

Equities

7 December 2011 | 44 pages

Global Emerging Markets Strategy

2012 Outlook – The End of Dear Money

Equity Strategy

- **A Better Year** — We expect a better year for EM equities in 2012; our year-end target is 1,225 on MSCI GEMs, a gain of 25-30% from current levels.
- **Citi Macro Views** — Global growth slows to 2.5% in 2012, but EMs grow at 5.1%. We expect China to slow to 8.4% growth. Europe is in recession; the US is not. The EU debt crisis may worsen in early-2012, but we believe it is ultimately contained.
- **Easier Money** —Against the backdrop of ‘financial repression’ in the DM world, interest rates in emerging markets are peaking at still very low real rates. Policy is being eased in Brazil and China and more countries should follow. We show that EM equities have performed better in recent years when rates are falling and Chinese RRR are declining.
- **Neutral Dollar?** — The dollar is forecast to edge higher to €1.25-1.30 by end-2012 and should, alongside commodity prices, be a more neutral factor for EM equities next year.
- **Earnings: How Far Down?** — EM earnings forecasts are down to 13.5% for 2011, mainly due to Asia, and to 9.6% for 2012, mainly due to EMEA. The outright earnings recession is underway with trailing EPS down 4% since August. There is more to come, although nothing like as much as the 42% fall in the 2008-9 recession, in our view.
- **Pricing in Recession** — Valuations are attractive. At 10.6x trailing (v. a recent average of 15x), markets price in another 29% drop in EPS – too much; MSCI GEMs is 20% cheap on forward earnings (9.1x v. 11.4x) and 19% cheap on P/BV (1.58x v. 1.96x).
- **Regions/Countries** — We go into 2012 Overweight in Asia, Neutral in Latin America and Underweight in EMEA. We favor large markets over small. We upgrade South Africa, Thailand and Peru to Overweight, alongside Korea and China. We are Neutral in Brazil, Russia, Taiwan and Turkey. We are Underweight in CE3.
- **Sectors: Overweighting Beta** — We upgrade Materials to Overweight, alongside Financials and Consumer Discretionary. Energy is lifted to Neutral. We favor the cyclicals and financials, in part as the risk to earnings is less (given the scale of the downgrades so far compared to the non-financial domestic sectors).

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GEMs Regional, Country and Sector Recommendations

	Overweight	Neutral	Underweight
Regions	Asia	Latin America ↑	CEEMEA
Countries	Korea, China, Peru ↑ Thailand ↑, S Africa ↑	Brazil, Russia ↑ Turkey ↓, Taiwan	Poland, Colombia, Indonesia Morocco, Czech ↓, Philippines, Malaysia ↓, Hungary Egypt, Chile ↓, India ↓, Mexico
Sectors	Financials Consumer Disc Materials ↑	Energy ↑ Industrials Utilities	Info Tech ↓ Health Care, Telecoms Cons Staples

Source: CIRA

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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2012 Outlook – The End of Dear Money

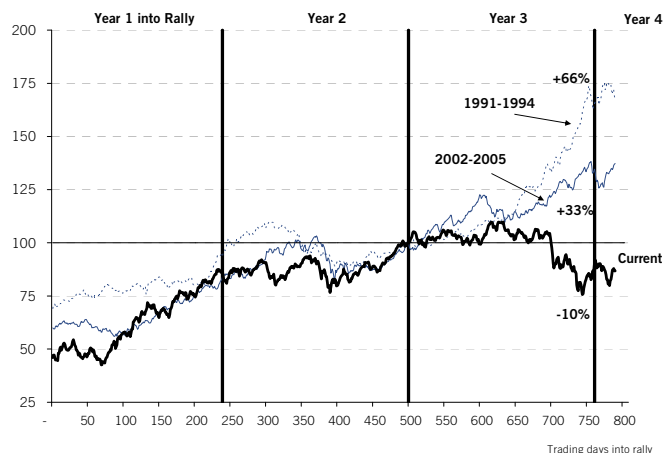
With a year-to-date fall in MSCI GEMs of 17% (Figure 1), 2011 has defied the (limited) historical pattern of Year 3's in bull markets at the start of economic cycles. Year 3 gains in the MSCI GEMs index at the start of the 1991-2000 and 2002-2007 economic cycles averaged 50% (Figure 2); in the latest Year 3 in the cycle that began in late-2008, MSCI GEMs *fell* by 10% (the year to October 27, 2011). The model failed. In our view, this was because for most of calendar 2011, investors worried that this was *not* the early stage of a new economic cycle, but the start of a relapse back into recession.

Figure 1. MSCI GEMs Index (Rebased to 100 at start of 2011)



Source: MSCI, Datastream and CIRA

Figure 2. MSCI GEMs – Year 3's (Start of Year 3 = 100)



Source: MSCI, Datastream and CIRA

Our forecasts for EM equities in 2011 were too bullish. The poor performance, in our view, of emerging markets this year can be boiled down to three factors:

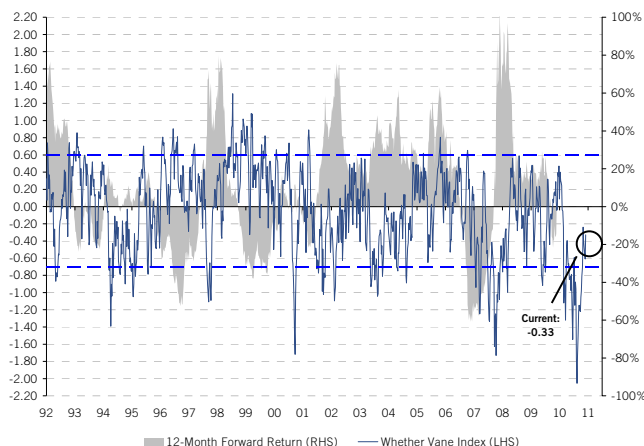
- US fears – double dip, debt ceiling, ratings downgrade, default, over and over;
- The seemingly never-ending EU debt crisis rollercoaster;
- The much sharper than expected rise in inflation and interest rates in emerging markets (the only 'pure' EM negative).

We expect two of the above three factors to turn in a much more positive direction in 2012. First, the risk of a 'double-dip' in the US seems to have eased markedly, at least for now. Secondly, inflation in the emerging markets is rolling over and the interest rate cycle is turning with it. In recent weeks, only Colombia and Hungary of the 21 members of the MSCI GEMs index have raised interest rates, although Turkey has tightened policy without a formal rate hike; in the other direction, Brazil, Indonesia and Thailand have now cut interest rates and, most importantly, China began to ease policy with the November 30 cut in RRR.

Most likely, in 2012, global equities will have to continue to deal with the challenges of the EU debt crisis and this is likely to lead to further periods of turbulence. However, supported by a better US economy and a much more favorable interest rate cycle in emerging markets, hope springs eternal for EM equities at the start of the new year. Moreover, few investors appear to be positioned for a positive outlook for the asset class in 2012. Sentiment has rebounded in recent weeks. However, our proprietary 'Whether Vane' sentiment indicator remains below Neutral, although

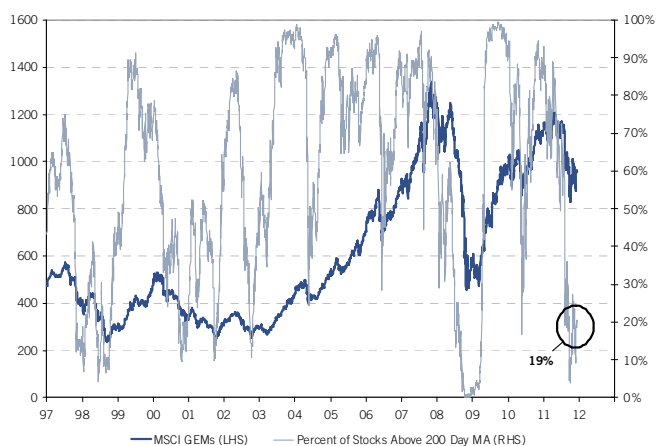
no longer in 'panic' territory (Figure 3); this model has been generating a bullish signal now for several weeks¹. Further, one of our favored indicators of momentum shows that just 19% of MSCI GEMs index stocks are currently trading above their 200-day moving average (Figure 4). That figure was over 90% at several recent market peaks and it bottomed out at 4% in early-October this year.

Figure 3. GEMs Sentiment Indicator: "Whether" Vane Index



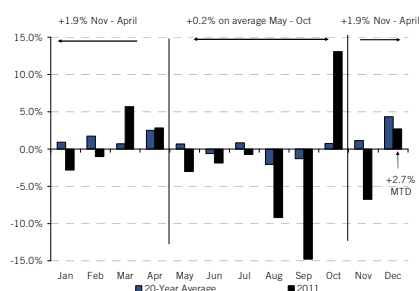
Source: MSCI, Datastream, EPFR, Bloomberg and CIRA

Figure 4. MSCI GEMs: Percent of Stocks Trading Above 200 Day MA



Source: MSCI, Datastream, Factset and Citi Investment Research and Analysis

Figure 5. GEMs Monthly Performances (Since 1990)



Source: Datastream and CIRA

Also, the seasonals (Figure 5) point to an extension of the end year-rally, which began in late-November and is already worth 10% from its recent low, and to a good start to 2012. The chart shows that December has been the best single month and November-April the best rolling six-month period of the year for MSCI GEMS since 1990.

Most of the gains in EM equities that we had expected in 2011 should now be captured in 2012. While the 'tail risk' of a collapse in the Euro (our economists give this a 5% chance in 2012) or even that one or more Euro members departs the single currency (for which our economists give a 25-30% chance in 2012-13)² remains, our *base case* is supportive of solid gains next year. This is premised on:

- a soft, but non-recessionary, global economy;
- a worsening of the EU debt crisis into 2012, without a blow-up of the system;
- solid EM economic growth of around 5% in 2012;
- a Chinese slowdown (to 8.4% growth in 2012), but no 'hard landing'; and
- a declining trend in EM inflation and interest rates.

Valuations on emerging market equities are very attractive (as we discuss below) and provide support for our positive view. At end-November, MSCI GEMs traded at

¹ 84% of the time that the "Whether Vane" has been in negative territory since 1993, MSCI GEMs has been higher in twelve months' time. We were in panic most of this past summer.

² See *Global Economic Outlook and Strategy* "Prospects for Economies and Financial Markets in 2012 and Beyond", Willem Buiter et al, November 28, 2011.

9.1x forward earnings, compared to a long-term average of 11.4x, and so discounts further earnings downgrades of 20% from current levels. The current P/BV on the index of 1.58x is 19% below its long-term average of 1.96x. We reiterate our extant end-2012 target for MSCI GEMs of 1,225, which translates into 25-30% gains in EM equities next year.

The Macro Backdrop – Slowing Growth

The global macro backdrop for 2012 should be supportive of equities at their current cheap levels. Our economists expect next year to be one of 'slowing global growth with wide divergences'. We now forecast global growth of just 2.5% in 2012 (Figure 6), which is down sharply from 3.9% six months ago (Figure 7 below). This also represents a slowdown from 3.0% global growth in 2011. Europe remains the overwhelming drag, with our forecast for Euro Area growth in 2012 having just been slashed to -1.2% (from -0.3% in October)³ and as high as +1.6% last May. Although our US forecast for 2012 has also been cut from just over 3% last spring to 1.9% today, it is a far smaller drag on global growth. Developed economies are forecast to grow by 0.9% next year, down from 1.4% in 2011.

Figure 6. The Global Macro Backdrop: 2009-13

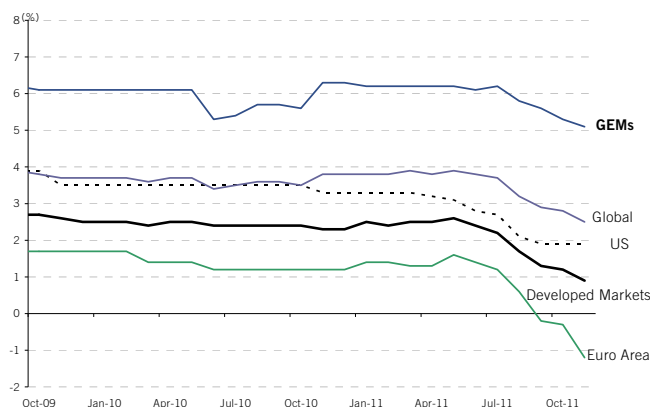
	GDP Growth (%)					CPI Inflation (%)			
	2009	2010	2011F	2012F	2013F	2010	2011F	2012F	2013F
Global	(1.9)	4.2	3.0	2.5	3.1	2.7	3.9	3.0	2.9
Industrial Countries	(3.5)	2.7	1.4	0.9	1.2	1.4	2.6	1.6	1.3
Emerging Markets	1.4	7.3	6.0	5.1	6.0	5.3	6.2	5.3	5.3
US	(2.6)	3.0	1.4	1.9	1.2	1.6	2.6	1.6	1.3
Japan	(5.2)	4.0	(0.4)	1.8	1.3	(0.7)	(0.3)	(0.3)	(0.1)
Eurozone	(4.1)	1.8	1.5	(1.2)	(0.2)	1.6	2.7	2.0	1.1
Asia	5.8	9.2	7.3	6.9	7.3	4.2	5.9	4.6	4.6
Latin America	(2.2)	6.1	4.2	3.7	4.4	7.5	7.0	6.4	6.5
CEEMEA	(5.2)	4.6	4.6	2.2	3.9	6.1	6.7	5.8	5.3
China	9.1	10.4	9.1	8.4	8.6	3.3	5.5	4.1	4.3
Brazil	(0.2)	7.5	2.9	3.3	4.5	5.0	6.6	5.3	5.2
India	7.4	8.5	7.1	7.0	7.7	8.6	9.5	7.5	7.0
Russia	(7.9)	4.0	4.0	2.5	4.2	6.9	8.6	6.2	6.1
Korea	0.2	6.2	3.6	3.7	4.4	3.0	4.4	3.3	3.2
Taiwan	(1.9)	10.8	4.5	4.0	4.5	1.0	1.4	1.4	1.7
South Africa	(1.8)	2.8	3.1	2.9	4.0	4.1	5.0	5.8	5.8

Source: Citi Investment Research and Analysis

Emerging markets should continue to account for the lion's share of global growth next year, even though our forecast for EM growth for 2012 has also been cut from 6.2% in May to 5.1% today. On current forecasts, our economists calculate that the contribution of the emerging markets to global growth will increase from 70% in 2011 to 76% in 2012 (Figure 8). Although this contribution was over 100% in 2008 and 2009 (when developed economies did not grow at all), the better comparison is with the growth phase of the last cycle. From 2002-2007, the annual contribution of emerging markets to global growth averaged 46% (with very little variation). The much higher 70%+ contribution of emerging markets to global growth in 2011-12 (early in this cycle) shows the scale of the current drag on developed economies from the prolonged de-leveraging process.

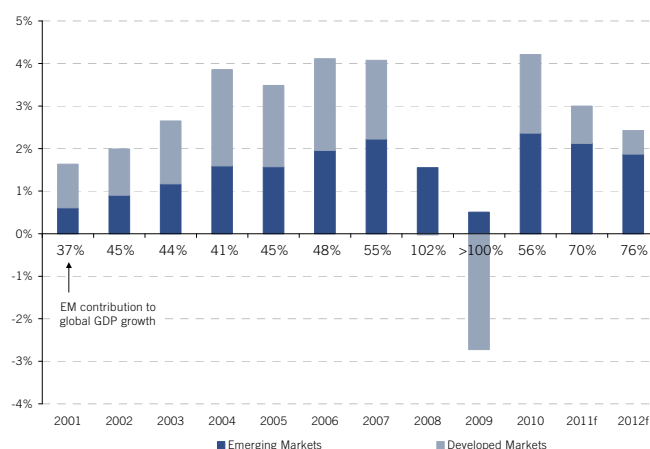
³ GDP in every country in the Euro Area is expected to contract in 2012, except for Germany (+0.3%).

Figure 7. Evolution of Citi Global Growth Forecasts (2012)



Source: Citi Investment Research and Analysis

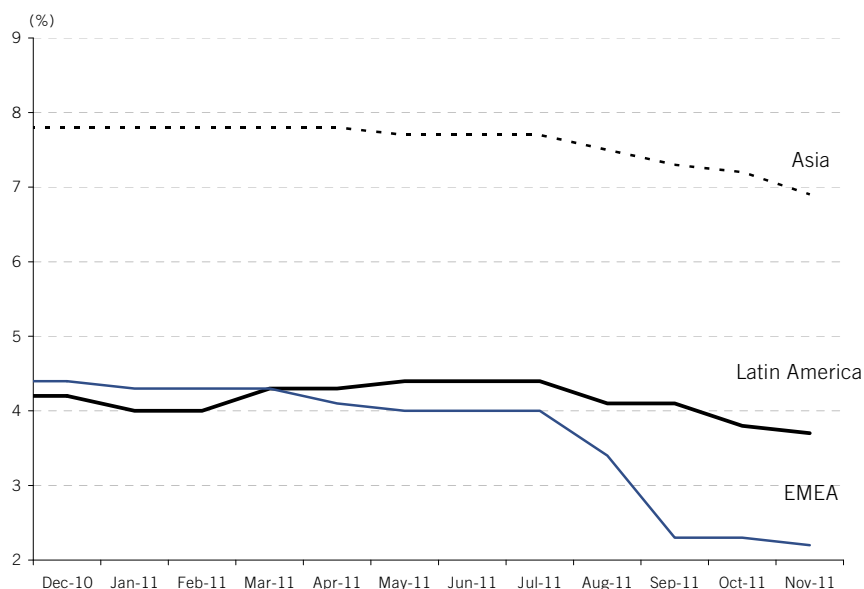
Figure 8. Contribution to Global GDP Growth; EM v. DM



Source: Citi Investment Research and Analysis

Within the emerging markets, the relative growth trends by region have been fairly stable (Figure 9). Asia leads the way with projected GDP growth of 6.9% in 2012, even though this is down from 7.3% this year and far down from 9.2% in 2010. We expect GDP growth in Latin America next year to slow further to 3.7% from 4.2% in 2011 and 6.1% in 2010. For CEEMEA, however, the phasing of growth is different. After flat growth of 4.6% this year and last, we expect CEEMEA growth to drop sharply to just 2.2% in 2012, with a significant decline in this forecast from around 4% as recently as July.

Figure 9. Evolution of Citi Global Growth Forecasts – EM Regions (2012)



Source: Citi Investment Research and Analysis

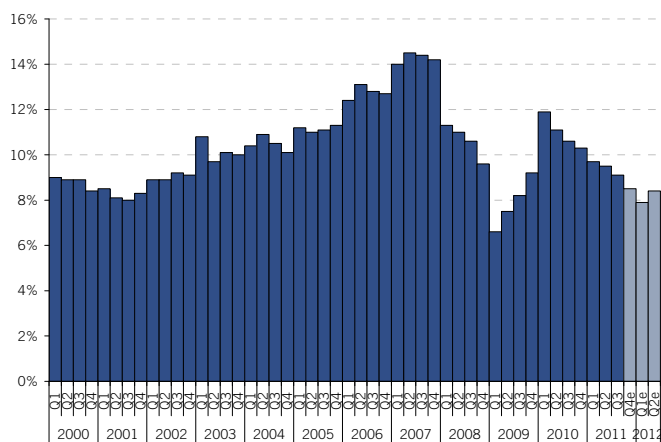
By country for 2012, the main themes are an easing of growth in China (to 8.4% next year – see below), a shift to a much lower trajectory of growth in 2011-12 in leaders such as India (to around 7%), Brazil (2.9-3.3%), (Korea 3.5-4%) and Taiwan (4-4.5%), sharp slowdowns in Russia (to 2.5% next year), Mexico (3%) and Turkey (2.5%) and a stalling of growth in Emerging Europe, with the risk of outright recession, especially in Hungary, due to the region's very close macro links to the Euro Area. Only in Thailand is GDP growth expected to be materially higher in 2012 (3%) than this year (1.7%) and this is due mainly to the projected recovery from the recent devastating floods.

China: Slower Growth and Easier Policy

Our China economist, Minggao Shen, is now expecting a 'soft patch' in the economy in early-2012⁴, but still without any realistic prospect of a 'hard landing' in the forecast period. Chinese GDP growth could drop below 8% (year-on-year) in 2012 Q1 (Figure 10), due to the ongoing correction in the property market and slower export growth, especially to Europe (Figure 11); this could trigger further easing, especially in terms of monetary policy. Moreover, the government may announce a target for GDP growth of 'only' 7.5% for 2012. However, our team argues that the policy framework should be supportive of growth in the 8-8.5% range next year, such that quarterly growth rebounds after Q1 to generate full year growth of 8.4%.

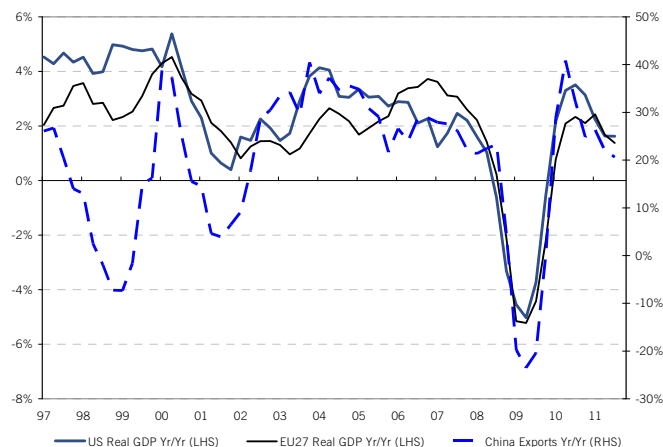
Slower, but still decent, growth in 2012 is also consistent with the longer-term prospect of a deceleration in potential GDP growth, as we discussed in a recent report⁵. The long-term challenge facing China remains its ability to lift the extremely low Consumer Spending/GDP ratio (only 34% in 2010, well below any other emerging market) before the boom – let us not even the emotive word 'bubble' – in investment spending (46% of GDP in 2010) deflates, all set against the risk of essentially flat net exports in 2012 as the global economy slows further.

Figure 10. China: Quarterly Real GDP Growth (Y/Y)



Source: Citi Investment Research and Analysis

Figure 11. China Export Growth v. US, Europe GDP growth



Source: Chins Nat'l Bureau of Stats, Haver and CIRA

⁴ See *China Macro View*, "Economic Prospects: Hitting a Soft Patch in 2012", Minggao Shen et al, December 1, 2011.

⁵ *Global Emerging Markets Strategy*, "China and GEMs: Perception v. Reality" Geoffrey Dennis, November 3, 2011.

Inflation in China is now falling sharply and should drop into the 4-5% range in the very short-term from a peak of 6.5% in August; this decline may be explained by a slower economy, tighter monetary policy, lower commodity prices and favorable base effects. The combination of falling inflation and slower growth has already set off a new monetary easing cycle via the recent cut in RRR. Although interest rates (which are negative in real terms) are likely to remain broadly stable, the scope for a *large* number of RRR cuts over the next few months – we expect two more cuts before Chinese New Year in late-January – is clear; this should be very helpful long-term for emerging markets.

A Quick Word on Europe

We are *emerging* market strategists, so we do not want to talk for long about the problems of *developed* Europe, i.e. the Euro Area; however, we are always asked about Europe and it does inform our EM strategy at present. So, here goes – and briefly.

Our economists expect the EU debt crisis to worsen during 2012, but ultimately to be contained⁶. In the very short-term, a step towards 'fiscal integration' may be taken if the EU agrees to new fiscal and governance rules to be monitored by member countries and the EU, with an automatic penalty procedure for countries that break the new rules. If these changes were to be agreed, they would give the ECB 'cover' to step up its purchases of sovereign debt within the Euro Area. Such support could be enhanced by 'extra-EU' assistance (presumably, from the IMF). Our team sees much greater ECB support for debt markets as essential to maintain stability and also likely to be forthcoming. So, spreads may widen at the beginning of 2012, only to narrow later, on increased ECB support.

Given this, our central scenario is that Italy and Spain are 'ring-fenced'. There will be orderly (importantly, not 'disorderly') defaults by Greece, Portugal and, possibly, Ireland in 2012-13. We see the risk of the break-up of the Euro in 2012 as being small (although non-negligible), but there is a 25-30% chance that one or more countries will leave the Euro over the next two years. In the other direction, there is a less than 5% chance that Germany and other 'core' countries will walk out of the Euro in 2012 as a rejection of the increasing costs of retaining the monetary union.

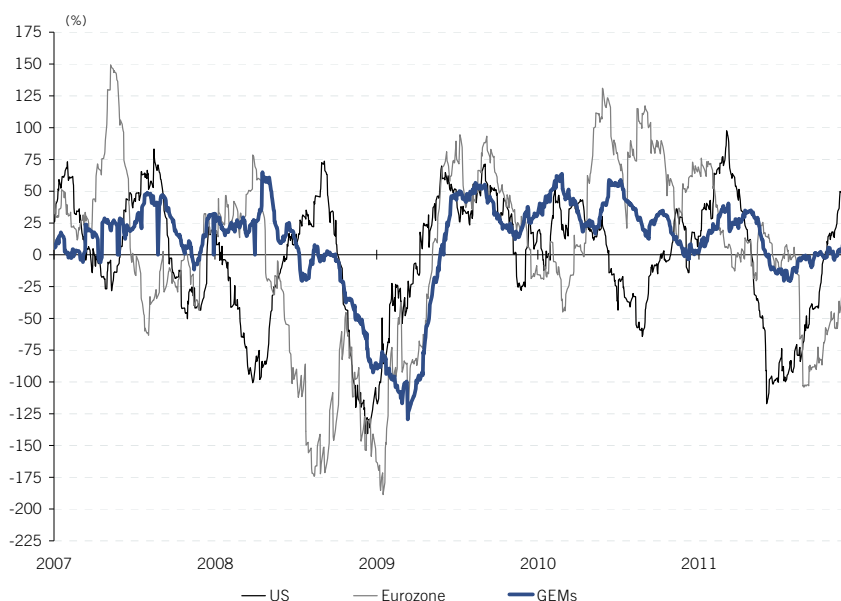
The above scenario is not, in our view, negative enough to de-rail a bull market in EM equities. Given the other strong supports for higher equity prices, we are not prepared to compromise our underlying constructive view. However, the consequences of a break-up of the Euro would be very serious. **Therefore, we believe the tail risk of a chaotic collapse of the Euro may be very small, but it is a fearsome risk were it to occur.** Hence, we fully understand that investors have a more cautious view than us and have to hedge for this severe tail risk. By implication, our view, on the other hand, is that there is 70-75% chance that *no one* will leave the Euro over the next two years. The extent to which we reflect the risk of a more disruptive outcome to the EU debt crisis in 2012 (in line with the very negative outlook for growth in the EU Area) is a blanket underweight in the CE3 markets within our model portfolio.

⁶ *Global Economics View*, "EMU Crisis Outlook: Lender of Last Resort on the Way", Willem Buiter, November 28, 2011.

The Bottom Line

In sum, global growth forecasts have been falling sharply over recent months and investors have been highly focused on the momentum (in some cases, the lack of momentum) of growth in many countries. And yet, in terms of the actual data, as published recently, and so the current performance of the leading economies, the 'bottom line' suggests a more constructive view. Citi's Economic Surprises indices for Emerging Markets as a whole, the US and even for Europe have all been moving sharply higher in recent months (Figure 12). We would match up this better data with the recent forecast downgrades for 2012 by our economists by suggesting that the downgrade process may soon run out of steam. This is a positive conclusion for EM equities in 2012.

Figure 12. Citi Economic Surprise Indices



Source: Bloomberg and Citi Investment Research and Analysis

Investment Themes

The backdrop to emerging markets for 2012 should, therefore, be a slower global economy, but where emerging markets contribute around three-quarters to the increase in global GDP. China will slow, but it should still grow at over 8%. As global growth slows further and inflation declines, monetary policy in developed economies should remain accommodating and interest rates should begin to fall in the emerging markets. These thoughts capture some of the key issues and define our main themes for EM equity investing in 2012.

1. Financial Repression/Easier Monetary Policy

The key support for emerging market equities in 2012 is, in our view, the prospect of a much more benign interest rate outlook than in 2011. The likelihood of significant declines in inflation in many leading emerging markets over the next few months will be we believe the key driver of this new monetary cycle.

However, there may be a much more broad-based set of circumstances at play here also. David Lubin, Citi's Chief Emerging Markets Economist, argued in a recent report⁷, that the best solution to the challenges facing developed economies – slow growth, de-leveraging and high budget deficits and public debt levels – may be 'financial repression'. David defines this as a set of policies designed to establish a financial system that is more able to assist a government in financing its deficit and creating a 'ready-made' demand for vast quantities of public debt. These policies include 'interest rate ceilings, reserve requirements, capital controls, transactions taxes, liquidity requirements, regulatory bullying and outright state ownership'.

Financial markets in developed economies were 'repressed' between 1946 and 1980, before a gradual shift since then to much greater financial liberalization. The pendulum is now likely to swing back towards more repressed policies again over the next several years. If the overriding aim of financial repression is to ensure that government debts can be financed, then a key part of such a strategy is likely to be to keep interest rates low – and likely negative in real terms. In fact, as the above report notes, 'negative real rates are almost a *sine qua non* of financial repression'. Real short rates are already negative in the US, the Euro Area and the UK and our economists do not expect the first tightening moves in monetary policy in the US until 2014, in the UK until 2015 and in the Euro Area until 2016. Low real rates in DM economies are here for a while – unless deflation appears (as is the case in Japan)⁸.

So, now, there are two reasons for interest rates in emerging markets to begin to ease in 2012, albeit slowly and selectively – **falling inflation and negative real rates across much of the developed world.** The 'financial repression' argument for easier monetary policy in emerging markets is crucially tied to exchange rates. If DM real rates are set to remain negative for a long period, this is likely to encourage a rebound in capital flows to the emerging markets, putting renewed upward pressure on exchange rates.

This suggests that the problems of autumn 2010 – high interest rate differentials in favor of emerging markets, possibly a weak dollar, capital inflows (which spill over into domestic money markets), and a highly-charged debate ('currency wars'?) over whether emerging market countries raise interest rates to control demand, allow currencies to appreciate or impose capital controls (or all three) – will eventually return. Any decision by the Fed to introduce QE3 over the next several months will simply exacerbate this trend. The most interesting policy implication for EM from 'financial repression' in DMs is, therefore, the likely use on a wider scale of controls on capital inflows into emerging markets. *As David Lubin argues, the result of financially repressive policies in developed economies may be more financial repression in emerging markets also.*

Lower Rates and EM Equities

We have little doubt that the direction of inflation and concerns about global (and local) recovery will be the *main* driver of monetary policy in emerging markets in the

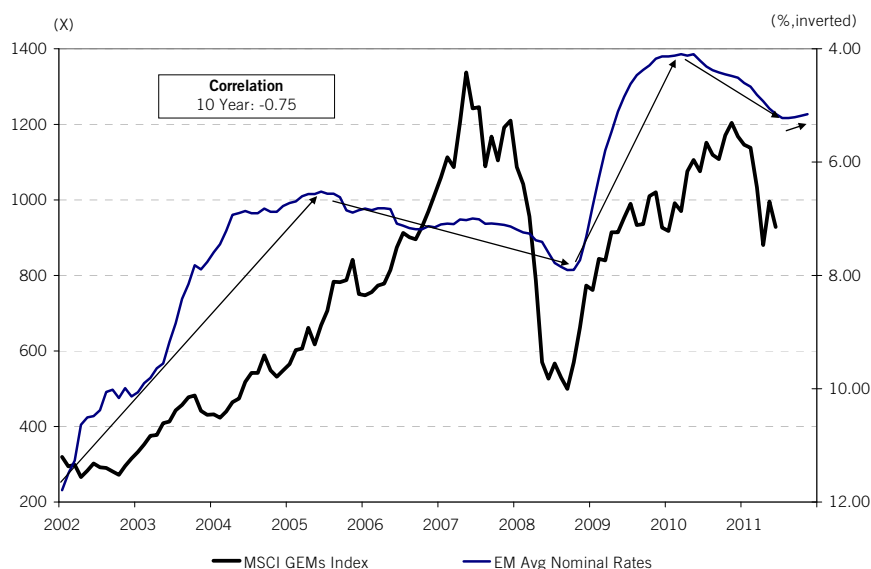
⁷ *Emerging Markets Macro View*, "Towards Financial Repression?: A View from EM", David Lubin, November 23, 2011.

⁸ The performance of equities in periods of financial repression tends to be mixed and is typically worse than in periods of liberalized financial markets. However, equities do far better than bonds in 'repressed' periods, as the latter tend to do poorly when real rates are low and inflation is threatened. See *European Portfolio Strategist*, "Pan-Europe: Financial Repression and Equities", Jonathan Stubbs et al, November 24, 2011.

near-term. However, if renewed flows of capital to emerging economies are a likely consequence of low real interest rates in DM, this provides another excuse for EM central banks to adopt easier policies – unless there is a lack of confidence towards a specific country (such as Hungary at present) – *at least until inflation starts to rise again*. Our most important theme for 2012 is, therefore, the benefits for EM equities of a much more benign interest rate outlook that was in place twelve months ago and also that seemed likely just 4-5 months ago.

The current phase of monetary tightening in the emerging markets began in early-2010; the key symbol of this new, more restrictive, monetary environment was the first increase for this cycle in RRR in China in mid-January 2010. This tightening trend, which continued until Q3 2011, is shown in Figure 13, which plots the average nominal interest rate across the emerging markets. (Our full monetary policy grid for the emerging markets is included in the appendix below.)

Figure 13. EM Nominal Interest Rates v. MSCI GEMs Index (Monthly, 5-Month Lag)



Source: Haver, Datastream and CIRA

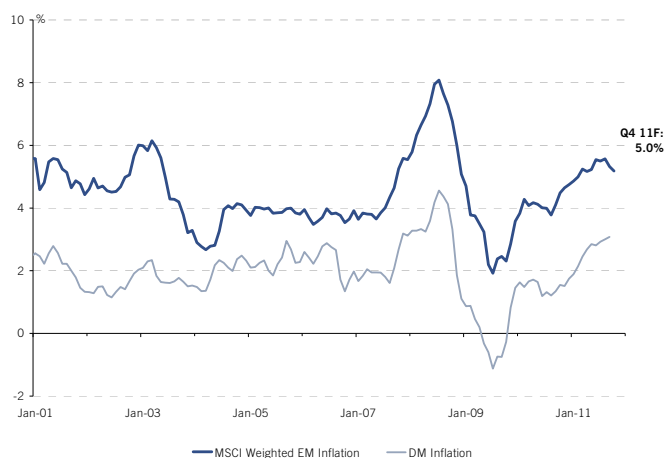
In the end, this monetary tightening trend ended rather abruptly. Compared to a situation around mid-year, when we expected well over 500bp hikes in rates up to year-end across the emerging markets, there have been far fewer rate increases in the second half of 2011 (although several countries, notably India and some of the smaller Asian and Latin American markets, have continued to tighten over recent months). The new easier monetary cycle was kicked off by Brazil, with its rate cut in late-August (the month, also, that our average EM nominal rate series peaked) and, as noted above, China, Indonesia and Thailand have also now eased policy; we expect further rate cuts in Indonesia, Thailand, Russia and Chile even before the end of 2011.

The abrupt switch to easier monetary policy across emerging markets was due, at first, to the sudden increased concern about global growth that built up in Q3 as the

EU debt crisis worsened and after the chaotic debt ceiling process in the US. The sharp drop since May in our forecasts for global growth illustrates this trend.

The other factor in play is that a new downturn in EM inflation may now be starting, especially in those emerging markets (primarily the BRICs) that saw big rises in inflation over the past year. Our measure of EM inflation (a weighted average of MSCI countries) jumped from 1.9% in July 2009 to 5.6% in August and is now clearly rolling over to an estimated 5% by year-end (Figure 14). Citi's forecast that Chinese inflation will drop into the 4-5% range by year-end from 6.5% as recently as August is a good example of this trend. Chinese inflation is set to fall by 150-250bp over the last four months of this year due to: i) a slower economy; ii) the effects of earlier policy tightening; iii) lower commodity prices; and iv) base effects. For 2012, we expect EM inflation to average 4.4% down from 5.2% currently.

Figure 14. Inflation: EM and DM



Source: Haver, Factset and CIRA

Figure 15. EM Real Interest Rates



Source: Datastream and CIRA

For interest rates to be no longer rising is one (good) thing for equity markets; however, what is also important is the *level* at which rates are or, in this case, the level at which rates are peaking. As consistently noted by our Asian strategist, Markus Rosgen⁹, liquidity is currently ample in his region, as it is around emerging markets as a whole. As a result of this and the abrupt switch from fears of inflation to fears over growth, emerging market central banks have stopped tightening at a still very low level of real rates (Figure 15 above); we estimate that real interest rates in the component countries of MSCI GEMs are currently just 40bp or 0.4%.

In our view, the trend of short-term interest rates is an important driver of EM equities. Lower rates tend to boost equity markets, and high rates are typically a negative, although the former trend can be overridden if economies are extremely weak. In some new work in Figure 13 (above), we show that the best (negative) correlation between nominal interest rates and EM equity markets is with a five-month lag. That is, since 2002, the correlation between interest rates and (lagged) equity markets is an impressive -0.75.

Figure 16 provides further support for this thesis:

⁹ See most recently, *Pan-Asia Strategy*, "Road Ahead: As Risk Returns, +25-30% for 2012", Markus Rosgen, December 1, 2011.

- Over the two periods of falling interest rates (2002-5 and 2008-10), MSCI GEMs has risen by an average of 50%, compared to an average gain of 16% when rates have been rising (2005-8 and 2010-11). In the most recent period of rising rates (March 2010 – November 2011), EM equities actually *fell* by 8%;
- The regional patterns are not entirely consistent; however, Asia seems to be most defensive when rates rise and least responsive when rates are falling, while higher-beta Latin America outperformed in both periods of falling rates;
- The countries that have outperformed in both periods of falling rates since 2002 have been Brazil, Chile, Colombia, India, Indonesia, Peru, South Africa and Thailand. Countries that have underperformed in both periods have been Mexico, Morocco, Philippines and Taiwan;
- The sectors that have outperformed in both periods of falling rates since 2002 have been Consumer Discretionary, Health Care and Materials, while the consistent underperformer has been Telecoms. (Full results by country and sector are in the appendix at the end of this report.)

Figure 16. EM Monetary Policy Phases and MSCI GEMs Performance

	Rates Decline Jan 2002- Jun 2005	Rates Rise Jun 2005- Sept 2008	Rates Decline Sept 2008 - Mar 2010	Rates Rise Mar 2010 - Nov 2011
Rates	11.35% - 6.25%	6.25% - 7.91%	7.91% - 4.10%	4.10% - 5.15%
GEMs	+72%	+39%	+28%	-8%
Asia	+55%	+23%	+35%	-7%
Latam	+85%	+97%	+31%	-12%
EMEA	+106%	+36%	+14%	-6%

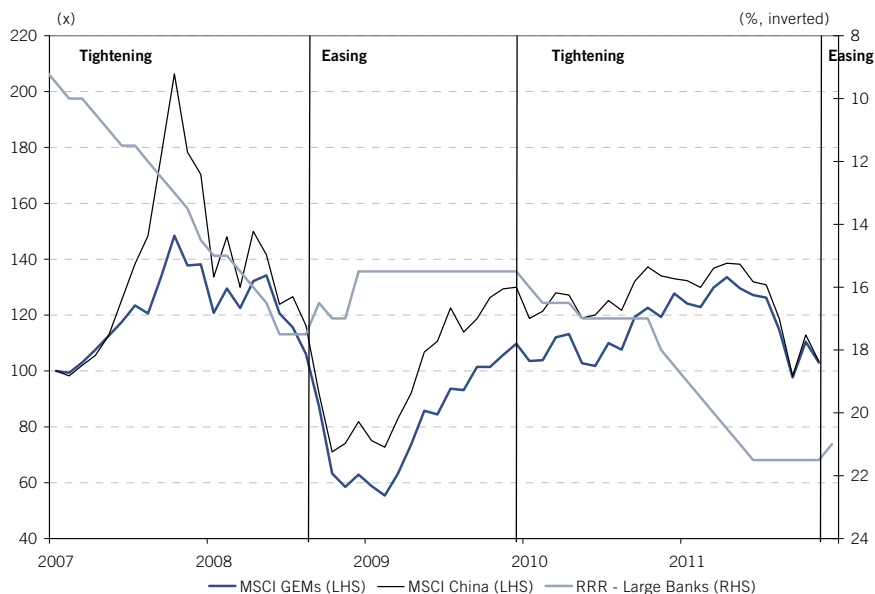
Source: Factset, Datastream, Haver and CIRA

Finally, if China is the ‘elephant in the room’ these days In terms of the performance of emerging markets, Figure 17 below also supports our positive view for 2012. It shows that in the two periods of rising RRR since the beginning of 2007, equities in both emerging markets overall and China have gone sideways (with considerable volatility). However, when reserve requirements were eased (albeit modestly) from late-2008 to March-2010, MSCI GEMs rose significantly, although MSCI China did less well¹⁰. (In this period, the initial cut in RRR came in the final stage of the savage 2007-8 bear market and it is reasonable to assume that the strength of the rebound in EM equities in 2009 was partly due to easier tone of Chinese monetary policy at that time.)

In short, there is considerable evidence that EM equities do better when EM interest rates are falling and Chinese RRR are being reduced; as this is the outlook for 2012, this analysis provides considerable support for our view that EM equities should have a much better year in 2012.

¹⁰ In the 2008-10 easing period, the initial cut in RRR came in September 2008 just before the final cathartic sell-off at the end of the 2007-8 bear market. In October 2008, MSCI GEMs fell by 27.5% and China by 23%. So, *EM equities bottomed out within a month of the first cut in China’s RRR* (there was then a bigger RRR cut in December 2008).

Figure 17. MSCI GEMs and MSCI China vs RRR



Source: MSCI, Datastream and CIRA

2. The Dollar and Commodities: A Neutral?

Our second theme for 2012 is it that commodity prices and the dollar will *not* provide much of a macro theme for the new year. If this seems contradictory, it is not. We are simply arguing that Citi's forecasts for commodity prices and the dollar for 2012 do not point to *major* moves in either asset class; this suggests that the role these factors will play in EM returns may be more muted next year than usual.

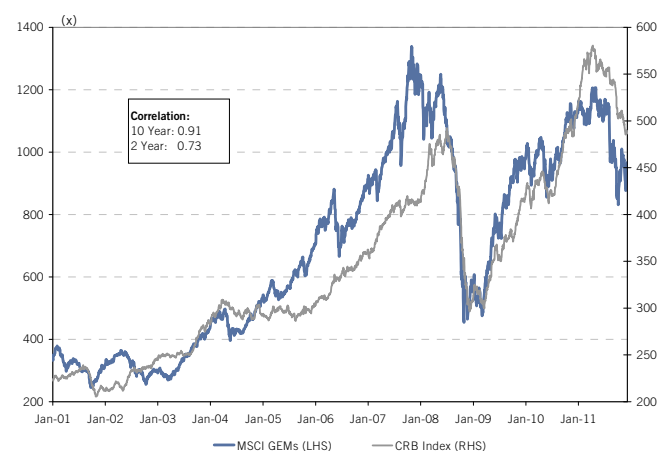
Figure 18 shows a summary table of commodity price history and forecasts. With the exception of oil prices (where we have been surprised by the recent strength, with spot prices now far above our 2012 forecasts, suggesting upside risk to the latter), our forecasts for 2012 are for flat to slightly higher prices than current spot. In the view of our commodity team, three factors will drive commodity price performance in 2012: i) the scale of the global slowdown, particularly the risks to European growth; ii) the US dollar outlook; and iii) sentiment and risk. In turn, our FX team sees the Euro/dollar rate dropping into the €1.25-1.30 range over the next year due to further European turmoil and weak growth; however, this should be partially offset by better US growth – the dollar tends to do well in outright US recession, but less well in a cyclical slowdown where risk aversion may be less – and the risk of QE3 from the Fed (which is likely to be dollar negative) over the next few months. The midpoint of our 2012 Euro/dollar range is just below current levels.

Figure 18. CIRA Commodity Price Forecasts

	Spot	2011E	2012E	2013E	Spot vs 2012e
Iron Ore (US\$/ton)	144	167	149	135	3%
Copper (US\$/pound)	3.58	3.98	3.68	3.87	3%
Gold (US\$/oz)	1,735	1,575	1,950	1,744	12%
WTI (US\$/barrel)	101	90	72	93	-29%
Brent (US\$/barrel)	110	106	86	102	-22%
Steel - HRC (US\$/ton)	635	704	738	738	16%
Nickel (US\$/pound)	8.05	11.03	9.56	10.63	19%
Pulp Softwood (US\$/ton)	920	980	890	750	-3%
Sugar (US\$/pound)	24.0	28.0	25.0	n/a	4%

Source: Bloomberg and CIRA

Figure 19. MSCI GEMs v. CRB Index (10-Years)



Source: MSCI, Datastream and CIRA

Emerging markets tend to do well when commodity prices are rising. The correlation between the two is very high at 0.91 over the past ten years, although slightly less than this, at 0.73, over the past two years (Figure 19). This close correlation is explained by the link between strong commodity prices and global growth, the high weight of commodity sectors (Materials + Energy) in MSCI GEMs (currently 28%) and the well-established correlation between a weak dollar, higher commodity prices and higher EM equities. One rather simplistic comment, which holds more than a kernel of truth, is that **'emerging markets produce commodities and developed markets consume them'**. So, rising commodity prices are good for EM equities until they threaten higher inflation, which may then cause emerging markets to do less well as higher interest rates follow.

The dollar's link to emerging markets is also well understood and is always a crucial feature of our strategy – dollar up, EM equities down and vice-versa. The (negative) correlation between the dollar's Trade-Weighted Index (TWI) and MSCI GEMs is also close at -0.84 over ten years and a still significant 0.54 over the past two years (Figure 20). If anything, the results in Figure 21 are even more powerful. In medium-term periods of dollar strength since 1999 (average gain of 14.2%), EM equities have fallen by an average of 12.8%; in periods of dollar weakness (averaging -20.1%), EM equities have risen by an average of 64%.

In truth, the current period – since the latest dollar uptrend appeared to end in early-October - has been unusual; the dollar has been virtually flat since October 5 and MSCI GEMs is up by 14%. However, even this recent period illustrates our point well. The dollar fell by 4.5% in October (reaching close to €1.42 at one point), as equities rallied sharply, and then rebounded by 5.1% to late-November (with Euro/dollar falling back to €1.326), as equities sold off again.

Figure 20. MSCI GEMs v. US Dollar (TWI)



Source: MSCI, BOE, Datastream and CIRA

Figure 21. Dollar TWI Trends and GEMs Performance

	Dollar TWI (% Change)	MSCI GEMs (% Change)
Dollar Strength		
1/11/99- 2/27/02	+21.3%	+7.8%
12/31/04- 11/16/05	+11.6%	+19.7%
3/17/08- 3/9/09	+20.9%	-53.5%
12/1/09- 6/7/10	+11.9%	-8.6%
5/3/11- 10/5/11	+5.5%	-29.5%
Average	+14.2%	-12.8%
Dollar Weakness		
2/27/02- 12/31/04	-29.1%	+ 61.8%
11/16/05- 3/17/08	-20.4%	+ 61.0%
3/9/09- 12/1/09	-16.4%	+100.6%
6/7/10- 5/3/11	-14.6%	+ 33.3%
Average	-20.1%	+ 64.2%
10/5/11- 12/6/11	-0.9%	+ 14.0%

Source: MSCI, BOE and CIRA

The dollar is currently back at the lower end of its trading range. As we have argued recently¹¹, EM equities look much better on a risk-reward basis at €1.33-1.35 today than they did at €1.42 some six weeks ago. Now, the dollar could break out of this range to the upside, which would be a negative for EM equities. Our forecasts do imply such a break to the €1.25-1.30 range over the next twelve months and, on its own, this would be a negative development for EM equities. However, this is still a very small forecast move and, in our view, the main theme of the next year is likely to be broad dollar and commodity price 'neutrality' for EM equities.

3. EM Earnings – How Far Will the Downgrades go?

EM equity markets are attractively valued (as we show towards the end of this report). However, many investors seem unimpressed. The argument goes that earnings are now falling and will continue to do and, so, by reducing the earnings base, will wipe out any valuation discount versus the asset class's long-term mean; therefore, markets are not cheap at all. Whether this gloomy view proves to be correct or not should be an important driver of EM equities this year. In short, how much will earnings fall?

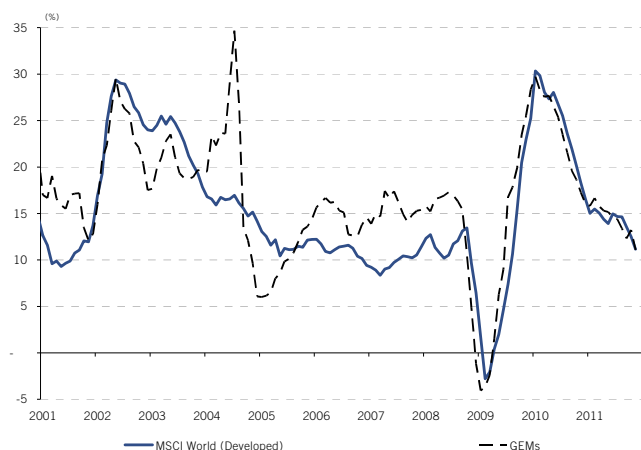
Let us look at the evidence. Trailing earnings for emerging markets peaked in August 2011 and have now fallen by 4-5% from their peak. (This is shown in Figure 25 below.) This remains a very modest decline compared to the 18% drop in EPS in the 2001 recession and the much sharper drop of 42% in the global financial crisis of 2008-9. Most likely, there are several more months of recorded earnings declines still to come, although we doubt very much that earnings will fall anything like they did in the 2008-9 crisis.

What about earnings forecasts? Earnings momentum (defined as 12-month forward consensus estimates) has been falling for both MSCI GEMs and World (DM) since early-2010 and is now down to around 11% for both, from close to 30% nearly two years ago (Figure 22). By EM region, earnings momentum has been most resilient for Asia at 13.5% and weakest for CEEMEA at 6.7%; for Latin America, the 12-

¹¹ *Global Emerging Markets Strategy*, "Update: Sound and Fury...", Geoffrey Dennis, November 29, 2011.

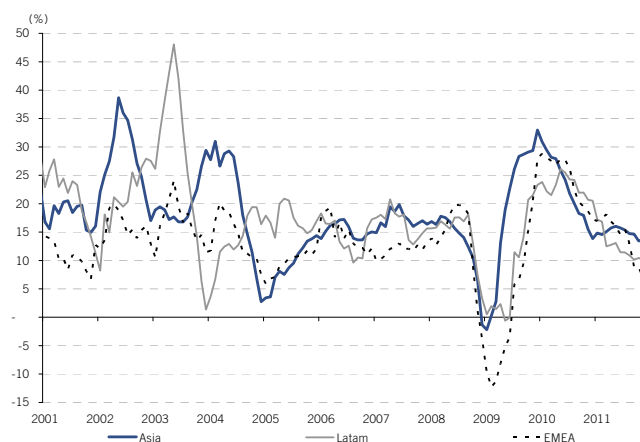
month growth rate is 10.1% (Figure 23). All of these forecasts continue to fall, although even now they are barely weaker than in the mid-cycle phase during the mid-2000s. With earnings momentum, on this measure, having briefly turned negative at its worst point in the 2008-9 recession, there is scope for further downgrades (although we stand by our long-held view that the earnings recession in this cycle will prove far less severe than it was in 2008-9).

Figure 22. GEMs v. DM: Forward Consensus EPS Growth



Source: Datastream and Citi Investment Research and Analysis

Figure 23. GEMs Regions: Forward Consensus EPS Growth



Source: Datastream and Citi Investment Research and Analysis

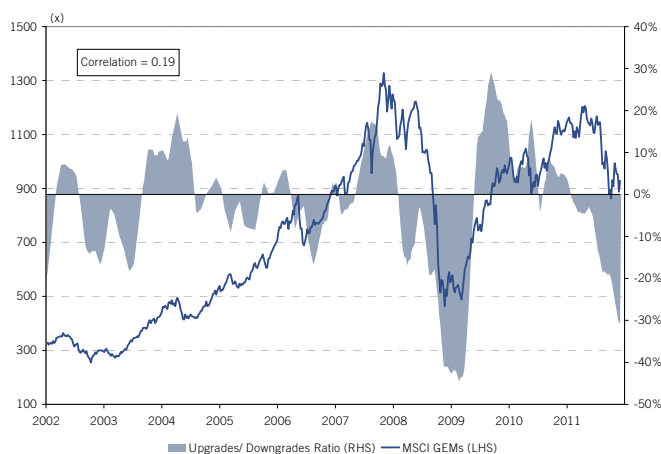
The worst of these downgrades to forward earnings estimates have been in the commodity sectors (Materials from a peak forecast of 33% at the end of 2010 to 11.2% today and Energy from 9.1% to 1.2%) and for Financials (21.3% to 10.5%). By country, therefore, the biggest downgrades have been for Peru (-27.2% from peak to current), Russia (-17.9%), Poland (-17.3%), Mexico (-12.4%) and Brazil (-10.2%). By contrast, forward earnings estimates, remarkably, are at their highs for the year still in several key domestic sectors such as Consumer Staples, Industrials, IT and Utilities. Similarly, countries where there have been no net downgrades as such are Chile, Czech Rep, Egypt, Philippines and Taiwan. **This analysis suggests that the downside risk to earnings may now be greater for domestic sectors, particularly if economic growth is now coming under pressure in emerging markets.** On the other hand, earnings may already have corrected close to what might be expected in the cyclical sectors and the banks; this sort of analysis is one factor behind our increased weight in global cyclicals as we enter 2012.

What about the calendar year estimates? The picture for 2011 consensus forecasts is remarkable. Within a current lower estimate of 13.5% for EPS growth in emerging markets (down from a spring peak of 18.3%), Asian earnings estimates have been crushed (to 6.8% from a peak of 16.8%), while those for EMEA have actually risen over the course of the year to 31.2%, currently.¹² For Latin America, the 2011 forecast numbers have been cut to 14.1% today from a peak of 21.8%. Payback comes, though, in the 2012 forecasts, which are very low for EMEA (+2.9% from a recent peak of 11.6%), while those for Latin America have fallen from 15.6% to 7.9% currently; Asian earnings estimates for 2012 have held up better at 13.5%. Currently, earnings growth for GEMs as a whole is forecast to be 9.6% in 2012.

¹² Much of this upgrade comes from strong recorded numbers this year for Poland and Russia.

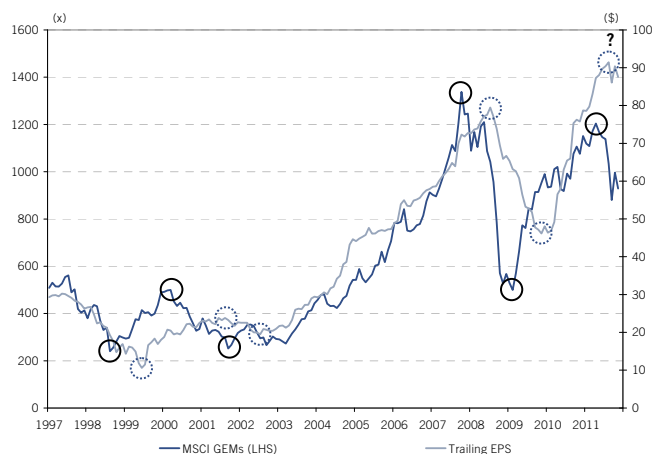
What does this earnings picture mean for the markets? Figure 24 suggests that there is only a fairly loose link between MSCI GEMs and our Upgrades/Downgrades ratio for the emerging markets – a correlation of 0.19 over the past ten years. However, if there is any validity in this link at all, it is noteworthy that there is now some tentative evidence that the long negative trend in this ratio since around the end of 2009 may finally be easing¹³. A turn in the momentum of our Upgrades/Downgrades ratio should be a positive factor for EM equities.

Figure 24. MSCI GEMs and Upgrades/Downgrades Ratio



Source: Datastream and Citi Investment Research and Analysis

Figure 25. MSCI GEMs and Trailing EPS



Source: MSCI, Factset and Citi Investment Research and Analysis

Finally, in Figure 25, we attempt to match the peaks and troughs of MSCI GEMs and trailing earnings. There is a clear pattern on six separate occasions since 1997 of turning points in the markets leading those in earnings; the most recent example is that the market peak in early-May 2011 portended the peak in earnings in August. The average lag between the two series since 1997 has been eleven months

Therefore, if, as we believe, MSCI GEMs hit bottom in early-October (after a 31% fall since May), then the average historical record suggests that the earnings recession may not end until September 2012, which is some way off. This does not have to be a negative for markets. On the contrary, markets price in news ahead of time. MSCI GEMs rose by 75% in 2009, despite earnings falling virtually all year. We expect the same in 2012. The earnings recession which, on the evidence of the downward momentum of earnings estimates discussed above, may continue for several months yet, has been effectively priced into markets at current levels unless the earnings recession proves to be as bad as in 2008-9.

4. Large v. Small

Our final theme for 2012 is that we expect large EM equity markets to outperform small markets. As we noted in our recent report on the subject¹⁴, large markets (-14%) have outperformed small markets (-20%) this year (Figure 26), which is unusual for a down market year. We explain this by: i) a series of unrelated factors

¹³ An easing of this Upgrades/Downgrades ratio does not mean that Upgrades now outnumber Downgrades. It is a sort of second derivative calculation. The number of downgrades may now be finally beginning to decline, relative to the number of upgrades.

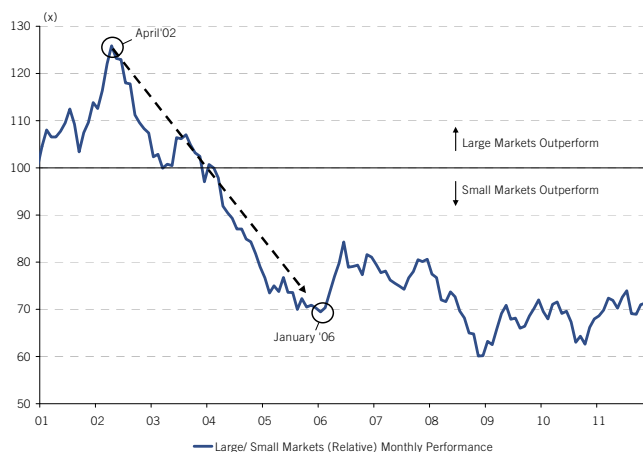
¹⁴ *Global Emerging Markets Strategy*, "The Return of the Bigs", Geoffrey Dennis, November 21, 2011.

Figure 26. MSCI GEMs Performance YTD: Large/Small (Relative)



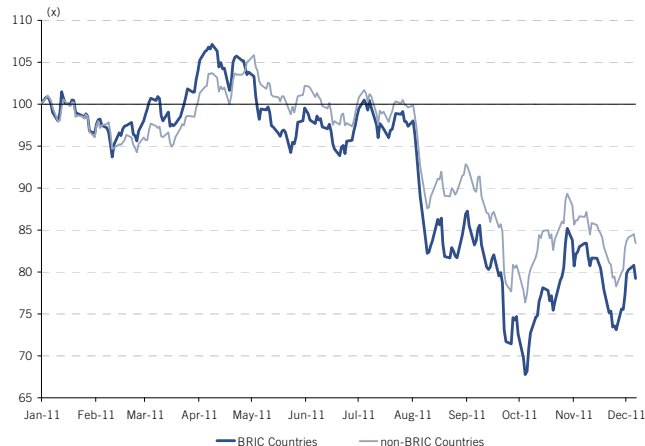
Source: MSCI, Datastream and CIRA

Figure 28. GEMs Performance: Large v. Small (Monthly)



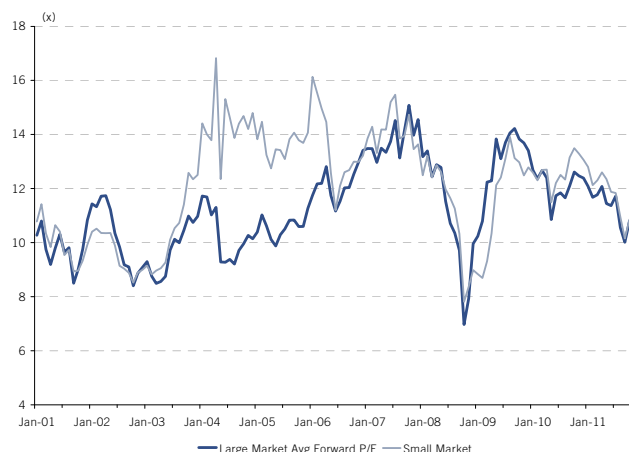
Source: MSCI, Factset and CIRA

Figure 27. MSCI GEMs YTD: BRIC v. non-BRIC



Source: MSCI, Datastream and CIRA

Figure 29. GEMs: Large and Small Markets Forward P/E



Source: MSCI, IBES, Datastream and CIRA

that have pulled certain small markets sharply lower in 2012 (e.g. Egypt and Peru – politics; CE3 – the EU debt crisis; and Turkey – weak fundamentals); and ii) while BRIC markets have followed the usual pattern of doing poorly in down years (an average decline of 21%, with only Russia outperforming, the 'large market' group has been sustained by strong relative performances by a number of non-BRIC large markets (Figure 27), such as Indonesia (even now, the only market in MSCI GEMs to have risen this year), Korea, Malaysia, Mexico and, just about, South Africa. Large non-BRIC markets have, on average, fallen by only 10% so far this year.

Small emerging markets have delivered better returns than large markets over the past ten years as a whole (Figure 28). For 2012, large markets should outperform, as they have done this year, for fairly conventional reasons. We expect 2012 to be a year of solid, if not huge, gains for MSCI GEMs in the range of 25-30%. Large markets have a higher average beta (0.97) than do small markets (0.80), such that, in a normal up-year, large markets should outperform. This forecast holds despite the recent erosion of the valuation discount in favor of large markets, in place for much of the last two years; large markets now trade at a forward P/E multiple of

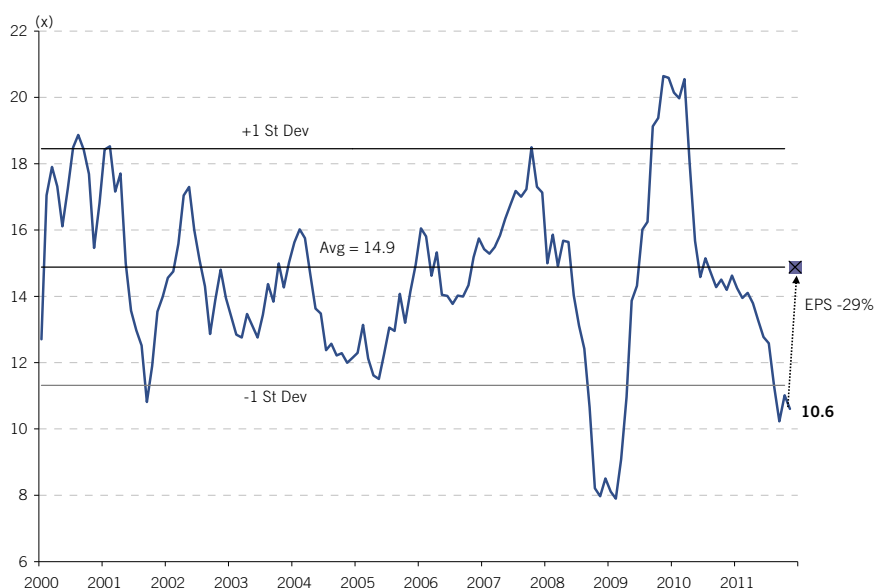
10.6x (simple average) versus 10.4x for small markets (Figure 29). Our **top large market picks, as we enter 2012, are China, Korea and South Africa.**

What's Priced In?

Valuations have edged higher during Q4 as EM equities have bounced and reported earnings have slid by 4% from their August peak. Despite this – and earnings are likely to continue to fall for several months – EM valuations remain cheap and are supportive of higher markets. While it is well understood that valuations tend not to act as catalysts for market moves, the help that valuations provide when underlying fundamentals shift was illustrated in Q4 with the strong rallies of 21.5% in 3½ weeks in October and around 10% in just over a week at the end of November. Our view remains the same. **At current valuations, equity markets are pricing in a lot of bad news on earnings, almost certainly more than is likely to materialize.** In short, valuations support our constructive view of EM equity markets for 2012.

The best way to show this is via the trailing P/E multiple, which currently stands at 10.6x for GEMs, just over one standard deviation and 29% below its historical average back to 2000 (Figure 30); on this basis, MSCI GEMs has only been cheaper (since 2000) at around the market trough at the end of 2008. Currently, EM equities are cheaper than after the 9/11 terrorist attacks (10.8x), at the trough of the markets in 2002 (12.9x) and after the spring sell-off of 2005 (11.5x). Emerging markets have only been cheaper than today in 7 of the past 195 months going back to late-1995 (or 3.5% of the time). Also, earnings could fall from current levels by 29% (a total peak-to-trough decline of 33%, given that they are down by 4% already) and equities would still be at fair value. While this outcome would not be as bad an earnings recession as in 2008-9 (-42%), it is far above the EPS fall of 18% in the 2001 recession. EM equities are, therefore, still pricing in a 'normal' recession, but not a return to 2008-9 which, however, we do not expect.

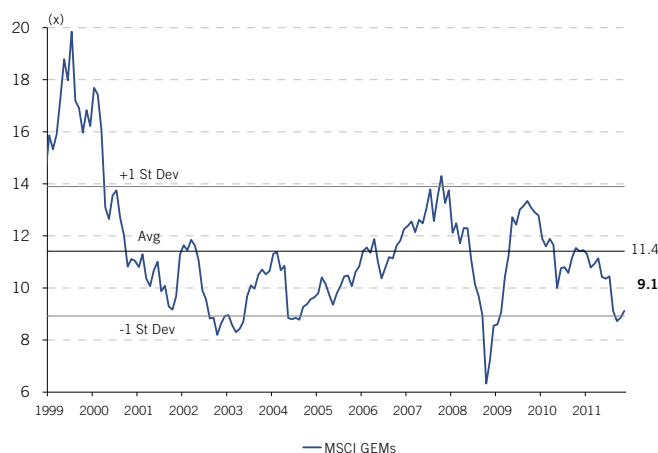
Figure 30. MSCI GEMs Trailing P/E (End- Month)



Source: MSCI, Factset and CIRA

Our standard valuation grid generates similar results. On a forward PE basis, EM equities are trading at 9.1x, or a 20% discount to their long-term average of 11.4x (Figure 31). Forward earnings forecasts could, thus, be downgraded by 20% and still EM equities would not be expensive. Similarly, EM equities trade in terms of forward EV/EBITDA (5.48x) at an 11% discount to their long-term average (6.16x - Figure 32). Looking at a P/BV ratio often creates more stability in valuation metrics as the cyclical nature of earnings is avoided. EM equities currently trade at 1.58x Book, which is one standard deviation and 19% below their long-term average (Figure 33). Finally, the historically wide yield gap between EM equities (9.43%) and EM sovereign bonds (4.32%) has barely budged over the past quarter (Figure 34); on this basis, EM equities remain very attractively valued against debt yields, which are still impressively low.

Figure 31. MSCI GEMs Forward P/E (IBES)



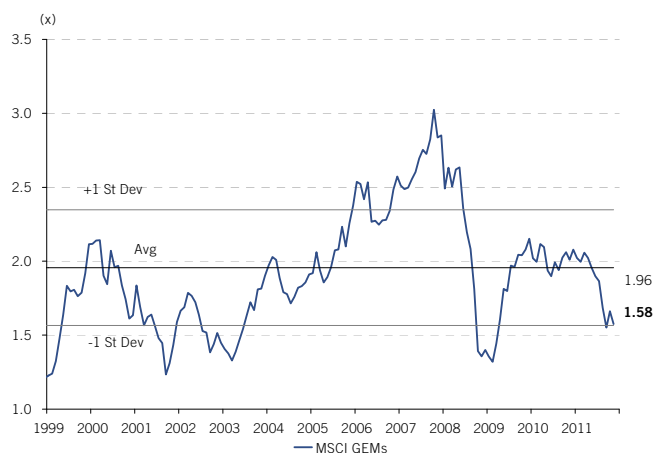
Source: MSCI, JP Morgan, Datastream and CIRA

Figure 32. GEMs Forward EV/EBITDA (CIRA)



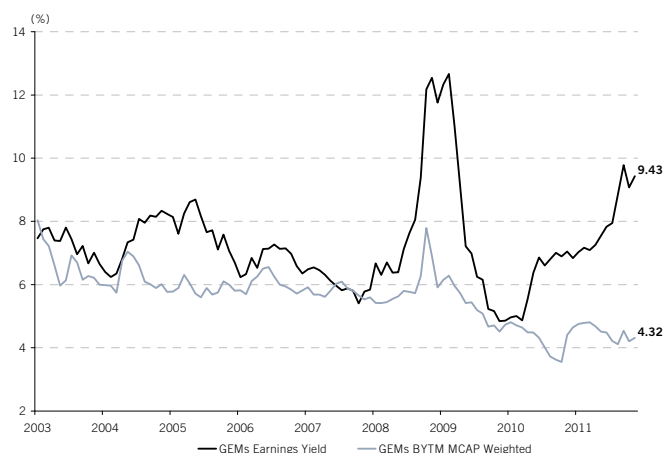
Source: MSCI, JP Morgan, Datastream and CIRA

Figure 33. MSCI GEMs Trailing P/B



Source: MSCI, JP Morgan, Datastream and CIRA

Figure 34. MSCI- Weighted EM Debt Yield v. MSCI GEMs EY (MSCI)



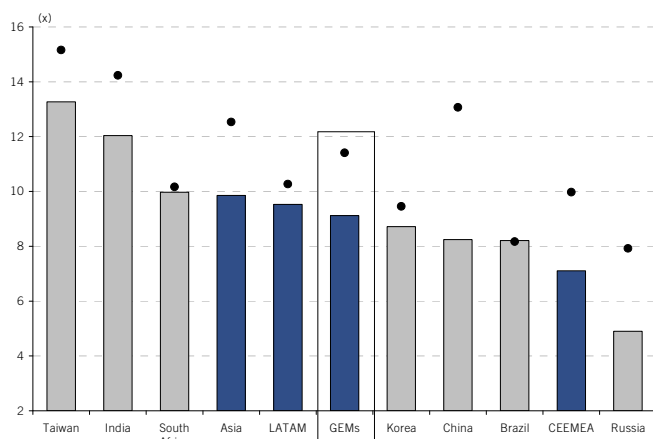
Source: MSCI, JP Morgan, Datastream and CIRA

Finally, Figures 35 and 36 provide our usual snapshot of current forward P/E valuations for EM regions, the 'Big Seven' countries and sectors and compares them to their long-term averages. EMEA is the cheapest region compared to its long-term average (a discount of 29%), followed by Asia (-21%). Latin America

looks far less out of line with history (-7%). By country, Brazil trades in line with its history (at 8.2x), while all other major markets trade at discounts ranging from 2% in South Africa to 37% in China and 38% in Russia, which are the two cheapest markets across the whole EM universe on this basis. (See the appendix for this data for all countries and in P/BV terms.)

The only markets currently trading above their long-term P/E averages are Mexico (+21%), Indonesia (+20%) and Colombia (+10%); we are Underweight in all three. The only sector that is expensive to its history remains Consumer Staples (+21%), where we are also Underweight; on this basis, the cheapest sectors are (tiny) Health Care (-42%) and Financials (-28%)¹⁵. The valuation discounts on other sectors range from 9% for Utilities to 17% for Materials and 19% for Energy.

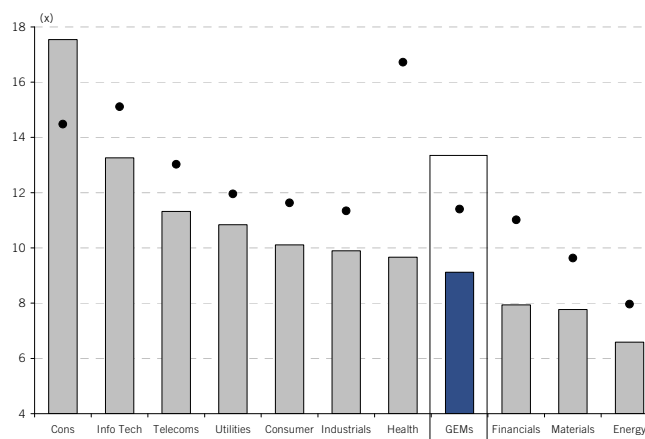
Figure 35. MSCI GEMs Regions and "The Big 7 Markets": Forward P/E



Source: MSC, Factset and CIRA

* Dots indicate historical averages

Figure 36. MSCI GEMs Sectors: Forward P/E



Source: MSC, Factset and CIRA

* Dots indicate historical averages

Strategy/Asset Allocation

- We expect emerging equity markets to have a much better year in 2012. Our target for MSCI GEMs is 1,225, which is a dollar-adjusted gain of 28% from current levels. Volatility is likely to remain high. The seasonals point to an extension of the current end-year rally and strong gains in early-2012, before another sell-off occurs;
- The key issues and themes for 2012 are: i) a new falling inflation and interest rate trend in emerging markets; ii) a broadly neutral impact on markets from the dollar and commodity prices; iii) how deep will the earnings recession be and for how long will earnings momentum continue to fall?; iv) large markets are expected to outperform small markets;
- The major risks to this view are: i) a much more serious turn of events in Europe, with the risk of one of more countries leaving the Euro and/or the Euro breaking up; ii) a Chinese 'hard landing'; iii) a US 'double-dip'; iv) a strong upside breakout in the US dollar;

¹⁵ On the more representative P/BV ratio, Financials currently trade (1.4x) at a 49% discount to their history (2.74x).

- Our Overweights are **China, Korea, Thailand, Peru and South Africa**. Our upgrade of **South Africa** is based on: i) strong earnings growth of 23-26% per annum in 2011-12; ii) a high beta way to play our constructive view on EM equities; iii) valuations are low compared to the market's history at 10x (v 10.2x) and at 2.43x book (v 2.69x), although not necessarily versus EM equities as a whole; iv) the risk of higher interest rates in South Africa in 2012 may be overdone; v) very limited outperformance in 2011.
- We upgrade **Thailand** to Overweight based on the view that the negative impact on the economy and earnings from the recent disastrous flooding should be short-lived. We expect strong investment-driven, post-flooding, growth, supported by the new down trend in interest rates and fiscal expansion; valuations are also well below their historical average on a forward P/E basis. We upgrade **Peru** to Overweight based on strong growth, exposure to our positive view on the Materials sector and historically cheap valuations.
- We upgrade **Russia** to Neutral from Underweight based on the current much stronger than expected path of oil prices; our Russian strategist, Kingsmill Bond argues that the market is the cheapest since 9/11 relative to the level of oil prices¹⁶; the current post-election political unrest represents a near-term risk. We cut **Turkey** to Neutral, as despite attractive valuations (discounts of 13-20% to long-term averages) and low real interest rates, the country's fundamentals continue to weaken and imply a rising risk of capital flight and currency weakness. Our other Neutrals are **Brazil** and **Chile** (cut from Overweight);
- Our major market Underweights are **India, Mexico and Taiwan**. Our other overriding theme is to be Underweight in **CE3** (Central Europe) as a hedge against the EU debt crisis worsening much more than we anticipate;
- On sectors, we are switching back to a net Overweight in global cyclicals in preference to domestic cyclicals. We upgrade **Materials** to Overweight (from Neutral) and **Energy** to Neutral. We also remain Overweight in **Consumer Discretionary** and **Financials**, signaling a high-beta bias to our sector calls. We cut **IT** to Underweight; we are also Neutral in **Industrials** and **Utilities**.
- Our sector themes are: i) the global economy will continue to grow in 2012, albeit in a subdued manner (2.5% forecast); however, we suspect that a worse outcome is priced into markets at current levels; ii) most importantly, the heaviest downgrades to EPS forecasts so far have been to Materials, Energy and Financials, while several domestic sectors have seen no net downgrades at all as yet. This suggests the major earnings risk from here is in the non-financial domestic sectors as economic growth slows slightly across emerging market countries.

¹⁶ See *Russia Strategy*, "Road Ahead: Russia 2012", Kingsmill Bond, December 6, 2011.

Model Portfolio

Our GEMs model portfolio can be found in Figures 46-48.

With this report, we add Sasol (SOLJ.J; ZAR390.80; 1), which offers production growth, strong CF generation and a progressive dividend policy, given our upgrade of South Africa to Overweight (and Energy to Neutral). In Russia, which we upgrade to Neutral, we add Globaltrans (GLTRq.L; US\$13.90; 1), an infrastructure play which should benefit from elevated oil prices, and remove X5 Retail (PJPq.L; US\$22.85; 1). We remove CEZ (CEZPsq.PR; Kc746; 1), as we are now underweight the Czech Republic and add KEPCO (015760.KS; W25,350; 1), which should benefit from fuel cost adjustments and the adoption of IFRS standards, and increases our exposure to Korea. In China, which remains a key Overweight, we add Mengniu Dairy (2319.HK; HK\$26.35; 1), as high-end milk consumption volume remains strong and price trends confirm an expected rise in raw milk supply. In Brazil, we remove AmBev (ABV.N; US\$35.10; Not Rated) as we have dropped coverage, and add retailer Grupo Pao de Acucar (PCAR4.BZ; R\$67.20; 1). Finally in Mexico, we remove Walmex (WALMEXV.MX; P\$36.86; Not Rated), and add Grupo Televisa (TV.N; US\$20.75; 1).

Since our most recent quarterly publication (on October 6, 2011), our GEMs model portfolio is up 13.6%, outperforming MSCI GEMs and the Thomson Reuters index by 325bps and 660bps, respectively. Since inception in May 2010, the portfolio is up 17.2%, outperforming both the MSCI GEMs index (by 1,175bps) and the Thomson Reuters index (by 1,625bps).

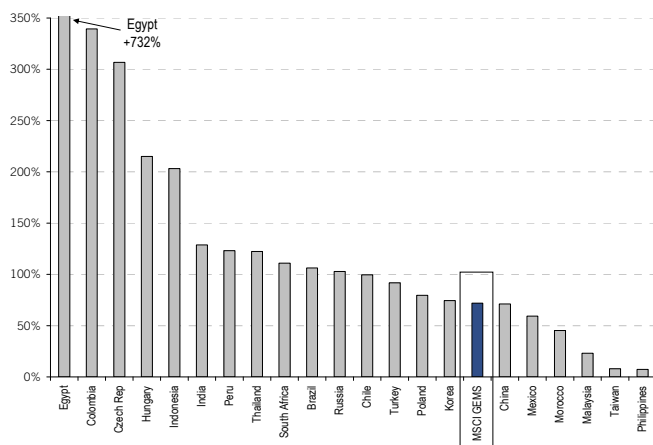
Appendix: Supporting Data

Figure 37. Emerging Markets: Monetary Policy Grid

	Current CB Rate	Total Hikes Since end-2010	2011 Year-End Forecast	Remaining % Change in 2011	End 2012 Forecast	2012 Change	Current		Nominal GDP Growth 2011e
							Inflation	Real Int Real Rate	
China	3.50	-	3.50	-	3.75	+25bps	5.5	-2.0	14.6
India	8.50	+225bps	8.50	-	8.00	-50bps	9.7	-1.2	16.6
Indonesia	6.00	-50bps	5.75	-25bps	5.50	-25bps	4.4	1.6	12.0
Korea	3.25	+75bps	3.25	-	3.25	-	3.9	-0.7	8.0
Malaysia	3.00	+25bps	3.00	-	3.00	-	3.4	-0.4	8.0
Philippines	4.50	+50bps	4.50	-	4.50	-	5.2	-0.7	8.2
Taiwan	1.88	+25bps	1.88	-	1.88	-	1.2	0.7	5.9
Thailand	3.25	+150bps	3.25	-25bps	3.50	+25bp	4.2	-0.7	5.6
Czech Rep	0.75	-	0.75	-	0.75	-	2.3	-1.6	3.7
Hungary	6.50	+25bps	6.50	-	7.25	+100bps	3.9	2.1	5.1
Poland	4.50	+100bps	4.50	-	3.75	-75bps	3.9	0.6	8.2
Russia	8.25	+50bps	8.00	-25bps	7.50	-50bps	7.2	1.1	12.6
S. Africa	5.50	-	5.50	-	6.50	+100bps	6.0	-0.5	8.1
Turkey	5.75	-75bps	5.75	-	5.75	-	7.7	-2.0	14.0
Brazil	11.00	+125bps	11.00	-	9.50	-150bps	6.9	4.6	9.8
Chile	5.25	+200bps	5.00	-25bps	4.25	-75bps	3.7	1.6	9.6
Colombia	4.50	+150bps	5.00	-	5.75	+75bps	4.0	0.5	8.4
Mexico	4.50	-	4.50	-	4.50	-	3.2	1.3	7.1
Peru	4.25	+125bps	4.25	-	3.50	-75bps	4.2	0.0	10.1

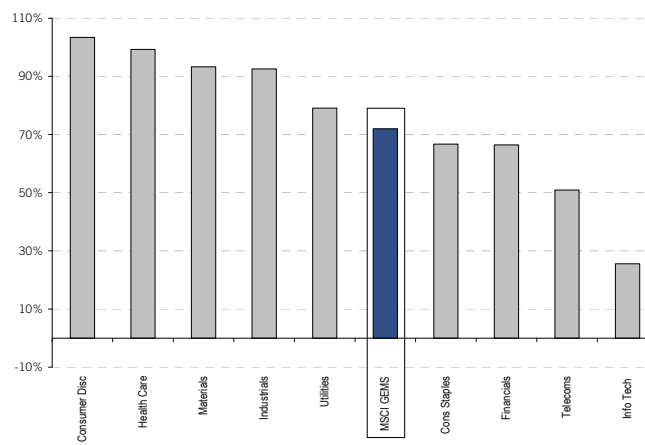
Source: Bloomberg and Citi Investment Research and Analysis

Figure 38. EM Performance During Falling Interest Rates
(Jan 02- Jun 05); Countries



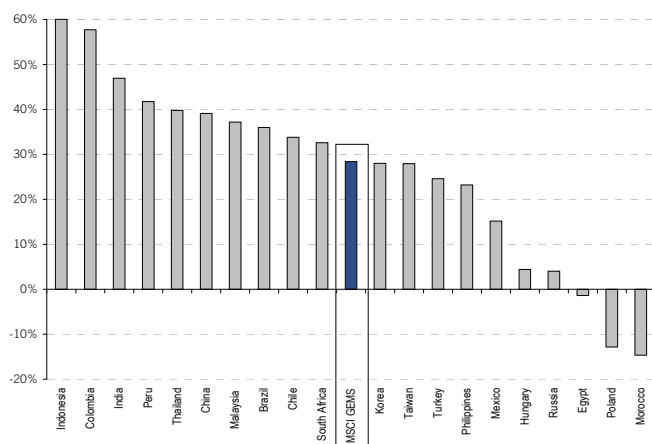
Source: Datastream and CIRA

Figure 39. EM Performance During Falling Interest Rates
(Jan 02- Jun 05); Sectors



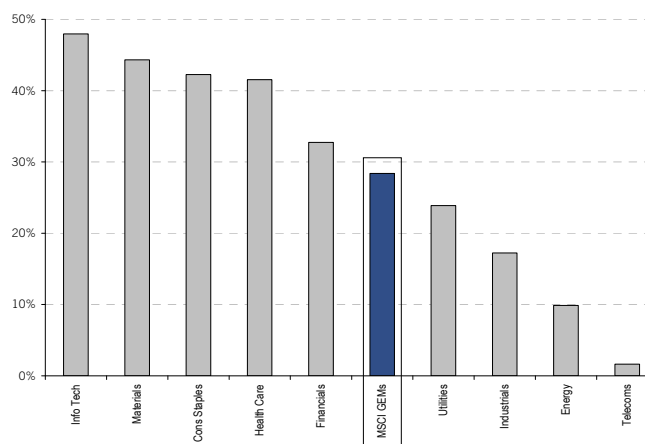
Source: Datastream and CIRA

Figure 40. EM Performance During Falling Interest Rates
(Sep 08 to Mar 10): Countries



Source: Datastream and CIRA

Figure 41. EM Performance During Falling Interest Rates
(Sep 08 to Mar 10): Sectors



Source: Datastream and CIRA

Figure 37. GEMS Forward P/E v. History

	Current	LT Avg	Premium/Discount
GEMS	9.1x	11.4x	-20%
Asia	9.9x	12.5x	-21%
LATAM	9.5x	10.3x	-7%
CEEMEA	7.1x	10.0x	-29%
Brazil	8.2x	8.2x	0%
Chile	13.5x	15.6x	-13%
China	8.2x	13.1x	-37%
Colombia	14.6x	13.3x	10%
Czech Rep	9.6x	13.2x	-27%
Egypt	6.9x	10.1x	-32%
Hungary	7.3x	9.9x	-26%
India	12.0x	14.2x	-15%
Indonesia	12.6x	10.5x	20%
Korea	8.7x	9.5x	-8%
Malaysia	13.5x	14.8x	-9%
Mexico	14.8x	12.2x	21%
Morocco	12.8x	14.5x	-12%
Peru	9.9x	11.4x	-13%
Philippines	13.6x	14.3x	-5%
Poland	8.6x	12.9x	-33%
Russia	4.9x	7.9x	-38%
South Africa	10.0x	10.2x	-2%
Taiwan	13.3x	15.2x	-12%
Thailand	9.6x	13.5x	-29%
Turkey	8.1x	9.4x	-13%
Energy	6.6x	8.0x	-17%
Materials	7.8x	9.6x	-19%
Industrials	9.9x	11.3x	-13%
Cons Disc	10.1x	11.6x	-13%
Cons Staples	17.5x	14.5x	21%
Health Care	9.7x	16.7x	-42%
Financials	7.9x	11.0x	-28%
Info Tech	13.3x	15.1x	-12%
Telecoms	11.3x	13.0x	-13%
Utilities	10.8x	12.0x	-9%

Source: Datastream and CIRA

Figure 38. GEMS Trailing P/B v. History

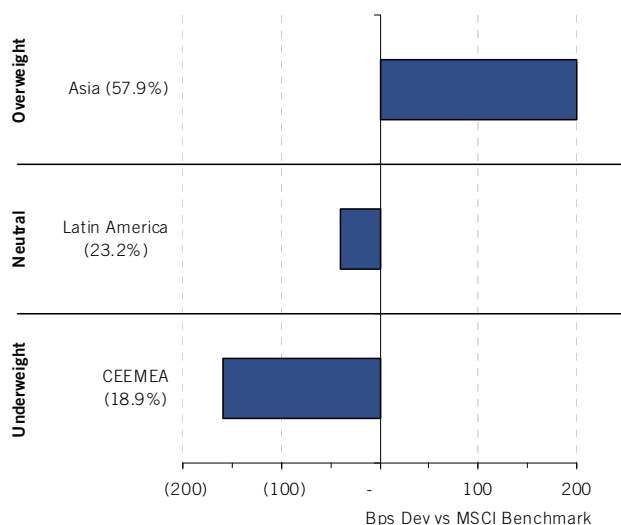
	Current	LT Avg	Premium/Discount
GEMS	1.58x	1.96x	-19%
Asia	1.61x	1.92x	-16%
Latam	1.65x	2.06x	-20%
CEEMEA	1.41x	1.98x	-28%
Brazil	1.41x	1.86x	-25%
Chile	2.29x	1.95x	17%
China	1.54x	2.29x	-32%
Colombia	1.73x	1.68x	3%
Czech Rep	1.78x	1.86x	-5%
Egypt	1.15x	2.98x	-61%
Hungary	1.00x	2.05x	-51%
India	2.43x	3.37x	-28%
Indonesia	3.71x	3.23x	15%
Korea	1.21x	1.46x	-17%
Malaysia	2.15x	1.96x	10%
Mexico	2.65x	2.60x	2%
Morocco	4.40x	3.65x	20%
Peru	3.46x	3.26x	6%
Philippines	2.52x	1.96x	29%
Poland	1.26x	1.82x	-31%
Russia	0.96x	1.53x	-37%
South Africa	2.43x	2.42x	1%
Taiwan	1.64x	1.89x	-13%
Thailand	2.05x	2.04x	1%
Turkey	1.56x	2.00x	-22%
Energy	1.15x	1.81x	-37%
Materials	1.53x	1.93x	-21%
Industrials	1.40x	1.68x	-17%
Cons Disc	2.19x	2.03x	8%
Cons Staples	3.37x	2.96x	14%
Health Care	3.07x	2.86x	7%
Financials	1.40x	2.72x	-49%
IT	1.94x	2.36x	-18%
Telecoms	2.19x	2.53x	-14%
Utilities	1.02x	1.01x	1%

Source: Datastream and CIRA

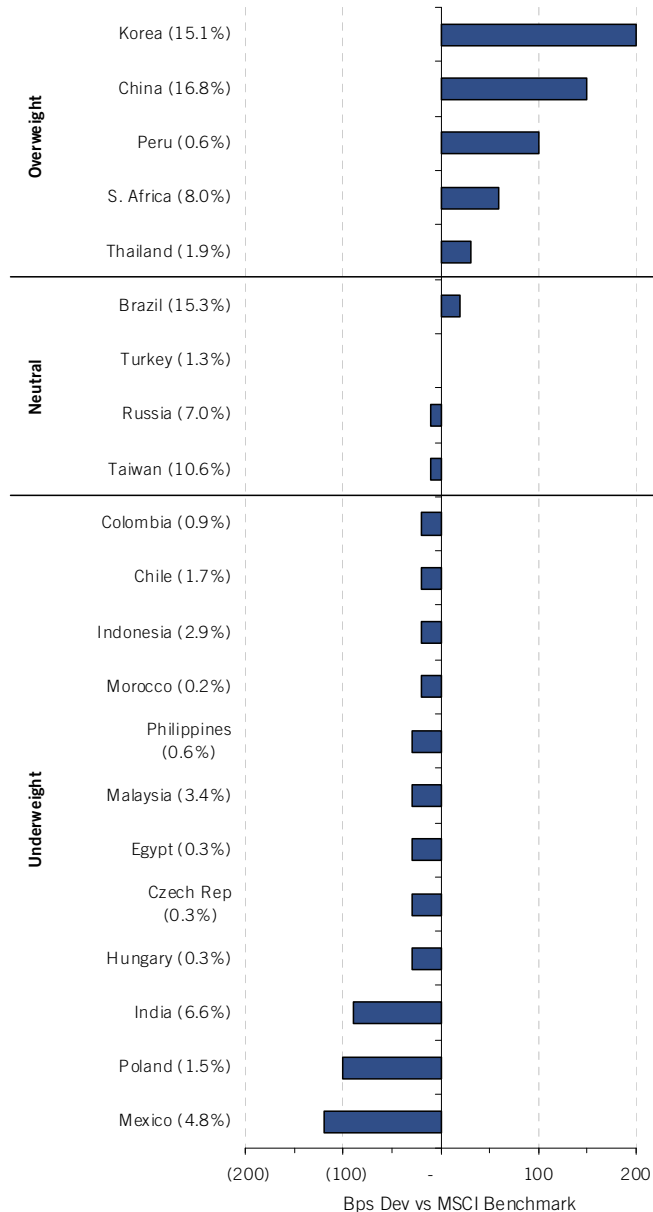
Regional, Country and Sector Allocations

Figure 44. GEMs Regional, Country and Sector Allocation Screen

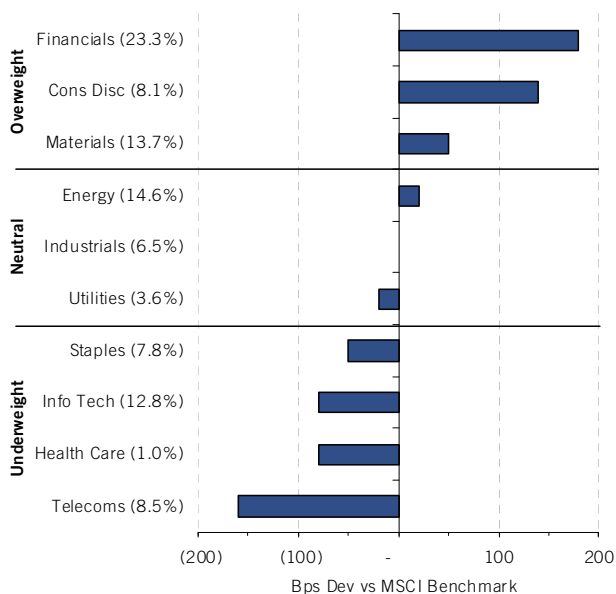
Regional Allocation



Country Allocation



Sector Allocation



Note: Number in parenthesis is benchmark MSCI weight as of close at quarter end.

For methodology, please refer to our Allocation Model in "Beyond the Turbulence", *Global Emerging Markets Strategist*, May 5, 2010.

Source: MSCI and Citi Investment Research and Analysis

Figure 45. GEMs Allocation Model Ranking

	Earnings Growth + Mom				Val + Price Mom			Macro		Other	Total 100%
	Growth 15%	E Mom 10%	RoE 5%	ERI 5%	Valuation 30%	P Mom 5%	Beta 10%	GDP 5%	Rates 10%	Qualitative 5%	
Emerging World											
Regions											
Em Asia	1	3	1	3	2	1	3	1	1	2	2
Lat Am	2	2	3	1	2	2	2	2	1	1	3
CEEMEA	3	1	2	2	1	3	1	3	1	3	1
Countries											
Brazil	17	16	16	12	2	12	6	13	14	11	9
Chile	8	16	4	9	17	8	16	9	11	1	13
China	15	18	7	16	2	6	8	1	8	11	1
Colombia	1	5	8	4	19	10	17	5	20	1	10
Czech Republic	21	12	6	14	5	3	12	21	3	21	12
Egypt	11	14	21	20	6	9	20	14	19	21	20
Hungary	16	11	20	21	7	1	1	20	21	21	19
India	9	20	17	16	13	4	11	2	1	21	17
Indonesia	3	9	13	10	20	14	9	3	15	11	11
Korea	7	13	14	13	12	17	4	10	5	1	8
Malaysia	13	6	10	15	13	20	18	7	10	1	15
Mexico	10	15	19	11	21	19	10	11	15	1	21
Morocco	18	4	2	3	15	7	21	6	17	21	16
Peru	6	10	5	8	10	18	14	4	4	11	2
Philippines	14	8	1	1	18	16	19	8	7	11	14
Poland	20	19	9	18	1	2	2	16	5	21	5
Russia	19	7	12	5	4	15	3	12	8	21	4
South Africa	2	3	18	7	16	13	5	15	17	11	7
Taiwan	4	21	11	19	11	5	13	17	12	21	18
Thailand	5	1	3	6	8	11	15	19	12	21	3
Turkey	12	2	15	2	9	21	7	17	1	21	6
Sectors											
Energy	9	7	10	2	1	6	2	3	2	10	5
Materials	5	9	5	5	3	1	1	9	9	6	3
Industrials	4	8	1	6	6	2	5	4	1	2	4
Consumer Disc.	1	3	2	3	9	5	3	6	3	1	1
Consumer Staples	3	2	7	1	10	9	8	7	3	3	8
Health Care	7	1	8	7	7	4	10	5	3	7	9
Financials	8	6	3	10	1	3	4	1	3	8	2
IT	2	10	9	9	5	10	6	10	8	9	10
Telecoms	10	4	6	4	4	7	9	2	9	5	7
Utilities	6	5	4	8	8	8	7	8	3	4	6

Source: MSCI, FactSet, Datastream, JP Morgan, IBES, Bloomberg and Citi Investment Research and Analysis

Model Portfolio by Country

Figure 46. GEMs Stocks: Model Portfolio

Company	CIRA Position	Over/Under (Bps)	MSCI Weight	Portfolio Weight	Ticker	Sector	Rating	Mkt Cap US\$, mn	Currency	Price 6-Dec-11	Perf YTD	Date Added	Inception Price	USD Perf
Brazil											-19.3%			
1 Vale (Preferred)	Neutral	20	15.3%	5.6%	VALE5.BR	Materials	1	\$118,515	USD	22.55	-20.7%	16-Aug-10	24.80	-9.1%
2 Petroleo Brasileiro - Petrobras				3.2%	PETRA4.BR	Energy	1	\$176,285	USD	23.32	-11.6%	6-Apr-11	28.17	-53.8%
3 Grupo Pao de Acucar				2.9%	PCAR4.BR	Cons Staples	1	\$5,970	BRL	67.20	-2.8%	6-Dec-11	67.20	-44.2%
4 Itau Unibanco				2.8%	ITUB4.BR	Financials	1	\$86,367	BRL	33.95	-12.4%	28-May-10	33.60	2.8%
5 PDG Realty, SA				1.0%	PDGR3.BR	Consumer Disc	1H	\$4,140	BRL	6.68	-33.4%	11-Jan-11	10.17	-35.6%
Chile											-23.0%			
6 Endesa Chile	Underweight	(20)	1.7%	1.5%	EOC.CL	Utilities	1	\$12,371	CLP	45.49	-15.9%	11-Jan-11	52.63	-13.6%
China											-17.9%			
7 CNOOC	Overweight	150	16.8%	5.0%	0883.HK	Energy	1	\$88,629	CNY	15.22	-13.7%	28-May-10	12.34	23.6%
8 China Mobile				4.2%	0941.HK	Telecoms	1	\$196,019	CNY	74.45	2.4%	11-Jan-11	76.90	-3.3%
9 Mengniu Dairy				3.1%	2319.HK	Cons Staples	1	\$5,953	CNY	26.35	28.1%	6-Dec-11	26.35	-0.1%
10 Golden Eagle				2.9%	3308.CN	Consumer Disc	1	\$4,383	CNY	17.66	-7.6%	6-Oct-11	14.68	20.2%
11 China Construction Bank				2.0%	0939.CN	Financials	1	\$183,687	CNY	5.65	-14.4%	6-Apr-11	7.52	-24.9%
12 Agricultural Bank of China				1.1%	1288.CN	Financials	1	\$132,658	CNY	3.41	-8.1%	9-Jul-11	4.03	-15.5%
Colombia											-10.0%			
Czech Republic											-10.3%			
Egypt											-43.1%			
Hungary											-28.2%			
India											-30.2%			
13 State Bank of India	Underweight	(20)	2.9%	2.7%	SBI.IN	Financials	1	\$24,001	INR	1.909	-30.0%	28-May-10	2.235	-22.8%
14 Tata Motors				1.5%	TAMOJN	Consumer Disc	1	\$10,994	INR	191.60	-25.3%	6-Oct-11	147.40	18.4%
15 Wipro				1.5%	WIPR.IN	Info Tech	1	\$19,362	INR	390.80	-16.4%	28-May-10	398.37	-11.3%
Indonesia											3.1%			
16 PT Telkom	Underweight	(20)	2.7%	2.7%	TLKM.ID	Telecoms	1	\$16,289	IDR	7.350	-4.5%	28-May-10	7.600	-0.9%
Korea											-7.5%			
17 Samsung Electronics	Overweight	200	15.1%	4.2%	005930.KR	Info Tech	1	\$137,775	KRW	1,044,000	11.3%	11-Jan-11	913,000	21.3%
18 KB Financial Group				3.6%	105560.KR	Financials	1	\$13,089	KRW	38,450	-36.3%	28-May-10	49,000	-21.4%
19 Samsung Engineering				2.9%	028050.KR	Industrials	1	\$8,361	KRW	235,500	22.9%	6-Oct-11	203,500	22.8%
20 Samsung Fire & Marine				2.5%	000810.KR	Financials	1	\$9,441	KRW	223,000	1.7%	6-Oct-11	209,000	13.2%
21 KEPCO				1.9%	015760.KR	Utilities	1	\$14,926	0	25,350	-13.1%	6-Dec-11	25,350	6.1%
22 Hyundai Heavy Industries				1.8%	009540.KR	Industrials	1H	\$19,858	KRW	294,000	-33.4%	11-Jan-11	472,500	-34.0%
Malaysia											-4.7%			
23 Maybank	Underweight	(30)	3.4%	3.1%	MBBM.MY	Financials	1	\$19,792	MYR	8.20	4.7%	29-Aug-11	8.72	-4.1%
Mexico											-10.4%			
24 Grupo Televisa	Underweight	(120)	4.8%	3.6%	TV.MX	Consumer Disc	1	\$9,889	MXN	20.75	-19.9%	6-Dec-11	20.75	0.0%
Morocco											-16.6%			
Peru											-24.1%			
25 Credicorp	Underweight	100	0.6%	1.6%	BAP.PE	Financials	1	\$8,399	USD	106.01	-9.4%	9-Jul-11	86.69	22.3%
Philippines											-4.4%			
Poland											-27.9%			
26 Bank Pekao SA	Underweight	(100)	1.5%	0.5%	BAPE.PL	Financials	1	\$11,559	PLN	146.10	-14.1%	6-Oct-11	138.10	2.1%
Russia											-15.6%			
27 Novatek OAO	Neutral	(10)	7.0%	4.0%	NVTK.RU	Energy	1	\$41,342	USD	136.10	15.5%	6-Oct-11	112.20	21.3%
28 Sberbank RF				1.9%	SBER.RU	Financials	1	\$60,781	USD	2.77	-19.5%	28-May-10	2.32	19.4%
29 Globaltrans				1.0%	GLTRQ.CY	Industrials	1	\$2,197	USD	13.90	-16.1%	6-Dec-11	13.90	-100.0%
South Africa											-15.7%			
30 Impala Platinum	Overweight	60	8.0%	4.4%	IMPJ.ZA	Materials	1	\$13,691	ZAR	171.50	-22.9%	6-Apr-11	201.71	-19.5%
31 Sasol Ltd				2.0%	SOLJ.ZA	Energy	1	\$30,950	ZAR	390.80	15.2%	6-Dec-11	390.80	-5.4%
32 Pick'n Pay Stores				1.3%	PIKJ.ZA	Cons Staples	1	\$2,721	ZAR	45.50	-3.4%	9-Jul-11	41.88	2.8%
33 Standard Bank Group				0.9%	SBKJ.ZA	Financials	1	\$19,868	ZAR	99.75	-3.0%	28-May-10	106.95	-11.4%
Taiwan											-24.7%			
34 TSMC	Neutral	(10)	10.6%	5.0%	2330.TW	Info Tech	1	\$65,517	TWD	75.40	11.8%	6-Oct-11	69.00	15.9%
35 Nan Ya Plastics				4.2%	1303.TW	Materials	2	\$15,330	TWD	56.00	-12.4%	6-Apr-11	88.00	-32.5%
36 Hon Hai Precision				1.3%	2317.TW	Info Tech	1	\$28,757	TWD	80.00	-23.0%	3-Dec-10	102.27	-17.0%
Thailand											-3.0%			
37 Kasikornbank	Overweight	30	1.9%	2.2%	KBAN.TH	Financials	1	\$9,662	THB	122.50	-2.7%	11-Jan-11	126.50	1.6%
Turkey											-30.8%			
38 TAV Havalimanlari Holding AS	Neutral	-	1.3%	0.8%	TAVHL.TR	Industrials	1	\$1,577	TRY	7.94	6.4%	6-Oct-11	7.34	-8.4%
39 Tofas				0.5%	TOASO.TR	Consumer Disc	1	\$1,750	TRY	6.42	-13.1%	9-Jul-11	7.36	-26.1%
CIRA portfolio of stocks												Since 27-May-2010:		17.2%
MSCI Asia											-16.4%			
Latin America											-17.8%			
EMEA											-18.9%			
MSCI GEMs											-17.2%	Since 27-May-2010:		5.5%
Thomson Reuters TR EM											-11.2%	Since 27-May-2010:		0.9%

A full history of changes to our model portfolio is available upon request. No transaction costs are assumed.
For methodology, please refer to "Global Emerging Markets Strategist: *GEMs Model Portfolio Update*," July 13, 2010.
Past performance is no indication of future performance. Source: MSCI, Thomson Reuters and CIRA

Figure 47. GEMs Stocks: Model Portfolio

	Company	CIRA Position	Over/ Under (Bps)	MSCI Weight	Portfolio Weight	Ticker	Country	Rating	Mkt Cap US\$, mn
1	Energy	Neutral	20	14.6%	14.8%				
	CNOOC				5.0%	0883.HK	China	1	88,629
2	Novatek OAO				4.0%	NVTK.RU	Russia	1	41,342
3	Petroleo Brasileiro - Petrobras				3.2%	PETR4.BR	Brazil	1	176,285
4	Sasol Ltd				2.0%	SOLJ.ZA	South Africa	1	30,950
5	Materials	Overweight	50	13.7%	14.2%				
	Vale (Preferred)				5.6%	VALE5.BR	Brazil	1	118,515
6	Impala Platinum				4.4%	IMPJ.ZA	South Africa	1	13,691
7	Nan Ya Plastics				4.2%	1303.TW	Taiwan	2	15,330
8	Industrials	Neutral	0	6.5%	6.5%				
	Samsung Engineering				2.9%	028050.KR	Korea	1	8,361
9	Hyundai Heavy Industries				1.8%	009540.KR	Korea	1H	19,858
10	Globaltrans				1.0%	GLTRQ.CY	Russia	1	2,197
11	TAV Havalimanlari Holding AS				0.8%	TAVHL.TR	Turkey	1	1,577
12	Consumer Disc.	Overweight	140	8.1%	9.5%				
	Grupo Televisa				3.6%	TV.MX	Mexico	1	9,889
13	Golden Eagle				2.9%	3308.CN	China	1	4,383
14	Tata Motors				1.5%	TAMO.IN	India	1	10,994
15	PDG Realty, SA				1.0%	PDGR3.BR	Brazil	1H	4,140
16	Tofas				0.5%	TOASO.TR	Turkey	1	1,750
17	Consumer Staples	Underweight	-50	7.8%	7.3%				
	Mengniu Dairy				3.1%	2319.HK	China	1	5,953
18	Grupo Pao de Acucar				2.9%	PCAR4.BR	Brazil	1	5,970
19	Pick'n Pay Stores				1.3%	PIKJ.ZA	South Africa	1	2,721
20	Health Care	Underweight	-80	1.0%	0.2%				
21	Financials	Overweight	180	23.3%	25.1%				
	KB Financial Group				3.8%	105560.KR	Korea	1	13,089
21	Maybank				3.1%	MBBM.MY	Malaysia	1	19,792
22	State Bank of India				2.7%	SBI.IN	India	1	24,001
23	Itau Unibanco				2.8%	ITUB4.BR	Brazil	1	86,367
24	Samsung Fire & Marine				2.5%	000810.KR	Korea	1	9,441
25	Kasikornbank				2.2%	KBAN.TH	Thailand	1	9,662
26	Sberbank RF				1.9%	SBER.RU	Russia	1	60,781
27	China Construction Bank				2.0%	0939.CN	China	1	183,687
28	Credicorp				1.6%	BAP.PE	Peru	1	8,399
29	Agricultural Bank of China				1.1%	1288.CN	China	1	132,658
30	Bank Pekao SA				0.5%	BAPE.PL	Poland	1	11,559
31	Standard Bank Group				0.9%	SBKJ.ZA	South Africa	1	19,868
32	Info Tech	Underweight	-80	12.8%	12.0%				
	TSMC				5.0%	2330.TW	Taiwan	1	65,517
33	Samsung Electronics				4.2%	005930.KR	Korea	1	137,775
34	Wipro				1.5%	WIPR.IN	India	1	19,362
35	Hon Hai Precision				1.3%	2317.TW	Taiwan	1	28,757
36	Telecoms	Underweight	-160	8.5%	6.9%				
	China Mobile				4.2%	0941.HK	China	1	196,019
37	PT Telkom				2.7%	TLKM.ID	Indonesia	1	16,289
38	Utilities	Neutral	-20	3.6%	3.4%				
	KEPCO				1.9%	015760.KR	Korea	1	14,926
39	Endesa Chile				1.5%	EOC.CL	Chile	1	12,371

A full history of changes to our model portfolio is available upon request. No transaction costs are assumed.
For methodology, please refer to "Global Emerging Markets Strategist: GEMs Model Portfolio Update," July 13, 2010.
Past performance is no indication of future performance. Source: MSCI, Thomson Reuters and CIRA

Figure 48. GEMs Stocks: Model Portfolio

Company	Ticker	Sector	Rating	Mkt Cap US\$, mn	EPS gr 12E	P/E (x) 12E	Analyst	Analyst Comments
Brazil								
Vale (Preferred)	VALE5.BR	Materials	1	\$117,521	-16%	6.3	Alexander Hacking, CFA	— well positioned to capture 1H12 rally in global mining equities
Petroleo Brasileiro - Petrobras	PETR4.BR	Energy	1	\$179,182	-8%	8.6	Pedro Medeiros	— better than expected Q3, discounted to international peers
Grupo Pao de Acucar	PCAR4.BR	Cons Staples	1	\$6,075	NM	9.2	Carlos Albano	— expect better operational results over coming quarters
Itau Unibanco	ITUB4.BR	Financials	1	\$87,005	18%	8.8	Daniel A. Abut	— solid loan growth; NPL ratios likely stabilized
PDG Realty, SA	PDGR3.BR	Consumer Disc	1H	\$4,102	15%	5.6	Dan McGoe, CFA	— cash positive in 2012; superior management execution
Chile								
Endesa Chile	EOC.CL	Utilities	1	\$12,486	20%	10.8	Marcelo Britto, Andrew J McC	— geographical diversification, strong track record
China								
CNOOC	0883.HK	Energy	1	\$88,629	-26%	10.5	Graham Cunningham	— positive LT growth prospects, increase in gross production
China Mobile	0941.HK	Telecoms	1	\$196,019	6%	9.5	Bin Liu	— defensive play, upside potential in EPS growth & cash return
Mengniu Dairy	2319.HK	Cons Staples	1	\$5,953	27%	19.0	Jasmine Bai	— high earnings growth potential; margins expanding
Golden Eagle	3308.CN	Consumer Disc	1	\$4,383	30%	17.4	Eddie Lau	— strong store execution; long term sector consolidation
China Construction Bank	0939.CN	Financials	1	\$183,687	12%	6.3	Simon Ho, CFA	— strong government support, attractive valuations, strong BS
Agricultural Bank of China	1288.CN	Financials	1	\$132,658	19%	6.1	Simon Ho, CFA	— strong deposit base, potential benefit from decline in credit costs
Colombia								
Czech Republic								
Egypt								
Hungary								
India								
State Bank of India	SBI.IN	Financials	1	\$24,001	34%	11.1	Manish Chowdhary, CFA	— strong deposit franchise; diversified asset book
Tata Motors	TAMO.IN	Consumer Disc	1	\$10,994	-8%	7.3	Jamshed Dadabhoi	— strong product positioning, exposure to India LT capex story
Wipro	WIPR.IN	Info Tech	1	\$19,362	5%	17.8	Surendra Goyal, CFA	— growing demand for offshore IT services, strong margins
Indonesia								
PT Telkom	TLKM.ID	Telecoms	1	\$16,289	13%	10.8	Arthur Pineda	— earnings growth recovery, constructive industry dynamic
Korea								
Samsung Electronics	005930.KR	Info Tech	1	\$137,775	39%	8.2	Henry H Kim, CFA	— market-dominating competitiveness, product leadership
KB Financial Group	105560.KR	Financials	1	\$13,089	-7%	6.2	Jinsang Kim	— stable credit costs; enhanced capital base post treasury disposal
Samsung Engineering	028050.KR	Industrials	1	\$8,361	30%	14.7	Sungmee Park, CFA	— strong revenue growth; rapidly declining SG&A burden
Samsung Fire & Marine	000810.KR	Financials	1	\$9,441	34%	11.8	Jinsang Kim	— healthy underwriting margin; resilient earnings
KEPCO	015760.KR	Utilities	1	\$14,926	NM	15.4	Pierre Lau	— attractive valuation; +ve news flow from fuel cost adjustment
Hyundai Heavy Industries	009540.KR	Industrials	1H	\$19,858	-9%	6.6	Ethan Kim	— operating efficiency, shipbuilding up-cycle, outlook
Malaysia								
Maybank	MBBM.MY	Financials	1	\$19,792	1%	12.8	Fiona Leong	— improving domestic banking operation, Kim Eng acquisition
Mexico								
Grupo Televisa	TV.MX	Consumer Disc	1	\$10,076	-4%	19.3	James Rivett	— dominant positioning in industry with significant barriers to entry
Morocco								
Peru								
Credicorp	BAP.PE	Financials	1	\$8,480	20%	10.4	Daniel A. Abut	— stable asset quality; solid fee income generation
Philippines								
Poland								
Bank Pekao SA	BAPE.PL	Financials	1	\$11,638	-15%	16.6	Andrzej Powierza, Simon Nellis	— high Tier 1, low loan-to-deposit ratio, limited CHF funding
Russia								
Novatek OAO	NVTK.RU	Energy	1	\$40,099	9%	19.2	Ronald Paul Smith	— high gas production, tolling contribution, constrained costs
Sberbank RF	SBER.RU	Financials	1	\$60,781	-15%	6.6	Simon Nellis	— dominant position in banking market, high net profit
Globaltrans	GLTRQ.CY	Industrials	1	\$2,127	24%	7.2	Kirill Kazanli	— consistent organic growth; M&A and participation in locomotives
South Africa								
Impala Platinum	IMPJ.ZA	Materials	1	\$13,691	23%	12.8	Johann Steyn, Johann Pretori	— best in class, superior economic value creation
Sasol Ltd	SOLJ.ZA	Energy	1	\$30,950	37%	8.4	Tassin Meyer	— expansion opportunities in synthetic fuel production
Pick'n Pay Stores	PIKJ.ZA	Cons Staples	1	\$2,752	-10%	31.5	Zaheer Joosub, Brady Martin	— gaining back market share, margin benefit from central distribution
Standard Bank Group	SBKJ.ZA	Financials	1	\$19,868	19%	9.7	Henry Hall, Simon Nellis	— smoother earnings profile, well diversified
Taiwan								
TSMC	2330.TW	Info Tech	1	\$65,517	1%	14.6	Roland Shu	— benefits from rapid 28nm production ramp; stable pricing
Nan Ya Plastics	1303.TW	Materials	2	\$15,330	45%	9.4	Oscar Yee	— upward earnings revisions, attractive valuations
Hon Hai Precision	2317.TW	Info Tech	1	\$28,757	49%	7.7	Kevin Chang	— reduced impact from wage hikes, iPad assembly rate
Thailand								
Kasikornbank	KBAN.TH	Financials	1	\$9,662	18%	9.8	Kritapas Siripassorn, CFA	— stabilizing NIM, robust earnings growth
Turkey								
TAV Havalimanlari Holding AS	TAVHL.TR	Industrials	1	\$1,565	30%	12.7	Mehmet Colakoglu, CFA	— strong passenger traffic, mostly TL cost base
Tofas	TOASO.TR	Consumer Disc	1	\$1,777	7%	6.7	Osman Memisoglu, Heidy Reh	— increasing market share, attractive valuation

Source: MSCI and CIRA

Performance

Figure 49. Performance Update

06-Dec-11	Market Data				Performance (Local Currency, %)					Performance (USD, %)				
	Ticker	Index	52w High	52w Low	1Wk	1Mo	3Mo	YTD	1Yr	1Wk	1Mo	3Mo	YTD	1Yr
Global Indices														
MSCI AC World	MXWD	303	358	272	4.4	(0.3)	5.6	(7.8)	(6.1)	4.8	(1.2)	3.4	(8.2)	(5.7)
S&P 500 Index	SPX	1,258	1,371	1,075	5.3	0.4	8.0	0.1	2.9	5.3	0.4	8.0	0.1	2.9
DJ Euro Stoxx 50	SX5E	2,357	3,077	1,936	5.5	2.8	13.3	(15.6)	(14.9)	5.9	0.0	8.0	(15.8)	(14.3)
Japan Nikkei 225	NKY	8,575	10,892	8,136	1.1	(2.6)	(0.2)	(16.2)	(15.7)	1.2	(2.0)	(1.0)	(12.6)	(10.4)
MSCI GEMs	MXEF	953	1,206	831	3.3	(2.1)	2.0	(12.8)	(11.9)	4.8	(3.7)	(3.5)	(17.2)	(15.4)
MSCI EM Asia	MXMS	391	494	344	2.8	(3.6)	0.5	(14.3)	(13.0)	3.6	(4.8)	(3.3)	(16.4)	(14.5)
MSCI Latin America	MXLA	3,791	4,730	3,203	5.8	0.7	5.5	(11.3)	(10.9)	8.7	(1.2)	(2.5)	(17.8)	(16.4)
MSCI EM EMEA	MXEE	318	428	277	2.2	(0.7)	2.8	(8.9)	(8.5)	4.0	(3.1)	(5.5)	(18.9)	(16.5)
MSCI Indices - Asia														
China	MSEUSCF	54	71	44	3.8	(4.3)	(3.9)	(17.9)	(19.4)	4.0	(4.4)	(3.6)	(17.9)	(19.5)
Korea	MSEUSCO	379	476	308	2.7	(1.4)	11.0	(7.8)	(3.0)	4.0	(3.2)	5.5	(7.5)	(2.9)
Taiwan	MSEUSTW	235	323	227	(0.1)	(7.6)	(4.1)	(22.0)	(19.7)	0.5	(8.1)	(7.6)	(24.7)	(19.9)
India	MSEUSIA	391	561	360	4.6	(5.4)	(0.9)	(19.7)	(17.7)	5.9	(9.6)	(11.2)	(30.2)	(28.0)
Malaysia	MSDUMAF	432	492	380	2.4	0.0	1.9	(3.1)	(2.0)	3.8	(0.7)	(3.2)	(4.7)	(1.7)
Indonesia	MSEUSINF	859	1,015	733	2.2	(1.5)	(2.2)	3.4	1.0	3.5	(2.5)	(7.3)	3.1	0.7
Thailand	MSEUSTHF	330	385	266	5.2	5.1	(0.8)	(0.7)	(1.7)	6.6	4.5	(3.8)	(3.0)	(4.2)
MSCI Indices - Latin America														
Brazil	MXBR	3,034	3,923	2,515	7.5	2.0	6.5	(12.8)	(12.4)	10.6	(0.4)	(1.6)	(19.3)	(17.8)
Mexico	MXMX	5,798	6,645	4,948	3.5	0.2	7.7	(2.0)	(0.0)	7.0	0.1	(0.2)	(10.4)	(8.2)
Chile	MXCL	2,241	2,942	1,904	0.8	(4.4)	(0.2)	(15.7)	(16.5)	3.0	(7.6)	(9.6)	(23.0)	(22.0)
Colombia	MXCO	1,002	1,218	956	0.9	(3.8)	(3.5)	(9.2)	(10.7)	2.8	(4.7)	(10.7)	(10.0)	(12.8)
Peru	MXPE	1,380	1,861	1,204	1.0	(6.1)	(6.9)	(24.1)	(25.9)	1.1	(6.1)	(6.9)	(24.1)	(25.9)
MSCI Indices - CEEMEA														
South Africa	MSEUSSA	515	626	452	3.3	2.4	9.0	2.7	4.2	7.1	0.1	(3.5)	(15.7)	(11.0)
Russia	MXRU	786	1,129	634	0.2	(2.6)	(0.8)	(13.6)	(13.3)	0.0	(4.1)	(5.5)	(15.6)	(13.7)
Israel	MXIL	200	288	185	3.7	(2.1)	1.7	(24.9)	(22.0)	4.8	(4.4)	(0.4)	(29.1)	(24.6)
Turkey	MSEUSTK	432	682	393	5.4	(2.3)	(0.2)	(17.4)	(20.9)	6.2	(6.1)	(4.1)	(30.8)	(36.1)
Hungary	MSEUSHG	476	901	421	2.6	3.5	(4.7)	(22.2)	(22.9)	6.0	1.9	(16.2)	(28.2)	(27.7)
Egypt	MSIUEG	489	868	452	0.6	(9.3)	(13.2)	(41.3)	(37.4)	0.5	(9.9)	(13.8)	(43.1)	(39.6)
Czech Republic	MSEUSCZ	452	654	418	5.8	(1.5)	(0.2)	(9.5)	(8.8)	7.4	(5.3)	(7.8)	(10.3)	(8.7)
Morocco	MSIUMOR	385	504	385	(0.3)	(4.3)	(10.4)	(16.5)	(16.3)	0.1	(6.5)	(13.7)	(16.6)	(15.7)
Local Indices - Latin America														
Brazil Bovespa	IBOV	59,536	71,924	47,793	7.7	1.5	5.2	(14.1)	(14.4)	10.7	(0.9)	(2.8)	(20.6)	(19.6)
Mexico IPC/Bolsa	MEXBOL	37,071	38,877	31,562	3.8	1.0	7.6	(3.8)	(1.8)	7.3	0.9	(0.3)	(12.1)	(9.8)
Chile IPSA	IGPA	4,092	5,041	3,606	0.8	(4.1)	(0.5)	(17.0)	(17.5)	3.1	(7.3)	(9.9)	(24.2)	(23.0)
Argentina Merval	MERVAL	2,616	3,701	2,212	6.7	(5.3)	(7.1)	(25.8)	(24.3)	6.5	(5.9)	(8.7)	(31.1)	(29.7)
Peru BVL General	IGBVL	20,090	23,802	17,150	4.4	3.7	0.8	(14.1)	(7.5)	4.8	4.2	2.1	(10.6)	(3.2)
Colombia IBB Gen	IGBC	12,665	15,805	12,151	1.1	(2.7)	(5.7)	(18.3)	(18.1)	3.0	(3.6)	(12.7)	(18.9)	(20.1)
Sectors - Latin America														
Cons Discretionary	MXLAOCD	488	606	401	6.3	2.3	0.1	(11.3)	(10.5)	9.5	0.8	(7.5)	(18.3)	(16.5)
Consumer Staples	MXLAOCS	540	568	455	4.1	5.7	12.4	10.2	11.9	7.2	4.1	3.8	1.2	4.0
Energy	MXLAOEN	821	1,136	630	8.1	4.6	13.0	(16.1)	(11.9)	11.1	2.3	4.4	(22.1)	(17.0)
Financials	MXLAOFN	769	969	648	8.8	1.0	6.4	(14.0)	(14.2)	11.7	(1.1)	(1.4)	(19.9)	(19.1)
Industrials	MXLAOIN	227	296	198	4.0	(1.3)	0.5	(11.2)	(13.2)	6.9	(3.5)	(7.5)	(18.3)	(18.8)
Materials	MXLAOMT	811	1,178	701	5.2	(3.5)	(1.8)	(22.3)	(22.7)	8.0	(5.3)	(8.8)	(27.8)	(27.3)
Telecom Services	MXLAOTC	357	438	322	1.8	(4.1)	4.0	(4.1)	(4.3)	5.1	(4.9)	(3.9)	(12.0)	(11.5)
Utilities	MXLAOUT	283	343	243	3.4	1.1	5.3	(2.2)	(5.0)	6.1	(1.5)	(3.3)	(9.6)	(10.8)
Sectors - EMEA														
Consumer Discretionary	MXEE OCD	572	738	517	0.9	(5.1)	2.3	(2.3)	(2.5)	4.4	(7.4)	(9.0)	(19.5)	(16.7)
Consumer Staples	MXEE OCS	537	598	451	3.3	5.3	10.9	5.5	6.7	5.8	2.9	2.1	(9.5)	(7.1)
Energy	MXEE OEN	699	971	564	1.5	(1.3)	7.5	(2.3)	(2.3)	2.0	(3.2)	0.7	(7.7)	(5.5)
Financials	MXEE OFN	246	347	222	4.8	0.5	1.3	(16.3)	(16.7)	6.8	(2.3)	(7.1)	(26.6)	(25.6)
Health Care	MXEE OHC	762	939	692	0.9	1.2	7.4	(4.9)	(7.2)	4.5	(0.9)	(5.0)	(18.5)	(17.9)
Industrials	MXEE OIN	260	361	236	4.0	(0.4)	4.7	(15.6)	(13.8)	6.4	(2.7)	(3.4)	(27.9)	(25.3)
Information Technology	MXEE OIT	54	74	40	2.5	1.5	25.9	(7.5)	(9.3)	4.2	(3.7)	13.5	(18.3)	(17.8)
Materials	MXEE OMT	541	743	485	1.2	(5.0)	(3.2)	(12.4)	(10.3)	3.8	(7.2)	(12.2)	(23.7)	(19.5)
Telecom Services	MXEE OTC	228	296	205	0.4	3.5	0.3	(4.7)	(3.1)	2.5	1.1	(7.8)	(16.8)	(13.7)
Utilities	MXEE OUT	1,610	2,285	1,410	1.9	1.8	2.8	(17.4)	(17.5)	2.6	(1.8)	(4.9)	(21.5)	(20.0)

Source: MSCI, FactSet and Citi Investment Research and Analysis

Valuations

Figure 50. MSCI GEMs Valuations

02 Dec 11	Free MC US\$bn	Wgt %	P/E			EPS YoY %			P/B	ROE	Div Yld	EV/	
			11E	12E	13E	11E	12E	13E				Sales 10	EBITDA 10
Global	26,025	100	11.9	10.8	9.7	11.4	10.6	11.5	1.58	13.2	2.9	1.5	7.7
Developed World	22,626	86.9	12.1	11.0	9.8	11.0	10.8	11.5	1.58	12.9	2.9	1.5	7.8
Emerging World	3,399	13.1	10.5	9.6	8.6	13.5	9.6	11.7	1.57	14.9	3.1	1.5	7.1
Em Asia	2,007	7.7	11.5	10.2	8.9	6.8	13.5	14.9	1.66	14.4	2.8	1.2	7.2
China	602	2.3	9.7	8.7	7.7	16.6	11.6	13.5	1.59	16.4	3.3	1.3	7.2
Korea	519	2.0	10.0	8.9	7.9	6.5	14.1	14.0	1.29	13.0	1.4	0.8	5.8
Taiwan	358	1.4	14.3	13.1	10.8	-19.6	15.9	22.1	1.69	11.0	4.4	1.4	7.6
India	227	0.9	15.2	13.1	11.3	13.9	16.0	15.8	2.47	16.2	1.5	2.2	10.4
Malaysia	116	0.4	15.9	14.1	12.7	8.7	12.9	10.7	2.11	13.3	3.4	2.3	9.3
Indonesia	97	0.4	14.7	12.7	11.0	21.0	15.3	15.7	3.58	24.3	2.6	2.6	8.3
Thailand	65	0.2	11.3	10.3	9.3	22.4	10.4	11.1	2.04	17.9	3.6	1.2	7.3
Philippines	24	0.1	15.4	13.8	12.5	2.0	12.0	10.5	2.47	16.0	2.8	2.8	9.3
Latin America	772	3.0	11.1	10.3	9.2	14.1	7.9	9.8	1.66	14.6	3.5	2.3	7.4
Brazil	508	2.0	9.4	8.9	8.3	13.7	5.3	7.9	1.39	14.8	4.0	2.1	6.7
Mexico	155	0.6	18.7	15.6	12.8	15.5	20.1	17.2	2.36	12.6	1.9	2.4	8.8
Chile	56	0.2	15.4	13.5	11.0	10.2	14.0	22.4	2.30	14.2	2.9	2.8	10.8
Colombia	31	0.1	17.6	15.7	12.7	20.8	12.3	8.3	2.40	16.6	2.7	3.8	12.2
Peru	22	0.1	11.3	10.2	9.9	25.8	11.1	3.6	3.24	28.0	3.9	8.0	15.7
CEEMEA	620	2.4	7.8	7.4	7.0	31.2	2.9	5.8	1.25	16.4	3.5	1.5	6.0
South Africa	260	1.0	12.8	10.1	9.3	23.3	25.8	8.8	2.22	17.3	3.5	1.7	7.9
Russia	230	0.9	5.1	5.3	5.2	42.5	-6.9	3.2	0.83	16.7	2.9	1.4	4.7
Poland	48	0.18	8.0	9.1	9.1	39.4	-12.3	0.3	1.20	14.9	5.8	1.7	5.6
Turkey	44	0.17	9.7	8.6	7.6	-2.9	12.4	13.0	1.48	15.3	3.2	1.5	7.9
Czech Republic	11	0.04	10.8	9.8	9.5	-14.6	9.6	3.6	1.70	15.8	6.9	2.6	5.5
Egypt	11	0.04	8.5	7.7	6.9	11.6	14.7	12.3	1.07	12.1	4.9	2.4	7.5
Hungary	10	0.04	8.5	7.7	6.3	0.0	11.2	21.5	0.90	10.5	3.7	1.1	6.8
Morocco	5	0.02	13.5	12.3	13.1	0.3	10.1	7.5	3.97	27.4	5.6	4.4	7.6
GEMs Sectors													
Energy	494	14.5	6.8	6.9	6.7	29.0	-2.3	2.8	1.07	15.9	3.3	1.2	6.1
Materials	462	13.6	8.9	8.3	7.7	29.5	6.7	7.3	1.50	16.8	3.9	2.1	8.0
Industrials	222	6.5	12.4	11.0	9.4	-1.6	13.4	16.5	1.49	12.1	2.2	1.2	8.5
Consumer Disc.	276	8.1	11.6	10.3	9.1	21.6	16.2	14.2	2.19	18.8	1.6	1.1	8.0
Consumer Staples	264	7.8	21.4	18.0	15.6	0.7	18.8	15.5	3.49	16.2	2.2	1.8	11.6
Health Care	34	1.0	19.9	16.7	14.1	10.7	19.4	18.6	2.80	14.0	1.4	2.2	15.6
Financials	811	23.9	9.5	8.6	7.6	21.8	10.2	13.7	1.43	15.1	3.4	NA	NA
IT	430	12.7	15.2	12.3	10.0	-26.9	30.1	23.0	1.97	12.2	2.6	1.3	6.4
Telecoms	283	8.3	12.9	11.7	10.5	5.3	10.1	11.1	2.05	15.9	4.1	2.0	5.1
Utilities	122	3.6	12.9	11.0	9.3	-0.9	17.1	18.4	0.96	7.6	3.5	2.0	7.5

Source: MSCI, IBES, FactSet and Citi Investment Research and Analysis

Macro Outlook

Figure 51. Citi Macro Forecasts

	GDP Growth			CPI Inflation			Current Balance (% of GDP)			Fiscal Balance (% of GDP)		
	2011F	2012F	2013F	2011F	2012F	2013F	2011F	2012F	2013F	2011F	2012F	2013F
Asia	7.3%	6.9%	7.3%	5.9%	4.6%	4.6%	4.0%	2.3%	1.7%	-2.1%	-2.6%	-2.4%
China	9.1	8.4	8.6	5.5	4.1	4.3	3.0	2.0	2.0	-1.0	-2.0	-2.0
India	7.1	7.0	7.7	9.5	7.5	7.0	-2.9	-3.0	-2.5	-8.3	-8.0	-7.5
Indonesia	6.5	6.3	6.5	5.5	5.7	5.6	0.3	-0.3	-0.5	-0.8	-1.0	-0.7
Korea	3.6	3.7	4.4	4.4	4.0	3.0	1.7	1.2	0.9	0.5	0.7	1.2
Malaysia	4.8	5.0	5.3	3.2	2.7	3.0	11.5	10.5	9.0	-5.4	-5.0	-4.7
Philippines	3.7	4.0	4.5	4.5	4.1	4.6	2.7	2.1	1.4	-1.6	-2.0	-1.3
Taiwan	4.5	4.0	4.5	1.4	1.4	1.7	8.3	8.7	8.4	-2.5	-2.0	-1.8
Thailand	1.7	3.0	5.0	3.9	3.4	3.5	1.7	0.9	1.2	-1.5	-3.8	-2.6
Latin America	4.2%	3.7%	4.4%	7.0%	6.4%	6.5%	-1.0%	-1.1%	-2.0%	-2.4%	-2.2%	-1.9%
Brazil	2.9	3.3	4.5	6.6	5.3	5.2	-2.3	-2.9	-2.4	-2.7	-2.5	-2.3
Chile	6.3	4.0	5.0	3.3	3.1	3.1	-1.2	-1.9	-1.9	0.8	0.7	0.6
Colombia	5.0	4.8	5.2	3.4	4.0	4.2	-2.9	-2.6	-2.9	-3.5	-3.0	-2.5
Mexico	3.8	3.0	3.4	3.3	3.6	3.7	-1.4	-2.8	-2.5	-2.5	-2.2	-2.0
Peru	6.8	5.5	6.5	3.3	3.3	2.9	-3.0	-3.6	-3.5	1.5	1.2	-0.3
CEEMEA	4.6%	2.2%	3.9%	6.7%	5.8%	5.3%	-0.4%	-0.8%	-1.7%	-2.4%	-3.0%	-2.7%
Czech Republic	1.8	0.0	2.1	1.9	2.7	2.0	-4.1	-3.3	-4.2	-4.5	-4.0	-3.5
Hungary	1.2	0.1	1.7	3.9	5.2	3.4	2.9	2.6	2.5	1.9	-3.0	3.0
Poland	4.0	1.9	2.8	4.2	2.9	2.6	-4.6	-3.5	-4.1	-5.2	-4.0	-2.9
Russia	4.0	2.5	4.2	8.6	6.2	6.1	4.7	1.9	1.4	-1.4	-3.1	-2.7
Turkey	7.7	2.5	4.3	6.3	8.1	6.6	-10.2	-8.5	-7.4	-1.7	-1.8	-2.2
Egypt	1.4	3.1	3.9	9.8	9.3	10.7	-3.5	-3.8	-5.6	-9.0	-8.8	-7.3
South Africa	3.1	2.9	4.0	5.0	5.8	5.8	-3.4	-4.4	-6.2	-5.3	-5.2	-4.7
Total	6.0%	5.1%	6.0%	6.2%	5.3%	5.3%	3.0%	2.0%	2.0%	-1.9%	-2.6%	-2.1%

Source: Citi Investment Research and Analysis

Notes

Notes

Notes

Appendix A-1

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