

FINANCIAL MARKETS IN FEBRUARY 2015

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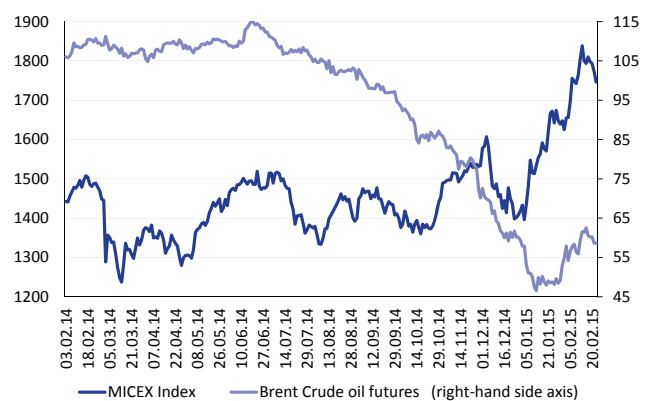
Over the course of February 2015, the MICEX Index continued to grow and hit its four-year record high of 1,809.6 points. The stock market's capitalization index as of 25 February amounted to Rb 27.4 trillion (or 38.6% of GDP). As before, the situation in Russia's domestic corporate bond market was unfavorable – mostly due to the effects of adverse external factors. The main negative feature of that market continued to be the high rate of weighted average effective yield on corporate bond issues, although it displayed a moderate downward trend (especially in the hi-tech sector). On the whole, the key indices of the Russian domestic corporate bond market, including the market volume and the market index, and the activity of the market's biggest bond emitters and investors, showed a positive trend. The emitters were becoming less punctual in fulfilling their obligations to their bond holders.

The Movement of the Russian Stock Market's Main Structural Indices

February saw a continuation of the MICEX Index's growth, which had started in January. By 18 February, its value had risen to its four-year record high of 1,809.6 points. Over the same period, the average futures prices of Brent crude were likewise on the rise, and in the two weeks from 2 through 17 February their growth rate amounted to 14.2%. However, in the last week of February both the MICEX Index and oil prices began to decline. As a result, over the period from 2 through 25 February, the average growth rate of the MICEX Index was 7.4%, while that of oil prices amounted to 7.1%.

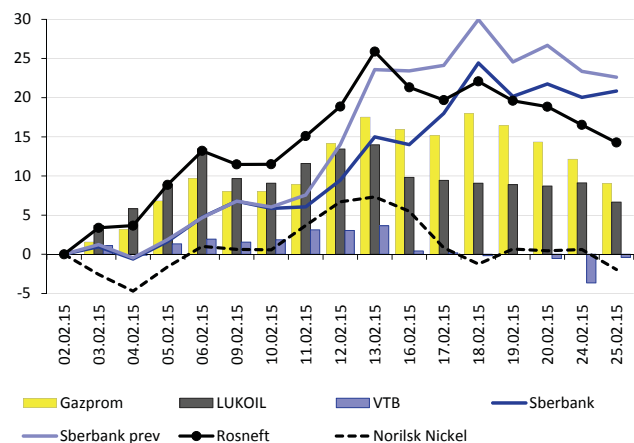
Over that month, the MICEX Index was being pushed up in the main by the rising quotes of highly liquid stocks, the leader in growth being Sberbank's preferred shares, which over the period from 2 through 18 February gained nearly 30%. Ordinary shares over the same period gained 24.4% but were unable to stay at that level, and so by 25 February their average growth rate since the month's beginning had amounted to only 22.6%. However, a positive trend was not uniformly displayed by all Blue Chip stocks. Thus, shares in *Norilsk Nickel* and *VTB*, in spite of their occasional upward movement periods, by the end February had lost 1.9% and 0.4% respectively compared with their value as of the month's beginning.

The annual yield on ordinary shares in *Sberbank* as of 25 February turned out to be negative, the annual loss amounting to -19.6%¹; the same index for privileged shares displayed an even greater loss of 32.9% (in terms of calendar year). Shares in *Norilsk Nickel*



Source: Quote PSK.

Fig. 1. The Dynamics of the MICEX Index and Brent Crude Oil Futures Prices in the Period from 1 February 2014 through 25 February 2015



Source: Quote.rbc.ru; the author's calculations.

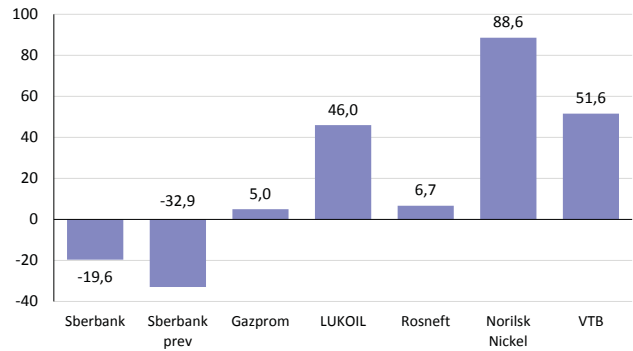
Fig. 2. Growth Rate of the Quotations of Highly Liquid Stocks on the Moscow Exchange over the Period from 2 through 25 February 2015

1 The annual yield on shares is estimated on the basis of their price movement and does not reflect information on dividend payments to shareholders in accordance with the results of year-end shareholder meetings.

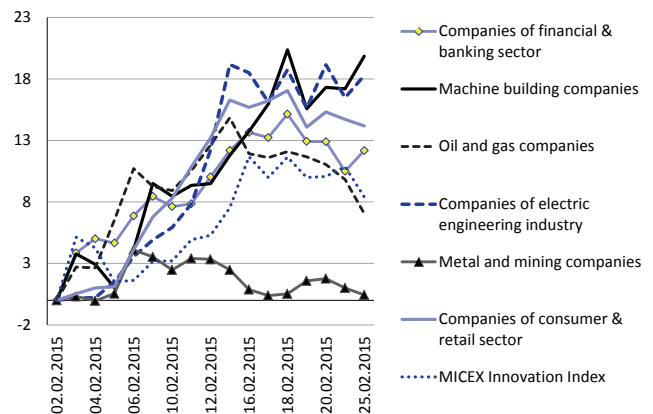
in February remained leader in terms of their annual yield, which as of 25 February amounted to 88.6%. A similar trend was demonstrated by shares in *LUKoil* and *VTB*, their value over the past year (from 26 February 2014 through 25 February 2015) having increased by 46.0% and 51.6% respectively.

Among sectoral indices, the highest growth rate (19.8%) over the period from 2 through 25 February was demonstrated by machine-building companies. Somewhat similar gains were achieved by the companies belonging to the energy sector – their index increased by 18.3%. The driver of growth in the machine-building sector were shares in OJSC KAMAZ, which gained 44.8%. This happened as a result of the news of the forthcoming merger of the joint ventures set up by OJSC KAMAZ and Daimler. The electric engineering industry index in February was pushed up in the main by the rising prices of shares in grid companies like Federal Grid Company of United Energy System (FEES) and ROSSETI. These stocks gained 45.8% and 48.0% respectively. Positive growth rates indices in February were demonstrated by the oil and gas sector, the banking and finance sector, the consumer sector, and the Innovation sector (by 9–14%). The only index that remained practically unchanged over the course of February was that of metallurgy – most likely as a result of the downward movement of prices of the majority of metals traded on world exchanges.

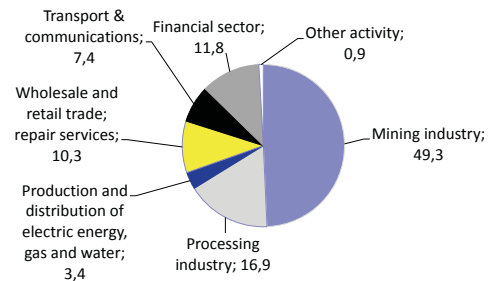
Over the course of 17 business days in February, the trading turnover of the Moscow Exchange amounted to Rb 805.8bn, which corresponds to an average daily trading turnover Rb 47.4bn. In February, trading in ordinary and privileged shares in *Sberbank* accounted for on the average for 30.2% of the trading turnover of the Moscow Exchange. This, over the course of February its share in the average daily trading turnover of the MICEX gained 2.5% on January. Shares in *Gazprom* were also in high demand in the stock market in February, their share in the trading turnover of the Moscow Exchange rose by 1.2% to 15.7%.



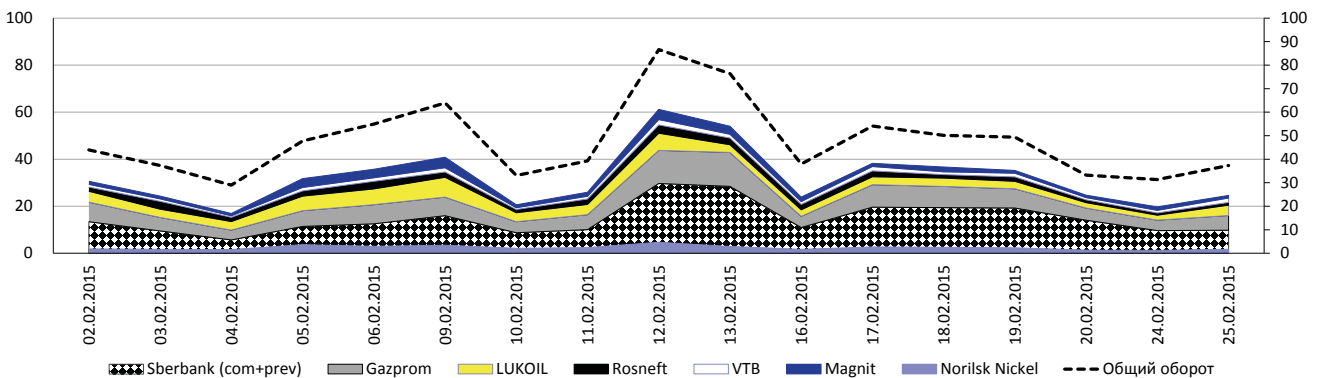
Source: Quote Rbc.ru, the author's calculations.
 Fig. 3. Growth Rates of the Prices of Highly Liquid Shares Traded on Moscow Exchange Over the Period from 26 February 2014 through 26 February 2015



Source: Quote Rbc.ru, the author's calculations.
 Fig. 4. Growth rates of Various Sectoral Indices on the Moscow Exchange (Over the Period from 2 through 25 December 2015)



Source: the MICEX's official website; the authors' calculations.
 Fig. 5. Structure of Capitalization of the MICEX Stock Market, by Type of Economic Activity



Source: Quote Rbc.ru, the author's calculations.
 Fig. 6. Structure of the Trading Turnover of the Moscow Exchange over the Period from 2 through 25 February 2015

Thus, in February these two biggest companies together accounted for more than 45.9% of the Moscow Exchange's trading turnover, their shares showing the highest liquidity. Trailing behind them were five companies whose combined volume of trade in shares on the MICEX accounted, on average, for 26.3% of the daily trading turnover of the Moscow Exchange. Another noteworthy phenomenon was the high market popularity of shares in *Surgutneftegas*, whose share in the Moscow Exchange's monthly trading turnover amounted to 3.41%.

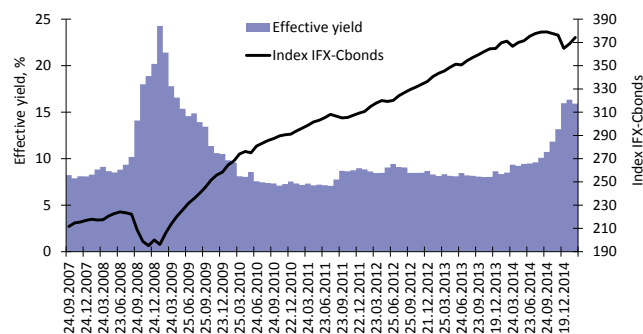
According to *Emerging Portfolio Fund Research* (EPFR), over the period from 29 January through 18 February funds oriented to the Russian market experienced an inflow of assets in the amount of \$ 312.3m. As of 25 February 2015, MICEX's total capitalization amounted to Rb 27.4 trillion (or 38.6% of GDP), having increased since 2 February by Rb 1,942.6bn (or 7.6% of GDP). As far as the stock market's capitalization structure by type of economic activity is concerned, in February the capitalization share of the mineral extraction sector increased by 0.55% to 49.3%. On the contrary, the capitalization share of the processing industries shrank by 1.3% to 16.8%. The other sector displayed slight growth over the course of February – for example, the capitalization share of the financial sector increased by 0.33% to 11.8%.

The Corporate Bond Market

In early 2015, the volume of Russia's domestic corporate bond market (by the nominal value of ruble-denominated securities in circulation, including those issued by RF non-residents) continued its growth, in spite of the crisis phenomena observed on the financial market. By the end of February, the volume of that market had risen over its previous record high to Rb 7,015.5bn, which represented a 6.2% rise on late January¹. That period also saw both growth in the number of issued bond loans (1,088 ruble-denominated corporate bond issues vs. 1,074 in late January), while the number of emitters represented in the debt segment remained practically at the same level (354 vs. 355). Besides, a total of 16 US dollar-denominated bond issues (with an aggregate face value of above \$ 2.2bn) and one yen-denominated bond issue placed by Russian emitters were circulating on the MICEX.

There was an unexpected surge in investment activity on the secondary corporate bond market, whose index returned to its annual average. Thus, in the period from 23 January through 20 February 2015, the combined volume of exchange transactions carried out on the Moscow Exchange amounted to Rb 118.2bn (for

1 According to data released by the Rusbonds information agency.



Source: According to data released by the Cbonds company.

Fig. 7. Behavior of the IFX-Cbonds Index of the Russian Corporate Bond Market and the Dynamics of Its Weighted Average Effective Yield

reference: over the period from 20 December 2014 through 22 January 2015, the monthly trade turnover amounted to Rb 58.8bn). The number of transactions carried out over the period under consideration hit its several-year record high of 36.1 thousand (vs. 30.1 thousand over the previous period)² – a fact that points to special interest displayed towards these stocks by retail investors.

In February, the IFX-Cbonds index of the Russian corporate bond market further consolidated its upward movement trend. By the end of February, it had increased 5.5 points (or by 1.5%) on late January. At the same time, the weighted average effective yield on corporate bonds displayed a downward trend for the first time since Q2 2014, having declined from 16.34% in late January to 15.91% by the end of the period under consideration – which is still above the current key interest rate (Fig. 7)³. However, the corporate bond portfolio duration index continued to display a negative trend. As of the end of February, that index amounted to 293 days, which represented a 25-day drop on late January.

In February, Russia's bond market was operating under external pressure: with an interval of only a few days, new sanctions against a number of RF citizens and legal entities were introduced by the European Union and Canada, while two international rating agencies downgraded Russia's sovereign rating to the speculative BB+ level. So far, these developments have been working against the emerging positive trends and continued to push down the corporate ratings and forecasts (Vnesheconombank, VTB, Gazprombank, Alfa-Bank, Bank of Moscow, SME Bank, Gazprom, Rosneft, Russian Railways, Transneft, NOVATEK, Federal Grid Company of United Energy System, AHML, Rusnano, etc.⁴). However, one noteworthy development against

2 According to data released by the Finam investment company

3 According to data released by the Cbonds information agency.

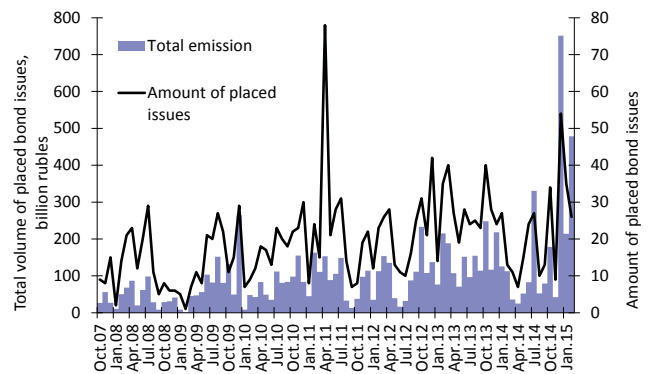
4 According to data released by the Cbonds information agency.

this negative backdrop was the AA- credit rating assigned to *Gazprom Neft* by Dagong, China's major credit rating agency.

Over the period under consideration, the most liquid segment of the corporate bond market – for the first time in several months – experienced rather significant drops in yields. The most significant drop in the interest rate (by more than 6 p.p.) was demonstrated by the following companies (and their affiliations) operating primarily in the industrial sector: OJSC *Mobile TeleSystems*; OJSC *Metalloinvest*; LLC *SUEK-Finans*; Leasing Company *TransFin-M*. However, in spite of the newly emerging positive trend, a significant yield increase was demonstrated by some of the series of securities issued by OJSC *Russian Agricultural Bank (Rosselkhozbank)*. On the whole, the most significant drop among liquid securities was once again demonstrated by hi-tech companies (on the average by 2 p.p.). The strongest pressure on yields is still being observed in the financial segment: in spite of some significant decline in yields on certain issues, the overall decline of interest rates on liquid securities issued by financial companies amounted to less than 1.5 p.p., while the key interest rate lost 2 p.p. In February, the highest investor interest was observed with regard to industrial companies and big energy producers¹.

Due to the new downward trend displayed by interest rates on the bond market, bond issuers continued their rather active attempts to attract new loans. Thus, over the period from 23 January through 20 February, 8 emitters placed 33 bond loans with a total nominal value of Rb 109.0bn (for reference: in the period from 20 December 2014 through 22 January 2015, a total of 14 bond series with a total nominal value of Rb 110.9bn were placed². Big issues were placed by CB *DeltaCredit*, OJSC *Polyus Gold*, and *Baltic Leasing Group*. Practically all of the placed bond loans were exchange-traded bonds.

However, in spite of the unfavorable recent developments, the situation on the market for initial placements of bond issues once became optimistic. Thus, over the period from 23 January through 20 February, 13 emitters placed a total of 26 bond issues with a total nominal value of Rb Rb 478.7bn (for reference: in the period 20 December through 22 January, a total of 35 bond series with a total nominal value of Rb 214.3bn were placed) (Fig. 8). However, it should be noted that this happened thanks to the activity of one of the bond market's major players: *Rosneft* alone placed a total of 8 exchange-traded bond issues with a total nominal value of Rb 400bn



Source: According to data released by the Rusbonds company.

Fig. 8. Dynamics of the Primary Placements of Issues of Ruble-Denominated Corporate Bonds

(besides, very recently – in December 2014 – *Rosneft* attracted an even bigger bond loan in the amount of Rb 625bn). Big bond issues were also placed by Mortgage Agent AHML 2014-2, VEB Leasing, OJSC *Russian Agricultural Bank (Rosselkhozbank)*, and *Sistema JSFC*³. Approximately two-thirds of all placed bond loans were exchange-traded bonds, and there were also some initial placements of bond issues. Although the situation in the financial markets was rather precarious, some bond emitters still managed to attract finance in the form of long-term loans: two mortgage agencies attracted loans for periods from 27 to 32 5 years, while one mortgage agency which placed a 15-year bond loan, and another two – 10-year bond loans.

In late January and February 2015, the Bank of Russia annulled 13 bond issues of two corporate emitters due to their failure to place even a single security (vs. 12 bond issues annulled for that reason over the previous period)⁴. Such statistics observed over recent months have led to the conclusion that emitters are making adjustments to their plans for attracting external funds in view of the dramatic surge of interest rates on the debt market.

The currently complicated situation in the national economy notwithstanding, over the period from 23 January through 20 February all 12 emitters redeemed their bond issues: 17 issues of ruble-denominated bonds with a total face value of Rb 69.9bn and 1 issue with a face value of \$ 500m (in the previous period, all the emitters likewise redeemed their bond issues in due time). In March 2015, the redemption of 15 issues of corporate bonds with a total face value of Rb 67.2bn is expected⁵.

Besides, in late January and February 2015 the situation with regard to the fulfillment, by emitters,

1 According to data released by the Finam investment company.

2 According to data released by the Rusbonds information agency.

3 According to data released by the Rusbonds information agency.

4 According to data released by the Bank of Russia.

5 According to data released by the Rusbonds information agency.

of their obligations to bond holders dramatically worsened. One issuer declared a technical default on the payment of the coupons, another one defaulted on the buyback offers to the current holders of securities before their maturity in due time (in the previous period, a technical default had been declared by only one issuer)¹. In addition, there were three real defaults on

1 According to data released by the Rusbonds information agency.

the payment of the coupons² (in the previous period, no real defaults on the payment of the coupons, on the buyback offers to the current holders of securities before their maturity, or on the redemption of a whole bond loan were declared). ●

2 That is, when the emitter fails to make due payments on securities even during the payment grace period.