



SEPTEMBER

MONTHLY REPORT

BNP Paribas L1 Equity Russia

October 2011



Performance overview

Performance at the end of October 2011 (gross of fees - %)	Oct	Last 3M	YTD	Last 12M	Last 24M*	Last 36M*	Last 60M*	Since inc.,**
BNP Paribas L1 Equity Russia (EUR)	13.44	-18.71	-19.16	-5.33	14.13	25.36	-	-0.03
MSCI Russia 10/40 Net Return Index	14.41	-18.42	-16.11	-2.31	13.23	24.10	-	1.32
Excess return	-0.97	-0.29	-3.04	-3.01	0.90	1.26	-	-1.35

Risk indicators (annualised)	Last 36W	Last 52W	Last 24M	Last 36M	Last 60M	Since inc.,**
Fund volatility (%)	29.75	-	24.57	34.00	-	36.83
Benchmark volatility (%)	31.78	-	24.01	35.25	-	37.23
Tracking error (%)	5.32	-	4.58	5.53	-	5.36
Information ratio	-0.72	-	0.20	0.23	-	-0.25

all figures gross of fees (in EUR)

* annualised performance

** inception date: 06/03/07 (annualised)

Past performance or achievements are not indicative of current or future performance,

Performance at the end of October 2011 (gross of fees - %)	Oct	Last 3M	YTD	Last 12M	Last 24M*	Last 36M*	Last 60M*	Since inc.,**
BNP Paribas L1 Equity Russia (USD)	17.81	-21.04	-15.92	-	-	-	-	-16.31
MSCI Russia 10/40 Net Return Index	18.93	-20.82	-12.79	-	-	-	-	-12.90
Excess return	-1.12	-0.23	-3.14	-	-	-	-	-3.41

Risk indicators (annualised)	Last 36W	Last 52W	Last 24M	Last 36M	Last 60M	Since inc.,**
Fund volatility (%)	34.02	-	-	-	-	-
Benchmark volatility (%)	36.15	-	-	-	-	-
Tracking error (%)	5.25	-	-	-	-	-
Information ratio	-0.75	-	-	-	-	-

all figures gross of fees (in USD)

* annualised performance

** inception date: 15/12/10 (annualised)

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MARKET REVIEW

- **The Russian equity market rose by 9.7% in rouble terms in October on the back of the global market rebound following the actions of EU authorities to stabilise the eurozone debt crises.** Local Russian news continued to be mostly positive, with supportive macroeconomic data for September and the positive development in Russia's WTO entry campaign.
- **Russian GDP growth accelerated significantly in Q3**, rising by 5.1% YoY vs. 3.4% YoY in Q2, according to estimates of the Economics Ministry. The main drivers of GDP growth were strong retail sales which rose by 7.6% YoY in Q3, and agricultural sector output on the back of recent good harvests. It is likely that the retail segment will continue to grow on the back of increases in social security spending ahead of the 2012 elections, including the increase of pensions and state employees' wages. Additionally, we expect strong investment growth figures in Q4 - a large part of the government's investment programme related to the 2014 Sochi Winter Olympics, the APEC summit in 2012 and other infrastructure projects should be accomplished in Q4. Overall, we expect full-year GDP growth of 4.1% in 2011, which is close to the 2010 figure of 4%.
- **Russia's federal budget surplus was 2.8% of GDP for the January-September period, according to Ministry of Finance estimates.** In September, the surplus reached 5.9% of GDP, which was higher than in August. The increase was due to a reduction in spending from 21.1% of GDP in August to 13.7% in September. Revenues declined as well, but less so - from 21.8% to 19.7% of GDP. We do not expect this to continue in Q4, as spending is likely to increase and outpace revenues in the run-up to next year's elections.
- **Russia and Georgia finally agreed on issues related to Russia's WTO entry.** Georgia was the last country to approve Russia's WTO accession. After the WTO working group approved Russia's accession package in the beginning of November, it is now reasonable to expect the WTO Ministerial Conference on 15-17 December to approve the application formally. The Russian Parliament should then vote on ratification of the accession before 15 June 2012. Fitch, the rating agency, was positive on Russia's likely entry into the WTO, predicting that the economy should become more diversified and see a decrease in its exposure to oil prices. We expect WTO accession to increase the overall efficiency of the economy, as uncompetitive manufacturers will be forced out of the market or face restructuring, freeing up labour and other resources. An efficiency increase should improve the long-term growth prospects for earnings in the corporate segment, which should support Russian equities. In the short term, Russian equities might react positively due to an improvement in market sentiment.
- **Unilever is set to acquire 82% of Kalina, one of the leading Russian cosmetics producers, for RUB 16.7 bn (about USD 540 mn).** Unilever is prepared to pay RUB 4 098 per share, which is 86% above the closing price the day before the announcement, in a bid to expand its business in Russia. Kalina's attraction as an acquisition target is its 30% market share of facial care products, 36% of the body care products market and 46% share of the mouth rinse products market. Unilever's bid for Kalina follows its 2008 purchase of Inmarko - one of Russia's largest ice-cream producers. The news of the potential Kalina acquisition is another sign that international investors are positive on Russia's retail market prospects. In 2010, PepsiCo decided to buy WBD and Danone bought Unimilk. We expect this trend to continue.



Fund performance

- **BNP Paribas L1 Equity Russia rose by 13.44% (gross of fees in EUR terms) in October**, underperforming the MSCI Russia 10/40 Net Return index, which gained 14.41%. In USD terms, the fund rose by 17.81% (gross of fees), while the benchmark rose by 18.93%.
- **Overall, the fund's defensive positioning in energy and cash had the largest negative impact on performance, with the overweight position in TNK-BP and Surgutneftegas preferred shares detracting the most within energy sector.** However we did not decide to change our allocation because we were not convinced that the actions of the EU in addressing sovereign debt concerns were sufficiently detailed to remove event risk in this area.
- **Materials made the largest positive contribution to excess return** at an industry level, mainly due to our underweight in Norilsk Nickel. The stock started to perform poorly as recent support from a conflict between major shareholders started to fade. We remain underweight since we believe the earnings growth prospects are poor, valuations are relatively high and the quality of its corporate governance is low. In our view, Norilsk Nickel has not invested sufficiently over the last few years in increasing production and we do not see current management being able to turn the situation around. Indeed, we have concerns about management's ability to significantly increase the company's value, as the CEO, Vladimir Strzhalkovsky, lacks experience in the mining sector. Escalating capital expenditure amid falling ore grades is also likely to hit free cash flow generation after years of underinvestment.

Portfolio activity

- **We continued to decrease exposure to cyclical stocks.** Thus, our largest sales were in Mechel and NLMK. The largest buys were Gazprom and Polymetal International.
- **We sold Mechel and decreased our exposure to NLMK** as the companies' target price estimates were downgraded due to the cut in our forecast for steel and raw materials prices. The increasingly likely global economic slowdown could have a negative effect on China, resulting in a slowdown in its GDP growth and a decrease in the share of investments in GDP. This could deteriorate demand for non-food commodities. In addition, we expect a lower EBITDA margin for NLMK. The company bought Duferco with an expected long-term EBITDA margin of 5-6%, while NLMK's is at 20-25%. For Mechel, we see additional risks due to high leverage (expected net debt/EBITDA for 2012 is 2.5x) and possible problems for Elginskoe's coal field development plans. The NPV of this project is expected to be lower than initial estimates due to low-quality coal's high share of the output.
- **We decreased our underweight in Gazprom** since we believe that there is an upside risk in the short term. However, information about expected high dividends for 2011 (double the size of 2010) should support the stock price. The dividend yield is expected to be 4-5%. In addition, possible seasonal increases in gas prices in Europe could have a positive influence on the company's stock. Nevertheless, we remain underweight since the medium to long-term prospects seem relatively poor and the company has relatively low efficiency. Gazprom's production for the local domestic market is hardly profitable, while NOVATEK (the second-largest gas producer in Russia) managed a healthy profit margin of 30-35%, mostly coming from the local Russian market. What's more, we expect higher taxation for Gazprom. Several of its large investment projects have ended (e.g. North Stream) which should improve cash flow. We believe that the authorities would be keen to use it to compensate for losses due to oil tax cuts, effective from November this year.
- **We participated in the IPO of Polymetal International.** This is one of the largest gold and silver producers in Russia. In the current volatile market, the stock can be seen as defensive, given the exposure to the gold and silver markets. In addition, we expect Polymetal to increase its production by more than 40% in 2012 as it begins exploring two new gold deposits.

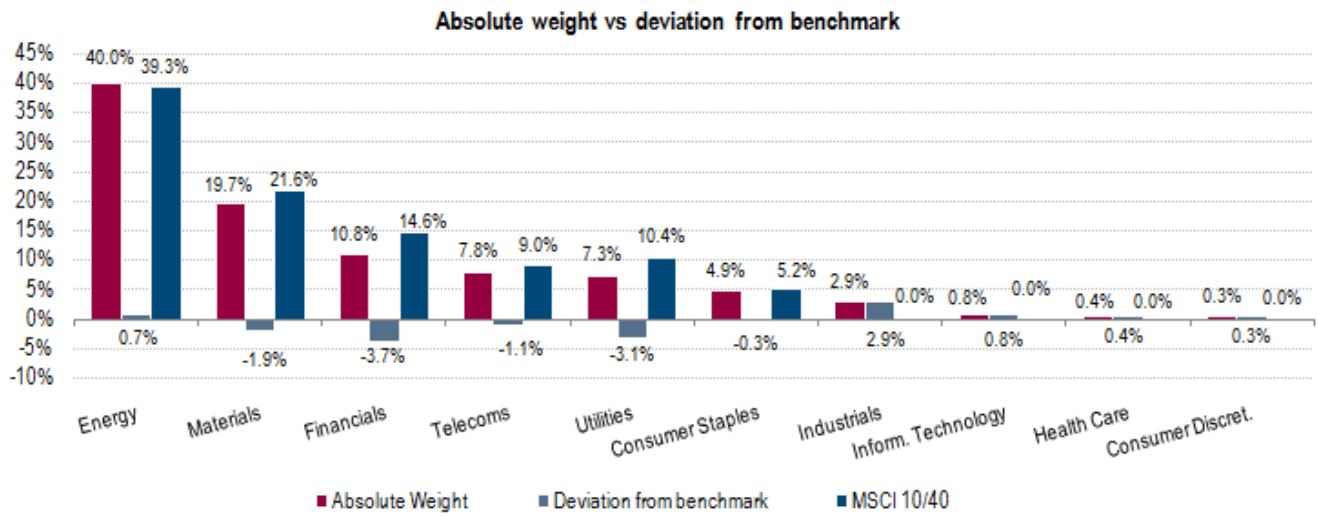


Outlook & positioning

- **Russia's economic outlook so far remains stable**, with the GDP/budget balance not yet indicating stress from a potential global slowdown. Forecasts should remain unchanged assuming no substantial falls in oil prices, other commodity exports prices or Chinese growth, all of which would affect fiscal performance. Despite strong underlying fundamentals, Russia's equity market performance remains vulnerable to contagion from sovereign debt concerns in Europe and the US and the risk of a global slowdown. Some sectors could be particularly sensitive, especially the pro-cyclical retail and real estate sectors, as well as materials, where vertically integrated steel producers with high leverage, such as Evraz and Mechel, might suffer from a short-term weakening of coking coal prices. We should also mention that for banks, the situation looks slightly better than the downturn three years ago, with less wholesale foreign-denominated debt, more deposits (in absolute and in relative-to-loan terms) and lower multiples (with a current P/B ratio of less than 2, down from the 3-4 seen three years ago).
- **The Russian equity market offers diversification of exposure versus other major EM economies**, with a large proportion of relatively defensive energy companies (low multiples, high dividend yields) making up the market capitalisation. Russian sectoral performance is typically contrarian to that of other emerging markets – its energy stocks are defensive and domestic consumer-oriented stocks tend to be high beta, while elsewhere among the emerging markets, this tends to be the other way round.
- **We expect the following factors to support Russian equities in the short to medium term:**
 - Low historical valuations, with a 2012 P/E for the MSCI Russia 10/40 of 6.0 (end October 2011)
 - Likely WTO entry, which should improve market sentiment and the long-term efficiency of the economy
 - Robust growth in consumption at 6.2% YoY for January-September 2011 on the back of declining unemployment and real wage growth. The positive outlook for local demand growth can be supported further by international companies' M&A activity with the latest announcement being Unilever's plan to buy 82% of Kalina for more than 500 mln USD
 - Expected government debt-to-GDP levels of 9% in 2011
 - International reserves high enough to cover all government debt more than three times over
 - 2011 budget is expected to be balanced, far better than the situation in the US and many European countries
- **We will maintain the defensive positioning of the portfolio, while looking at the possibility of increasing our exposure to consumer staples, banks and power utilities in the case of market volatility.**



Additional information



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Performance details

ISIN Codes: LU0269742168, LU0269742671, LU0269742754, LU0269742325, LU0269742598, LU0531769684, LU0531769767

Total AUM as of end of reporting date: EUR 967 mn

Performance (net of fees C share) (%)	Oct	Last 3M	YTD	Last 12M	Last 24M*	Last 36M*	Last 60M*	Since inc.,**
BNP Paribas L1 Equity Russia (EUR)	13.23	-19.16	-20.57	-7.32	11.76	22.78	-	-2.01
MSCI Russia 10/40 Net Return Index	14.41	-18.42	-16.11	-2.31	13.23	24.10	-	1.32
Excess return	-1.18	-0.74	-4.45	-5.01	-1.46	-1.32	-	-3.32

Risk indicators (annualised)	Last 36W	Last 52W	Last 24M	Last 36M	Last 60M	Since inc.,**
Fund volatility (%)	29.73	-	24.53	33.94	-	36.77
Benchmark volatility (%)	31.78	-	24.01	35.25	-	37.23
Tracking error (%)	5.32	-	4.58	5.52	-	5.35
Information ratio	-1.04	-	-0.32	-0.24	-	-0.62

all figures net of fees (in EUR)

* annualised performance

** inception date: 06/03/07 (annualised)

TER : 2,17%

Performance (net of fees I share) (%)	Oct	Last 3M	YTD	Last 12M	Last 24M*	Last 36M*	Last 60M*	Since inc.,**
BNP Paribas L1 Equity Russia (EUR)	13.34	-18.93	-19.83	-6.30	12.95	24.09	-	-1.00
MSCI Russia 10/40 Net Return Index	14.41	-18.42	-16.11	-2.31	13.23	24.10	-	1.32
Excess return	-1.07	-0.51	-3.72	-3.99	-0.27	-0.01	-	-2.32

Risk indicators (annualised)	Last 36W	Last 52W	Last 24M	Last 36M	Last 60M	Since inc.,**
Fund volatility (%)	29.74	-	24.55	33.98	-	36.81
Benchmark volatility (%)	31.78	-	24.01	35.25	-	37.23
Tracking error (%)	5.32	-	4.58	5.52	-	5.35
Information ratio	-0.87	-	-0.06	0.00	-	-0.43

all figures net of fees (in EUR)

* annualised performance

** inception date: 06/03/07 (annualised)

TER : 1,06%

Performance (net of fees C USD share) (%)	Oct	Last 3M	YTD	Last 12M	Last 24M*	Last 36M*	Last 60M*	Since inc.,**
BNP Paribas L1 Equity Russia (USD)	17.60	-21.48	-17.38	-	-	-	-	-18.10
MSCI Russia 10/40 Net Return Index	18.93	-20.82	-12.79	-	-	-	-	-12.90
Excess return	-1.34	-0.67	-4.59	-	-	-	-	-5.20

Risk indicators (annualised)	Last 36W	Last 52W	Last 24M	Last 36M	Last 60M	Since inc.,**
Fund volatility (%)	34.01	-	-	-	-	-
Benchmark volatility (%)	36.15	-	-	-	-	-
Tracking error (%)	5.24	-	-	-	-	-
Information ratio	-1.08	-	-	-	-	-

all figures net of fees (in USD)

* annualised performance

** inception date: 15/12/10 (annualised)

TER : 2,19%

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