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PORTFOLIO MANAGER'S COMMENT MARCH 2012

MARKET OVERVIEW:

- The global rally took a break in March with most European indices posting declines last month on worries about slow down in Chinese economic growth mainly. Still, the first quarter has been the strongest for larger European stock markets since the global financial crisis outbreak while American ones tested early 2008 levels.
- Bulgarian indices finished mixed in March as SOFIX declined another 1.5% MoM with YtD drop widening to 4.1%. On the opposite the performance of REIT companies continued to impress with local BG REIT index reaching 3-year high by advancing by 6.3% MoM and 21.8% YtD. As expected, the cause behind the increase was the release of audited annual financial reports which confirmed the significant dividend yield for some of the largest REIT companies. Now, that the dividend story has been played away we expect sector price growth to decelerate but investors might continue to look for undervalued opportunities.
- During the period government proposed that the so-called "Silver Fund" which accumulates future pension benefits to invest up to 30% of its resources in domestic government bonds in 2012 (the limit should increase by 10% each year until it reaches 70% in 2016). For now we see strong opposition to this proposal but note that, if accepted, it will create conflict of interests within the Ministry of Finance which manages it and will technically further contract the fiscal reserve (BGN 3.8bn in end-Feb).
- Rising volatility dipped high-beta Russian market into negative territory and local indices ranked among bottom 10 performers globally. MSCI Russia posted a 5.8% decline in March on combination of fears about global economic slow down and domestic factors. The ongoing debate on rising oil&gas taxation as well as proposals for increased regulation in some sectors, including steel industry, caused underperformance to Brent oil which remained flat during the period.
- Political risk started to recede as post-election demonstrations were peaceful in general while the opposition did not seem united enough to challenge the re-elected president Vladimir Putin.
- Released Russian macro data was predominantly supportive as most indicators, including industrial production, investments, retail sales and disposable income, accelerated in February - some of it stemming from the leap year effect. However, budget expenditures rose by 48% YoY in Jan-Feb 2012 (1% of GDP deficit in 2M 2012) which resulted in expressed concerns on budget stability and warning for possible rating downgrade by Fitch and S&P. Additionally, the World Bank recently cut its GDP forecast for Russia to 3.5% for 2012 and 3.9% for 2013 which caused additional volatility for Russian stocks.

PORTFOLIO ALLOCATIONS:

FFBH Vostok

- In March FFBH Vostok's NAV per unit dropped by 3% MoM which was a 2% outperformance of Russian indices, due to larger weight of mid caps in our portfolio. YtD return was 17% which continued to rank it as the best performing Bulgarian mutual fund. During the period we started some shift away from the retail sector where we expect deceleration in data in the post-election period and increase in exposure to market underperformers from energy and metal&mining sectors. Additionally, we used the increased volatility to realize some short-term market strategies. As a result, equity allocation temporarily dropped to 81% of assets as compared to 88% in end-February.

FIB Avangard

- In FIB Avangard domestic exposure remained unchanged as the continuing decrease in exposure to REITs that have reached target levels was offset by increase in Materials sector where we deem valuation attractive. We also increased slightly the exposure to oil&gas sector in Russia on stable near-term outlook for oil price. Still, market declines resulted in negative 2.3% MoM performance.

FIB Classic

- In March FIB Classic's equity and bond allocation remained almost unchanged as we took more conservative position due to increased market volatility.

FIB Garant

- FIB Garant also took more conservative stance on rising market volatility.

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OUTLOOK & STRATEGY:

- In March macro indicators in EU continued to point to a mild recession while Chinese data suggested growth deceleration. Nevertheless, the strength of the US economy and rising consumer confidence there supported global markets and prevented larger declines. Now, we expect that if US data remains supportive the investors will finally turn eyes to large undervalued emerging markets such as the Russian. Still, we remind that the risk factors related to European indebtedness and expected recession in the region remain in place and market volatility should be on the watch.
- Negatively influenced by deterioration in EU, activity indicators remained slow in Bulgaria. The stock market has also continued its poor trend since last spring which is not expected to change significantly by mid-2012. 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, it should be rated a BUY in H2 2012.
- The most significant short-term domestic events are related to government's privatization plans, including the remaining stakes in the electricity distribution sector. Although we do not expect it to trigger significant market movements, Q1 financial reports, due to be released in end-April, might give us a good check on how big was the slow down in the export sector. Official data already showed that exports in Jan 2012 declined by 10.2% YoY, the first drop since October 2009.
- On the opposite we see many short-term triggers for Russian equities, as they continue to trade at larger than usual discount to other emerging markets. Also, we expect that state policy would shift from anti-inflationary to pro-economic which would unlock some value, especially, in suppressed utility sector. Still, we warn that increased budget expenditures might lead to approval of some of the recent proposals for increased taxation in the oil&gas sector, which will definitely suppress market growth.
- 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 is also positive for the Russian investment case, if monetary policy in major economies remains expansionary and Eurozone debt crisis continues to unravel.
- In Bulgaria we shall continue to stick to blue-chip companies but market weakness might present some attractive opportunities.
- In conclusion we expect that equity allocation will remain high and rising in FIB Avangard and FFBH Vostok and will continue to be increased slightly in FIB Classic and FIB Garant in April. Some of increased equity exposure may come from rising exposure to cyclical stocks and 2011 market laggards.