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Strategy
GEMS

GEMS Strategy

US Feedback: Sentiment, Korea vs. Taiwan, Stronger USD, Crowded Trades, and Russia

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- **Sentiment in EM has improved, but the conviction level remains low** — Being short DM vs. EM hasn't panned out, nor have other trades which used EM as a funding source. Having been unable to make money off negative EM investments is the prime motivator of a more positive mood. Few DM investors suggested that there were real improvements in EM. Tighter money by the Fed in 2015/rising long bond yields were seen as the next opportunity to put on bearish EM trades. Some mention was made of switching out of Europe into EM for an opportunistic trade.

- **We continue to prefer Taiwan over Korea; many suggest we switch** — Taiwan has stronger earnings revisions, more ample liquidity conditions, better terms of trade and unit labour cost performance. The positives for Korea is a potential 25bps easing in monetary conditions and the passing of proposals relating to companies returning excess capital to shareholders. If this becomes law, the Korean discount should disappear. Korea has an ROIC below the EM average and a payout-to-capex ratio which is lowest in the world – not a good combination for shareholders.

- **Stronger USD fears have surfaced again** — This is a periodic event, and we are in such a period again, it would seem. In the past, a strong USD was good for DM, bad for EM. There are certain differences now vs. then: floating exchange rates, lower valuations and more CA surpluses. A stronger USD is bad for commodity exporters, as export prices tend to fall, but therefore good for those who import commodities, notably Asia. By sector, industrials/tech benefit while commodities and reflation trades lose out. CA deficit countries suffer more than those with surpluses.

- **Crowded trades are India, Brazil and Russia, Korea, Taiwan and China least** — Plenty of investors have good things to say regarding India, to the extent that the Indian overweight is now more than twice the size of the consensus next biggest overweight. For all the talk of switching out of Taiwan into Korea, both are consensus underweights, the former just more than the latter. When it comes to China, the skeptics continue to loom large – interesting in that regard, as since the election, China has outperformed India.

- **Surprisingly few questions on Russia, but our Russia overweight hasn't panned out** — Only two investors brought up Russia as a topic of discussion, and yet consensus data suggests it is an overweight – maybe not in the US, but more so in Europe. We've been with the consensus-overweight – which hasn't panned out. Yes, it looks cheap with negative implied EPS growth of 5% to perpetuity, but at present it does not look as if that number will improve. We now cut the overweight down to neutral. The beneficiaries of this move are China and Taiwan. EMEA now becomes an underweight. We remain overweight Turkey.

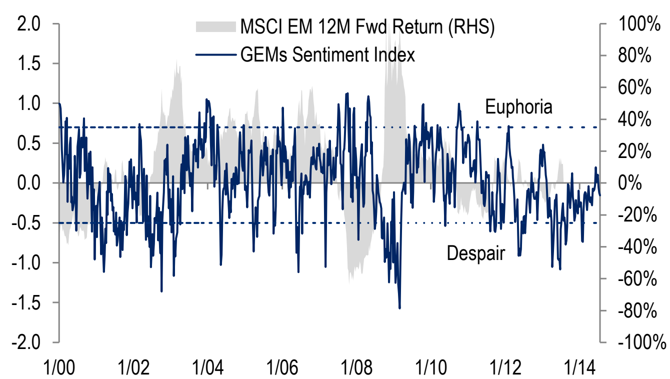
US Feedback: Sentiment, Korea vs. Taiwan, Stronger USD, Crowded Trades, and Russia

Sentiment has improved, but conviction level remains low

The improvement in sentiment towards EM is more better price driven than anything else.

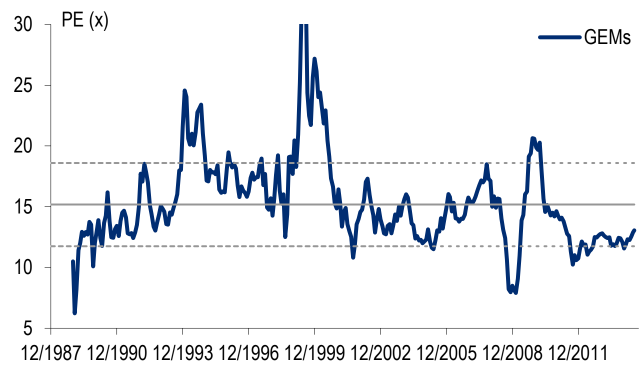
Overall, sentiment towards the EM asset class has improved over the course of the first six months of the year (see Fig. 1 for our aggregate GEMS sentiment indicators). Sentiment has shifted from levels of despair towards the asset class towards a more neutral assessment of the prospects for EM. The general tone of our recent meetings with investors would confirm this. The dedicated EM investor no longer walks into the meetings with his or her head in their hands, as if they have just spent the last few days on the naughty step, nor do the DM investors quite have the confidence of earlier in the year anymore.

Figure 1. GEMs Sentiment Index and MSCI EM Forward 12M Returns



Source: MSCI, Haver, EPF, Bloomberg, Citi Research

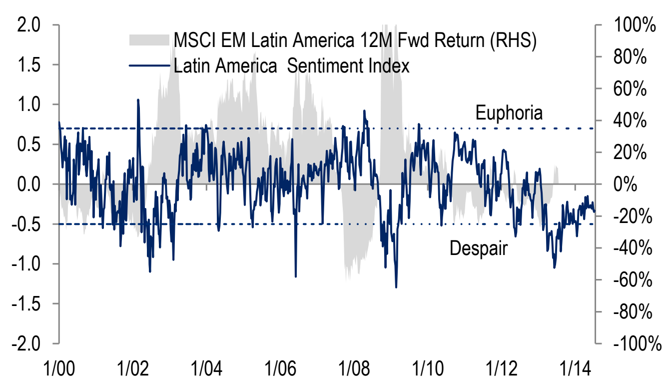
Figure 2. GEMs Price-to-Earnings Ratio



Source: MSCI, Citi Research

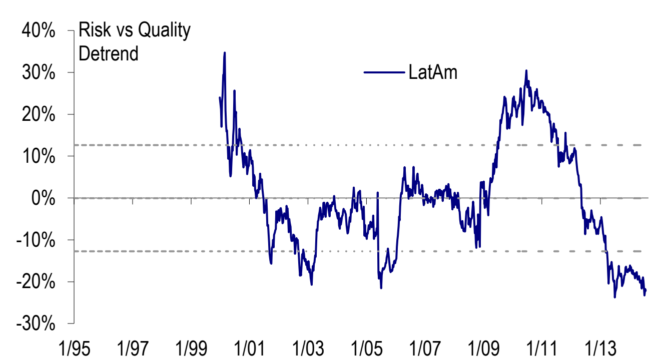
What is still missing though, is a sense of conviction that the better performance of EM isn't just a fluke to be reversed at any time. Those who are of the opinion that it is all a bit of a fluke point to the time when the Fed will raise official rates – that will be the time when EM will really feel the pressure. Markets will tumble as the liquidity which has gone to EM will head for the door. More on that topic from us in the next few weeks, once we've run all the numbers. Just looking at the valuations of EM, (see Fig. 2) in terms of P/E and it is not as if there has been a re-rating of EM equities.

Figure 3. LatAm Sentiment Index and MSCI Lat AM Fwd 12M Returns



Source: MSCI, Haver, EPF, Bloomberg, Citi Research

Figure 4. Latin America Risk vs. Quality Style Index Performance



Source: Bloomberg, Citi Research

Where sentiment remains really quite risk averse is Lat Am. In the case of both Asia and EMEA, there have been returns towards a more risk-seeking investment style. Investors have begun to move their portfolios towards a higher-beta weighting and away from high weight on quality attributes. This has not been the case in Lat Am, (see Fig. 4). Post a brief bounce in favour of risk (beta and volatility), investors have again shifted back towards stocks with greater quality attributes.

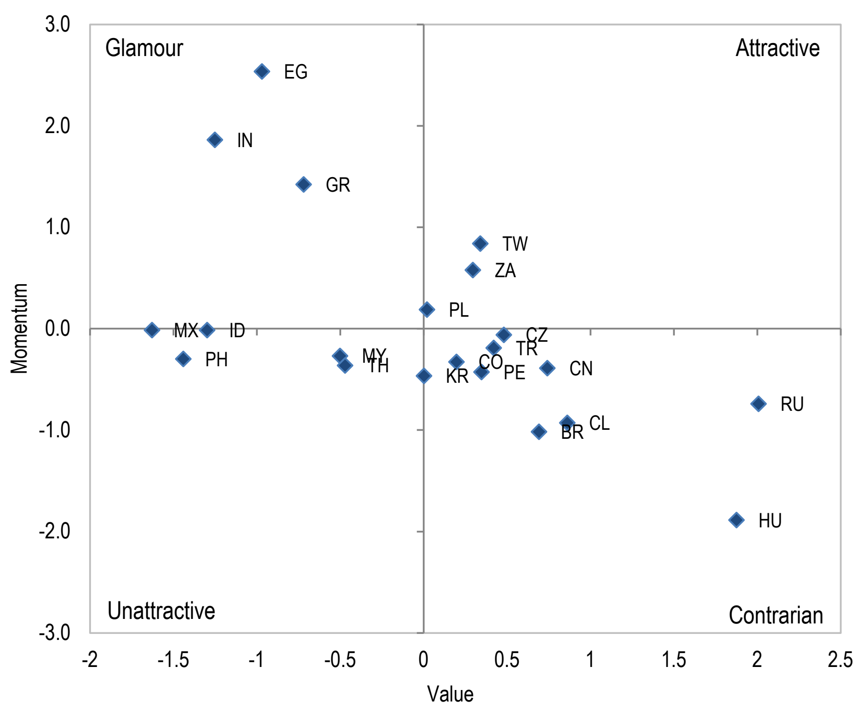
Korea vs. Taiwan; time to switch out of the latter into the former?

Hard to argue with better EPS revisions in Taiwan than Korea, better liquidity and terms of trade.

We are overweight Taiwan and have a small underweight in Korea. Given the relative outperformance of Taiwan vs. Korea on more than one occasion, the question came up, "Is it time to switch?" The unusual aspect to this question is that on all the data we can get, Taiwan is still a consensus underweight. Yes, Korea is a little more so, but it is not as if Taiwan is a consensus overweight. So the idea of a switch is more of one from a smaller underweight to a larger one.

Why are we overweight Taiwan vs. Korea? First, our methodology, which is a combination of both looking for good value and then a positive signal from both the price and also EPS revision factors, puts Taiwan in the attractive quadrant (cheap and better momentum factors than the other countries) and has been for a while. Korea on the other hand, is as cheap/expensive as all the other markets, but has worse momentum (see Fig. 5).

Figure 5. GEMs Radar: Value and Momentum Scores by Market

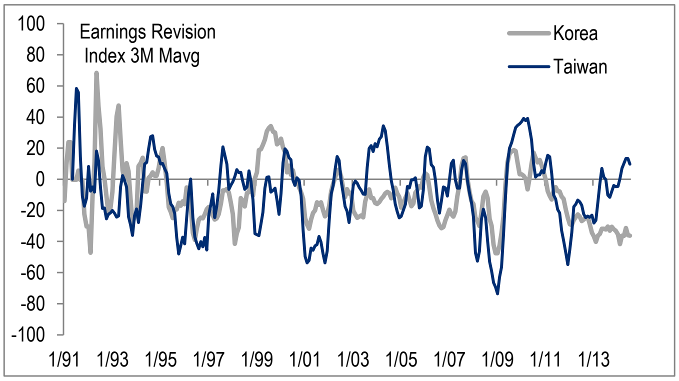


Source: Citi Research

One of the aspects of momentum where Korea scores poorly – this is the second point – is earnings revisions (see Fig. 6) when we look at those of Korea and Taiwan. Taiwan has outright upward revisions to earnings, whilst Korea does not. Nor is it as simple as just to say that EPS revisions in Korea are poor, and hence there will be a rebound any moment now. With the Korean consensus according to IBES still forecasting 18.6% earnings growth, the risk to further earnings

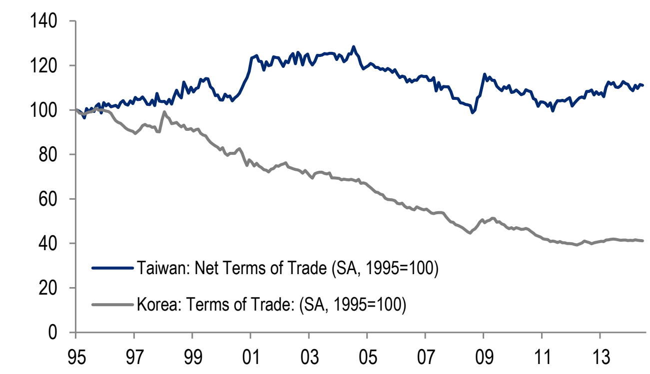
disappointments looms larger for Korea than Taiwan. The latter is doing well on the component side, whilst Korea at the moment is struggling.

Figure 6. Earnings Revisions Index of Korea and Taiwan



Source: IBES, Citi Research

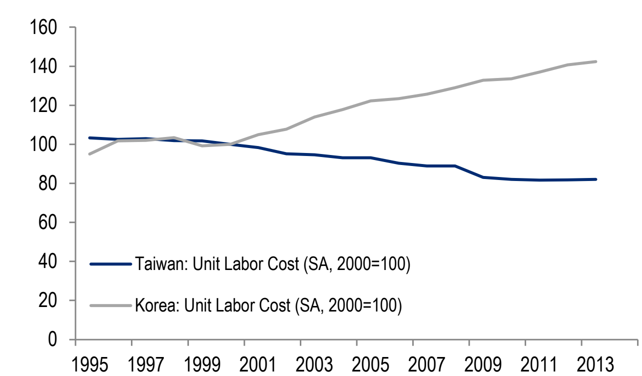
Figure 7. Terms of Trade in Korea and Taiwan



Source: Haver, Citi Research

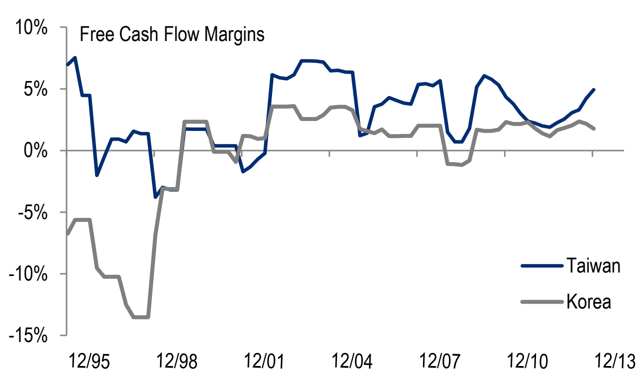
Part of the struggle which Korea is facing is twofold. The first (see Fig. 7) is that the terms of trade in Taiwan have been better than those of Korea. Yes, in the case of Korea they have stopped declining as of late, but in the case of Taiwan, the terms of trade have actually been rising. In the case of Korea, from a low base, things are no longer getting worse, whilst in the case of Taiwan, from a high base, they are actually getting better. Now this ultimately matters, as it will get reflected in the level of corporate profitability. Linked to the topic of earnings is also the whole issue of unit labour cost.

Figure 8. Unit Labor Cost in Korea and Taiwan



Source: Haver, Citi Research

Figure 9. Free Cash Flow Margins of Korea and Taiwan



Source: Worldcope, FactSet, Citi Research

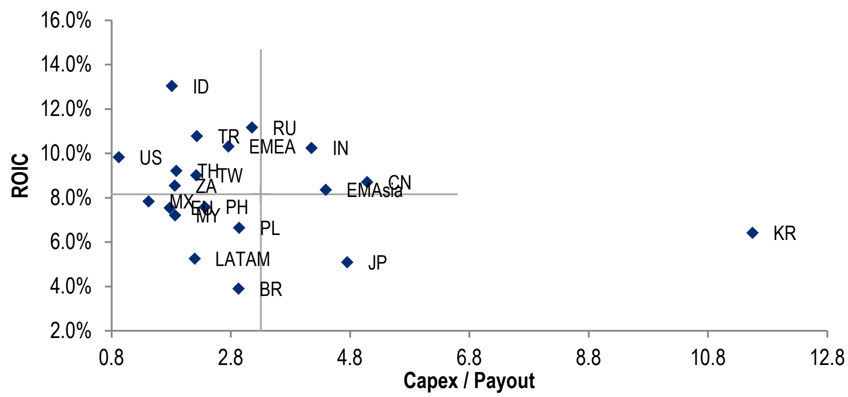
In that regard again, Taiwan is doing better at present than Korea (see Fig. 8). Between 1996 to 2000, the unit labour costs in both countries progressed at the same pace. Since then, Korea has seen its unit labour cost rise by 2.75% p.a., whilst in the case of Taiwan, unit labour cost have fallen by -1.51% p.a. Taiwan has been getting more cost competitive, whilst Korea has not. Hence the increased pressure on the BOK to cut rates – the Citi view is 25bps – in order to weaken the currency.

Worse terms of trade and rising unit labour costs is mirrored by what is happening with the free cash flow margins – the third reason (see Fig. 9). In the case of Korea,

the free cash flow margin is rolling over, whilst in the case of Taiwan, the free cash flow margins are increasing, which ultimately spells better dividends for Taiwan shareholders vs. those of Korea.

So what would it take to make us switch? First, relative value and then better revisions. There is one area which has even been getting the attention of the Korean government, and that is the issue of dividends. One area where Korea lags quite significantly is returning cash to shareholders. The other is that ROIC in Korea is lagging that of the other Ems. The two are clearly not a great combination for multiples going forward (see Fig. 10).

Figure 10. Cross Section Comparison of ROIC vs. Capex-to-Payout Ratio



Source: Factset, Citi Research

Anything which forces companies to return more cash to shareholders and invest less will be a +ve for Korea.

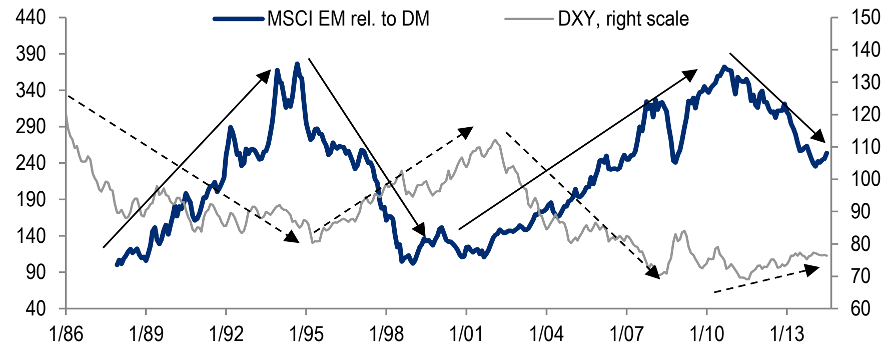
As such, any move by the government to successfully increase the cash which goes back to shareholders and leads to an increase in the ROIC of Korea would be welcome for investors. Should the current push prove successful, then we suspect the Korea discount would be a thing of the past. Until then, the market trades at a discount for a good reason. Note Taiwan returns more to shareholders than the average EM country and enjoys an above-average ROIC.

What if the USD rallies? That will be bad for EM

A USD rally has historically been negative for EM, but that was before floating exchange rates and a big valuation discount.

The USD question is back in vogue. USD is bad for EM, and that will bring the asset class down again. So yes, if either you or you know of someone who has a very good track record of calling the USD, then a stronger USD has tended to be bad for EM (see Fig. 11) for the USD vs. EM relationship. Note though that unlike in the prior cycle, it isn't as if the USD has been particularly strong, and yet EM in this case vs. the US has seen a very significant underperformance. Why is it the case that the USD has had such a strong impact on EM?

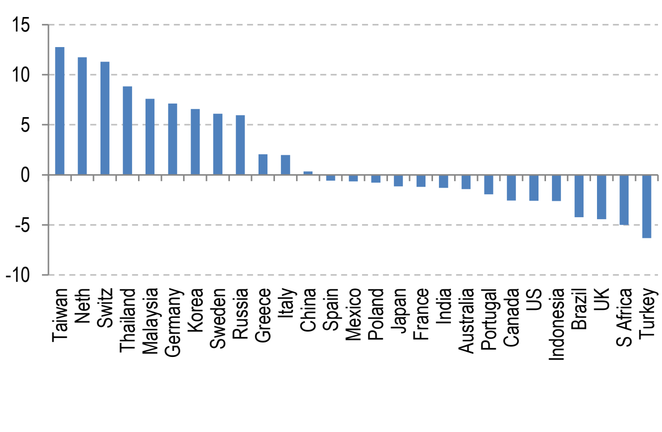
Figure 11. Strong US Dollar traditionally bad for GEMs Equities



Source: Datastream, CEIC, Citi Research

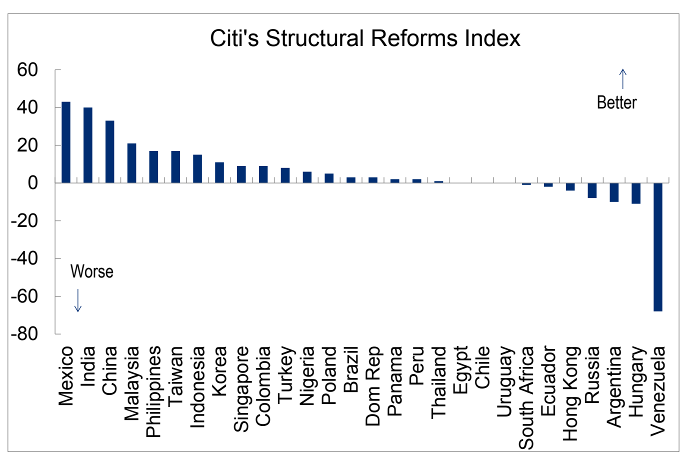
Historically, the USD has rallied post a prolonged period during which imbalances have been built up in EM. Current accounts have deteriorated, private sector balance sheets have become more leveraged (often with a currency mismatch attached to the rise in leverage), and overall valuations have risen. A stronger USD and the threat of higher rates makes the funding of CA deficits more difficult. A stronger USD makes the financing of foreign debt more expensive, and with the threat of higher rates, stretched valuations become unsustainable. The other factor is that a stronger USD has over time tended to be negative for commodities, which thus hits the terms of trade for the commodity producers. A higher discount rate due to moves in rate expectations and reduced earnings power regrettably depresses the NPV of future earnings, and hence equities de-rate. One country's worsening terms of trade though is another's improving terms of trade – higher rates on the back of stronger growth bodes well for the asset turn business model, but poorly for the low-asset-turn high-margin models. The profitability baton shifts from the "reflation/commodity" trade to the manufacturing/exporter part of the equity spectrum.

Figure 12. Global Current Account Rankings



Source: CEIC, Haver, IMF, Citi Research

Figure 13. Citi Structural Reforms Index



Source: Citi Research

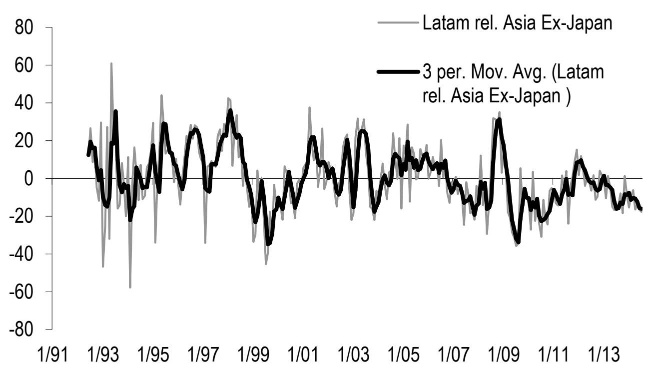
Large CA deficits with little in the way of reforms are especially vulnerable.

So who is the most vulnerable? See Fig. 12 for those with the biggest CA deficits. Top 3 on the list are Turkey, South Africa and Brazil. Next you have a gap with Indonesia and then India. At present, the latter two are continuing to benefit from the

political honeymoon, but they have also shown improvements in the CA deficits compared to a year ago. Those countries running CA surpluses are clearly in a much better position given that they are net creditors to the rest of the world rather than being a net debtor. What also helps is if there is a reform impetus in the country with a CA deficit – sadly not all are doing equally well (see Fig. 13).

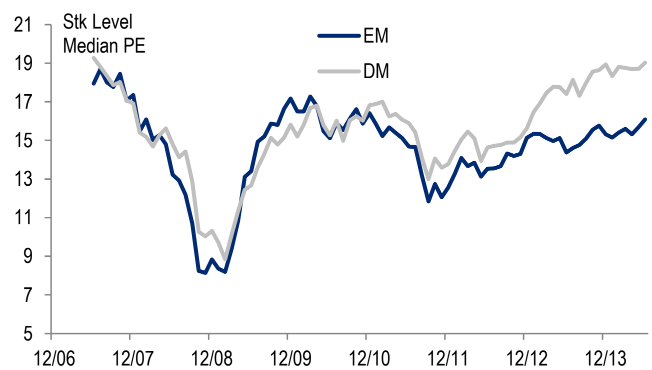
By region, a stronger USD will be more beneficial to Asia than to Lat Am or EMEA. Lat AM and EMEA have more of a commodity tilt, and a stronger USD has tended to lead to weaker commodity rather than stronger commodity prices. Worse terms of trade for the commodity exporters is a terms of trade improvement for the commodity consumers. The terms of trade graphs we've shown above (see Fig. 7) for both Korea and Taiwan highlight that point. The end effect is that in terms of relative EPS revisions, it gives you a worse revisions dynamic in Lat Am vs. Asia (see Fig. 14).

Figure 14. Earnings Revisions of Latin America relative to AxJ



Source: IBES, Citi Research

Figure 15. Median PE of EM vs. DM stocks



Source: MSCI, Citi Research

Commodity and reflation trades lose out during periods of a stronger USD; Asia, manufacturing and technology are the relative winners.

In terms of sectors, commodities lose out due to a weaker pricing environment. The other sectors which historically struggle are the so called "reflation trade" which is comprised mostly of real estate names. Tighter money as a result of a stronger USD tends to be an issue for the sector. Another sector which tends to struggle is utilities, especially if the stronger USD is accompanied by higher long rates. The winners as we alluded to are the asset turn plays. That is comprised of the manufacturing sector (terms of trade also help here) plus stronger volumes. The other winner is technology, which in EM is effectively a manufacturing process.

So if the USD rally is now for real, EM in aggregate will struggle, but bear in mind that valuations are significantly cheaper than in prior cycle and vs. EM (see Fig. 15) where we've looked at median P/E. Secondly, unlike the prior cycle of USD strength, most EM currencies are now floating not fixed. Asia is a net beneficiary due to improving terms of trade vs. both EMEA and Lat Am. By sector, manufacturing / technology wins over commodities and reflation trades.

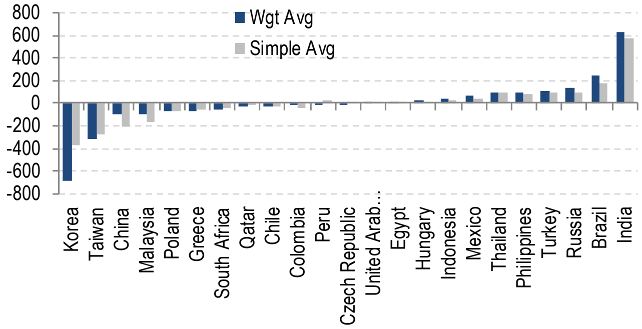
Most crowded and least crowded EM trades

India, Brazil and Russia are the most liked; Korea, Taiwan and China the least.

In terms of positioning, we've used the most recent data which we published in Fund Flow Insights - July 2014 EM funds holdings: India is the most over-weight space. In terms of countries (see Fig. 16), the five biggest country overweights amongst EM investors at present are India, Brazil, Russia (see below on Russia), Turkey and the Philippines. Note that the India overweight is 2.6x larger than investors next biggest overweight, Brazil. The five least preferred markets are

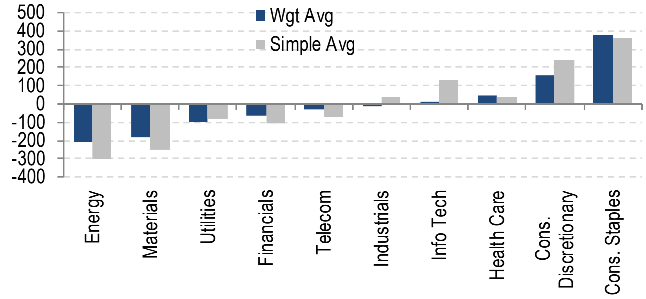
Korea, Taiwan, China, Malaysia and Poland. In the same way that India is 2.6x more of an overweight, Korea is an 2.2x bigger underweight than the next biggest underweight which is Taiwan.

Figure 16. EM Funds Country Allocations rel. to MSCI EM



Source: MSCI, FactSet, Citi Research

Figure 17. EM Fund Sector Allocations rel. to MSCI EM



Source: MSCI, FactSet, Citi Research

By sector, there is still a bias towards a more quality/defensive posture, with the large overweight in consumer staples. The next biggest overweight is in consumer discretionary, and then we have health care – again a defensive sector. At the other end of the distribution, we have energy as investors biggest underweight, followed by materials, utilities and then financials. We continue to only have a mild overlap with the consensus. Our biggest overweight remains consumer discretionary followed by technology; then we have the financials and lastly energy. Staples is our biggest underweight vs. this being the consensus's biggest overweight.

Consumer staples, consumer discretionary and health care are the overweights; commodities, utilities and financials the underweight.

By individual stocks, Fig. 18 highlights the top 20 most overweighted stocks in EM, excluding the out-of-benchmark holding in DM stocks. We have left EM stocks which are listed in the US or EU in the sample. Fig. 19 highlights the most underweighted stocks in the EM universe. As expected, the names follow on from the various sector and country weights.

Figure 18. Top 20 Overweight Stocks in Emerging Markets

RIC	Name	Ctry	Weights in GEM Funds	Weights in MSCI EM	O/U Wgts (bps)	Rating	Price
BIDU.O	Baidu	CN	2.5%	0.0%	128	1	216.05
HDFC.BO	HDFC	IN	2.4%	1.0%	59	2	1063
HDBK.BO	HDFC Bank	IN	1.3%	0.2%	51	2	829
ICBK.BO	ICICI	IN	1.2%	0.2%	45	1	1468.7
AXBK.BO	AXIS Bank	IN	0.7%	0.0%	33	1	391.85
ASII.JK	Astra Intl	ID	1.2%	0.5%	28	1	7725
INFY.BO	Infosys	IN	1.7%	1.0%	24	1	3360.8
ULTC.BO	UltraTech Cement	IN	0.5%	0.1%	23	3	2426.95
ZEE.BO	Zee Ent	IN	0.4%	0.0%	21	3	290.75
CTRP.O	Ctrip.Com	CN	0.4%	0.0%	19	-	64.03
TCS.BO	Tata Consult	IN	1.3%	0.7%	18	2	2583.5
ITC.BO	ITC	IN	0.9%	0.5%	18	1	357.5
BRTI.BO	Bharti	IN	0.5%	0.1%	17	1	373
EDU.N	New Oriental	CN	0.3%	0.0%	17	-	19.55
SCB.BK	Siam Comm	TH	0.7%	0.3%	17	1	178
SM.PS	SM Inv	PH	0.4%	0.1%	14	1	797
0322.HK	Tingyi	CN	0.5%	0.2%	13	1	22
NTES.O	NetEase.com	CN	0.3%	0.0%	13	2	84.04
TAMO.BO	Tata Motors	IN	0.5%	0.2%	13	1	447.5
TBEV.SI	Thai Beverage	TH	0.2%	0.0%	12	-	0.615

Source: MSCI, Citi Research

Figure 19. Top 20 Underweight Stocks in Emerging Markets

RIC	Name	Ctry	Weights in GEM Funds	Weights in MSCI EM	O/U Wgts (bps)	Rating	Price
005930.KS	Samsung Elec	KR	4.3%	6.2%	-173	1	1312000
0939.HK	CCB	CN	1.2%	2.0%	-64	1	5.95
1398.HK	ICBC	CN	1.1%	1.8%	-57	1	5.3
0700.HK	Tencent	CN	2.9%	3.2%	-55	1	128.8
3988.HK	BoC	CN	0.7%	1.4%	-51	1	3.68
0941.HK	China Mobile	CN	1.9%	2.3%	-46	1	85.65
000660.KS	SK Hynix	KR	0.5%	1.1%	-45	1	45400
2317.TW	Hon Hai Precision	TW	0.9%	1.5%	-45	-	101.5
005490.KS	POSCO	KR	0.1%	0.8%	-41	1	338000
005380.KS	Hyundai Motor	KR	1.4%	1.7%	-36	1	244500
0386.HK	Sinopec	CN	0.6%	0.9%	-30	1	7.63
051910.KS	LG Chem	KR	0.2%	0.6%	-25	1	292000
000270.KS	Kia Motors	KR	0.2%	0.6%	-25	1	60800
035420.KS	Naver	KR	0.7%	0.9%	-22	2	756000
0857.HK	PetroChina	CN	0.8%	1.0%	-22	3	10.16
RELI.BO	Reliance Ind	IN	0.6%	0.8%	-21	2	1003.5
006400.KS	Samsung SDI	KR	0.0%	0.4%	-20	2	160000
2412.TW	Chunghwa	TW	0.2%	0.5%	-19	3	91.7
2628.HK	China Life	CN	0.6%	0.8%	-18	1	23.25
TENA.KL	Tenaga	MY	0.2%	0.4%	-18	1	12.38

Source: MSCI, Citi Research

Russia overweight hasn’t panned out; cut to neutral

The rational to own Russia at the start of the year we felt was sound. Valuation support, signs of greater shareholder value with stronger growth and hence better EPS revisions. It all looked right – until it did not. Given the current trajectory of further sanctions by both camps, the risk premium on Russian equities at best stays high, in our view, but more likely than not rises further, which would hamper performance. Equities become cheaper rather than more expensive.

Cut Russia to neutral weight.

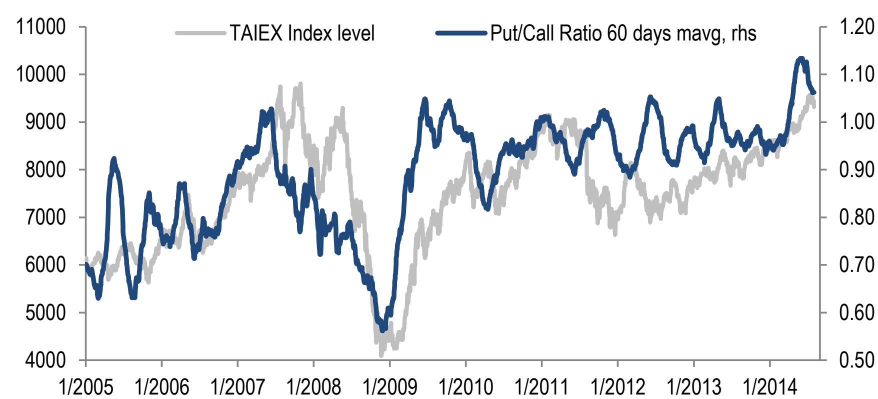
As per Fig. 16, Russia is still an overweight market amongst EM investors. We did not meet any during this latest trip in the US, which may suggest that the overweight is more commonly held in Europe. The current weight in US investors' portfolios is between zero to neutral. For those with zero, the fear of the market becoming un-investable due to specific sanctions keeps them out. Those investors who have chosen to be neutral highlight the value component and hence the rather large risk premium. On any resolution, being zero is viewed as too great a performance risk; this particularly so as long as the market remains both in the MSCI EM index and the seventh-biggest market in EM.

The money from Russia is redeployed to both Taiwan and China. We are also now underweight energy.

By cutting Russia to neutral, we now have additional funds to allocate to other EM markets. Using our relative value vs. relative momentum combination forces us into some rather tough decisions (see Fig. 5). Does one buy expensive but generally defensive markets such as Mexico? Or do we increase the China overweight further and so have a strong value tilt, and/or add more to Taiwan which has a good combination of value and momentum? India has good momentum, but the valuations suggest that investors are paying up for that. Much of ASEAN is in the same position. Brazil remains a contrarian play – cheap, price momentum has been good this year, but the earnings revisions continue to lag. With the election due in October there is still room for plenty of volatility between now and then.

As a consequence of the reduction in the weighting of Russia, we are going to increase our overweight in Taiwan further. The market still has good momentum and compared to all others, still offers value. We have liked Taiwan since last year; it is far from a consensus overweight and as per Figure 20 supplied by Peter Kurz, our Head of Taiwan Research, the locals in particular remain quite bearish on the outlook of the market given the high put-to-call ratio. We are increasing our Taiwan weight by 2%age points to now 21%. We are now 875 bps overweight.

Figure 20. Put-Call Ratio of TAIEX



Source: Bloomberg, Citi Research

The other recipient is China, where we are also increasing our overweight further to 910 bps or a weight of 27.5%. Valuations remain favourable, the reform momentum has accelerated again as has growth, and the consensus remains underweight the market.

Asia stays an overweight for us. EMEA now becomes an underweight, with only Turkey as an overweight for us. Lat Am is also an underweight.

By sector, the reduction in our Russian overweight means we are no longer overweight in the energy sector.

Style performance and is quality still expensive vs. value

In EM, the attribute which investors have turned to thus far in 2014 has been growth. Whereas last year growth was not an attribute which investors sought – too much fear that there would be no growth – this year it has proven to being the best attribute to have followed (see Fig. 21). After growth, in second place we have value. In third, we have size – but have a look at the returns to a quality investment. Pure style returns to quality have actually been negative in both Asia and EMEA but positive in Lat Am (see also our point on this issue above). Momentum, a firm favourite in 2014, has not delivered returns in 2014 to date, especially in Asia where the factor is down 4.5%.

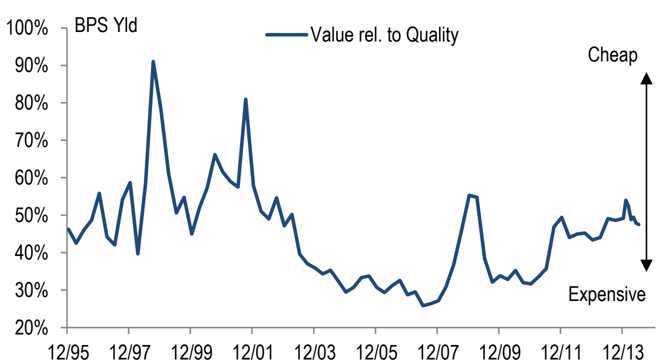
Figure 21. Index Style Performance Year-to-Date

7/29/2014 YTD	Growth	Value	Quality	Risk	Momentum	Size
GEM	7.0%	3.6%	0.0%	-1.0%	-2.4%	1.6%
Asia	6.1%	4.5%	-2.0%	-1.0%	-4.5%	0.5%
EM Asia	9.9%	5.9%	-2.5%	1.7%	-3.2%	1.7%
CEEMEA	-4.5%	-0.2%	-2.6%	4.4%	1.3%	1.0%
LatAm	8.5%	4.2%	5.3%	-5.8%	-0.6%	4.2%
Global	-0.3%	4.1%	-1.2%	-0.8%	-3.0%	-0.4%
NA	-2.0%	3.5%	-1.4%	5.4%	-1.6%	1.1%
Europe	-1.0%	5.8%	-1.6%	-2.3%	-0.4%	-1.6%
Japan	0.3%	0.2%	-5.0%	-9.4%	-1.7%	-7.0%
AU	-3.1%	-6.4%	-3.7%	-0.8%	0.6%	-1.1%

Source: Citi Research

There are some distinct differences between what we see happening in the EM world vs. the DM world. In EM, growth as an attribute has been rewarded, but not so in DM. In North America and Australia, this attribute has actually cost you performance. In DM, value was the way to go above all others, with the exception of Australia. In North America, risk was the way to go, posting the strongest returns as opposed to Japan, where risk proved to be the worst attribute to have owned.

Figure 22. Book Yield difference between a value and quality portfolio



Source: Worldcope, FactSet, Citi Research

Figure 23. Quarterly Performance of Index Styles 2001-2014

	Average Return (2001-2014)			
GEM	Q1	Q2	Q3	Q4
Growth	0.8%	0.3%	-0.6%	-0.3%
Momentum	1.4%	1.3%	1.0%	1.6%
Quality	0.0%	0.7%	1.1%	-0.2%
Risk	-0.6%	-0.9%	-0.9%	1.7%
Size	-0.8%	0.3%	0.3%	-0.1%
Value	2.8%	2.0%	1.5%	2.1%

Source: Citi Research

As regards the valuation differential between value to quality (see Fig. 22), at present, the differential is still favourable towards a value as opposed to a quality-

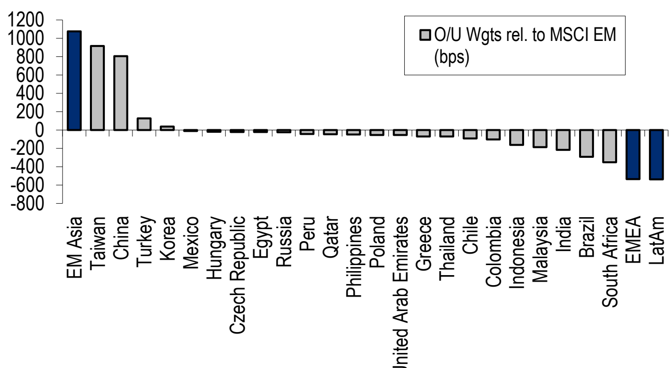
biased strategy. Nor is it the case that EM has over time rewarded quality attributes over value attributes.

In Fig. 23, we highlight on a quarterly basis of the returns of the various style strategies within EM from 2001 to 2014. The two best return quarters for quality in EM has been Q3 at +1.1% and then Q2 at 0.7%. The reason behind the strong Q3 is that in Asia in particular, Q3 at +3.5% is a very strong quality quarter. Why? In Asia, there is a very strong seasonal bias for EPS revisions and hence market weakness. August and September have historically seen the sharpest downward revisions to earnings and thus also amongst the worse market moves. As such, a quality bias has proven to being useful. Looking at it beyond that one quarter, the returns are far from stellar. Flat in Q1, plus 0.7% in Q2, Q3 as we reported +1.1% and then -0.2% in Q4.

The most consistent returns have come from a value strategy (see Fig. 23). Since 2001, each quarter has yielded positive returns with 1st quarter being the strongest at 2.8% and then the 4th quarter at 2.1%. Q3 is weakest at 1.5%, followed by Q2 at 2%. The only other strategy which has yielded positive returns consistently in each of the four quarters has been momentum, which given that half of the strategy is market returns, the consistency should not come as a surprise.

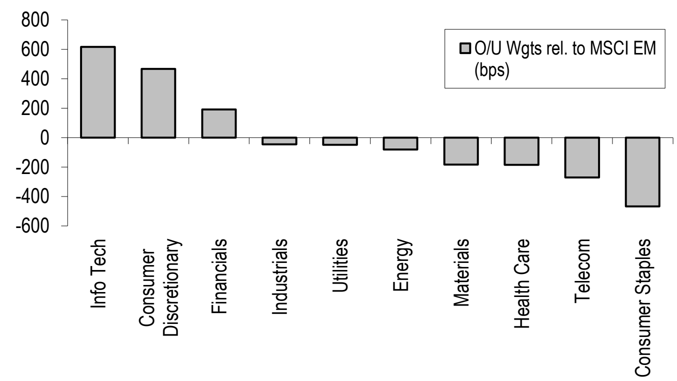
As to the other strategies, risk is a Q4 strategy; try size in the middle of the year; and growth in the early part of the year. Best way forward is a focus on value with a twist of momentum. That is exactly what we use and the reason we do is that it is what has worked, and year-to-date value continues to be the second-best return style.

Figure 24. Country Allocation in EM Model Portfolio



Source: MSCI, Citi Research

Figure 25. Sector Allocation in EM Model Portfolio



Source: MSCI, Citi Research

Figure 26. EM Model Portfolio Holding

RIC	Name	Price (local) 7/31/2014	Mkt Cap US$mn	Ratings	Wgts (%) in MSCI EM	Model Wgts	O/U-Wgts bps	2014E PE	2014E EPS Growth (%)	2014E DivYld (%)
	GEMs				**100.0**	**100.0**	**0.0**	**8.8**		**3.2**
	EM Asia				**63.2**	**73.5**	**1026**			
	China				**19.4**	**27.5**	**806**			
0939.HK	China Construction Bank	5.98	192,909	1		6.0		5.1	8.0	6.8
2380.HK	China Power International	3.26	2,825	1		3.0		6.8	12.3	6.2
0883.HK	CNOOC	13.88	79,961	1		4.0		9.6	-8.3	3.5
3988.HK	Bank of China	3.72	134,093	1		6.0		5.4	2.8	6.8
0762.HK	China Unicom	13.6	41,836	1		4.5		20.4	20.6	1.6
2777.HK	Guangzhou R&F Properties	11.44	4,757	1		2.0		5.1	0.5	6.8
1133.HK	Harbin Electric	5.24	931	1		2.0		12.2	-33.1	1.9
	India				**6.7**	**4.5**	**-218**			
CAIL.BO	Cairn India	316.25	9,788	2		1.5		5.5	-12.5	3.6
TAMO.BO	Tata Motors	447.5	22,564	1		2.0		8.1	9.1	0.1
ICBK.BO	ICICI Bank	1468.7	28,051	1		1.0		14.8	19.4	1.5
	Indonesia				**2.6**	**1.0**	**-163**			
INTP.JK	Indocement	24950	7,933	1		1.0		17.8	3.0	1.9
	Korea				**15.6**	**15.5**	**-12**			
000720.KS	Hyundai E&C	63400	6,868	1		0.5		11.5	22.3	0.8
005930.KS	Samsung Electronics	1343000	192,435	1		7.0		7.8	-15.0	1.0
005380.KS	Hyundai Motor	245500	52,605	1		3.5		6.6	-3.6	0.9
066570.KS	LG Electronics	76800	12,226	2		3.0		14.3	396.3	0.3
161390.KS	Hankook Tire	56900	6,857	1		1.5		9.0	5.8	0.7
	Malaysia				**3.9**	**2.0**	**-185**			
UMWS.KL	UMW Holdings	11.7	4,276	1		2.0		14.3	46.5	4.2
	Taiwan				**11.8**	**21.0**	**916**			
2330.TW	TSMC	121	104,367	1		6.0		12.3	36.0	2.5
2891.TW	Chinatrust FHC	21.1	10,327	2		2.5		12.4	15.4	3.2
2882.TW	Cathay FHC	50.4	21,063	2		2.5		17.1	20.4	2.8
	Thailand				**2.2**	**1.5**	**-71**			
KTB.BK	Krung Thai Bank	21.5	9,335	2		1.5		9.9	-10.6	4.0

Source: Citi Research estimates Note: Stock weights may not add up as stocks may be removed from time to time owing to internal restrictions or discontinuation of coverage.

Figure 27. EM Model Portfolio Holding (continued)

RIC	Name	Price (local) 7/31/2014	Mkt Cap US$mn	Ratings	Wgts (%) in MSCI EM	Model Wgts	O/U-Wgts bps	2014E PE	2014E EPS Growth (%)	2014E DivYld (%)
	EMEA				**17.9**	**12.5**	**-536**			
	Czech Republic				**0.2**	**0.0**	**-21**			
	Egypt				**0.2**	**0.0**	**-21**			
	Hungary				**0.2**	**0.0**	**-20**			
	Greece				**0.7**	**0.0**	**-71**			
	Qatar				**0.5**	**0.0**	**-45**			
	United Arab Emirates				**0.5**	**0.0**	**-55**			
	Poland				**1.5**	**1.0**	**-53**			
GPW.WA	GPW	35.7	480	1		1.0		14.1	-6.4	6.0
	Russia				**4.7**	**4.5**	**-24**			
SBER.MM	Sberbank RF	73.6	46,073	1		1.0		4.7	-7.0	4.1
SNGS_P.MM	Surgutneftegaz	26.33	30,537	1		1.0		3.2	7.4	9.0
MGNTq.L	Magnit	59	27,896	1		1.5		21.6	29.7	1.4
NVTKq.L	Novatek OAO	103.85	31,400	1		1.0		10.4	25.7	2.9
	South Africa				**7.5**	**4.0**	**-351**			
MPTJ.J	Mpact Limited	30.11	460	2		2.0		12.5	3.0	2.8
	Turkey				**1.7**	**3.0**	**126**			
ARCLK.IS	Arcelik	13.6	4,291	1		1.5		13.0	13.1	3.3
SISE.IS	Sisecam	3.12	2,476	1		1.5		9.7	26.3	2.4
	LatAm				**18.9**	**14.0**	**-489**			
	Colombia				**1.0**	**0.0**	**-101**			
	Peru				**0.4**	**0.0**	**-43**			
	Brazil				**10.9**	**8.5**	**-242**			
VALE.N	Vale	14.35	70,901	1		2.5		9.5	1239.1	6.1
ITUB4.SA	Itaú Unibanco	35.1	85,751	1		2.0		10.1	20.0	3.0
BRKM5.SA	Braskem	14.03	4,291	2		2.0		12.3	23.9	1.7
PBRa.N	Petrobras	16.82	106,430	2		2.0		9.3	6.2	3.2
	Chile				**1.4**	**0.5**	**-93**			
RIP.SN	Ripley	342.7	1,160	2		0.5		15.8	-4.5	2.0
	Mexico				**5.1**	**5.0**	**-11**			
GENTERA.MX	Gentera	26.77	3,338	1		1.5		16.8	16.1	0.0
WALMEXV.MX	Walmex	32.83	43,588	2		2.0		24.1	6.4	3.8
OHLMEX.MX	OHL Mexico	38.44	5,038	1H		1.5		10.7	-10.8	0.0

Source: Citi Research estimates Note: Stock weights may not add up as stocks may be removed from time to time owing to internal restrictions or discontinuation of coverage.

Appendix A-1

Analyst Certification

The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

IMPORTANT DISCLOSURES

Hyundai Motor (005380.KS)

Ratings and Target Price History
Fundamental Research

Analyst: Ethan Kim

#	Date	Rating	Target Price	Closing Price
1	4-Oct-11	1M	*320,000.00	205,000.00
2	7-Oct-11	Stock rating system changed		
3	7-Oct-11	*1	320,000.00	200,000.00
4	23-Jul-12	1	*300,000.00	219,000.00
5	14-Nov-12	1	*280,000.00	216,500.00
6	18-Jan-13	1	*260,000.00	213,500.00
7	31-Jan-13	1	*254,000.00	205,000.00
8	26-Mar-13	1	*262,000.00	220,500.00
9	17-Apr-13	1	*256,000.00	192,500.00
10	9-Jun-13	1	*270,000.00	208,000.00
11	1-Oct-13	1	*320,000.00	254,500.00
12	21-Jul-14	1	*300,000.00	227,500.00

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Hyundai Motor (005380.KS)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Ethan Kim

#	Date	Rating	Target Price	Closing Price
1	9-Aug-11	*REM MP	-	194,000.00
2	7-Nov-11	*ADD MP	-	237,000.00
3	25-Apr-14	*REM MP	-	236,000.00

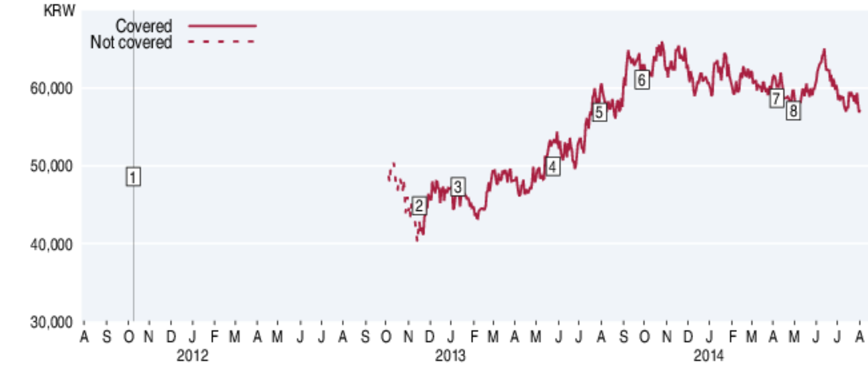
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Hankook Tire (161390.KS)

Ratings and Target Price History
Fundamental Research

Analyst: Ethan Kim
Covered since November 17 2012



	Date	Rating	Target Price	Closing Price
1	8-Oct-11	Stock rating system changed		
2	16-Nov-12	*1	*53,000.00	42,700.00
3	10-Jan-13	1	*56,000.00	46,600.00

	Date	Rating	Target Price	Closing Price
4	24-May-13	1	*65,000.00	53,100.00
5	30-Jul-13	1	*69,000.00	58,800.00
6	27-Sep-13	1	*77,000.00	63,100.00

	Date	Rating	Target Price	Closing Price
7	7-Apr-14	1	*73,000.00	60,200.00
8	30-Apr-14	1	*69,000.00	59,700.00

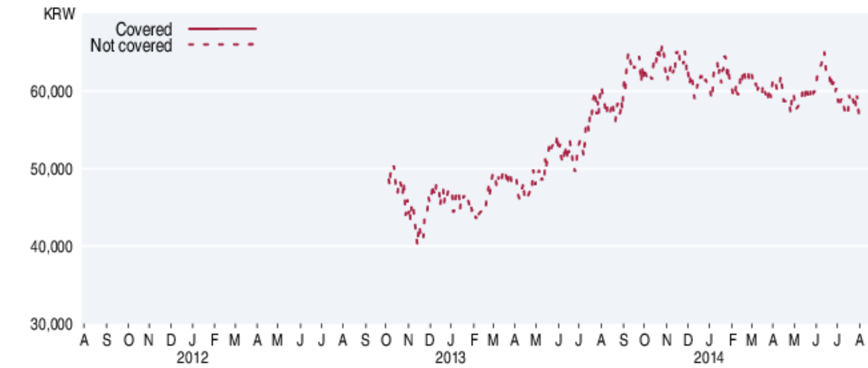
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Hankook Tire (161390.KS)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Ethan Kim
Covered since November 17 2012



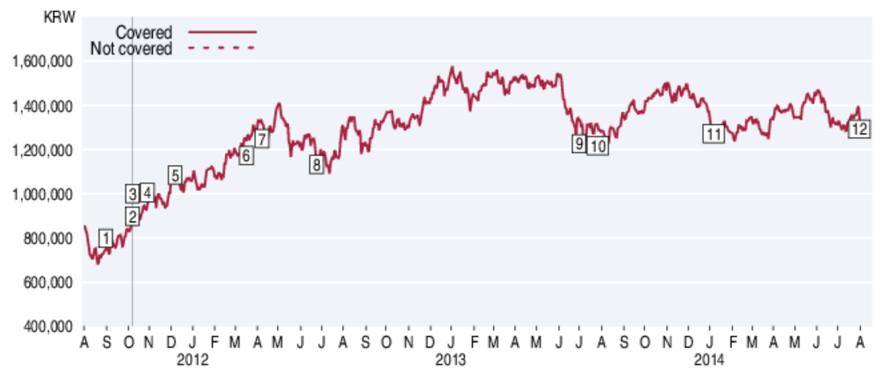
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Samsung Electronics (005930.KS)

Ratings and Target Price History
Fundamental Research

Analyst: Henry H Kim, CFA



	Date	Rating	Target Price	Closing Price
1	31-Aug-11	1L	*1,200,000.00	744,000.00
2	7-Oct-11	Stock rating system changed		
3	7-Oct-11	*1	1,200,000.00	860,000.00
4	28-Oct-11	1	*1,300,000.00	945,000.00

	Date	Rating	Target Price	Closing Price
5	7-Dec-11	1	*1,400,000.00	1,056,000.00
6	16-Mar-12	1	*1,800,000.00	1,238,000.00
7	9-Apr-12	1	*1,900,000.00	1,317,000.00
8	25-Jun-12	1	*1,970,000.00	1,132,000.00

	Date	Rating	Target Price	Closing Price
9	1-Jul-13	1	*1,950,000.00	1,326,000.00
10	26-Jul-13	1	*1,900,000.00	1,303,000.00
11	7-Jan-14	1	*1,800,000.00	1,304,000.00
12	31-Jul-14	1	*1,700,000.00	1,343,000.00

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Samsung Electronics (005930.KS)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Henry H Kim, CFA

	Date	Rating	Target Price	Closing Price
1	16-Mar-12	*ADD MP	-	1,238,000.00
2	31-Jan-14	*REM MP	-	1,280,000.00

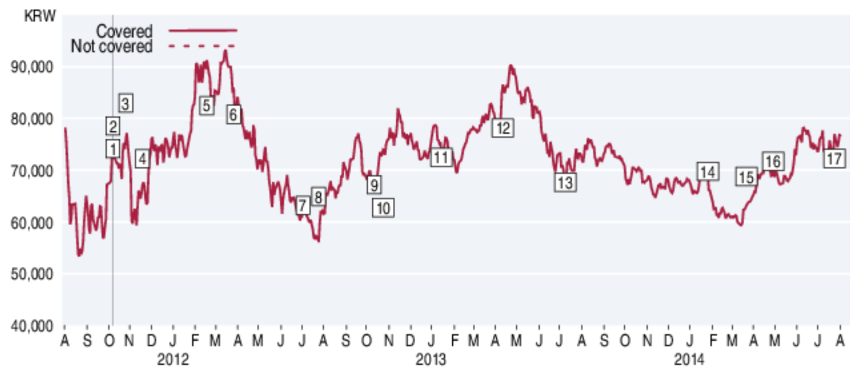
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

LG Electronics (066570.KS)

Ratings and Target Price History
Fundamental Research

Analyst: Henry H Kim, CFA



	Date	Rating	Target Price	Closing Price
1	7-Oct-11	Stock rating system changed		
2	7-Oct-11	*1	131,931.84	72,318.20
3	26-Oct-11	1	*112,386.39	75,738.66
4	18-Nov-11	1	*112,000.00	67,200.00
5	17-Feb-12	1	*107,000.00	91,300.00
6	27-Mar-12	1	*105,000.00	86,000.00
7	3-Jul-12	1	*93,000.00	63,200.00
8	25-Jul-12	1	*68,000.00	56,100.00
9	11-Oct-12	*2	*70,000.00	67,200.00
10	24-Oct-12	2	*75,000.00	74,000.00
11	15-Jan-13	2	*77,000.00	73,500.00
12	11-Apr-13	2	*89,000.00	86,600.00
13	9-Jul-13	2	*78,000.00	69,000.00
14	27-Jan-14	2	*75,000.00	68,900.00
15	21-Mar-14	2	*72,000.00	63,200.00
16	29-Apr-14	2	*80,000.00	71,700.00
17	24-Jul-14	2	*83,000.00	77,000.00

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

LG Electronics (066570.KS)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Henry H Kim, CFA

	Date	Rating	Target Price	Closing Price
1	8-Feb-12	*ADD LP	-	89,100.00
2	6-Aug-13	*REM LP	-	74,900.00

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Hyundai E&C (000720.KS)

Ratings and Target Price History
Fundamental Research

Analyst: Sungmee Park, CFA

	Date	Rating	Target Price	Closing Price
1	7-Oct-11	Stock rating system changed		
2	7-Oct-11	*1	110,000.00	57,000.00
3	20-Oct-11	1	*90,000.00	64,100.00
4	29-May-12	1	*83,000.00	69,900.00
5	4-Jan-13	1	*90,000.00	73,700.00
6	2-Jul-13	1	*85,000.00	56,800.00
7	3-Apr-14	1	*80,000.00	56,400.00

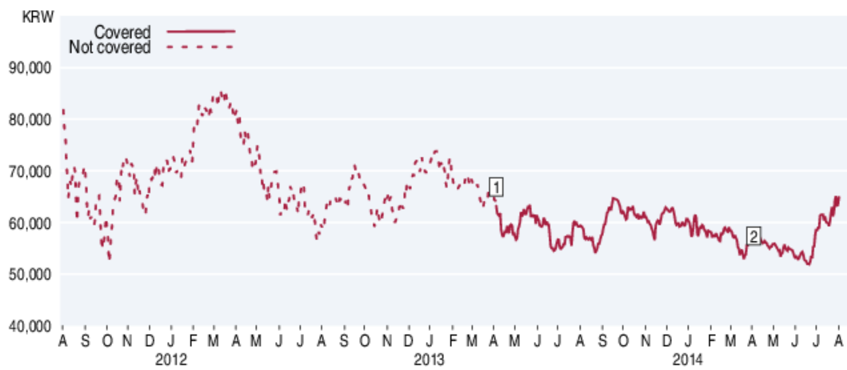
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Hyundai E&C (000720.KS)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Sungmee Park, CFA



	Date	Rating	Target Price	Closing Price
1	4-Apr-13	*ADD MP	-	63,200.00
2	3-Apr-14	*REM MP	-	56,400.00

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Citigroup Global Markets Inc. owns a position of 1 million USD or more in the debt securities of Vale SA

Due to Citigroup Global Market Inc.'s involvement in connection with the announced public tender offer by Itaú Unibanco Holding S.A. ('Itaú') to acquire the outstanding ordinary shares of Redecard not held by Itaú or its affiliates, Citi Research restricted publication of new research reports,and suspended its rating and target price for Itau on February 29,2012 (the 'Suspension Date'). Please note that Itau's price chart available on Citi Research's disclosure website does not reflect that Citi Research did not have a rating or target price between the Suspension date and June 4, 2012 when Citi Research resumed full coverage.

DMBH rating distribution versus Investment Banking service provision in the past 12 months as at 30th June 2014 is as follows: Buy (1) representing 26% of the DMBH coverage 0% of which are IB clients, Hold (2) representing 42% of the DMBH coverage 0% of which are IB clients, Sell (3) representing 32% of the DMBH coverage 0% of which are IB clients.

One or more members of the board of directors of one of the subsidiaries of Citigroup Holdings are members of the board of directors of OHL Mexico S.A.B. de CV. Citigroup Holdings or its affiliates beneficially owned 1% or more of any class of common equity securities of Ohl Mexico SAB de CV at the end of at least one of the last three months.

Citi is acting as a joint lead manager for Caifu Holdings Ltd, a wholly owned subsidiary of Guangzhou R&F Properties Co's senior notes offering.

Grupo Financiero Banamex Inc. or its subsidiaries' proprietary portfolio had 1% or more of the composition invested in securities of Walmart de México at the end of at least one of the last three months One or more members of the board of directors of one of the subsidiaries of Citigroup Holdings are members of the board of directors of Wal - Mart de Mexico, S.A.B. de C.V.

Citigroup Holdings or its affiliates beneficially owned 1% or more of any class of common equity securities of Compartamos SAB de CV at the end of at least one of the last three months.

Citigroup Global Markets Inc. or its affiliates beneficially owns 1% or more of any class of common equity securities of POSCO, OHL Mexico, Walmex, Gentera, Baidu.com, Tata Motors, AXIS Bank. This position reflects information available as of the prior business day.

Within the past 12 months, Citigroup Global Markets Inc. or its affiliates has acted as manager or co-manager of an offering of securities of China Construction Bank, CNOOC, Tencent Holdings, China Life Insurance, China Mobile, Petrobras, SK Hynix, ICICI Bank, Hyundai Motor, Sinopec, GPW, Industrial & Commercial Bank of China, Indocement, Bank of China, POSCO, Tata Consultancy Services, Guangzhou R&F Properties, PetroChina, Harbin Electric, Walmex, Braskem, China Unicom, Gentera, Tata Motors, SM Investments, AXIS Bank.

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