HSBC Market Update

- BRIC Markets Weekly

23-27 Jan 2012

Summary

- BRIC equities gained last week thanks to positive performance in all underlying markets
- The rally was aided by the cut in Brazil's key policy rate, the Selic, by 50 basis points to 10.5%
- Indian equities put in a strong performance on currency gains, while the Hong Kong listed Chinese equity market also put in a solid performance, despite being closed for most of the week
- BRIC markets continue to trade on very attractive valuations, and we expect support in the equity markets in 2012

Brazil

The Brazil Bovespa Stock Index gained 0.95%* for the period

Market news

- The MSCI Brazil outperformed US equities and emerging market equities
- The BRL ended up 0.9%
- The unemployment rate reached 4.7%, which was below market expectations of 4.9%
- Brazil's Central Bank Monetary Policy Committee (Copom) sees a "high probability" the Selic will fall to single digits, policymakers said Thursday in the minutes from their January 18 meeting, when they cut the Selic to 10.5% from 11%
- "Considering that the Brazilian economy's deceleration in the second half of last year was greater than anticipated and that recent events indicate a delay in a definitive solution for the European financial crisis, at this moment, the Copom attributes a high probability to a solidifying scenario that contemplates the Selic rate moving to levels of a single digit," the minutes said
- The mid-month CPI came in higher than consensus at 0.65% (vs consensus of 0.56%). Annual inflation declined to 6.44% YoY, down from 6.56% YoY in the previous result, below the target's upper limit of 6.5% YoY

Implications

- Earnings downgrades in Brazil have stabilized, and valuations are among the most depressed when compared to EMs when DMs and its own history
- We now see a potential for re-rating, particularly for domestic sectors
- The Brazilian economic cycle may bottom out by the end of the 1Q12 and enter a recovery phase throughout the year, a phase that usually supports momentum for equities
- Brazil has plenty of policy flexibility including accelerating the monetary easing cycle; USD 350billion in International reserves; Reserve requirements (USD 250bn) cut; Aggressive BNDES and Banco do Brasil action on credit; Reversion of the current non-expansionary fiscal policy

HSBC Global Asset Management

Russia

The Russian RTS Index rose 4.64%* for the period

Market news

- The Russian market saw a strong rally, as global risk appetite returned. The Russian market performed well both versus both Emerging Markets and the US
- Crude Oil, Russia's biggest export earner, headed for a weekly gain as gasoline jumped to the highest level since August gaining approximately 1%.
- Cobber price gained approximately 2.5% indicating increasing demand from China. The gain in the price is good news for our non oil commodity stocks
- December retail sales numbers showed the fasted growth of 2011 as investment growth accelerates

Implications

- Russian equities in the short term may be influenced mostly by domestic political factors, but should these risks dissipate, it is likely that global investor sentiment will return as a key driver of the market
- Events relating to the sovereign debt crisis in Europe, US fiscal issues and the outlook for Chinese growth will again be the things to watch
- A worsening on any or all of these will likely cause weakness in the Russian market
- From a valuation perspective, Russian equities remain at trough levels in absolute and relative terms so any resolution of these external factors beyond what is expected, would likely be the source of significant upside for the Russian market

India

The India Sensex Index jumped 2.91%* for the period

Market news

- Indian equities posted a gain of nearly 3% on the back of currency appreciation and anticipation of easing monetary conditions
- The Indian rupee appreciated during the latter half of the week, as the Indian Central Bank left interest rates unchanged but moved to boost liquidity
- The government indicated that it was not likely to aggressively cute interest rates in the near future, as inflation was still a concern
- However, slowing global growth and domestic spending were likely to limit hiking activity
- Despite global risks, growth in India is expected at above 7% for 2012
- India has been one of the strongest performing markets in Asia year to date, rising almost 12%

Implications

- India remains a strong growth story, and may benefit this year as investors rotate into previously unloved, growth orientated markets
- Consumption remains buoyant especially in rural India and this along with a normal monsoon will support growth and overcome slowing investment / infrastructure spend
- Going forward we see some signs of a pick-up in investment spend as the government decision making process has churned out a few positive policy actions – e.g. easing environmental norms, recent award of road projects
- Valuations remain attractive compared to the past 10 years and very attractive compared to the past 5 years with a much stronger economy and corporate sector (better balance sheets)

China

The HSCEI Index rose 2.69%* for the period

The China A-share market was closed for Chinese Lunar New Year holiday

Market news

- Despite being closed for most of the week, Hong Kong listed H-shares put in a solid performance, as rising risk appetite supported Chinese shares
- Chinese equities have been strong performers this year, as monetary easing and China's strong growth prospects have lifted market sentiment
- While the government has recently reduced the Reserve Ratio Requirement, the lack of further cuts in the run up to the Chinese New Year holiday, signals that Central Bank may be taking cautious approach to further easing
- The main reason cited is to potentially prevent a repeat of the problems, such as the credit bubble that formed, following the massive stimulus to tackle the 2008 crisis
- Despite the global slowdown, China's economy is expected to grow above 8%, and achieve a soft landing

Implications

- Valuation for Chinese equities remain very attractive with a P/E ratios of 8.8x
- Looking into 2012, inflation should no longer be a key policy concern, because of normalizing credit expansion, a moderating GDP growth rate and the continued delivery of supply-side measures designed to stabilize food prices
- The Chinese government recently cut the Reserve Ratio Requirement by 50 basis points to 21% effective 5 December 2011
- As global growth cools and inflation recedes, authorities have the latitude to further ease monetary policy, and further reductions in the RRR are quite likely
- This should in addition with other measures, help China achieve a soft landing also have a positive impact on market sentiment
- We reiterate our preference to Chinese equities over other Asian markets because of the attractive valuation and robust growth profile

Source: HSBC Global Asset Management and Bloomberg, as at 30 January 2012.

* Performance of indices are expressed as price returns in local currency terms.