



Deja Vu?

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Investment Rational

There are never two identical situations on the stock market. Each time there is something new. Nevertheless, looking back can be instructive and sometimes can give a hint about the eventual trend that could prevail.

- The Russian market's movements in January 2008 were similar to the way the market moved in May 2006. The market volatility and, more importantly, the forces behind the heavy sell-off now and in May 2006 are similar. That is why we believe the pattern that occurred in 2006 could (with certain reservations) be repeated.

If our assessment is correct, in the next week or two, the RTSI could fall to 1750 – 1780. In the worse case – to 1700.

- The key uncertainty unsettling global markets concerns the probability and magnitude of the slowdown/recession. Like many other analysts we do not think that a slowdown/recession in the US will have a significant direct impact on the Russian economy. However, we think it could impact the commodity markets, and thus change investors' attitude towards Russia's commodity driven economy and its main companies.

We assume that while waiting for a clearer picture to emerge of the slowdown/recession, investors will stay on the sidelines holding abnormally high cash positions. In case fears of a recession recede, the market reversal could be sharp and unexpected. This possibility has led some risk-averse investors to start building positions at current prices.

- On the Russian market, we would advise investors to select companies focused on the domestic market. We assume that the Russian government will continue to invest in infrastructure construction and social projects, to set up sub-sovereign financial institutions that would help to dampen any adverse impact from global market volatility on the Russian economy. Thus, companies oriented towards the domestic market are well positioned to outperform the broad market, whatever happens.
- The market correction has brought back value to blue-chip stocks. Keeping in mind the “domestic market stock” idea, we recommend a SHORT TERM BUY on the following stocks in order to benefit from the expected market rebound: Gazprom, Novatek, Sberbank, VTB, RAO UES, Gazpromneft, MTS.

So far, second-tier stocks have been less volatile than their more liquid peers. We continue to recommend Rambler, Severstalavto, and Bank Vozrojdentye.

January 08 vs. May 06

What we know:

Now	Then
The downward movement in the current market lasted 7 days (before the first white candle).	In 2006 the first leg of the descent (before the first white candle) lasted 9 trading days.
The index dropped 460 points, or 19.6%.	The index lost 480 points, or 26.7%.
Emerging markets equity funds saw an outflow of \$10 bn (2.1% of their assets), the largest weekly outflow ever.	The sell-off was inspired by redemptions in emerging markets equity funds. Weekly outflow - \$4.9 bn (1.7% of their assets) - marked the end of a two-year long period of funds inflows into emerging markets.

RTS Index Daily Chart – 2007/2008



Source: RTS

What we don't know:

Now	Then
Whether the second wave of the current descent will take place and if so, how long it will last?	In 2006 the second leg of the descent (before the first white candle) lasted 5 trading days.
From the high of January 15, 2008 over 17 trading days the index dropped 19.6%. Is it a bottom?	From the high of May 10, 2006 the index lost 32% of its value in just 25 trading days.
There is a risk that the outflow of funds will continue. How much capital will investors withdraw from emerging markets?	The outflow lasted 7 weeks in a row. Altogether, emerging markets equity funds lost over \$16 bn (over 6% of their assets).

RTS Index Daily Chart – 2006



Source: RTS

Favorable Background

	2008			2006		
	15-Jan	7-Feb	Change	10-May	14-Jun	Change
Fed Rate (%)	4.25	3.00	-29.4%	5.25	5.25	0.0%
LIBOR USD 3m (%)	3.99	3.09	-22.5%	5.16	5.34	3.4%
10-y UST yield (%)	3.675	3.709	0.9%	5.123	5.062	-1.2%
RUS 30 yield (%)	5.333	5.340	0.1%	6.172	6.329	2.5%
MIBOR 1 day (%)	3.04	3.37	10.9%	2.6	2.3	-11.5%
Cur. Account with CBR, bn rubles	664.1	513.6	-22.7%	314.5	377.1	19.9%
RUB/USD	24.29	24.78	2.0%	27.03	27.04	0.0%
USD/EUR	1.4805	1.4485	-2.2%	1.2784	1.2587	-1.5%
P/E						
MSCI EM	15.6			10		
RTS	10.6			14		

Cost of funds for foreign investors is low enough to stimulate short term speculative movements.

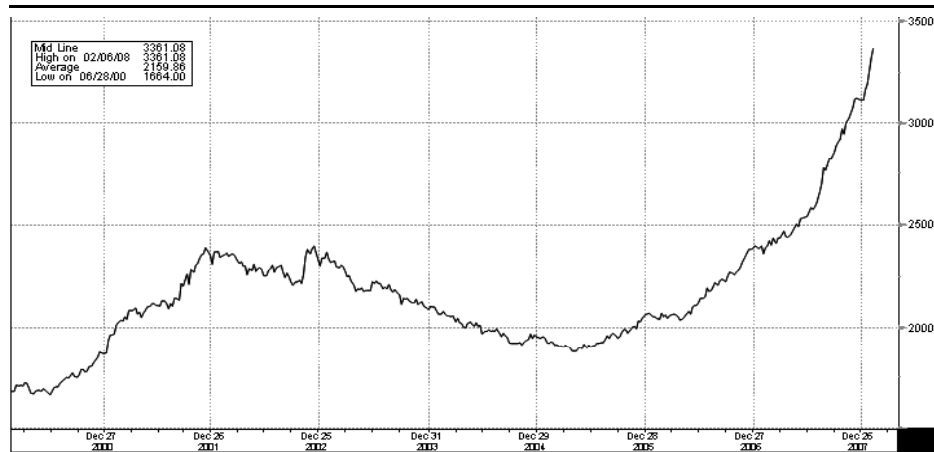
The bond market is stable and is not showing signs of a major downturn in the near future.

Cost of funds for domestic investors could also spur speculative buys to cover the losses suffered at the beginning of the year.

In relative valuation terms, the Russian market today looks cheaper than other BRIC emerging markets. This is the main difference in comparison with 2006, when the Russian market was overvalued.

We do not have a reliable indicator of investors' current cash positions but believe that the US Money Market Funds Assets graph speaks for itself. We assume that some investors have been extremely cautious and have preferred to keep abnormally high cash positions that will be available to them in case the market rebounds sharply.

ICI Money Market Funds Assets



Source: Bloomberg



Get Ready for Bottom Fishing

In case our forecast turns out to be accurate, blue chip prices will fall. In the table below, we have given our expectations of the eventual prices of the stocks recommended by us in relation to two different levels of the RTS index.

Company, in USD	RTS index		% drop comparing February 8 closing prices with the RTS index (at the 1780 level)
	1780	1700	
Gazprom	11.06	10.53	-4.5%
Sberbank	3.22	3.08	-3.7%
RAO UES	0.99	0.96	-7.3%
Novatek	6.16	5.79	-5.2%
MTS	11.47	10.98	-5.2%
Gazpromneft	4.78	4.60	-8.2%
VTB	0.0036	0.0034	-6.0%
Less liquid stocks			
Severstalavto	46.90	45.71	-7.6%
Bank Vozrojdenyie	63.50	62.20	-1.6%

Less risk-averse investors could consider other liquid stocks, such as:

Company, in USD	RTS index		% drop comparing February 8 closing prices with the RTS index (at the 1780 level)
	1780	1700	
Norilsky Nickel	240.16	232.98	-8.3%
LUKOIL	63.43	61.35	-3.8%
Polymetal	7.80	7.10	-2.6%
Polyus Gold	51.02	49.10	-1.9%
Rosneft	6.29	5.84	-6.9%
Surgutneftegaz	0.78	0.76	-13.1%



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