Russian Market

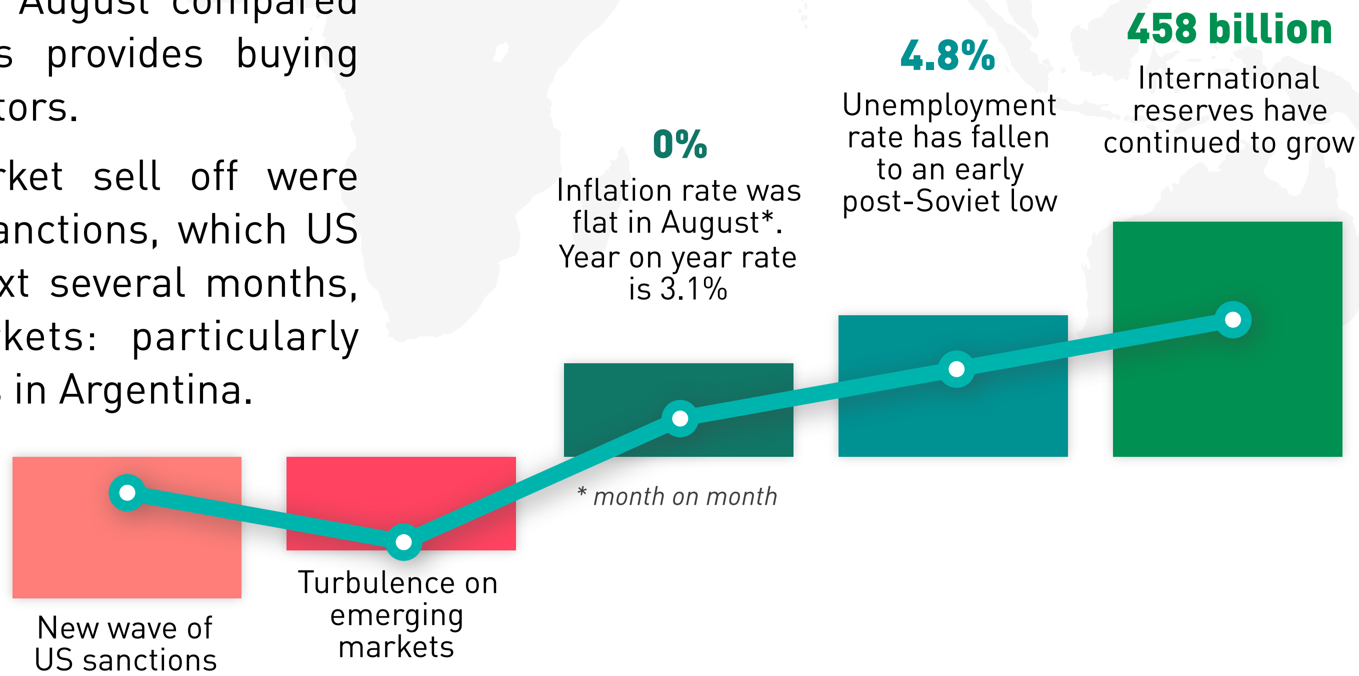
ITI Funds Newsletter
September 2018

Russian USD Eurobonds outperformed broader USD Emerging Markets: ITI Russia-focused USD Eurobond Index lost 1.75% for the last month vs JP Morgan Emerging Markets Bond index was down 2.03%

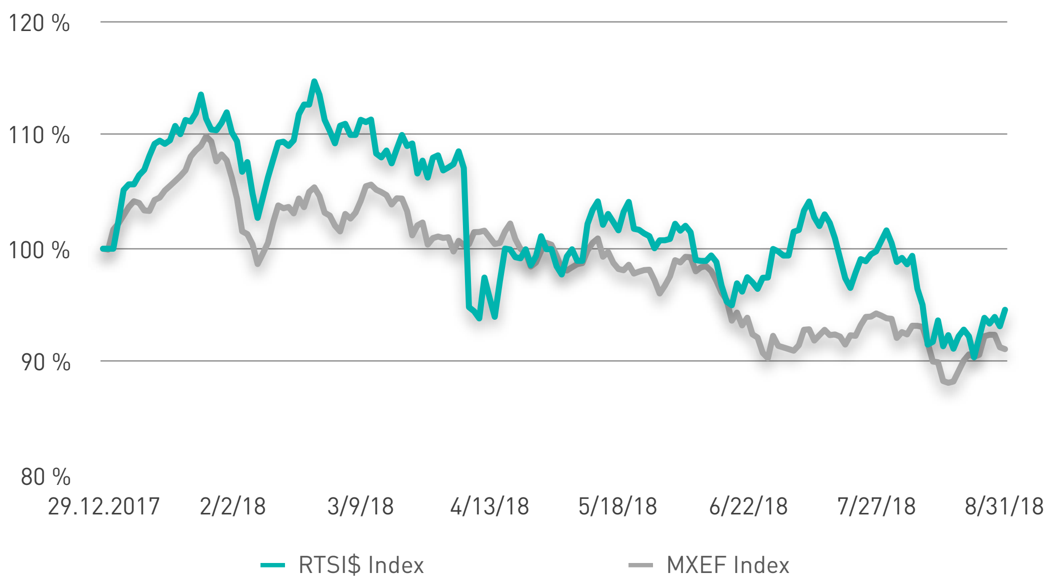
The RTS index decreased by 6.9% in August compared with 2.9% drop for MSCI EM. This provides buying opportunity for emerging market investors.

The main reasons for Russian market sell off were uncertainty about new round of US sanctions, which US Congress should discuss over the next several months, and turbulence on emerging markets: particularly Turkey's currency crisis and debt crisis in Argentina.

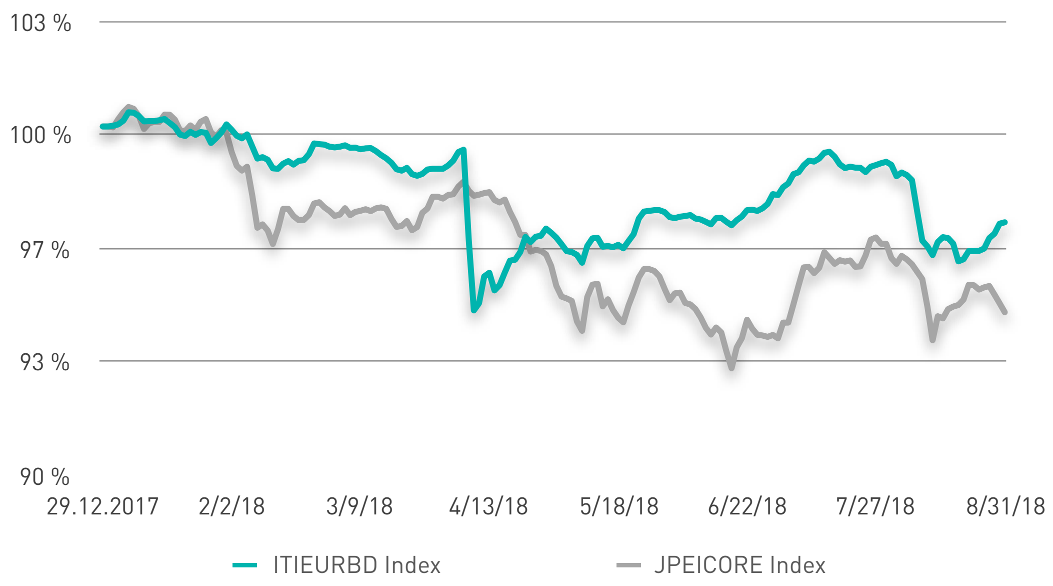
Despite sanctions, Russia's economic fundamentals have remained stable:



RTS Index performance vs MSCI EM

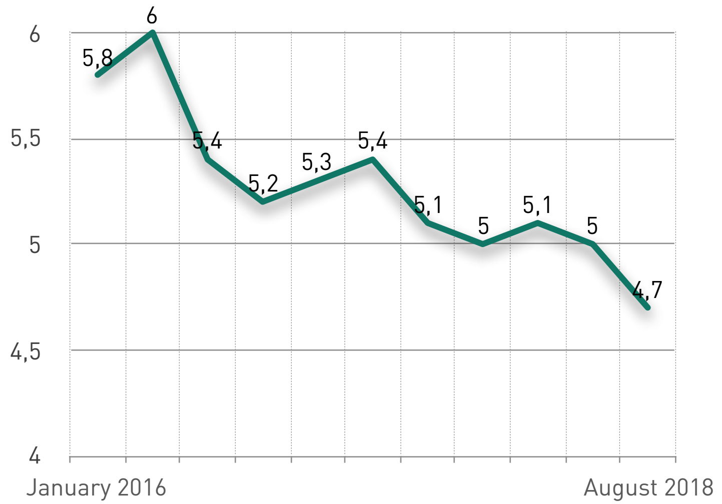


ITIEURBD index performance vs EM



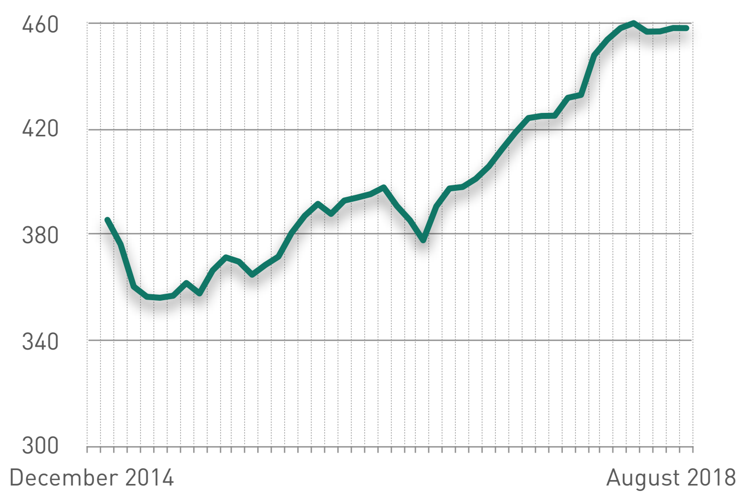
Russian unemployment rate

Unemployment fell to an early post-Soviet low



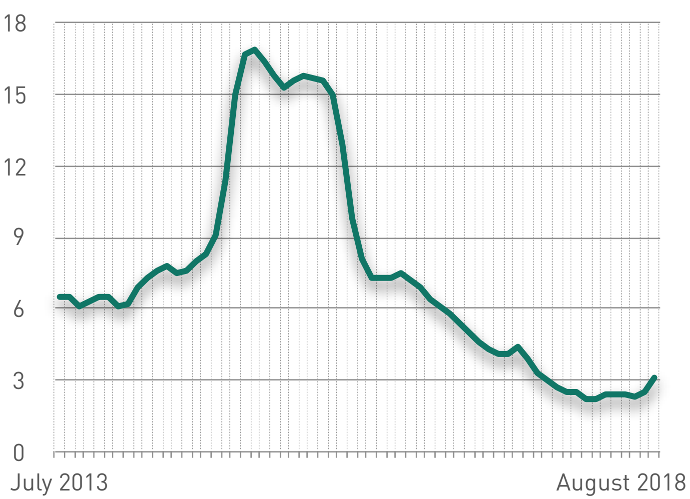
International reserves, in USD

Russia's international reserves continued to grow



Year-over-year inflation rate

Inflation is consistently dropping since 2015



Source: Bloomberg, ITI Funds as of 08/31/2018

What happened

US sanctions: do they make any difference?

The latest set of US sanctions against Russia in response to chemical weapons / U.K. poisoning sanctions came into effect on August 27. This first wave of the sanctions tightens restrictions on exports of national security-sensitive items. The second wave, which may come in 90 days, could include ban on trade with Russia and suspend diplomatic relations.

New U.S. sanctions which came into effect have had little impact on the Russian economy and the financial market, despite new bill which was submitted to Congress earlier in August by senators Lindsey Graham and Bob Mendez.

U.S. senators prepared a draft bill, called DASKAA (Defending American Security from Kremlin Aggression Act of 2018) that includes restrictions on investment in new Russian sovereign debt and bans several state-run Russian banks from operating in the United States.

Even with renewed sanctions concerns, foreign investors, for the second consecutive month, have been cautiously increasing their investments in Russia. According to EPFR (Emerging Portfolio Fund Research) since the beginning of the August, **the inflow of funds targeting Russia investments has been exceeded $100 million**. The recovery of interest in ruble assets is supported by higher oil prices and the the increase of ruble yields.

Brent Oil prices were at their highest level for the last several years, they increased by 4.3% to 77.4 in August. This increase is mainly due to growing concerns that U.S. sanctions on Iran will decrease the OPEC member's exports and create a supply gap that other producers may struggle to fill.

What to watch

Diversification is still a good choice

Most analysts do not expect this "Bill from Hell" to become law, because it might have a too big a side effect on international markets. We assumed that the Russian market overreacted on these renewed sanctions concerns and that the recent Russian market sharp fall is a good buying opportunity.

One of the reasons we see the RTS rebound will be RUB appreciation, from the current USDRUB level of 71 (lowest RUB value since 2014). The Russian currency may reverse a substantial amount of previous losses due to possibility of future rate hikes. CBR Governor Elvira Nabiullina said at the beginning of September that "there were factors in favor of rising interest rates". Higher rate and bond yields will bring back the appetite for carry trading. We anticipate that investors who previously abandoned the carry trade will return to the market, which should create additional demand for Russian currency.

Relevant to other EM countries, Russia's Economy is in a good shape. Both S&P and Fitch retained its positive outlook for Russia, and maintained its investment grade. "The Russian economy has coped well with the new round of U.S. sanctions," Fitch said in the statement. According to the Fitch, Russia has "a strong sovereign balance sheet, robust external finances and a credible macro-economic policy framework". It has estimated a general government debt ratio of 16.2% of gross domestic product in 2018, among the lowest in the BBB category.

RATINGS

AGENCY	RATING	OUTLOOK
S&P	BBB-	stable
Moody's	Ba1	positive
Fitch	BBB-	positive

RUSSIA ECONOMIC ACTIVITY

	1Q 18	2Q 18	3Q 18	4Q 18	2018
RUSSIA ECONOMIC ACTIVITY					
Real GDP (YoY %)	1.3	1.8	1.9	2.2	1.8
Industiial Prodaction (YoY %)	1.8	3	2.5	2.9	2.5
PRICE INDICES					
CPI (YoY%)	2.3	2.4	3.3	3.7	2.9
LABOR MARKET					
Unemployment (%)	5.1	4.8	4.8	4.9	4.9
INTEREST RATES					
Key Rate	7.25	7.25	7.25	7.25	7.25
EXCHANGE RATES					
USDRUB	57.34	62.78	64.2	65	65

Source: State Statistics Committee, CBR, Bloomberg, ITI Funds

Negative news made Russian capital markets to ignore the strong economic fundamentals - Russia's high real interest rates, current-account surplus, strong fiscal balance and solid reserve-cover ratios - all leaving the ruble and financial assets undervalued.

Diversification today must be a key element to any investment strategy, especially when there is an internal risk - potential sanction from U.S. - and external risk - the trade war between the U.S. and China might further intensify, which could have negative impact on the global growth.

Both our ETFs (RUSE and RUSB) provide investors with a diversified exposure to Russian Market.

ITI Funds RTS Equity UCITS ETF (RUSE), which replicates the RTS index (benchmark for the Russian Market) invests in 41 physical shares traded on Moscow Exchange, providing diversified exposure to 13 industries. Dividend yield is 5%+

ITI Funds Russia-focused USD Eurobond UCITS ETF (RUSB), which replicates the total return of the ITIEURBD Index, offers unique opportunity to have physical access to 23 Russian USD Eurobonds, issued by top quality sovereign, quasi-sovereign and corporates.

ITI FUNDS

RUSE

41 physical shares

RTS® index

RUSB

23 USD Eurobonds

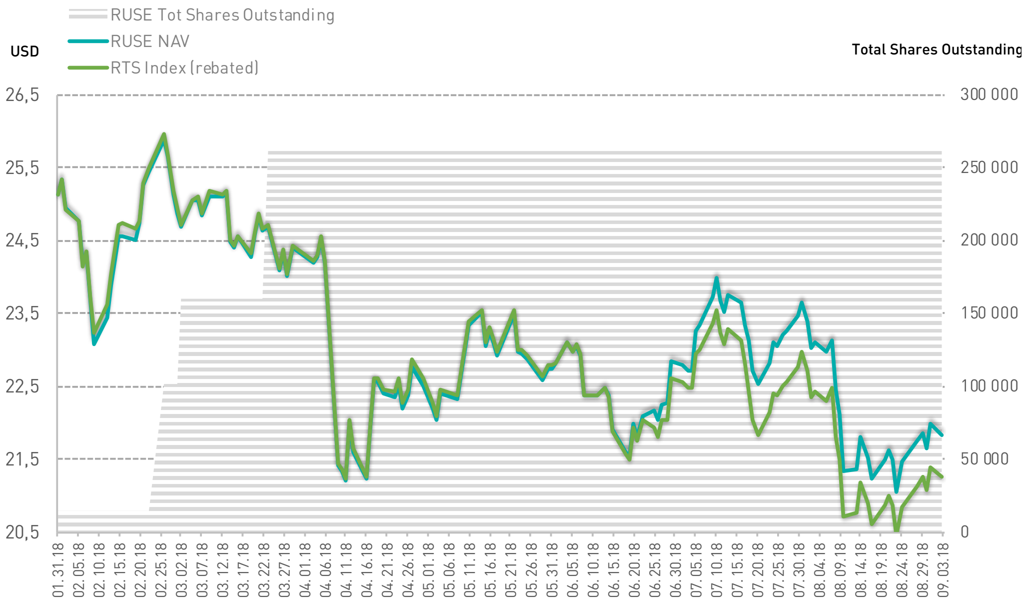
ITIEURBD® index

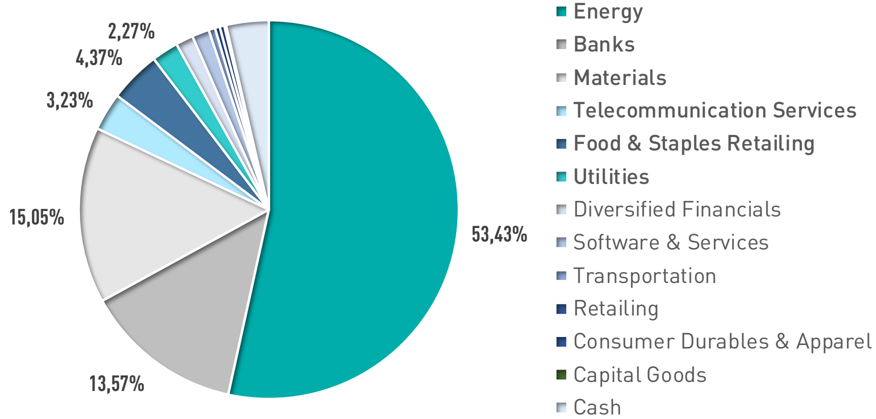
Both ETFs are listed on LSE and MOEX with the same ticker and ISIN

London Stock Exchange

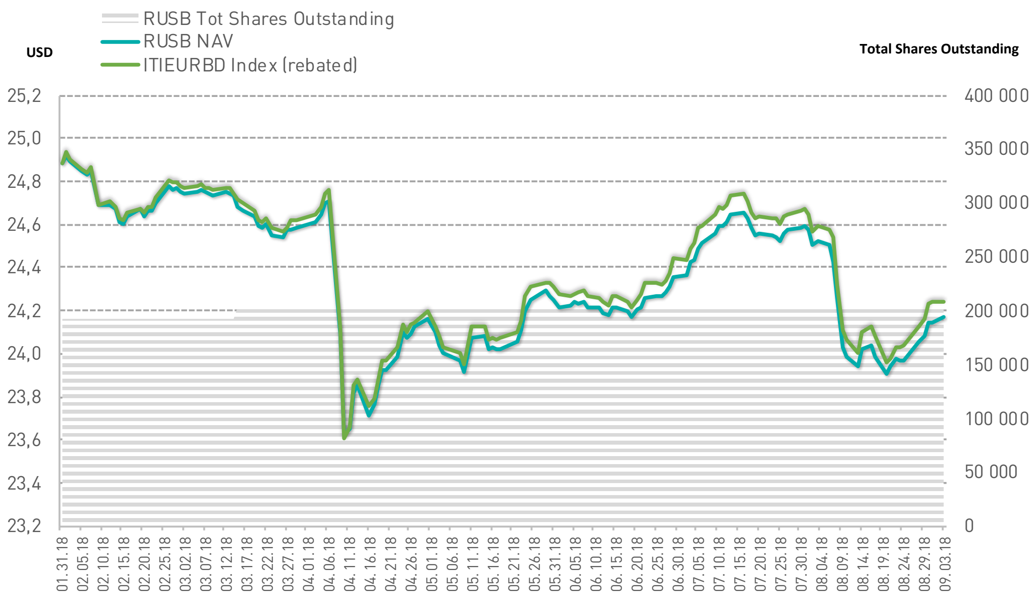
MOSCOW EXCHANGE

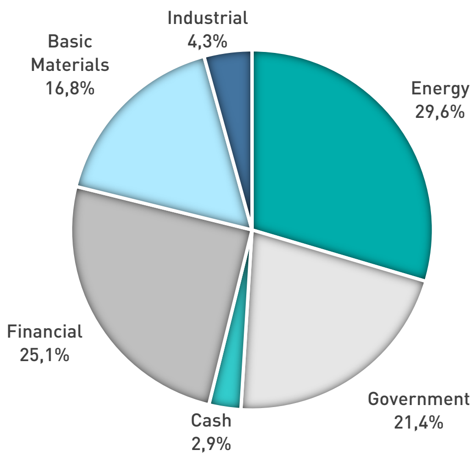
ITI Funds Russia Equity ETF (RUSE)

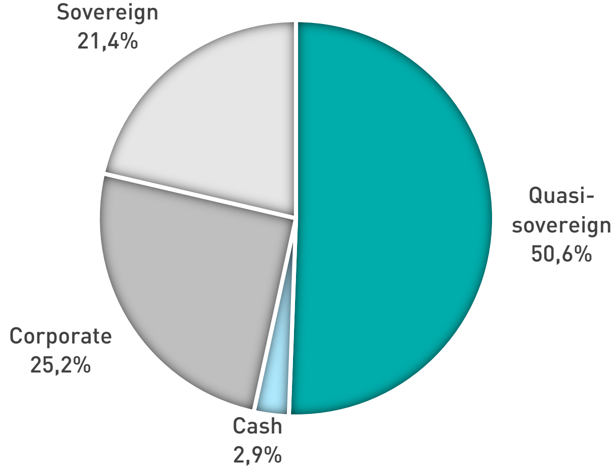




ITI Funds Russia Bond ETF (RUSB)







NAME

	Russia Equity UCITS ETF	Russia Bond UCITS ETF
	RUSE LN / RUSE RX	**RUSB LN / RUSB RX**

INVESTMENT OBJECTIVE

Russia Equity UCITS ETF

ITI Funds RTS Equity UCITS ETF is an open-ended Exchange Traded Fund, which aims to replicate the return of the RTS Index, Russia's oldest and most traded index. The ETF invests in 421physical shares traded on Moscow Exchange, providing diversified exposure to 13 industries.

Russia Bond UCITS ETF

ITI Funds Russia-focused USD Eurobond UCITS ETF is an open-ended Exchange Traded Fund, which aims to replicate the return of the ITIEURBD Index. The ETF offers unique opportunity to have physical access to 23 Russian USD Eurobonds, issued by top quality sovereign, quasi-sovereign and corporates.

KEY BENEFITS

Russia Equity UCITS ETF

- Diversified exposure to Russian equity markets
- Physical replication to 41 largest and most liquid Russian equities
- Low cost access to local Russian securities
- USD denominated
- Euroclear settlement
- Listing on the London and Moscow Exchanges

Russia Bond UCITS ETF

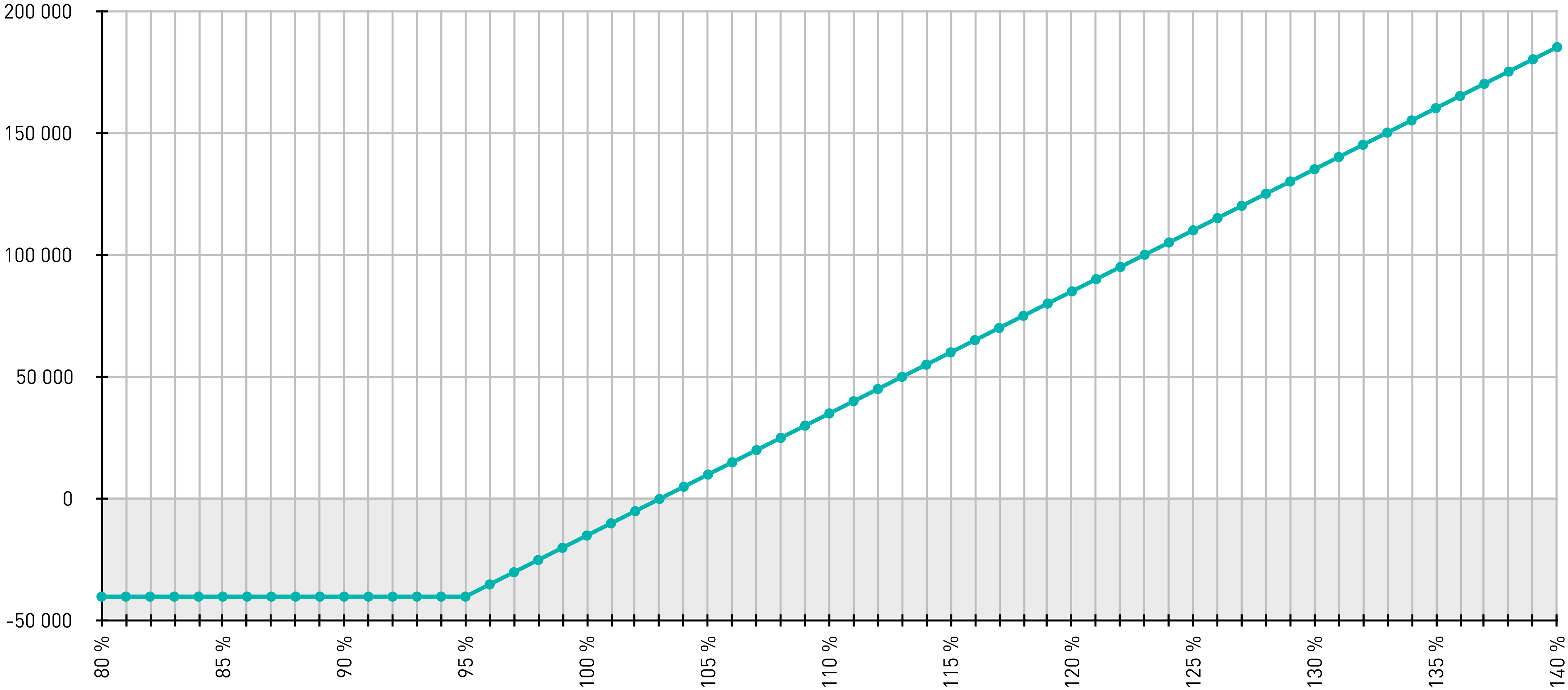
- Diversified exposure to Russian USD Eurobonds
- Access to bonds with credit rating equal to Russia's sovereign rating (Ba1/BBB-)
- No sanctioned issues
- USD exposure
- Euroclear settlement
- Listing on the London and Moscow Exchanges

KEY DATA

Fund Type:	UCITS ETF	UCITS ETF
Asset Class:	Equity	Fixed Income
Geo Focus:	Russia	Russia
ISIN:	LU1483649312	LU1483649825
RIC:	ITRUSE.L / RUSE.MM	RUSB.L / RUSB.MM
Bloomberg:	RUSE LN / RUSE RX	RUSB LN / RUSB RX
Exchanges:	London / Moscow	London / Moscow
Fund base currency:	USD	USD
Underlying currency:	RUB	USD
Benchmark:	RTSI$ Index	ITIEURBD Index
Replication Method:	Physical - Fully	Physical - Fully
Distribution:	Annually	Capitalization
Rebalance Frequency:	Quarterly	Quarterly
Total expense ratio (TER):	0.65%	0.5%
Fund domicile:	Luxembourg	Luxembourg
Custodian:	Edmond de Rothschild (Europe)	Edmond de Rothschild (Europe)
Management Company:	Fuchs Asset Mgmt.	Fuchs Asset Mgmt.
Investment Manager:	Da Vinci Capital Mgmt.	Da Vinci Capital Mgmt.
Auditor:	KPMG	KPMG

TRADING IDEA

Buy ETF (RUSE) that still has some dividends due in next 3 months. Buy put on RTS index for next 3 months with strike of 95% (cost approx. 3%). If sanctions are overestimated you get full upside in ETFs growth minus 3% spent on puts. We see upside of 20%+ in this scenario plus dividends. If sanctions are somewhat real, you sell put at profit and keep ETF till agitation is lowered and sell it a profit. We see 10%+ in that scenario by simply revaluation of RUB plus dividends. If sanctions are fully fledged, you cut both positions realizing a loss of 5 to 8%



ITI FUNDS SPECIFIC NEWS

In September 2018 ITI Funds team will take part in ETF forum in London

25 September 2018

London, UK

The TRADE's ETF Forum

In response to the growing interest in and activity around exchange-traded funds the TRADE will be hosting a series of in-depth panel discussions focusing on ETFS. Despite years of increasing popularity and growth in the ETFs space, industry participants, experts and trading services providers will gather to address lingering questions around the use of these funds among asset management firms.

You can contact us:
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info@itifunds.com

ITI FUNDS ETF SPECIFIC NEWS

First trades in REPO with CCP were conducted in ruble and dollar order books. Market maker provides instantaneous liquidity for investors trading in both ETFs. Previously there were no market makers for REPO transactions with CCP on Moscow Exchange. ITI Capital became the first market maker for this operation with ITI Funds' ETFs.

RUSE SPECIFIC NEWS

As of 30 August Megafon shares were removed from the RTS index due to decrease of free float caused by the company's buy back. Now there are 42 shares in the index while ITI Funds RTS Equity UCITS ETF has 41 shares in the portfolio. The difference is Rusal, that is still in the RTS index, but has been excluded from the investment universe of the ETF due to imposed sanctions.

RUSB SPECIFIC NEWS

RUSB shows perfect tracking of ITI Funds Russia focused Eurobonds USD index being just 9bps worse than the benchmark (see the chart displayed on page 6).

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ITI FUNDS

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UCITS ETFs units/shares purchased on the secondary market cannot usually be sold directly back to UCITS ETF. Investors must buy ands sell units/shares on a secondary market with the assistance of an intermediary (e.g. a stockbroker) and may incur fees for doing so. In addition, investors may pay more than the current net asset value when buying units / shares and may receive less than the current net asset value when selling them.

ITI Funds UCITS ETF SICAV S.A. is an open-ended investment company organised under the laws of Luxembourg as a société d'investissement à capital variable (SICAV), under the form of a public limited liability company (société anonyme) and authorised under part I of the 2010 Act. The Company has an umbrella structure consisting of several Sub-Funds. A separate portfolio of assets is maintained for each Sub-Fund and is invested in accordance with the investment objective and policy applicable to that Sub-Fund. ITI Funds UCITS ETF SICAV are authorised in Luxembourg and regulated by the Commission de Surveillance du Secteur Financier.