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# BRIC Update

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**This material is for professional advisers and should not be distributed to retail investors.**

**The following is an edited summary of questions and answers from a conference call hosted by Michael Konstantinov on 7 November 2008.**

## **Where are BRIC markets right now?**

The market has undergone a heavy correction year-to-date and is now down around 50% to 55% in USD terms. Despite the recent strong rebound, market valuations (P/E, price-to-book, price-to-sales) are already discounting a very bleak picture. Downgrades regarding GDP and earnings growth are ongoing.

This was a very strong correction, generating a very negative outlook for the coming year, with analysts downgrading their valuations. However, a floor should be reached in the coming months.

## **Russia: How have the trading activities of hedge funds and foreign investors impacted?**

In the BRIC universe, Russia was the "darling" of many investors, there were many global equity first-time investors - a lot of non-dedicated money - who have not experienced Russia's default of 1998. Consequently this money left the market quickly. Hedge funds have their own problems, but there is selling pressure, accompanied by selling pressure on oligarchs, who used their holdings in companies as collateral for loans for building their empires.

**Background:** When the financial crisis hit the markets, banks asked oligarchs for margins or to repay parts of their loans. The consequence of this: liquidation of holdings, selling pressure.

The outcome were very sharp drops from July to mid-October. However, over the last four weeks, the market stabilised and was almost flat.

## **How did the team react to market closures?**

First of all, markets were closed temporarily, partly for technical reasons because of the increased trading activity. Huge backlogs of unsettled deals had to be worked through.

A large proportion of the fund's holdings is in ADRs and GDRs, traded in London and New York.

A smaller proportion is in the local market: here we were unable to trade, but companies were clearly selected on the back of good fundamentals and solid balance sheets.

## **For China, Goldman Sachs forecasts 53.4% growth in 2009 for H-shares, 11% growth in A shares? Do you share this optimism?**

This depends on the individual analysis, but I am very positive on China, ie. regarding the direction of the market the view is shared. The market has reached very attractive levels, and growth is expected to be sustained at relatively high levels. Analysts

are downgrading their expectations (the consensus is 9% for next year, some analysts are going lower). China will use their fiscal flexibility to come up with a comprehensive stimulus program, accompanied by monetary easing. We expect sustained growth rates of between 9% and 10%, and we think that analysts are discounting too negatively.

### Which kinds of companies do you target?

We target those companies that will come out of the crisis strengthened, have strong market positions and business models, are able to maintain positive pricing environment, balance sheet, generate cashflow and have a relatively low leverage ratio. Consequently, these will be less vulnerable, will see ongoing earnings growth and gain market share.

**Example:** Localiza: a leading car rental company ('Avis of Brazil'), even though growth in sector may slow. The company has proved through the previous crises that it can gain market share (throughout hyper-inflation etc.), it is a strong cashflow generator and has low leverage.

### BRIC currencies vs. developed currencies?

Most have weakened against USD recently. And that's not just the BRIC currencies, but also GBP and EUR.

However, against GBP, with exception of Brazilian real (which was the strongest currency in emerging markets in the past and should therefore stabilise) all have either strengthened or moved along in-line. The ruble has only slightly devalued against USD.

### Lessons learned from exceptional market conditions?

There are two main aspects:

- To an extent our team was surprised by the undifferentiated selling in markets, driven by short-selling, even of companies with good fundamentals. Going forward, we will try to increase our focus on companies with the fundamentals to weather a crisis of these dimensions.
- Unlike previous slowdowns, or recessions, this one was initiated by financials, whereas previously there first was an economic slowdown. The lesson of this is that the financial industry as a driver of the world economy has to be kept in focus.

### Country weightings

- Brazil: 25% (BM: 28%)
- Russia: 21% (BM: 22%)
- India: 19% (BM: 22%)
- China: 35% (BM: 27%)

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