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INVESTMENT NOTE **17 FEBRUARY 2015**

HERMES: IS RUSSIA STILL AN EMERGING MARKET?

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After Vladimir Putin swept back to power in 2012, he had the air of a chess grandmaster: plotting each intricate move from the Kremlin. He swiftly annexed Crimea, suppressed opposition at home, and antagonised a seemingly vulnerable and tactically inept West at every turn. With oil comfortably around $100 barrel – the government's treasury was swelling and his opinion rating at home was soaring. How quickly fortunes change! Now the rouble has plummeted, Western sanctions have gripped, allies are in short supply, and a recession more bitter than a Russian winter looks set to take hold. It appears as if Vladmir Putin has spectacularly over played his hand. From an emerging market, Russia may well now be submerging.

Last week's 17-hour meeting in Minsk brought some initial relief to the markets as the first details of the ceasefire agreement were revealed. These included a broad ceasefire, withdrawal of heavy weapons, an amnesty for prisoners involved in fighting, lifting of restrictions in rebel areas and constitutional reforms that grant more independence to Donetsk and Luhansk by the end of 2015.

We continue to remain cautious as many commentators have already highlighted the similarities between this agreement and the peace plan drawn up in September 2014. It is clear that the ceasefire is very fragile and already the rebels argue that the city of Debaltseve is not covered by it. The Minsk 2 deal was a great deal for Russia and a terrible one for Ukraine, essentially preventing entry into NATO, but it would not be prudent to assume Russia's territorial ambitions are sated and sanctions will be withdrawn. We are also concerned about the challenges that Ukraine's President, Petro Poroshenko, will have pushing this deal through the nation's parliament. Then there are the very important logistical questions of just how Russia will withdraw its weapons from territories embroiled in the conflict and which nation will physically man the borders between the two countries.

For Ukraine, the focus in the near-term must be on implementing all aspects of the ceasefire agreement as this is the only way it will secure the IMF support.

On a different trajectory

While, this development may suggest tentative progress, Russia still faces a myriad of problems. A broad definition of an emerging market is a country which has structured its economy along market–oriented lines, and, in the process, is converging towards developed market standards. For many, progress for powerhouses like China and Russia seemed inevitable as they moved away from the shackles of collectivism and organised labour. However, EMs are not all on the same trajectory, and some have the capacity to take divergent paths, as appears the case of Russia.

We believe the question must be asked: is Russia still an emerging market? According to the definition outlined above, yes. It has a financial infrastructure resembling those of other emerging markets – such as banks, a stock exchange, a unified currency and some form of regulatory body. Yet there lies a more fundamental question: is it really a market at all? Its government seems to regard many listed companies and their management as playthings. This makes one question the convergence argument. And like other EMs, is it modernising, becoming more efficient, attracting foreign investment, and strengthening its institutions by embracing the rule of law? No. It might, at times, appear to be progressing towards liberalisation and modernisation, but the structures of its industries, its culture of kleptocracy and recent return to militarism compromise its long-term prospects.

Periodically, Russia will perform strongly as the market responds to rising oil prices, long-term trade deals with countries like Kazakhstan and China, or hints of political or economic reform (such as reappointing Kudrin). Today, with the valuations of its currency and stock market, not to mention dour investor sentiment towards the country, a substantial bounce this year cannot be ruled out. We currently maintain a neutral exposure through investments in solid companies like Norilsk (high dividend yield) and Mail.ru, (a beneficiary of an economic recovery). Still, looking out over the next decade, it is difficult to see how Russia will emulate more successful emerging markets such as Taiwan and Korea, not to mention the developed economies it regards as its equals.

In the coming years, Russia is likely to suffer the stagnation that typifies resource-heavy economies that have not internalised the rule of law. Its terms of trade are set to reverse the last decade's leap, subjecting the economy to inflation and low growth rates. This has little to do with any US desire for hegemony and everything to do with the Russian Government's failure to diversify the economy.

Dr. Martin Luther King Jr. once remarked that progress is neither automatic nor inevitable but achievable only through human endeavour. The work of root and branch economic restructuring requires a will beyond that of gritty survival that Russians have demonstrated in the past. They will need positive energy, inspired by an optimistic vision of the future and based on trust and hopeful determination. Under Putin, Russia has shown a lack of political resolve to modernise its economy and innovate to be globally competitive, and the kind of can-do optimism that it needs – which is abundant in the US and China – is scarce. Russia has achieved greatness in many dimensions of society. However, as we know from history, there is no guarantee of progress.

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