

Portfolio investors are buying the "Putin Plan"

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By Simon Shuster - Analysis

MOSCOW (Reuters) - Russia's equity market has lagged those of other emerging economies this year, but the clouds of political uncertainty are clearing and Moscow stocks are in demand again.

Investors had been holding their breath ahead of elections to a new parliament on December 2 and of a successor to President Vladimir Putin next March.

But signals have grown clearer that Putin will remain a powerful force even after stepping down as president, and Russia's political risk premium has started to unwind, leading the market to outperform at last.

Since 2000, the year Putin was elected, Russia's benchmark RTS stock index .IRTS has risen 15-fold. But based on a prospective earnings multiple of 12, the market is still cheap relative to its peers, reflecting fears over what comes next.

"With the elections still off in the distance, there's been this short-term wall blocking the Russian investment case," said Roland Nash, head of research at Renaissance Capital, Russia's largest investment bank.

"That's been a major reason why Russia has underperformed since the beginning of the year," he added.

The dollar-denominated RTS is up 16.5 percent in the current year to date, just off an all-time high set on November 9, but far behind rivals China, India and Brazil that with Russia form the BRIC group of major emerging markets.

Even record oil prices have been unable to support Russia's oil and gas blue chips -- a paradox some link to the fact that megacaps such as Gazprom (GAZP.MM: [Quote](#), [Profile](#), [Research](#)) and Rosneft (ROSN.MM: [Quote](#), [Profile](#), [Research](#)) are state-controlled and subject to murky power politics.

And the value of TNK-BP TNBPI.RTS, a private oil venture between BP (BP.L: [Quote](#), [Profile](#), [Research](#)) and three billionaires, is down 13 percent this year, plagued by talk of a Kremlin takeover.

"For investors sitting in New York, a lot of it has to do with the political rhetoric. It scares them," said Peter Halloran, founder and manager of the Pharos Fund in Moscow.

"They see this unpredictable animal, and they say, 'Why would I invest here when I could go invest in Asia?'"

TURNAROUND

Putin's announcement on October 1 that he would lead the pro-Kremlin United Russia party into the parliamentary election has at last offered the markets a look around the corner that Russia is turning.

"From an investment point of view, the risks dropped sharply when Putin announced that he was going to lead the party ticket," said Ronald Smith, head of research and strategy at Alfa Bank in Moscow.

Putin has said he plans to remain influential in Russian politics after the election of his successor, perhaps as premier. United Russia has launched a personality-based campaign touting a "Putin Plan" based on the Kremlin chief's speeches.

At that point one thing became clear, said Eric Kraus, founder and manager of the Nikitsky Fund in Moscow: "This is not going to be an election. This is going to be a handover.

"The likelihood of political turmoil is potentially higher in France, or even Washington," Kraus said.

RUSSIA RE-RATING

In the five weeks since the United Russia congress, the RTS has outperformed the MSCI Emerging Markets Index .MSCIEF by 5 percentage points and the Dow Jones Industrial Average .DJI by 16 percentage points, regaining ground lost earlier in the year.

"As you move forward, the definition of the future will attract money in," said Halloran of the Pharos fund.

He added that over the next six months this would lead to a complete re-rating of Russia's political risk, which he said was keeping stocks 10 percent below their potential value.

The State Duma election will be the next revealing moment, but in a country where power lies mainly with the Kremlin, this event is not expected to make much of ripple in trading habits.

"From a strategic point of view, I'm not even worried about the elections. I'm looking past that," said Smith of Alfa Bank.

The next real political milestone for market comfort could come with the anointing of a successor, probably before the year is out.

The main other concern beyond the Duma vote is whether cheap fundamentals will be enough to attract portfolio cash, with many international funds still underweight Russia.

The central bank's readiness to support the banking sector at a time of tight global liquidity with its \$450 billion in reserves, also merits the attention of investors, said Ekaterina Trofimova, senior analyst at Standard & Poors in Moscow.

"If anything, fiscal policies and the political situation in general are positive factors in our ratings," she said.

Fiscal restraint will weaken as Russia embarks on a \$1 trillion drive to overhaul its infrastructure, supporting the investment case for everything from steel to electricity.

But to leverage budget spending on these projects, the government will need a lot of private cash, said Nash: "And to get it, the next regime is going to be at least as friendly to foreign investment as this one."

(Writing by Simon Shuster, Editing by Douglas Busvine/Andrew Callus)
