From:	Martin Zeman [redacted]
Sent:	8/14/2018 10:03:46 AM
To:	'Paul Barrett [redacted]
CC:	Xavier Avila [redacted] Stewart Oldfield [redacted]
Subject:	EM Special Publication – Sanctions on Russia: New action not a game-changer but risks have increased

Paul – see today's publication on Russia with specific recommendations. I spoke to Christian – he says on Turkey it's quite impossible right now where value is, but he said he will have another piece later today.

EM Special Publication – Sanctions on Russia: New action not a game-changer but risks have increased

We just published an update on Russia with the focus on the recently announced sanctions and the potential implications for the Russian economy. Please see here for more details:
https://research.db.com/Research/Article?rid=4df70f08-db6d-4523-8fc4-a7607d35868c-604&kid=RP0001&documentType=R

Best regards, Rebecca, Peter and Christian

We also updated our FI/FX local market views:

Trade recommendation – overweight bonds in the belly, cautious view on FX, despite attractive long-term valuation On the back of the recent bear-flattening we switch back from being overweight duration, into the belly of the curve. We see most value in Jan-23 (target: 7.35%), Aug-23 (7.40%), Feb-24 (target: 7.50%) or Oct-24 (target: 7.50%). Although we also remain long-term constructive on RUB and see the most recent weakness as not justified from a fundamental but also technical point of view, risks around FX remain higher than local bonds. For more cautious investors, we therefore recommend to hedge the FX exposure for now. For pure FX investor, we recommend to re-enter a long vs the basket (current 71.86, target: 65.0). This said, while headline news around further sanctions have to be watched closely, the recent weakness in oil should also not be ignored and could further weigh on FX in the near-term. Hence we recommend a tight stop (73.5).

Background:

Next to Polish bonds (Q1), Romanian bonds (Q2 and Q3) and South African bonds (since Q1, however, with active FX hedges during the year), Russian local bonds (expressed via 5Y-7Y OFZs) have been among our preferred EMEA fixed income positions for most of 2018. Despite a relatively hawkish central bank - which does not necessarily speak in favour of expressing a bullish view via duration bonds, we argued that particularly the latter has been in fact one of the main reasons for our constructive view from a total return perspective (FX unhedged vs USD). The pause to the easing cycle (without ruling out additional cuts later in the cycle), has reduced volatility in local assets and created a buffer against external shocks. This said, the cautious CBR, higher real rates, lighter positioning, the low inflation pressure, the improved domestic growth dynamics and last but not least the low macro sensitivity to external shocks, did not prevent Russian local assets against the recent selloff. The implementation of new sanctions – although not yet material for the Russian economy, but more importantly the threat of further action by the US, led to a sharp selloff in Russian assets. RUB weakened by almost 9% vs USD since late July, and reached with levels above 69.0 the highest level since early 2016.

During this most recent move, we got stopped out of our long RUB recommendation vs the basket (50% USD/EUR) at 70.0 (entry 67.02 in late May) and closed the trade with a 2% loss since initiation (adjusted for carry). So far, price action was somewhat less extreme in local bonds. 5Y bonds sold off by 60bp during the same time period to now 8.10%. This said, the latter is still the highest 5Y yield level since late 2016 and Russia is with a negative return of -15% next to Hungary, Brazil and Philippines among the worst performing EM countries YTD (not considering Turkey and Argentina of course).

Strategy – fundamentals overshadowed by sanctions discussion... Our overall constructive long-term view on Russian local assets has not changed. In fact, we argue that during periods of global external shocks, other EM countries with large current account deficits and/or heavy positioning (Turkey, South Africa, Indonesia, Brazil, Argentina) are noticeably more exposed. In our view, price action has overshot and is not justified anymore with what is implied by fundamentals. This said, the ongoing discussion on potential further sanctions weighs on price action in Russian local asset. Although the sanctions announced so far are not yet material for the Russian