EMERGING MARKETS

BRAZIL (3.0 STARS – ATTRACTIVE)

- Manufacturing PMI at 53.2 in Feb 18, up from 51.2 in Jan 18
- Services PMI rose to 52.7 in Feb 18, up from 50.0 in Jan 18
- Composite PMI rise to 53.1 in Feb 18, up from 50.7 in Jan 18
- Retail sales rose 3.2% y-o-y in Jan 18, slowing from an upward-revised 4.0% y-o-y rise in Dec 17
- Industrial production rose 5.7% y-o-y in Jan 18, down from an upward-revised 4.5% y-o-y increase in Dec 17
- IPCA inflation came in at 2.8% y-o-y in Feb 18 as compared to a 2.9% y-o-y increase in Jan 18

RUSSIA (3.5 STARS – ATTRACTIVE)

- Industrial production rose 1.5% y-o-y in Feb 18, down from 2.9% in Jan 18
- CPI came rose 2.2% y-o-y in Feb 18, similar to the print in Jan 18
- PPI came in at 5.7% y-o-y in Feb 18, rising from a 5.0% increase in Jan 18
- Retail sales rose 1.8% y-o-y in Feb 18, down from a 2.8% increase in Jan 18

MARKET OUTLOOK

Brazilian corporations (as gauged by the Bovespa index) enjoyed another month of earnings upgrades, as 2018's and 2019's estimates were upgraded 1.6% and 1.3% respectively (as of 26 March 2018). Year-to-date, total upgrades for 2018's and 2019's earnings were 9.5% and 6.4% respectively. The materials sector contributed strongly for this month's upgrades, with mining titan Vale seeing EPS upgrades as sell-side analysts are more confident of its deleveraging and cash return prospects. Index heavyweight and energy juggernaut Petrobras also contributed to the headline upgrades with a bump up in its earnings estimates. Earnings revisions among the consumer discretionary and consumer staples sectors were overall rather mixed this round, while the financials sector saw a slight upgrade on aggregate. In Eastern Europe, Russian companies (as gauged by the constituents of the RTSI$ Index) saw their earnings estimates for 2018 and 2019 lowered (by -1.4% and -1.5% respectively) over the month (as of 26 March 2018). This leaves year-to-date revisions for 2018's and 2019's earnings estimates at 7.3% and 6.7% respectively. The Russian financials sector as a whole saw earnings upgrades, with VTB and Sberbank driving the sector's changes in estimates for 2018. Sell-side analysts remain optimistic about prospects of these banks as asset quality is expected to continue improving. The situation was more mixed in the heavyweight energy sector, with Novatek seeing a slight bump up in its estimated EPS for the year while Surgutneftegas and Rosneft seeing downgrades to their respective EPS (the latter affected by higher debt loads). The iron and steel industry, which includes companies like Severstal, Novolipetsk, Magnitogorsk and MNC Norilsk, saw earnings upgrades over March.

In terms of recently-released economic data, industrial production in Brazil beat estimates in January, and is reflective of improving conditions within the country, with earlier months of data enjoying upward revisions as well. While retail sales data for January came in below expectations, the overall outlook for domestic consumption in Brazil remains bright. Leading indicators such as the manufacturing and services PMI rose strongly in February, suggesting improving confidence in both the manufacturing and non-manufacturing areas of the economy. Latest inflation data also suggests that inflationary pressures are more or less aligned with what economists are expecting. Despite Brazil's central bank declaring an end to any further rate cuts, we do not think that monetary policy will be tightened anytime soon, given disinflationary trends in the country. Monetary policy is still expected to remain accommodative, supporting the outlook for growth moving forward. Over in Russia, despite both retail sales and industrial production data coming in below consensus estimates, the overall outlook for domestic consumption and manufacturing remains supported given improving readings on leading indicators. While the manufacturing PMI came in below expectations, services actually rose above expectations in February, enabling the composite index to remain in expansionary territory. The consensus expects Russia's economy to grow by 1.85% in 2018, which we think is achievable barring any unforeseen adverse shocks or a complete collapse in energy-related commodity prices.

Global equity markets took a hit once again as trade tensions (from an increasingly protectionist US) sparked risk aversion among investors. Brazil's Bovespa index fell -1.1% in BRL terms (-4.1% in SGD terms) over the month, which leaves year-to-date returns of 10.4% as of 26 March 2018 (8.2% in SGD price terms). Consequently, the index trades at 12.8X and 11.2X 2018's and 2019's estimated earnings as compared to its fair PE ratio of 11.5X. At this juncture, **we maintain our star ratings of Brazil at 3.0 Stars "Attractive"**. Over in Russia, the Russian equity market also went through a similar encounter, with the RTSI$ Index falling -1.9% in RUB terms month-to-date (-2.6% in SGD price terms). We note that geopolitical risks remain for the Russian market, which is a factor that could hurt investor sentiment. Russian equities trade at 6.4X and 6.3X 2018's and 2019's estimated earnings, comparing favourably to its fair PE ratio of 7.0X. **We believe that a star rating of 3.5 Stars "Attractive" remains warranted for the market.**

RECOMMENDED FUND:
WELLS FARGO EM EQUITY INCOME A USD ACC
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EMERGING MARKETS COUNTRY STAR RATINGS

Brazil (3.0 stars –Attractive)

Why we like it

1. Accommodative Monetary Policy
    - As disinflation continued in 2017, the central bank stepped up its rate of easing so as to aid the economy in emerging from its recession. For the whole of last year, the central bank had cut rates by a total of -675 basis points to a historical low of 7.00%.
    - In 2018, the Selic rate was lowered by another 50 basis points (to 6.50%) with policy-makers announcing that the easing cycle is over. While no more rate cuts are on the table, we do not think that monetary policy will be tightened any time soon. Monetary policy is still expected to remain accommodative, supporting the outlook for growth

2. Secular Growth Story Still Intact
    - While Brazil's economy is still recovering from its recession which it entered in 2014, its long-term structural growth story as an emerging market still remains intact. With positive demographic trends and huge potential, long-term investors would still find that there are many opportunities.
    - Brazil remains amongst one of the most attractive investment destination amongst Latin American nations.

3. Strong Foreign Currency Reserves Position
    - Brazil is able to service its debt obligations due to its strong foreign currency reserves of USD 374.0 billion (as of end-February 2018) that represents a comfortable buffer of close to seven times its short-term external debt.

Why we don't like it

1. Heavy Trade Dependence On Europe And China
    - China accounted for approximately 19% of Brazil's exports in 2016. The restructuring of China's economy towards a services-led economy rather than a manufacturing-led one has seen Brazil's steel exports to China decline. Even though the majority of Brazil's exports to China have shifted to soybeans —which has helped to cushion the fall in steel exports, the economy's dependence on exports to China remains a risk.
    - While economic momentum in Europe, which accounted for approximately 18% of Brazil's exports in 2016, is becoming increasingly entrenched, it remains prudent not to strike out the possibility of downside risks to economic growth.

2. Political Risks Could Affect Investment Sentiment
    - Brazil has been met with several political corruption scandals in recent history and sentiment is prone to be adversely affected by these developments, resulting in unexpected volatility in the equity market at times
    - At this juncture, the country is led by President Michel Temer, who, since having taken office in August 2016, has already had two major incidences of corruption charges announced against him.