



# *AEB Annual Pension Conference*

*November, 2011*

*Vladimir Potapov, CFA  
Head of Portfolio Management Business*



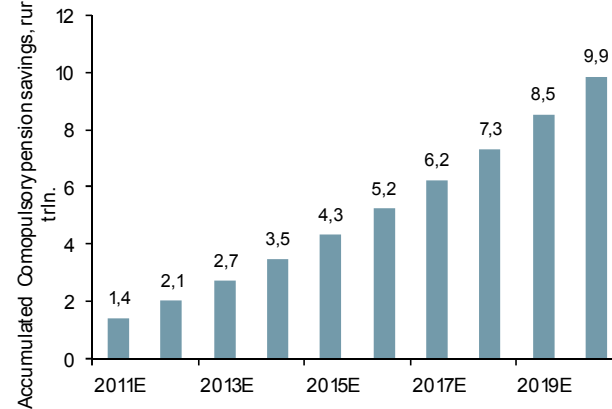


# Compulsory pension savings market

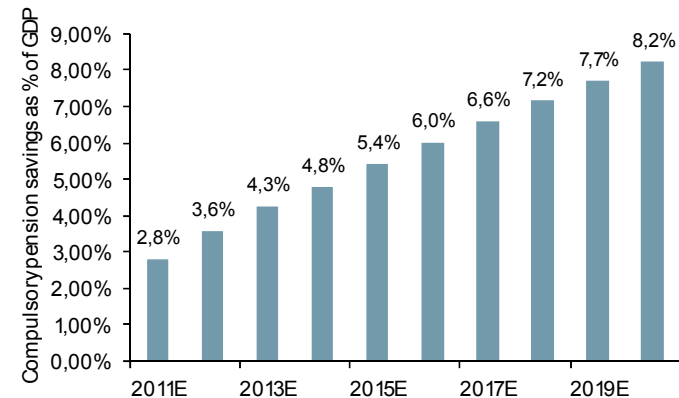
The growth of compulsory pension savings market is driven by mandatory contributions from employers and returns from investment of previously accumulated assets. We estimate 2012-2020 market CAGR at 24%.

The process of customer migration from VEB to NPFs is proceeding at full speed supported by intensive marketing efforts. Due to increase in the market share of NPFs and private AM companies this market may expand 10-fold by 2020.

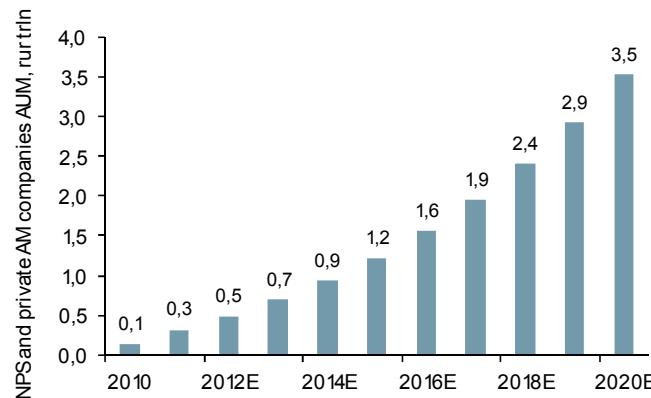
**Contributions from employers and investment gains should drive the total amount of compulsory pension savings from rur 1,4 trln as of 2011YE to rur 10 trln by 2020.**



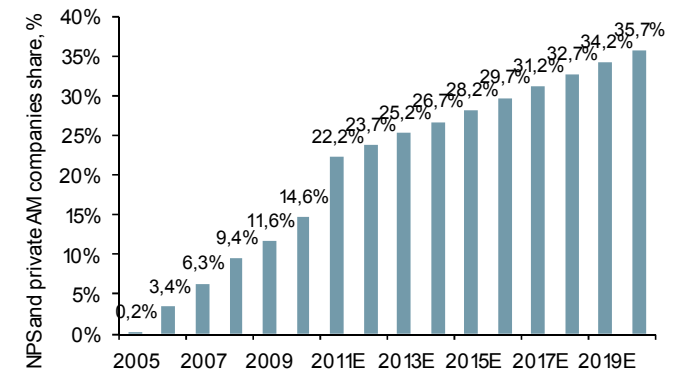
**... which is due to correspond to approximately 8% of Russian GDP**



**Migration from VEB to NPFs may increase the total market size 10 times during the next 10 years**



**% of compulsory pension savings managed by non-state pension funds (NPFs) and private asset management companies**



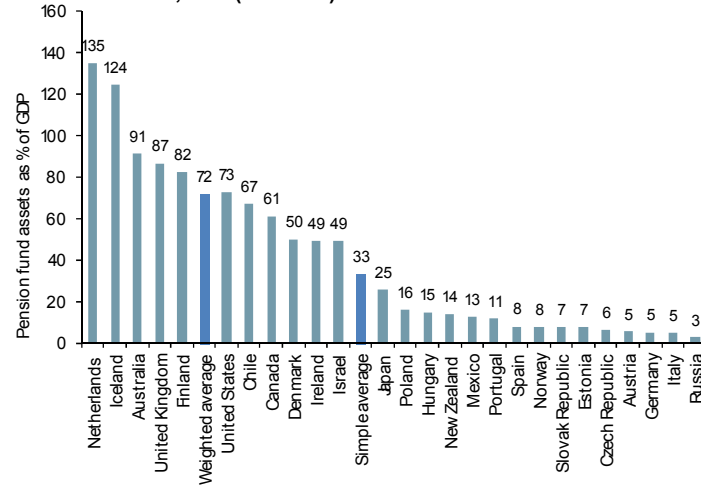
# International comparisons

Pension funds on average account for 33% of GDP within a sample of OECD countries, however individual market proportions vary widely.

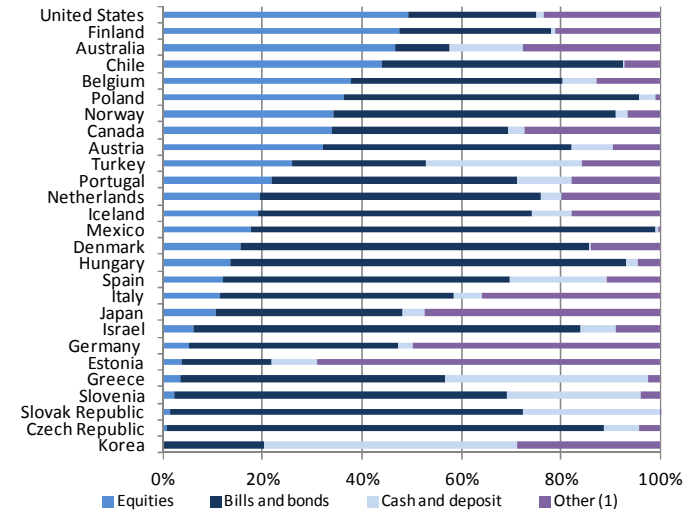
Highly developed pension fund markets such as United states, Australia, Finland tend to have a higher allocation to equities in the asset mix.

Pension fund annual operating costs range from 0,1% of year-average AUM in Denmark to 1,4% of AUM in Czech Republic

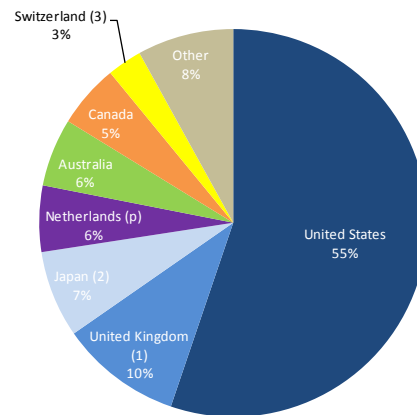
Importance of pension funds relative to the size of the economy in OECD countries, 2010 (% of GDP)



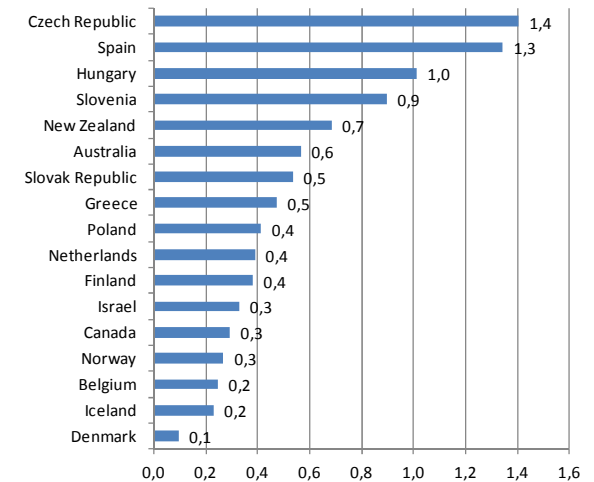
Pension fund asset allocation in selected OECD countries, 2010



Geographical distribution of pension fund assets in OECD countries, 2010



Operating costs in selected OECD countries, 2010 (% of total Assets)





## *Asset allocation – key challenge*

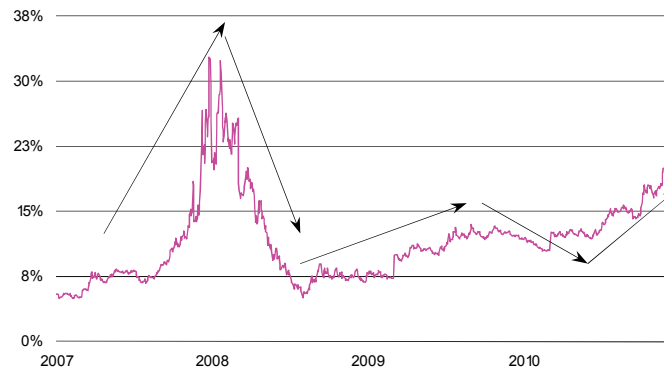
- **Asset allocation is an important determinant of investment returns and a potential source of alpha generation**
- **Legal constraints (A1 listing, implicit principal guaranty approach) impose a significant challenge**
- **It is hard to beat a simple approach based on regularly rebalanced neutral Equity / Fixed Income mix (~80%/20% for pension money)**
- **A bulk of variation in equity returns is explained by changes in implied Equity Risk Premium**
- **Equity risk premium has a more pronounced propensity to trend rather than mean-revert in the short to medium-term horizons**
- **Incorporating macro inputs into asset allocation is complicated because of the need to time an economic cycle with at least 3-month accuracy to be successful**
- **We employ a combination of valuation and macro factors for tactical asset allocation decisions**

# Tactical Asset Allocation: what works and what hurts

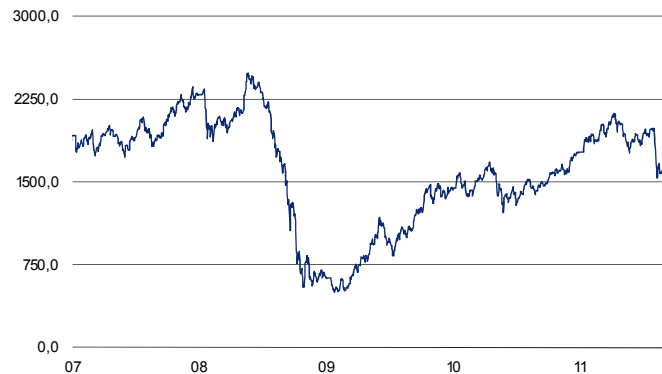
ERP (EPS / Price – Bond Yield + g ) tends to mean-revert only at relatively long time horizons (12 months+). Over the shorter-term horizons (3-6 months) the trend component is much stronger. A high absolute level of ERP does not mean that it cannot subsequently go even higher.

Overweighting risk too early based on seemingly high level of risk premium may be disastrous for performance.

Russian Implied Equity Risk Premium, %



RTS Index

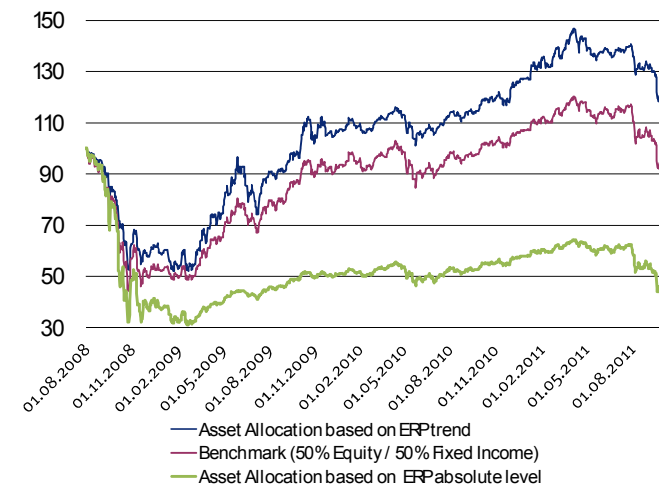


## Sample Asset Allocation Rules

Following the trend: +/- 20% equity overweight/underweight based on direction of implied ERP for the previous 3 months

Hunting for Value: +/- 5% equity overweight/underweight for each 100 bps deviation of implied ERP above/below 12% (LT average level).

## Simulated Performance of Asset Allocation Rules based on Implied ERP



Source: Bloomberg, VTBC IM estimates

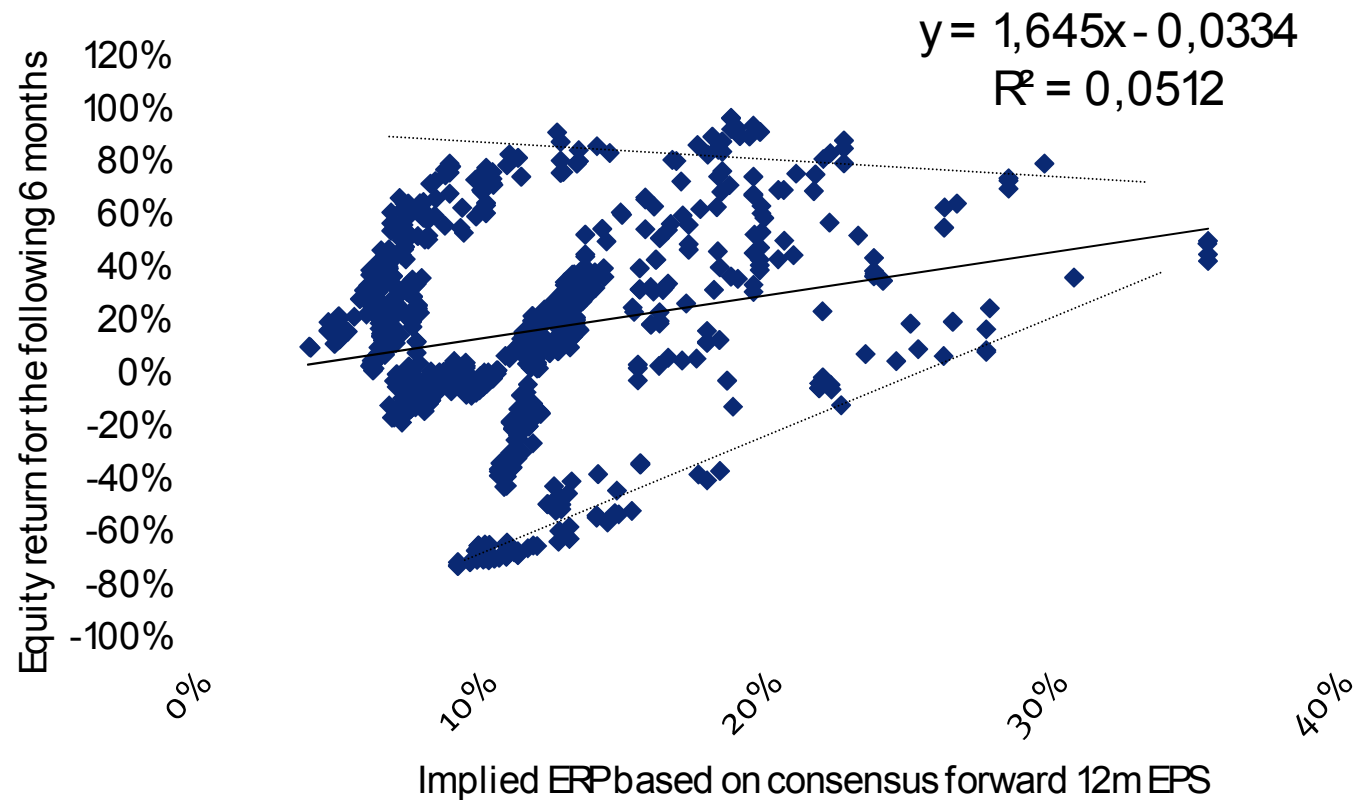
# Absolute level of ERP is a poor predictor of medium-term returns

6-month equity returns are positively related to the initial level of implied equity risk premium but the strength of such relationship is rather weak and variation of possible outcomes given the starting level of implied equity risk premium is extremely high.

High equity returns are likely to follow only after risk premium becomes extremely stretched.

Normalized levels of ERP (5%-7%) are associated with the widest dispersion of possible returns afterwards.

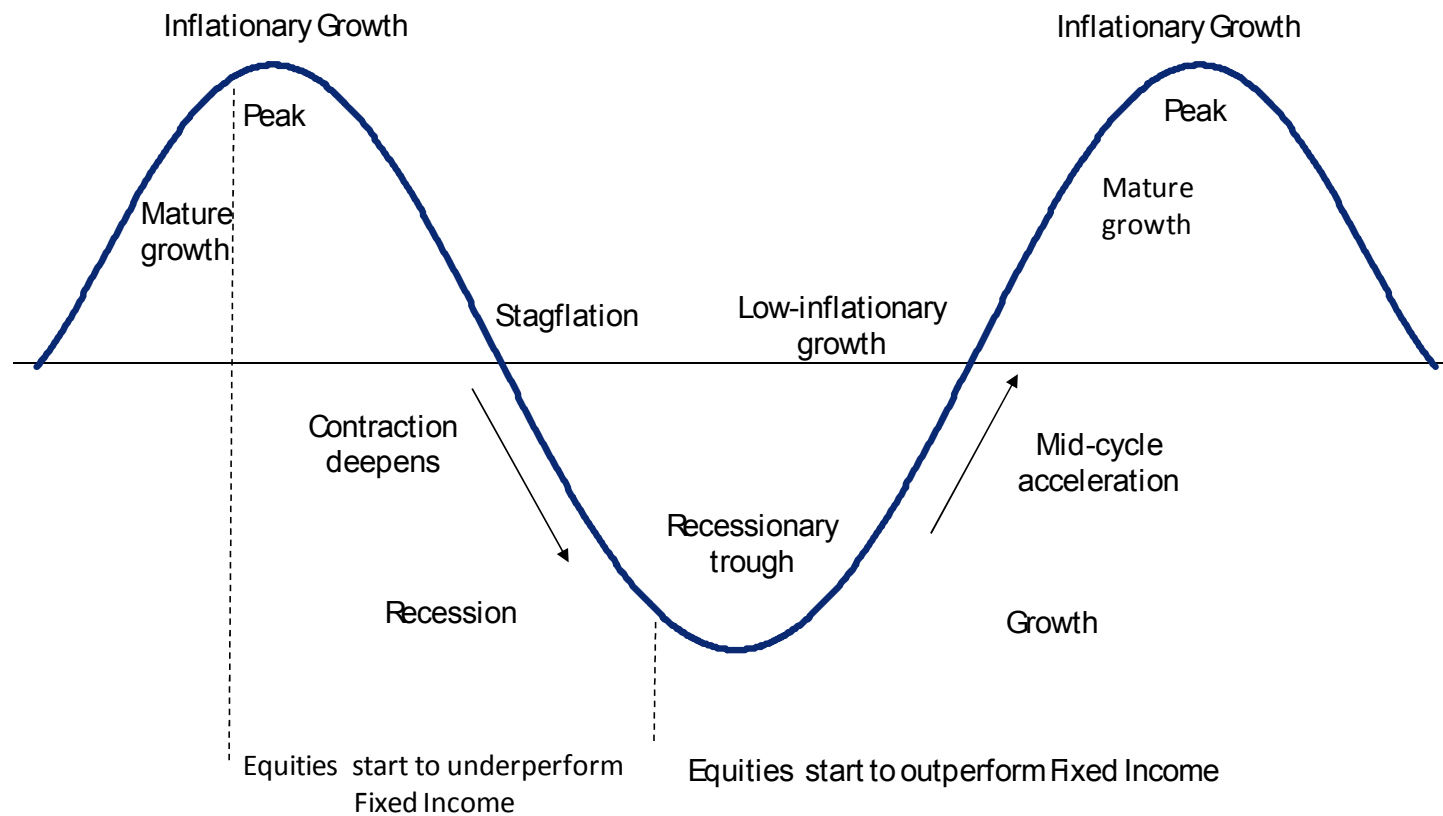
## Relationship between the Implied ERP and subsequent equity returns



Source: Bloomberg, VTBC IM estimates

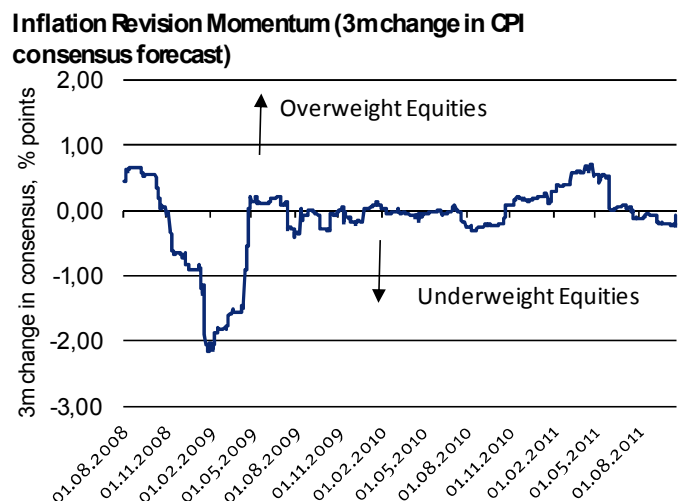
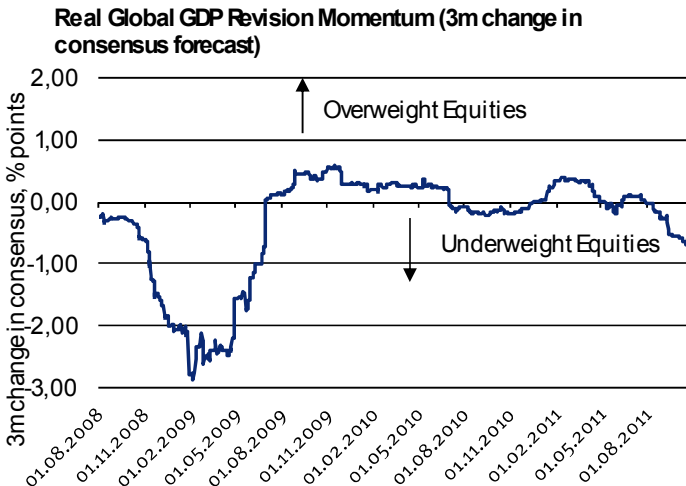
# *We need to time an economic cycle to make successful asset allocation decisions*

## **Business cycle and equity market performance**





# GDP factor can add value in terms of improved performance and volatility reduction while inflation factor effect is mixed



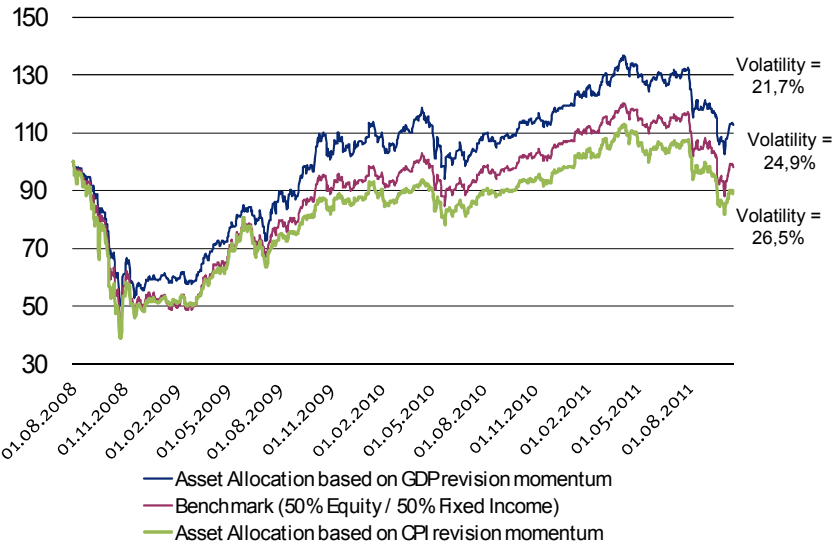
Source: Bloomberg, VTBC IM estimates

## Sample Asset Allocation Rules

**Global GDP Factor: 15% equity overweight/underweight if the 3-month change in consensus Global GDP forecast is above/below zero**

**Global Inflation Factor: 15% equity overweight/underweight if the 3-month change in consensus Global CPI forecast is above/below zero**

## Simulated Performance of Asset Allocation Rules based on Macro Factors





# Russian equities: scenario analysis

RTS Index is now trading close to 5x next 12m forward EPS estimate. The process of downgrading unrealistically high earnings expectations has already started and current market consensus is much closer to long-term sustainable profitability levels compared than in was in the middle of 2011.

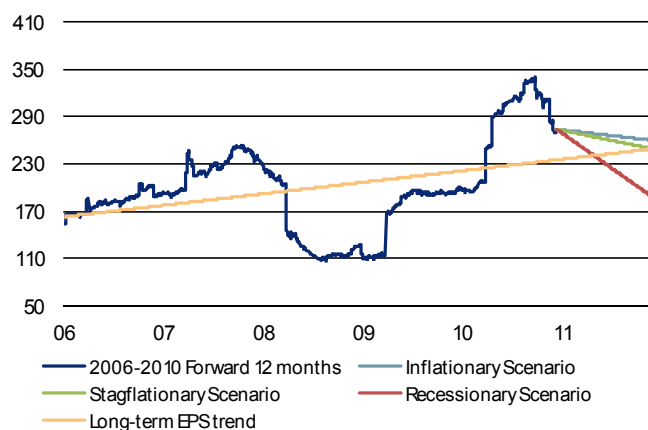
Our inflationary scenario assumes RTS Index mid-cycle ROE of 15,7% and target P/E ratio of 11,4x which results 12m fair value estimate of 2953 points. Recessionary scenario assumes corporate profitability at cyclically through levels and elevated risk premium. Stagflationary scenario assumes somewhat higher profitability levels due to higher commodity prices, but the latter is being outweigh by multiple compression due to higher interest rates and risk premium.

Probability-weighted total return estimate for RTS Index is 44,7%.

## RTS Index Top-Down Scenarios (Next 12 months)

	Recessionary Scenario	Inflationary Scenario	Stagflationary Scenario
EPS2010, \$	212,5	212,5	212,5
Normalized EPS	181,0	258,3	246,8
Russian Sovereign Risk, %	5,6%	4,7%	5,8%
Russian ERP, %	12,0%	7,0%	8,0%
Terminal earnings growth, %	3,0%	3,0%	3,0%
Current RTS Index Value	1500	1500	1500
Target P/E multiple	6,4	11,4	9,1
RTS Index Fair Value	1243	2953	2290
Upside/ Downside, %	-17,1%	96,8%	52,7%
Dividend Yield, %	1,9%	2,6%	2,5%
Total Return, %	-15,2%	99,4%	55,2%
Probability-weighted return, %		44,7%	
Estimated probability, %	40%	40%	20%

Scenarios of RTS Index EPS Normalization



RTS Index Target P/E Scenarios



Source: Bloomberg, VTB Capital investment Management estimates

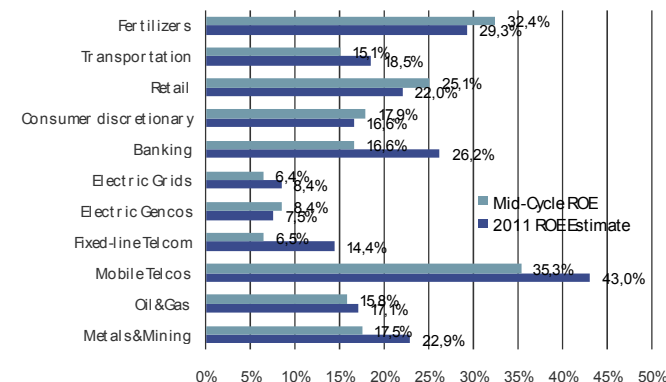
# We expect earnings to normalize at 15%-16% ROE

RTS Index trading at 5,5x EPS'11 means that investors are reluctant to believe that the current level of corporate profitability is sustainable in the longer term. Last time we had a chance to see similar valuation levels right after Lehman filed for Chapter 11 in Sep'08.

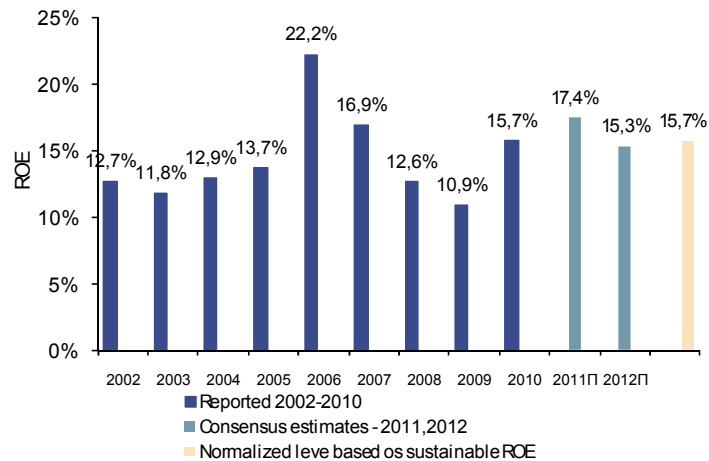
Given the sector structure of RTS Index we estimate its sustainable mid-cycle ROE at 15,7% (assuming \$90 LT Brent) which represents some reduction from the peak profitability level of 2011. The corresponding cyclically-adjusted EPS estimate is approximately 10% below the 12m forward consensus, but nowhere near the 40-50% earnings recession being priced in by the market.

Normalized ROE Estimate		
	Index Weight	Normalized ROE Estimate
Oil&Gas	46,9%	14,0%
Metals&Mining	14,6%	18,0%
Telecoms	5,0%	20,0%
Consumer	2,4%	20,0%
Banking	17,1%	16,0%
Electric Utilities	6,2%	12,0%
Fertilizer	7,2%	20,0%
Transportation	0,5%	15,0%
<b>Aggregate - RTS index</b>	<b>100,0%</b>	<b>15,7%</b>

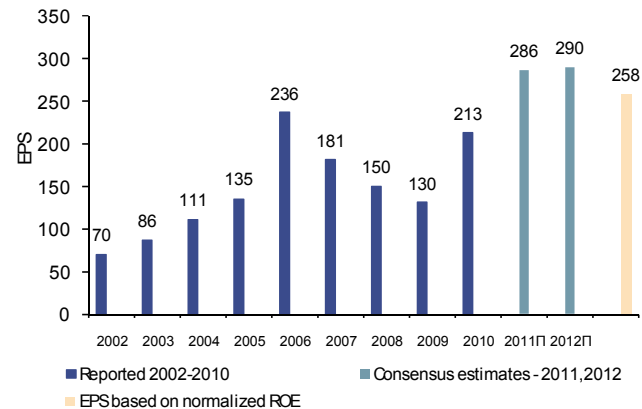
2011E ROE by sector compared with last cycle average



RTS Index ROE



RTS Index EPS

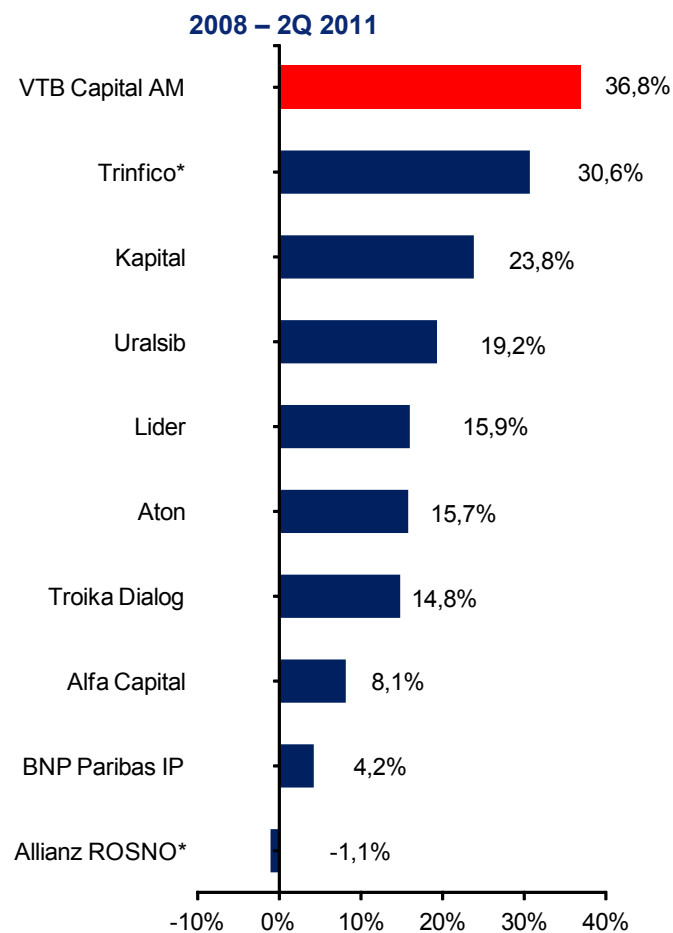


Source: Bloomberg, VTBC IM estimates

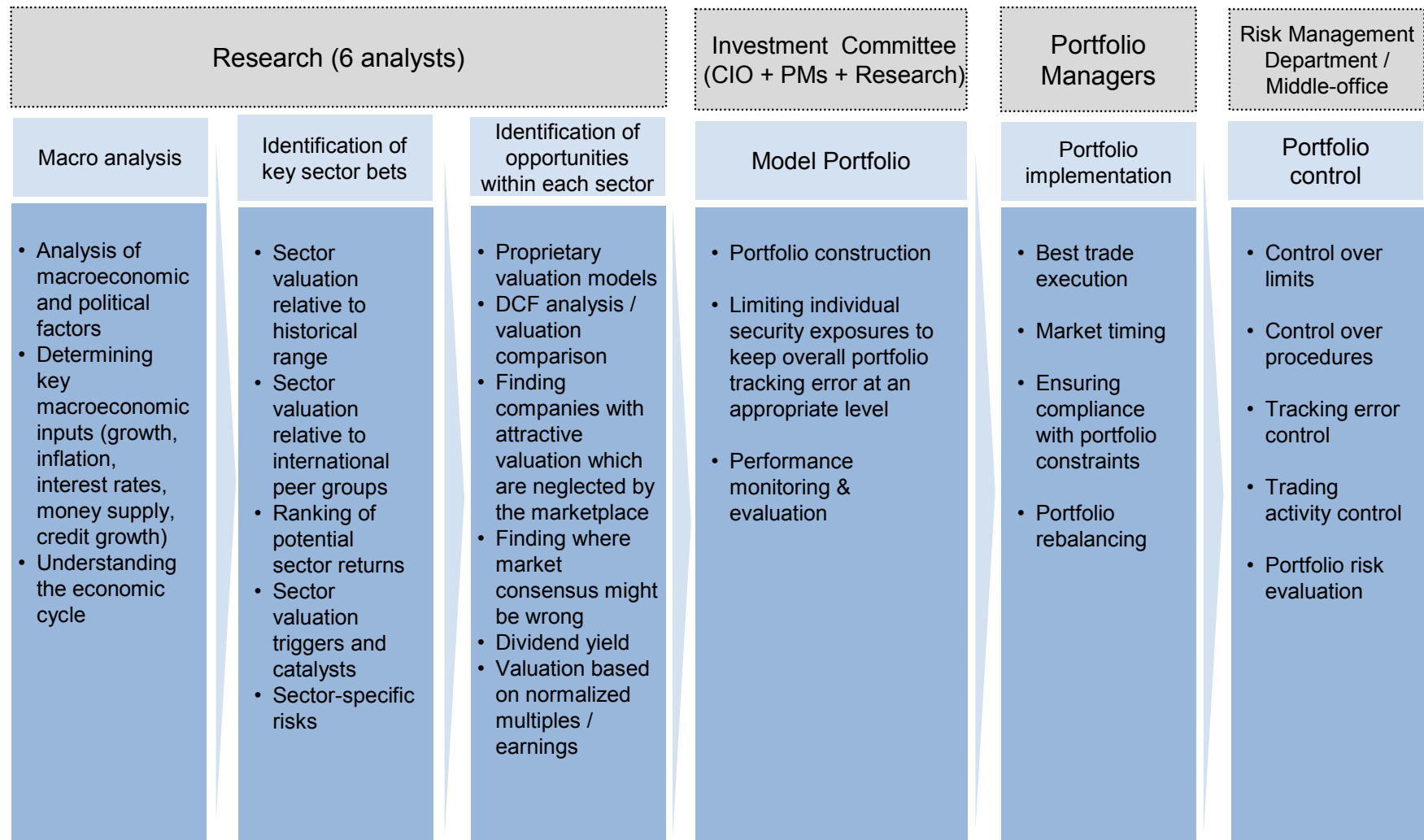
# A strong track record underpinned by sound investment process

VTB Capital Asset Management is leading within the long-term performance ranking of the most respectable domestic investment managers.

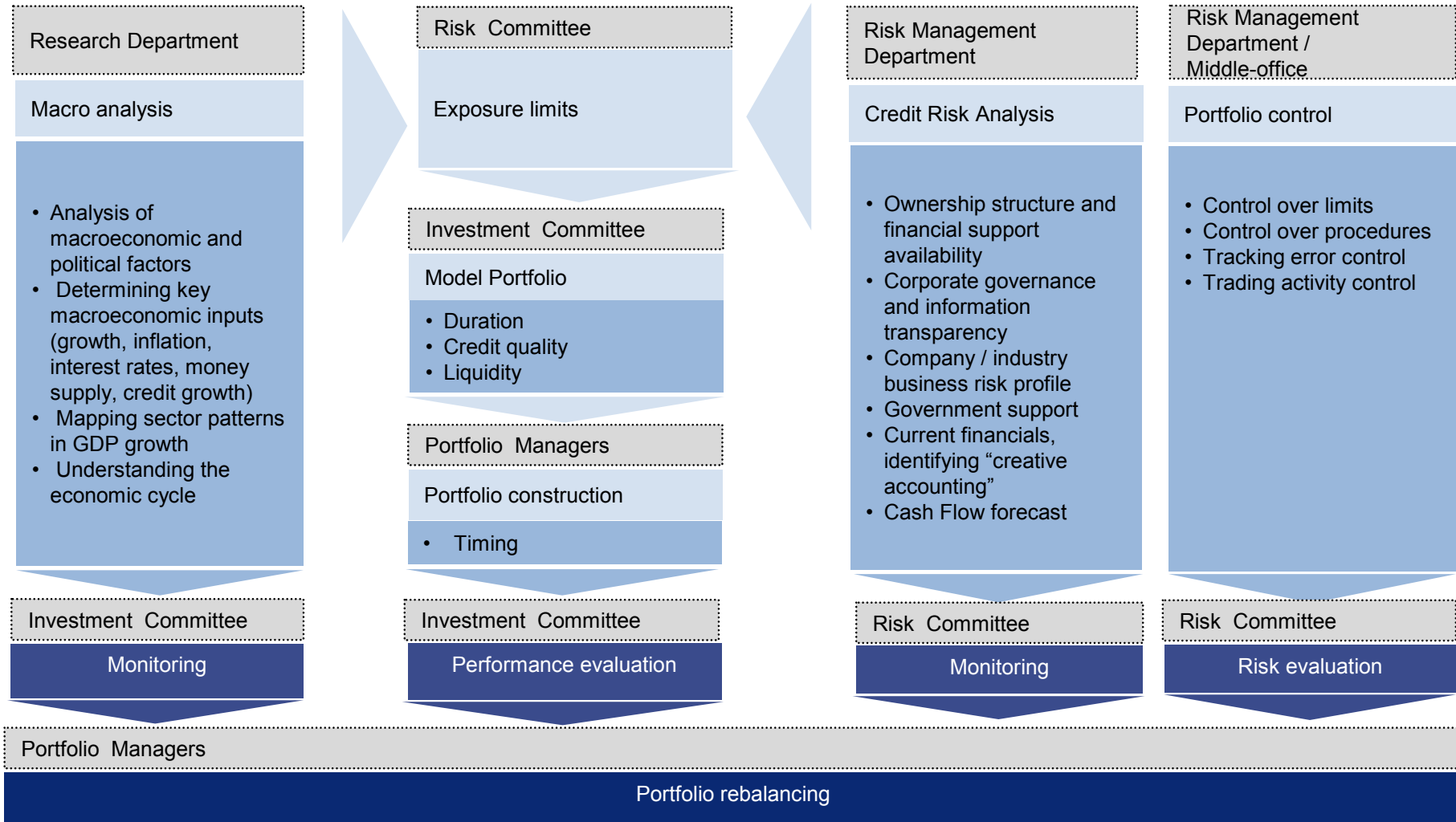
## Pension savings investment performance



# Stock selection process



# Bond Selection Process



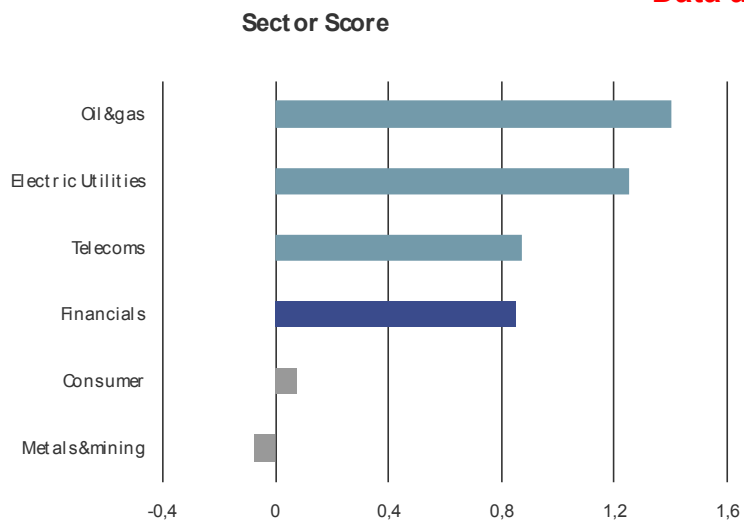
# Stock selection process on a sector level

We employ a multi-factor sector ranking model to decide in which sectors to be overweight / underweight. We rank sectors by aggregate valuation upside to in-house DCF models, 1Y forward P/E premium/discount to international peers, sector-specific catalysts and risks, earnings revision momentum. We weight sector rankings in each category to get a total sector attractiveness score.

Sector selection scorecard											
Sector	DCF upside, %		P/E (1Y Fwd) discount/premium to international peers		Sector-specific risks	Sector-specific catalysts	Earnings Revision Momentum (last 3m)		Current P/BV valuation as % of 5Y average		Total score*
	Value	Score*	Value	Score*	Value	Score*	Value	Score*	Value	Score*	
Oil&gas	43%	2	-40%	2	-1	1	6%	1	70%	1	1,40
Metals&mining	5%	0	-11%	1	-1	0	-4%	0	124%	-1	-0,08
Telecoms	32%	2	-17%	1	-1	0	-3%	0	99%	0	0,88
Financials	23%	1	-13%	1	-1	1	5%	0	65%	2	0,85
Consumer	8%	0	15%	-1	1	2	9%	1	144%	-1	0,08
Electric Utilities	51%	2	-42%	2	-2	0	0%	0	49%	2	1,25
Weight	40%		15%		8%	8%	15%		15%		100%

\* Score definitions: "2" - very attractive, "1" - attractive, "0" - neutral, "-1" - negative, "-2" - very negative

Data as of July 2011

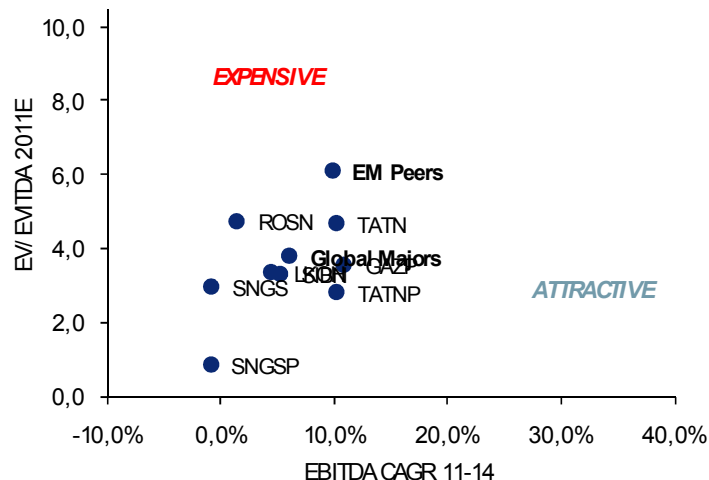


Source: Bloomberg, VTBC IM estimates

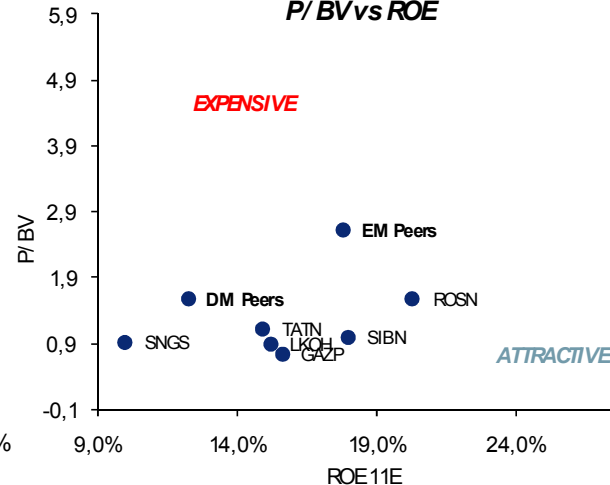
# Choosing winners within each sector (oil & gas sector example)

We use a combination of in-house DCF models together with other valuation metrics to determine the most attractive / expensive stocks within each sector and place overweight / underweight accordingly

**EV/ EBITDA11E vs EBITDA CAGR 11-14**

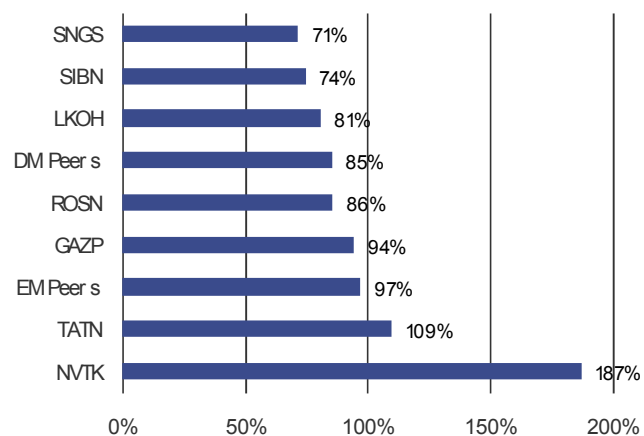


**P/ BV vs ROE**

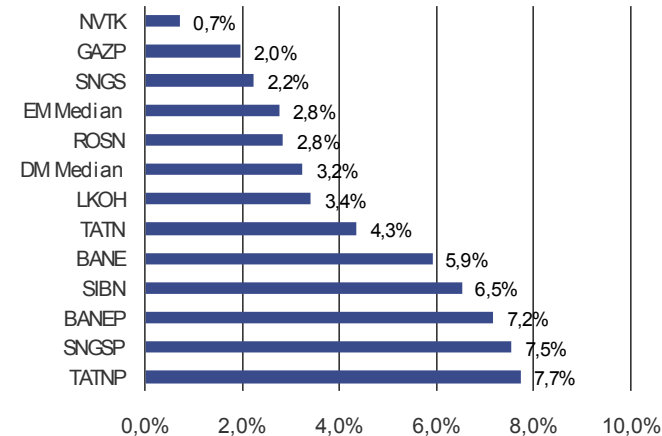


Data as of July 2011

**EV/ EBITDA11E as % of 5Y average**



**2011E Dividend Yield**



Source: Bloomberg, VTBC IM estimates

# The Portfolio Management Team



**Vladimir Potapov, CFA**  
Head of Portfolio  
Management Business

Joined VTB AM as Head of Portfolio Management Business of CJSC VTB Asset Management (VTB AM) in 2010. Vladimir Potapov is responsible for the strategy development and implementation in Portfolio Management Business. Prior to joining VTB Capital, Vladimir spent over 7 years at Troika Dialog, acting as a Director and Portfolio Manager. Under his supervision Troika mutual funds were recognized for their outstanding performance among the largest in their categories. Vladimir Potapov's team managed funds worth over USD 3.5bn in total. Vladimir graduated with honors from the Higher School of Economics and People University of China (Beijing) . CFA and FSC 1.0, 5.0 certified.



**Sergey Dyudin**  
Head of Portfolio Division

Joined the team in November 2006 and responsible for portfolio investment Experienced in the Russian financial markets 1996-2006 - Head of Trading, IFC Solid 1995-1996 - Head of Trading, BC Raptors Group 1994-1995 - Trader, IR Business Services FFMS Series 1.0, 5.0 , MICEX and RTS certified.



**Ivan Ilushin, CFA**  
Head of Research

Joined the team in November 2007

- Responsible for overall research support for the firm's investment decision-making process including valuation modeling, security selection and asset allocation
- 2006-2007 – Head of Research - Alliance Continental AM
- 2001-2006 – Analyst, Senior Analyst, Head of Equity Research – Uralsib Asset management
- 1999-2001 – Investment Specialist, ZAO "National Investment Agency"
- Earned a CFA Charter in 2005
- Graduated from Moscow State University in 2000
- FSC 1.1 certified.



**Alexey Vorobiev**  
Chief Economist, Deputy  
Head of Research

Joined the team in November 2007  
PhD, specialized in finance  
10 years experience in financial markets at Aton Capital, Maxwell AM, VTB AM  
Responsible for the top-down macro analysis, FX/rates, research support for strategic and tactical asset allocation  
2007 FFMS 5.0 certified  
2006 Institute of Economy of RAS, Moscow postgraduate study, PhD, Dissertation titled "Dividend Policy Optimization"  
2004 Moscow University for the Humanities, Moscow postgraduate study  
2001 State University of Management, Moscow graduate, Diploma with Honors



**Oleg Tsetsegov, CFA**  
Portfolio Manager

Joined the team in June 2008  
Responsible for the management of open-end mutual funds portfolios "VTB - Treasury Fund", "VTB - Bonds Plus", "VTB - Balanced Fund", "Leader-Invest", "Closed-end mutual funds", NPF, RPF retirement savings and wealth management in fixed income instruments.  
2007-2008 - Asset Manager, Alliance Continental  
2003-2007 - Asset Manager, Region  
1999-2003 - Trader, IC RFT  
1997-1998 - Specialist / Head of Depository, Renaissance Capital  
Russian Government Finance Academy graduate  
CFA and FSC 1.0, 5.0 certified.



**Miftahov Il'nar**  
Portfolio Manager

Responsible for managing the mutual fund portfolios "VTB - Fund Industry", "VTB - Electric Power Fund", "VTB - Foundation for Consumers", "VTB - Promising Investment Fund"  
2003-2007 - Portfolio Manager, Capital AM , with the last two years managing strategy for Tier 2 companies  
M.V. Lomonosov Moscow State University graduate  
FCSM 5.0 certified.



**Eduard Harin**  
Portfolio Manager

Joined the team in 2007 as a fund manager  
In charge of managing portfolios of the mutual funds "VTB - Fund Oil and Gas Sector", "VTB - Fund Financial Sector".  
2005-2007 - Portfolio Manager, Capital  
2006 - Best Portfolio Manager, Finance Magazine and RBC  
2004-2005 - Trader, BrokerCreditService  
2002-2004 - Securities Specialist , Capital-Invest  
Higher School of Economics, Perm graduate  
FFMS 5.0 certified.



**Andrey Matveev**  
Portfolio Manager

Responsible for "VTB - Telecommunications Fund", "VTB - Fund companies with state participation," VTB - Balanced Fund ", "VTB - Bonds plus  
1997-2007 –Different positions in Uralsib; Asset Manager , Northbrook; Otkritie AM; Managed the funds of mutual funds, nongovernmental pension funds, pension funds, RPF customer control.  
M.V. Lomonosov Moscow State University Moscow State University, graduate specializing in applied mathematics  
FFMS 5.0 certified.





## *Contacts*

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