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Is the Sentiment Pendulum Swinging Back in Russia's Direction?

By The Moscow Times

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Is the sentiment pendulum finally starting to swing back in Russia's direction? Last week, fund manager megastar Jim Rogers said he might start investing in Russia, and Russia has attracted more portfolio investment than any other BRIC country in the past five weeks, witnessing unbroken gains over that period. Some analysts have even been incautious enough to start talking about an "autumn rally" for Russian equities.

Rogers' comments, made in an interview to CNBC television, are particularly shocking because he is famously down on Russia, and in the past has said the country is a kleptocracy and that he would never consider it as an investment destination. Rogers has been more bullish on China — he has even been bringing up his two daughters to speak Chinese.

"I do not invest in Russia now, but for the first time in my life I have started considering it," Rogers said on the show.

Rogers' claim to fame is that he was a co-founder with George Soros of the Quantum Group that broke the Bank of England in 1992, forcing it out of the Exchange Rate Mechanism and making the two men billionaires in the process.

But with China's economy slowing and Brazil's currency soaring to the point where its central bank has imposed currency controls, investors are starting to cycle out of the fashionable BRIC countries and into the unpopular ones.

Russia has enjoyed five weeks of net inflows, according to EPFR Global, and attracted more new money than any other emerging market through August except for South Korea. Troika Dialog's Chris Weafer said in a note this week that investors should start positioning themselves for a possible fall rally.

"Data provided by EPFR Global show that investors added a total of $4.3 billion into all EM [emerging markets] funds in August," Weafer wrote. "That compares with a net redemption of $189 million for July and a loss of $869 million in June. Despite the considerable uncertainty still prevalent in global markets, fund investors are generally optimistic that policymakers will come up with the right formula to at least provide a platform for an autumn rally."

Russia was one of the winners in August, adding $90 million (0.66% of assets under management, or AUM) last week, bringing the total for August to $244 million. This is a modest figure but was still the second highest amount among emerging market funds after South Korea, which attracted $866 million.

There are two factors driving investors into Russia. The first is simply that there is nowhere else to go. The "it girls" of emerging markets — China and Brazil — are both looking very rough after partying for so long. At the same time, fears of a renewed crisis in Europe are rising and will not abate for the foreseeable future, while America is looking a bit better — but not much.

The second thing is that Russia is looking more attractive than ever. The political fears that followed the first street protests last year have diminished as it becomes increasingly clear that there will be no "Russian spring," as the opposition has failed to make any progress in transforming itself from a popular protest movement into an effective political force.

As the hubris surrounding the protest story dies (all those BBC reporters flown in for the marches have gone home again) and the Eurozone crisis rumbles on, investors are slowly turning back to look at fundamentals. And Russia shines on this score even if its economy is slowing thanks to the pall of gloom that hangs over the whole world.

Does that mean stocks will go back toward their record highs set in May 2008? Not a chance. As Charlie Robertson, chief economist at Renaissance Capital, pointed out in a note last week, the current crisis is a once-in-a-century event like the Great Depression or America's first big crash in 1837, and these whopping collapses usually last eight years — so we are only halfway through this crisis.

Still, the slowdown is good news, as it has refocused the Kremlin on the need to make real reforms. The Economic Development Ministry drew up a crisis budget scenario last week that assumed an oil price of $60 a barrel, and the state has started implanting a Russian version of austerity (instead of spending masses of money, they are now only going to spend a lot of money).

Personally I hope oil prices do go to $60 and stay there so the Kremlin will be forced to do all those things it is doing half-heartedly now. It would be very painful. But after a few years, Russia would eventually emerge as a "normal" country. It is German Chancellor Angela Merkel who is in charge of that decision, however; she holds the power to precipitate the next wave of crisis or to avoid it.

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