One-on-One with Douglas Helfer
HSBC Global Investment Funds – Russia Equity

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Douglas Helfer, Manager of HSBC GIF Russia Equity Fund
Douglas Helfer joined HSBC Global Asset Management (UK) Ltd. in January 2006 as Senior Fund Manager – EMEA. He was previously at F&C Emerging Markets where he was responsible for Eastern European, Middle Eastern and African investments and ran their Russia Fund. Prior to this he worked at Brunswick and Clifford Chance. Douglas started his career working for the US Embassy in Moscow in 1988. He speaks fluent Russian. Douglas has a BA in Soviet and Eastern European Studies from the University of Colorado, an MA in Russian Studies from the University of London and an MBA in Finance from City University Business School.

This week, Vladimir Putin secured more than 60% of the votes in the first round of Russia's presidential election. Therefore, he has won outright with no need for a second round. Of the four other candidates, Communist Genady Zyuganov appears to have received the second most votes, approximately 18%. Meanwhile, voter turnout was estimated to be 56%, considerably higher than in the 2008 election. Furthermore, the election took place under the scrutiny of 200,000 webcams across 98,000 polling stations and half a million observers, including 700 foreigners, in an attempt to increase election transparency. The next stage is the presidential inauguration, which will take place in early May, with the new president having to propose a new Prime Minister within two weeks of his appointment. It is possible that key cabinet appointments and a policy platform will begin to emerge in the meantime.

Q: What have been the impacts of the recent Russian elections on the country's markets?

A: The election result goes some way to addressing the political uncertainty that has been hanging over the Russian market, particularly since early December when street protests broke out on the back of parliamentary elections which were widely viewed as flawed. Events remain fluid, for example opposition protests continue sporadically, but with the elections now completed peacefully, political risk has subsided. Despite controversy, the elections demonstrated to regional and business elite that Putin remains the most popular politician in the country and signals he is in firm control. The market will no doubt remain sensitive to ongoing developments.

Q: Following strong Russian equity performance year-to-date, how do valuations look now?

A: No matter how you look at current Russian equity valuations, the market still looks cheap. Russia is trading on a forward price earnings ratio of 5.4 times, nearly a 35% discount to its 10-year average of 8.2 times. When measured relative to its broad peer group, the MSCI Global Emerging Market Index (currently trading on 10.3 times), Russia's discount is nearly 50%. Some will say that Russia is cheap for a reason and should trade at a significant discount to peers. But looking at the past 10 years, this discount to the MSCI GEM index has averaged about 25%, so even in these relative terms Russia now looks inexpensive versus its history. Energy companies and financials look particularly cheap compared to both their own history and to peers.

Q: Why do you think they look so cheap and what would it take to change them?

A: The most often cited explanations cover a number of grievances ranging from corruption, an under-developed legal system and poor corporate disclosure to regulatory and other political risks. It just so happens that the protestors on the streets of Moscow are calling for improvements relating to a similar range of issues. We may now be entering a phase when the interests of a new vocal political force are aligned nicely with those of minority investors in the Russian stock market.

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Q: What are the likely policy implications of Putin's return to the presidency?

A: Putin has already given some indications of his agenda via recent speeches and published op-ed articles. For financial markets, the key elements include reducing state interference in the economy via more privatisation, increasing the depth and duration of domestic capital sources and ensuring macroeconomic stability.

Some doubt Putin's reform intentions, but we should not forget what he accomplished in his first term as president, beginning in 2000. Following years of economic contraction under Yeltsin, Putin brought stability and growth. He radically simplified Russia's tax system and put the country's finances in order for the first time since the collapse of the Soviet Union a decade before. Over the course of his two terms, GDP per capita increased from less than US$3,000 to over US$10,000, and the country has since run significant twin surpluses. Markets can often move the most when fundamentals go from terrible to stable. It is notable that from Putin's first presidential inauguration until early 2008, the Russian equity market rose by nearly 600%. It's true that reform has lost momentum more recently but it is far from inconceivable that the recent demands of the street will re-focus policy makers' attention in the right direction.

Q: More importantly, what do you think is the outlook for Russian equities?

A: Russia clearly cannot be viewed in isolation and to a large extent its stock market remains hostage to a range of external factors including the eurozone debt crisis, global growth and trade, not to mention commodity prices and geopolitics. It is likely that Russia will remain a high-beta market for some time, meaning that any deterioration or improvement in these external factors should affect Russian equities disproportionately. Given current bargain valuations, the real upside in the market could come from a closing of the Russian discount. If our assumptions about Putin's reform agenda and market friendly cabinet appointments are correct, the outlook is promising.