EMERGING MARKETS

BRAZIL (3.5 STARS – ATTRACTIVE)

- Brazil's GDP grew 0.3% y-o-y in 2Q 17,up from -0.4% y-o-y in 1Q 17
- Manufacturing PMI stood at 50.9 in Aug 17, up from 50.0 in Jul 17
- Services PMI came in at 49.0 in Aug 17, up from 48.8 in Jul 17
- Composite PMI was recorded at 49.6 in Aug 17, up from 49.4 in Jul17
- Retail sales rose by 3.1% y-o-y in Jul 17, up from a 2.9%y-o-y increase in Jun 17
- Industrial production rose 2.5% y-o-y in Jul 17 after a 0.5% y-o-y increase in Jun 17
- IPCA inflation came in at 2.5% y-o-y in Aug 17, easing from a 2.7% y-o-y increase in Jul 17
- Selic rate at 8.25% as of 25 September 2017

RUSSIA (3.5 STARS – ATTRACTIVE)

- Russia's GDP grew 2.5% y-o-y in 2Q 17 (preliminary estimates), up from 0.5% y-o-y in 1Q 17
- Industrial production grew 1.5% y-o-y in Aug 17, up from a 1.1% expansion in Jul 17
- CPI came in at 3.3% y-o-y in Aug 17, down from 3.9% y-o-y in Jul17
- PPI came in at 4.7% y-o-y in Aug 17, up from a 1.8% increase in Jul17
- Retail sales at 1.9% y-o-y in Aug 17, up from a 1.2% increase in Jul 17
- CBR rate at 8.50% as of 25 September 2017

MARKET OUTLOOK

Through the course of September as of 25 September 2017, the earnings estimates of Brazilian companies in 2017 were revised downwards by -0.3% while the earnings estimates of Brazilian companies in 2018 remained unchanged from that as of end-August 2017 (0.0% change). Consequently, the earnings of Brazilian companies are expected to grow 29.7% and 11.6% for the whole of 2017 and 2018 respectively. Over the month, the materials sector dominated earnings upgrades in the market, led by steel markers Usinas Siderurgicas de Minas Gerais SA and Gerdau SA as well as pulp and paper companies Suzano Papel e Celulose SA and Klabin SA. Meanwhile the consumer staples sector lagged over the course of September in terms of earnings revisions, with food companies BRF and Marfrig seeing the greatest downgrades upon announcements in the recent months relating to their financial losses. Other heavy-weighted sectors such as the financials and energy sectors saw mixed earnings revisions over the month. On the other hand, the 2017 and 2018 earnings estimates of Russian corporations were revised downwards by -0.9% and -1.0% respectively. As of 25 September 2017, the earnings of Russian companies are expected to grow 4.3% in the whole of 2017 and grow 11.9% in the whole of 2018. Oil prices rose 10.6% to over the month as of 25 September 2017 to USD 52.22 per barrel amid good oil demand and favourable supply-side factors such as the fall in OPEC oil output for the first time in 5 months, recent hurricanes which disrupted US crude production as well as Turkey's threat to cut oil flows from Iraq. In Russia, the earnings estimates of major oil producers such as LUKOIL PJSC and Gazprom PJSC were revised upwards; although the earnings estimates of non-producers such as oil & gas industry steel pipe provider TMK PJSC and provider of crude oil pipeline transportation Transneft PJSC were revised downwards after having seen some of the greatest earnings upgrades amongst Russia's energy sector in the month before. As a whole, companies from varying sectors were seen at the top and the bottom in terms of earnings revisions over the month. Telecommunication services company Rostelecom PJSC and utilities company Mosenergo PJSC led earnings upgrades over the month, while precious metals mining company Polymetal International PLC and food company DIXY Group PJSC saw the greatest earnings downgrades over the month.

In South America, Brazil's GDP exited contractionary territory and grew 0.3% year-on-year in 2Q 2017, up from 1Q 2017's -0.4% growth. Growth in the quarter was largely supported by the country's consumer spending, which grew 0.74% year-on-year, and was supported in part by an increase in exports (2.5% year-on-year) amid a drop in imports (-3.3% year-on-year), which lifted net exports in the quarter. Investments in the country had contracted by a greater -6.5% year-on-year compared to the -3.7% decline in 1Q 2017 amid greater political uncertainty. Nonetheless, the increase in certain GDP components outweighed the decrease in other GDP components. In addition to GDP growth, other economic data releases over the course of September also reflected good progress in the country's road to economic recovery. Brazil's industrial production expanded for the third consecutive month in July 2017 and business sentiment (as revealed by a survey released by the National Confederation of Industry Brazil) in the sector has remained generally positive since the beginning of the year, while manufacturing PMIs remained above the 50.0 reading since April 2017. The country's unemployment rate had dipped for the fourth consecutive month in July, amid continued decline consumer price inflation to 2.71% in July and even an even lower 2.46% in August, giving consumers better bang for their buck. Consequently, retail sales rose for the fourth consecutive month in July, by 3.1% year-on-year, up from a 2.9% increase in June. In September, Brazil's central bank slashed its benchmark Selic interest rate by another -100 basis points, bringing it down from a prior 9.25% to 8.25%. While the central bank of Brazil has signalled a slowing of its pace of monetary easing in the coming quarters, the continued easing is likely to continue to lend support to growth in the meantime. According to the latest weekly central bank survey, expectations, as of 22 September 2017, are for the Latin American economy to grow 0.68% for the whole of 2017, up from -3.6% in 2016.

The Russian economy, which had fallen into a recession in 2014, has, since late 2016, shown good economic progress. The latest GDP numbers had followed an exponential upward trend, with growth coming in at 0.3%, 0.5% and 2.5% year-on-year in 4Q 2016, 1Q 2017 and 2Q 2017 respectively. In addition, several economic releases over the month of September such as industrial production, unemployment rate and retail sales, had continued to reflect improvement in the economy. While manufacturing and services PMI readings have moderated from their highs in the beginning of the year, they have consistently remained above the 50.0 neutral reading since mid-2016, reflecting relatively resilient expansion in both sectors. In September, the central bank of Russia made the decision to cut rates further by -50 basis points to 8.50%, with a mention that the bank deems it "possible to cut the key rate further" over the "next two quarters", boding well for economic growth in the near term. Nonetheless, the bank had highlighted upside risks to inflation including, acceleration in the transition from savings to consumption behaviour considering an increase in wages, as well as a continued rebound in economic activity. The central bank expressed its baseline-scenario expectations for growth come in around "1.7-2.2%" for the whole of 2017, up from -0.2% in 2016; and growth in the mid-term to come in around "1.5-2.0%", and that the possibility for higher mid-term growth will be "predominantly shaped by the speed and scale of structural reforms and institutional changes in the Russian economy".

Over the course of September, as of 25 September 2017, the Bovespa Index has risen 5.1% in local currency terms and currently trades at estimated PE ratios of 14.4X and 12.9X 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 which currently trades at a notable premium to its fair**. On the other hand, the Russian equity market rose 3.2% in RUB terms month-to-date (as of 25 September 2017), trading at estimated PE ratios of 7.2X and 6.4X 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 coupled with the country's continued low oil production in the near term (in view of the ongoing oil production cut agreement with OPEC) presents risks to the earnings of oil companies. At this juncture, **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, PARVEST EQ RUSSIA EUR

EMERGING MARKETS COUNTRY STAR RATINGS

Brazil (3.5 stars –Attractive)

Why we like it

1. Active Central Bank
   - The central bank has been supporting the local currency, the Brazilian Real (BRL), via currency purchase programs in an attempt to reduce imported inflation. It has hiked the benchmark Selic rate by a total of 200 basis points in 2015 in a move to rein in inflation and add credibility to its perceived independence.

   - In 2017, as inflation continued to trend downwards, the central bank stepped up its rate of easing so as to aid the economy in emerging from its recession. Thus far in 2017 as of 25 September 2017, the central bank had cut rates by a total of -550 basis points to 8.25%, the lowest rate since July 2013.

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, long-term investors would still find that there are many opportunities for growth.

   - Brazil remains amongst the more attractive investment destination amongst Latin American nations and is, at this juncture, expected to see positive GDP growth in 2017.

3. Strong Foreign Currency Reserves Position
   - Brazil is able to service its debt obligations due to its strong foreign currency reserves of USD 378.4 billion (as of end-June 2017) 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. Notable Political Risk
   - Brazil has been met with several political corruption scandals in recent history and investors in the market are relatively reactive to political corruption-related news, resulting in greater volatility in the equity market.

   - In September 2017, the office of the prosecutor general announced a second set of corruption charges against current president Michel Temer and the lower house of Congress is slated to vote on whether he should stand trial by the Supreme Court.