Investment Strategy Note

August 13 2018

Prerana Seth
Fixed Income Strategist
Tel: +971 (0)2 696 2878
prerana.seth@adcb.com

Luciano Jannelli, Ph.D., CFA
Head Investment Strategy
Tel: +971 (0)2 696 2340
luciano.jannelli@adcb.com

Mohammed Al Hemeiri
Analyst
Tel: +971 (0)2 696 2236
mohammed.alhemeiri@adcb.com

Visit Investment Strategy Webpage to read our other reports

Taking profit on Russia dollar sovereign bonds

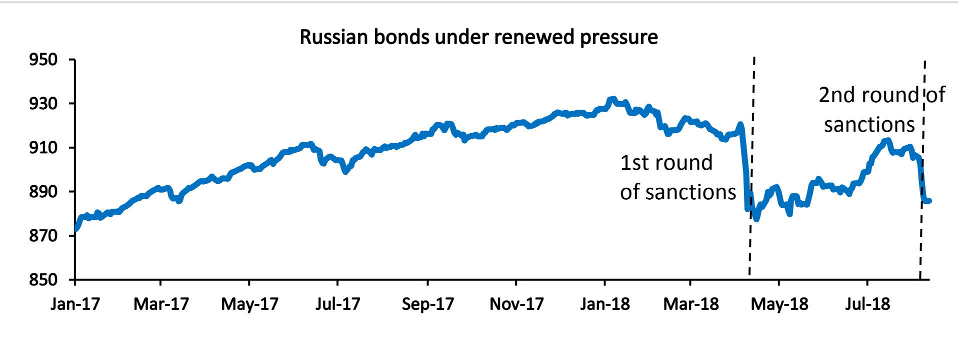
- On 31st January 2017, we recommended to go overweight on Russia dollar sovereign bonds due to the country's strong debt position, adequate reserve coverage and better fiscal prospects in the light of higher oil prices
- Russia was the last emerging bond market in which we had maintained a selective overweight after we had removed our overweight on Indonesia in June, in line with our long-standing overall underweight stance on emerging equity and bond markets.
- The reason of our relatively bullish stance on Russia was based on the country's strong economic fundamentals, both domestically and in terms of external balances.
- Whilst Russia still remains better placed from a macroeconomic view point compared to other emerging markets, there is renewed risk of rising political risk premium with the US imposing further sanctions
- Market speculation has been rising that these sanctions could be followed with another round of sanctions extending to financial markets
- Risks of further escalation from the US have intensified, especially after taking into account the current friction between US and Turkey and ahead of the US mid-term elections
- We close our overweight call on Russia dollar sovereign bonds with slight profit of 1% on a total return basis (although the call has underperformed relative to the global bond benchmark)

Political premium to rise if more US sanctions follow suit

We had selectively turned overweight on Russia dollar sovereign bonds on account of the country's solid public finances and manageable external debt compared to other emerging market bonds in 2017. The call performed decent in spite of the US imposing sanctions in April and amidst the recent emerging market sell-off. In fact, even after further *reducing risk* in June, we held on to our overweight recommendation as the country appeared well positioned due to its low debt levels and current account surplus.

However, recently Russian assets have come under renewed pressure with US imposing another round of sanctions on Russia. The sell-off also exacerbated with the Turkish lira crisis last week. The recent underperformance has partially reversed the gains made post the April sanctions. The latest sanctions have been imposed on US exports to Russia, on goods sensitive on nation security grounds including US technologies and industrial equipment and are effective from 22nd August. While these sanctions do not cover financial markets yet, market speculation has been rising that these could be followed with another round of sanctions which could ultimately put restrictions on bank lending and cut off nearly all exports and imports. Based on reports from the US state department, the current sanctions could widen to include financial markets, particularly if Russia fails to comply with on-site inspections by the UN and refuses to provide "reliable assurances" on not using chemical weapons henceforth. Separately, there have been reports that some US senators are working on introducing a bill that would impose restrictions on US entities to invest in Russia's sovereign debt.

Taking into account the recent actions by US administrations (sanctions on Iran and current friction with Turkey), the possibilities of more sanctions have intensified. In fact, further escalations from the US administration cannot be ruled out ahead of the mid-term elections in November. At the same time, Russia still remains an attractive proposition within emerging markets given its low debt levels and higher oil prices this year. However, we fear that the political risk premium is likely to grow due to sanctions risks and could even overshoot the favourable economic backdrop. Further, we believe that the markets are yet to fully price in these sanction risks. As a result, we close our overweight recommendation on Russia dollar sovereign bonds with a slight profit of 1% and a relative performance of -4% against the Bloomberg Barclays Global Bond Index



Source: Bloomberg, ADCB

Sources

All information in this report has been obtained from the following sources except where indicated otherwise:

1. Bloomberg
2. Wall Street Journal
3. RTTNews
4. Reuters
5. Gulfbase
6. Zawya

Disclaimer

ADCB Asset Management Limited ("AAML"), is a member of ADCB Group, licensed by Financial Services Regulatory Authority in Abu Dhabi Global Markets under financial services permission number 170036.

This publication is intended for general information purposes only. It should not be construed as an offer, recommendation or solicitation to purchase or dispose of any securities or to enter in any transaction or adopt any hedging, trading or investment strategy. Neither this publication nor anything contained herein shall form the basis of any contract or commitment whatsoever. Distribution of this publication does not oblige ADCB Group to enter into any transaction.

The content of this publication should not be considered as legal, regulatory, credit, tax or accounting advice. Anyone proposing to rely on or use the information contained in the publication should independently verify and check the accuracy, completeness, reliability and suitability of the information and should obtain independent and specific advice from appropriate professionals or experts regarding information contained in this publication. Investment products are not available to US persons.

Information and opinions contained herein is are based on various sources, including but not limited to public information, annual reports and statistical data that AAML considers accurate and reliable. However, AAML makes no representation or warranty as to the accuracy or completeness of any statement made in or in connection with this publication and accepts no responsibility whatsoever for any loss or damage caused by any act or omission taken as a result of the information contained in this publication. This publication is intended for customers who are either retail or professional investors.

Charts, graphs and related data or information provided in this publication are intended to serve for illustrative purposes only. The information contained in this publication is prepared as of a particular date and time and will not reflect subsequent changes in the market or changes in any other factors relevant to their determination. All statements as to future matters are not guaranteed to be accurate. AAML expressly disclaims any obligation to update or revise any forward looking statement to reflect new information, events or circumstances after the date of this publication or to reflect the occurrence of unanticipated events.

ADCB Group does and may at any time solicit or provide commercial banking, investment banking, credit, advisory or other services to the companies covered in its publications. As a result, recipients of this publication should be aware that any or all of foregoing services may at time give rise to a conflict of interest that could affect the objectivity of this publication. Opinions expressed herein may differ from opinions expressed by other businesses or affiliates of ADCB Group.

Past performance does not guarantee future results. Investment products are not bank deposits and are not guaranteed by ADCB Group. They are subject to investment risk, including possible of loss of principal amount invested. This publication may not be reproduced or circulated without ADCB Group written authority. The manner of circulation and distribution may be restricted by law or regulation in certain jurisdictions. Persons who come into possession of this document are required to inform themselves of, and to observe such restrictions. Any unauthorized use, duplication, or disclosure of this document is prohibited by law and may result in prosecution.