

PORTFOLIO MANAGER'S COMMENT JANUARY 2012

MARKET OVERVIEW:

- Bulgarian stock market failed to maintain the positive momentum from the end of the year and significantly underperformed larger Emerging Europe markets in January. SOFIX added just 0.2% for the entire January, while BG40 lost 4% unlike most global markets which reached record January return. The largest gainers during the period were among REITs where the sector index BG REIT added 10% on high expected dividend yields and oncoming liquidation of the second largest farmland REIT – ELARG Land Opportunity Fund [4EC BU] which shrank the discount between its share price and NAV/share down to 35%.
- The Q4 reporting season of BSE-listed companies started in the end of the month, but it failed to trigger index movements as the reported QoQ slow down was already expected.
- The reported macro data during the period confirmed that the export-oriented Bulgarian economy continued to feel the negative impact from the slowdown in the Eurozone; in November the current account registered a monthly deficit of EUR 126.5m for a second consecutive month, while 11-month FDI dropped to 1.9% of projected GDP. We expect that the reduced EU demand and global uncertainties would be main factors for weak investment plan of the companies and sustained high level of unemployment rate in 2012 (in December unemployment reached 11.2%). That said, preliminary data showed that Bulgarian government managed to meet its budget deficit target of 2.5% of GDP, reporting 2.1% deficit on cash basis.
- On the opposite Russian indices were among Top 10 performers globally, rising by 15% on average on strong performance by financial and utilities sectors especially. Russian reporting season also started with Q4 trading updates by metal&mining and consumer companies, which came positive on balance. Among blue chips largest disappointment came from X5 Retail [FIVE LI] which unexpectedly reported first ever like-for-like annual traffic outflow. On corporate level the most significant event was listing of Severstal's gold unit Nord Gold NV [NORD LI] on LSE AIM through share swap from existing Severstal shareholders. Now, Nord Gold is expected to be spun-off by end-February which would leave Severstal focused entirely on its core steel-related businesses. We note that the spin-off may remove some downside protection to Severstal's shares due to defensive nature of the gold business.
- Post-election unrest subsided in January as no protests were scheduled till Feb 4. At the same time the government moved to win support of lower income people as the Energy Ministry reached an agreement with power generators to freeze electricity prices in January and February at the December-level. The government has been also on its way to finalise an agreement with oil companies to freeze domestic oil product price. As a result of pre-election policy, January CPI declined to 4.2% but this level seems unsustainable and should rise sharply in mid-year.
- Macro data came mainly above expectations. Real GDP growth was at 4.3% in 2011 for second consecutive year (2010 figures were revised up by 0.3%) on 4.8% YoY growth in consumption. Retail trade growth accelerated to 7.2% YoY in 2011 from 6.3% in 2010, supported by strong 36% growth in retail loans in 2011 (versus only 14% YoY in 2010), despite the modest increase in real disposable income (0.8% YoY in 2011). At the same time unemployment decreased in the last quarter to 6.1% in December. Investment growth reached 6.2% in 2011 as both construction and housing construction growth rate exceeded 2010 results (5.1% YoY and 6.6% YoY in 2011 compared to 3.5% YoY and -2.4% YoY).

PORTFOLIO ALLOCATIONS:

FFBH Vostok

- In January we enjoyed the increase in risk appetite globally while holding our equity portfolio intact. As a result FFBH Vostok was Top 3 performer among all Bulgarian mutual funds with monthly return of 10.5%.

FIB Avangard

- Both our high-yield funds benefitted from their already high equity allocation. However, FIB Avangard's performance could not match FFBH Vostok's as Bulgarian capital market was among the laggards due to its small size and low liquidity which offset the high return on Russian shares held.

FIB Classic

- In January we continued to increase the dividend yield of our equity portfolio by adding domestic REITs. During the period our bond allocation remained unchanged.

FIB Garant

- In January we added a Bulgarian blue-chip company to our equity portfolio as we expected that increased appetite for emerging market equities and decreasing market premiums would slowly start to trickle down to SEE region. During the period our bond allocation remained unchanged.

OUTLOOK & STRATEGY:

- In January we saw a sharp improvement in business confidence surveys and PMI indicators across Europe. The above combined with the strength of the US economy, renewed hopes for QE3 in the US and the calm down of the European debt crisis for now lifted equities across Europe with Eastern Europe being an outperformer on global level. Now, we deem that the rally may continue some way into February as diminishing expectations in Europe provide some room for positive surprises and recent data shows that German economy may avoid decline in Q1. Still, investors should not get carried away as the debt crisis is not solved yet and the oncoming fiscal tightening in the region will provide strong headwinds for the European economy.
- In Bulgaria lagging data continued to confirm the slow down in Bulgarian economy but sentiment surveys followed European trend and rebounded strongly in January. However, stock performance lagged as usual as investors were still exploiting attractive opportunities in the most liquid markets in the region. Still, we note that Bulgaria is among the most attractive capital markets in Eastern Europe based on both trailing and forward P/Es and, if global backdrop remains supportive, this might lead to some outperformance in mid-2012.
- On micro level the significant short-term domestic events are the scheduled privatization in the utility sector which might lead to temporarily improvement in liquidity and Q4&2011 financial reports which might be triggers for dividend-paying stocks.
- Considering the increasing risk appetite, the stable oil price and attractive equity valuations, we might expect that the strong performance of Russian equities to continue in February. Recent macro releases continued to confirm the good performance of the Russian economy as discussed above. On the downside the Russian government continues to announce new initiatives in its economic policy (including retroactive tax on Eurobonds, VAT increase and minimum capex levels in steel industry) which combined with the implementations of tight price control before presidential elections raises investors concerns and might put a temporary break on the rally by end-March.
- Overall, our long-term focus on Russian equities remains in place on resilience of local economy and strong debt profile, supported by high oil price and strong domestic demand potential on growing middle class. The high market beta may turn Russia in one of top performing markets in 2012 if Eurozone debt crisis continues to unravel positively.
- In Bulgaria we shall continue to stick to blue-chip companies, while further decreasing investments in less liquid and highly-leveraged companies.
- In conclusion we expect that equity allocation will remain high in FIB Avangard and FFBH Vostok and will be increased slightly in FIB Classic and FIB Garant in February but we are ready to collect some gains as some investments are closing our target levels. Simultaneously, we are considering some increase in weight of cyclical stocks but will continue to watch the development of leading indicators.