

ADR/GDR leaders and laggards last week*

	Price* \$ per share	Last week	YTD*
Top 15			
Uralkali	34.93	4.2%	-4.9%
PIK Group	3.42	4.1%	-40.0%
Globaltrans	13.00	3.6%	-23.5%
O'Key	6.18	3.0%	-55.1%
Magnit	20.16	0.3%	-31.2%
NOVATEK	128	0.0%	6.7%
Sberbank***	2.61	-0.1%	-23.3%
LUKOil	51.00	-0.1%	-9.7%
Gazprom	10.69	-0.4%	-22.5%
Novorossiisk Commercial Seaport	7.29	-0.7%	-27.1%
RusHydro	3.40	-0.7%	-37.6%
Evraz Plc	367	-1.3%	-54.3%
TransContainer	7.60	-1.3%	-20.0%
VTB	3.93	-1.7%	-40.4%
Gazprom Neft	21.71	-1.7%	4.4%
Bottom 15			
Raven Russia (GBP)	0.49	-8.0%	-22.0%
Highland Gold Mining (GBP)	181	-8.1%	-3.9%
Chelyabinsk Zinc	2.37	-8.4%	-45.9%
MMK	5.09	-8.6%	-63.9%
Cherkizovo Group	12.30	-9.0%	-31.7%
X5 Retail Group	20.84	-9.1%	-54.9%
VimpelCom Ltd	9.38	-9.2%	-37.6%
Global Ports**	12.20	-10.0%	-18.7%
AFI Development	0.42	-10.4%	-63.1%
Mechel	8.95	-10.7%	-69.4%
PhosAgro**	8.50	-11.9%	-39.3%
Yandex*	17.55	-12.0%	-29.8%
Polyus Gold International	17.80	-12.1%	-51.2%
LSR Group	3.20	-13.4%	-65.3%
TMK	9.65	-13.6%	-53.3%
RTS Index	1,373.7	-2.3%	-22.4%
MICEX Index	1,383.4	-0.9%	-18.6%
IOB GDR Index	779.9	-0.8%	-21.1%
MSCI EM Index	904.1	-3.2%	-21.5%
MSCI World Index	1,146.5	-3.4%	-10.4%
S&P 500 Index	1,219.6	-2.8%	-3.0%
Copper, \$/lb	333.10	-6.6%	-25.1%
Brent, forward, \$/bbl	103.35	-5.1%	9.1%
RUB/USD	31.82	-0.9%	-4.3%
USD/EUR	1.30	2.5%	-2.5%

* as of close on December 16

** YTD is from IPO issue price

*** Sberbank price is RTS local listing

Source: Bloomberg

Strategy Week Ahead

New Game, New Rules

The inherent vice of capitalism is the unequal sharing of blessings; the inherent virtue of socialism is the equal sharing of miseries.

Winston Churchill

There are three events in the diary for this week that have significance for Russia's markets as we head into 2012. The first of those is the migration of the RTS cash equity business to MICEX today. The second is the first session of the new, and likely more demanding, Duma on Wednesday. The third is the next mass protest planned for central Moscow on Saturday. All have potential implications for government policy, foreign investor activity in, and perception of, Russian assets and for some specific stocks and themes.

These events come after a generally good news week for the investment story in Russia, which, because of the dominance of external drivers and political risk dominating the headlines in international media, had less of a market impact than they deserved. Russia's WTO membership application was approved after almost 18 years of negotiations; Prime Minister Vladimir Putin made a few, but significant concessions during his televised Q&A session; and macro data confirmed a steadily improving growth trend in the economy and national balance sheet that is already one of the best in the world. The decision taken by OPEC ministers also creates a better basis for assuming an average oil price of \$100-110/bbl for 2012, albeit we may still see weakness in 1Q12 before Middle East regional risks rise again in 2Q12.

As Western markets now head into the usually quiet Christmas and New Year holiday, there should soon be less external impact on the domestic market, and the domestic news headlines will be more of a dominant driver. But, before we get to that period, there is the potential for a few more external bumps as, for example, the war of words continues over the rating agencies' review of European Sovereign debt ratings and we get the usual year-end populist statements from political leaders across the region. Eurozone finance ministers will hold a conference call later today to try to advance the rescue talks.

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Capital market reforms

The first step in an important series of market reforms starts today with migration of the RTS cash equity business to MICEX. Stocks will continue to be listed in both ruble and dollar format and all index series from both bourses will remain. This is the first step in making the local bourses more transparent and with better liquidity. The next step, on January 1, is even more important, as the law creating a domestic central depository kicks in. It really makes a huge difference from July when foreign investors will be able to open an account directly at the central depository.

Over the next six months, therefore, these changes could do the following.

- Increase transparency and liquidity on the local bourse.
- Open up the local bourse to a much bigger pool of global investors, such as Japanese trust banks, which are currently prohibited from dealing in local shares.
- Eliminate the discount that local shares have relative to their GDR and ADR equivalents.

In the longer term, Russia still needs to address the most important issue of building a much bigger pool of domestic capital. Only then will the volatility/beta fall, the valuation discount with EM peers close and more issuers look to raise money at home rather than on international bourses.

New Duma

The newly elected Duma will hold its inaugural session on Wednesday. United Russia now has a very slender majority, which will very likely make a difference to the government's economic policy and reform agenda over the next few years. The first thing that we should notice is that there now is a very vocal and invigorated opposition. The Duma is no longer the irrelevant rubber-stamp for government legislation that it has been.

Structure of new Duma				
	Old Duma		New Duma	
	Seats	Duma votes	Seats	Duma votes
United Russia	315	70.0%	238	52.9%
Communist Party	57	12.7%	92	20.4%
LDPR	40	8.9%	56	12.4%
A Just Russia	38	8.4%	64	14.2%
Total	450	100.0%	450	100.0%

Source: Troika

The opposition may, for example, be opposed to any material cuts in social programs; may prove less cooperative with any government proposals to expand the privatization program; and may try to adopt more protectionist policies that may make the passage of WTO entry legislation a tougher project than previously expected. The first major legislation that the Duma debates in 2012 may well be the WTO entry bill.

In terms of stock market themes, a more influential Duma that requires some government policy compromise should be good for sectors such as the following.

- Pharma: pensions and health spending.
- Real estate: addressing current overcrowded and bad city housing.
- Banks: stable macro growth.
- Consumer themes: stable macro growth.
- Transport: stable macro growth and infrastructure improvement.
- Agriculture: expected to be a major government and Duma reform theme.

- Manufacturing: state support to help the manufacturing industries improve ahead of WTO entry competition, etc, and as the Duma adopts a more nationalist protectionist stance.

Sectors that may be adversely affected include the following.

- Utilities: less support for higher residential tariffs.
- Extractive industries: may see additional extraction taxes and/or export tariffs.

Next major protest

Although there was a small event last Saturday, the next major street protest is set for Saturday (December 24), and the authorities have already issued a permit for a gathering of 50,000. That is likely to be the last major gathering ahead of the New Year-January holidays, and the government is no doubt hoping that this break will diffuse the momentum. How well attended Saturday's event is, how it is conducted and whether any specific protest leaders emerge will determine whether that hope is realized or wishful. Currently incarcerated protest figures, such as anti-corruption blogger Alexei Navalny, are expected to address the crowd.

Putin did address the protest movement during his Q&A last week, and while some of his comments were either dismissive or again blamed foreign provocateurs, he did make several important comments that showed he is paying attention to the threat posed to his election campaign. Putting video cameras in all voting stations is probably a logistic impossibility, but the point made is that the government will be very keen to avoid any allegations of fraud at the March election in case it taints the next presidency.

Putin also referred to former Finance Minister Kudrin in very positive terms. Kudrin is regarded as a very able and pro-business administrator, so making it clear that he will have a very influential role in the next administration was a clear message to both the business and the investor communities. Putin's reference to Mikhail Khodorkovsky was also very tellingly different this time. He specifically said that a presidential pardon is possible, albeit if Khodorkovsky applies with an admission of guilt. That is a big improvement from the "the thief sits in jail" reference made last year. This is hopefully another sign that the next government will be much more proactive in pushing measures to improve the business and investment climate, as Khodorkovsky's controversial second jail sentence is continually highlighted as part of the negative perception of Russia risk.

This week: winding down

Most major investment funds have now closed their books for the year, and while markets are likely to remain very volatile, volumes will start to slide into the holiday season. There are few major economic updates due in the US or Europe this week, with the most important likely to be monthly housing statistics in the US (several updates this week) and the German Ifo business sentiment index on Tuesday. The US will release the final reading of 3Q11 GDP on Thursday, albeit no deviation is expected from the previous reading of 2.0%. Investors will be more focused on indicators for the current month, such as the leading indicator and the jobless claims update, also on Thursday.

In Russia, the full macro report for November will be published, showing updates for retail sales, unemployment, investment spending and real wage growth as well other indicators. A similar trend to that of last month is expected.

Trading last week: drifting with shrinking volumes

Global markets finished nervously last week as the rating agencies cut the outlook for several European economies, including France, and promised a full review by end January. That will ensure a continuation of the uncertainties that have affected global markets for most of this year at least

into the first month of the new year. The US markets did manage to pull back to a flat close on Friday, but the S&P 500 Index finished the week 2.8% lower and down 3.0% YTD. It was again a case of balancing generally positive domestic economic indicators with Eurozone debt fears. The MSCI World Index lost 3.4% over the five days and is down 10.4% YTD. The MSCI EM Index lost 3.2% and extended its YTD loss to 21.5%.

Moscow's bourses moved back into a familiar pattern last week as domestic political risk was put to one side and external news moved back into the driving seat, albeit the indexes did outperform global peers because of Monday's relief-bounce. The RTS Index finished the week down 2.3% after losing 1.5% on Friday. The MICEX Index lost 0.7% on Friday and 0.9% over the five days. The FTSE GDR Index fared better as the long overlap with Wall Street on Friday helped it to close the day with an 8 bps gain and a loss of 0.8% for the five days.

There was no major theme in last week's stock movements other than some of the worst-hit stocks during the previous week, e.g. Uralkali and NOVATEK, staging a small relative rally. At the other end of the table, some steel names, such as Mechel, and other stocks that have been poor performers all year, such as LSR Group, again propped up the table. Most stock moves, such as the 8.8% rise in PIK Group on Friday, were on low volumes.

The ruble also moved more in line with the trend in the EM currency asset-class, losing 0.9% against the dollar and gaining 1.4% against the euro. The euro continued its slide against other major currencies as the rating agencies put several countries on negative watch. The euro lost 2.5% against the dollar over the five days. The US currency is also now the haven asset of choice, and that resulted in a loss of 6.8% for gold and 8.0% for silver over the past five days. Industrial metals fared no better, copper losing 6.6%. Brent lost \$5.5/bbl after OPEC's decision to finish Friday at \$103.55/bbl.



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