulty to cut rates will press on the performance of equities. Turkey is a different proposition insofar as domestic factors have been important in driving the economy, but its external deficit could be also impacted by higher USD rates, although its fiscal position is quite strong. Of these three economies,Turkey is the most likely candidate for rates to boost equities. Politics, however, will continue to dominate in all three economies.

The stories so far (politics, politics, politics)

In the last three months the media headlines have been flooded with corruption scandals: Libor manipulation by major banks, unending fines on all major banks for all types of infractions, FIFA kickbacks and, last but not least, Petrobras. We leave aside the on-going daily litany of Chinese party functionaries caught with their fingers (sorry, arms to their elbows) in the cookie jar. Leaving cheap moralizing aside, one wonders what these people thought--clearly that they would not get caught! In **Brazil**, Rousseff’s reelection in October 2014 presented her with an economy which was already decelerating to negative growth. Indeed including the- just- announced 1Q.15 rate, Brazil has had four successive quarterly YoY negative growth rates, and the outlook for 2015 remains poor. The causes of this recession were primarily three: (a) the sharp fall in the prices of iron ore, soy, wheat and coffee, all key exports from Brazil, (b) the progressive deterioration of the fiscal balance which put brakes on state-driven investment and spending, and the weak USD/BRL which forced the central bank to hike rates several times since November 2014. As Chart 1 shows the BRL (green) made a brief recovery, but it is helping to fuel inflation which rose from 6.4% in December 2014 to 8.1% this April.Lastly, (c), the corruption scandal in the state firm Petrobras involved the company writing down USD 17.0 bl in losses and, effectively, stopping all its investment activities especially after the halving of oil prices. As the outlook for oil prices remains dim, a major source of investment has now nearly stopped, thus adding to the fall of GDP.

Chart 1:Forex rates,BLR,RUB &TRY,2014-2015

Source: Bloomberg

weakening now thus

ECONOTE No.36

Here come the Russians, followed by the Turks

The sharp recovery of the **Russian** economy from the 2009 recession (nealry -10.0% shrinkage) was followed by decelerating growth dipping into recession again in 2014-15, with the economy expected to shrink by 3.4%in 2015 (IMF).There were two factors at work here.Following the annexation of the Ukraine in March 2014, the G20 countries imposed economic sanctions to which Moscow replied with its own restrictions on imports and trade in general. Added to that, was the fall in the price of oil, the key export of Russia which helped to push the country into recession.It also generated a relatively short-lived financial crisis which caused a sharp depreciation of the Ruble from the end of 2014 till about February this year. Prompt action by the central bank allowed the RUB to float, with rates hiked to 17%,

FACT BOX: Stock market metrics

Market	P/E 12M frwd	P/B 12M frwd	USD YTD %
Brazil	12.5	1.3	-10.7
Russia	3.7	0.5	30.0
Turkey	10.0	1.3	-14.5

Russia's spectacular performance so far has been helped by the strong rise in the USD/RUB with the market very cheap indeed, seling at less than book value.Brazil and Turkey are not expensive, but here the potential impact of weak currencies will play a big role.Turkey may cut rates at the teeth of higher inflation. (Bloomberg)

now cut back to 14%. Banks were recapitalized and emergency measures introduced to break the GDP deceleration, including capital controls. As Chart 1 shows the Ruble made a remarkable recovery and capital outflows stabilized. However, sanctions remain and oil prices will not increase this year, or even perhaps in 2016. Russia's dominant position in gas and oil exports to European economies has now created a backlash which may lead to future reductions in exports, coupled with low or falling energy prices. Politics play here a crucial part, and Russia's position is unlikely to change thus leaving all these economic pressures unchanged for now.

Chart :Stocks ,Russia(red),Brazil(green),Turkey(Bl) 2014-2015

Source : Bloomberg

Turkey and a summary

Turkey's economy made a sharp recovery from the 2009 recession, with the economy even hitting quarters of 10% and over of yoy growth.However, rising inflation and weaker external balances caused the TRY to weaken (Chart 1)and the central bank to nearly double interest rates in 2014, although it started to ease now. Political unrest throughout 2014 did not help sentiment which in terms of PMI has stayed firmly below 50 since January this year. The political aspirations of president Erdogan will be tested in elections in June, and if he wins parliamentary majory, the constuitution will be changed to a presidential form of government allowing for speedier decisions but possibly less accountability. Pressurers on the central bank to cut rates, despite still lingering inflation, have not helped.

Chart 2 shows that Brazil's equities have found it difficult to make a convincing recovery while Russia's strong performance was helped by the strong RUB .Turkey's equities may be given a lift if the central bank finally cuts rates or the political environment improves. Bottom line is that the "ifs" concentrated more on Brazil and Russia and relatively less on Turkey, where the political issues may well be less onerous than in Brazil or in Russia.

Andrew Freris (wting completed on 30/5/2015)