

EM high dividend yield stock price “see-saw” effect and the
outlook for Russian equities in 2021

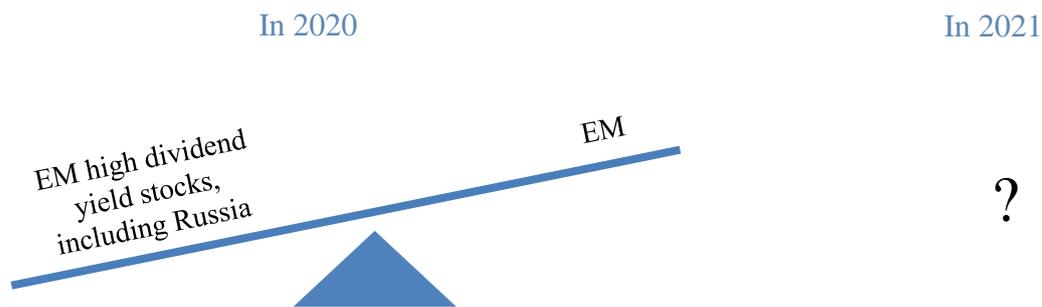
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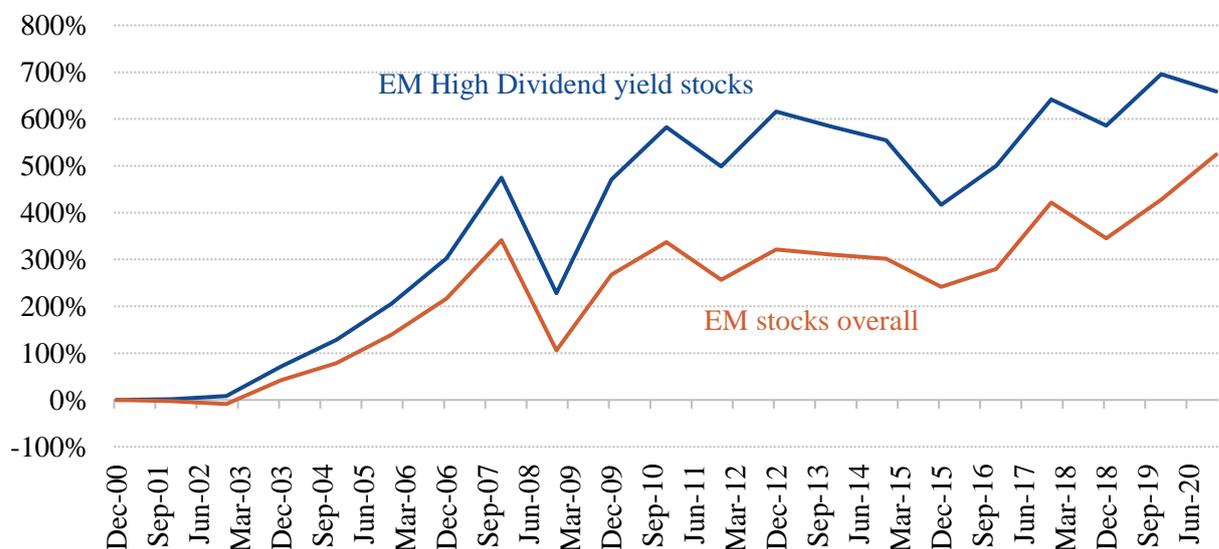
High dividend yield stocks can perform well over the long term

Imagine it is 1926, and you and your friend are in the US. You each have 1 000 USD to invest in stocks – an amount equating to about half a year’s average salary at that time. Your friend decides to invest in the US equity market overall while you choose to invest in high dividend yield stocks with annual rebalancing. Let us assume that you and your friend continue this strategy until 2000. At the end of 2000, your original investment would be worth around USD 4.7 million, while your friend’s would be worth just USD 1.7 million.¹

A high dividend strategy also works well on a global scale. Between 1988 and 2010, the best global high-dividend stocks yielded an average annual return of 16.3%, while the overall global equity market returned 9.4%².

This distinction can also be seen in emerging market (EM) stocks. Over the last two decades, EM high dividend yield stocks outperform EM equities overall.

Graph 1. Cumulative growth of EM high dividend stocks and EM equities overall
(in USD terms)



Note: Figures based on MSCI EM High Dividend net total return index and MSCI EM net total return index.
Source: Bloomberg, TKB Investment Partners; December 2020

Not many people invest over decades. Let us assess what can happen with an EM high dividend yield equity strategy over 12-month periods.

¹ Based on data from Dimson, Marsh and Stanton: Triumph of the Optimists: 101 years of global investment returns cited in [“The High Dividend Yield Return Advantage”](#) Page 9

² From [Stocks, Bonds, and the Efficacy of Global Dividends](#) page 4

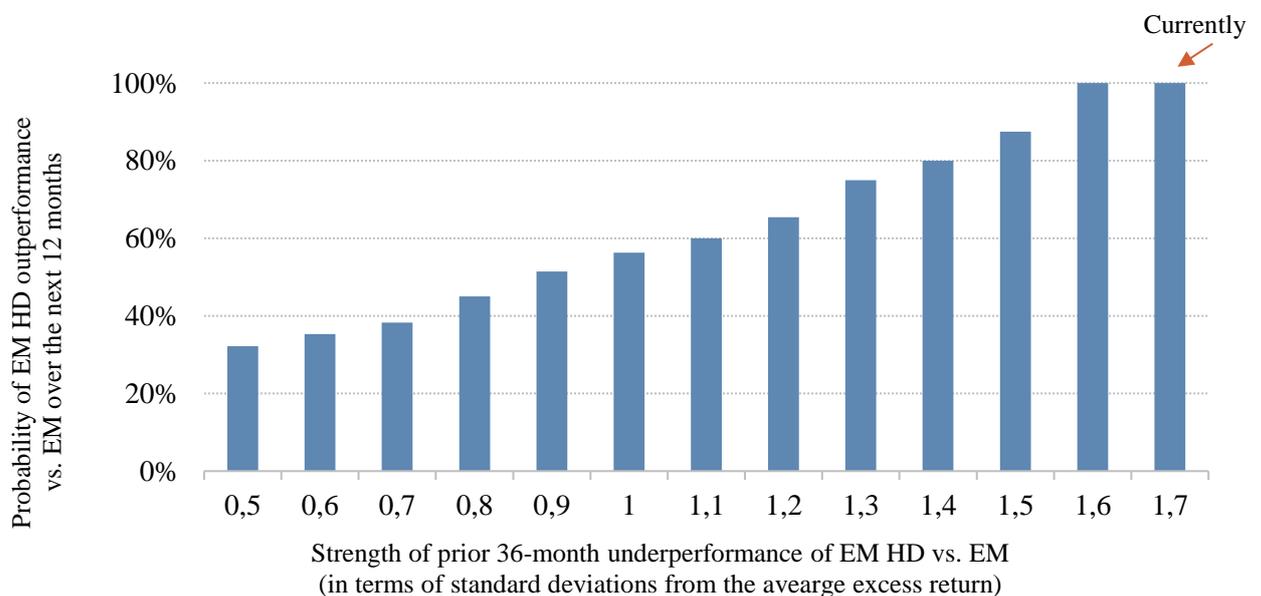
The “see-saw” effect in EM high dividend yield stock relative performance

“See-saw” stock price behaviour is common in equity markets. Over several decades, researchers have explored the profitability of contrarian strategies. For example, in 1985, De Bondt and Thaler examined the performance of “loser” US stocks that had strongly underperformed in the previous three years and “winner” stocks which had strongly outperformed over the same period³. They found there was an average difference of around 25% in USD terms between the performance of “losers” and “winners” over the subsequent three-year period.

This “see-saw” effect can also be seen with EM high dividend yield stocks. The stronger the prior underperformance, the greater the chance they will outperform broader EM equities in the future (see Graph 2).

Over the last three years, EM high dividend yield stocks have underperformed broad EM equities by 14.5%⁴. In the past, such strong underperformance was followed by EM high dividend yield stocks outperforming general EM equities over next 12-month period in 100% of cases.

Graph 2. Probability of EM high dividend yield stocks (EM HD) outperforming overall EM equities over the next 12 months depending on how strongly high dividend yield stocks underperformed during the prior 36 months



Note: We took a sample of excess returns for the MSCI EM high dividend yield index vs. the MSCI EM index over 36 and 12-month periods from end 2000 to end November 2020 in one-month steps, e.g. for the 12-month periods we took excess returns from end 2000 to end 2001, from end January 2001 to end January 2002, etc. All figures are in USD terms and on a total return basis. We calculated the excess return for each period using geometric formula. We calculated the average share of the periods of outperformance over the 12-month periods depending on how strong was underperformance during the prior 36-month period. We calculated the average excess return for the 36-month periods and standard deviation of excess return for high dividend index over EM index on the basis of the whole 36-months period sample. The greater the standard deviation below the average, the stronger the underperformance. There was no case where the underperformance was lower than the average excess return minus 1.7 standard deviations in the sample where we had prior 36-month performance and next 12-month performance. We used combination of past 36-month and next 12-month periods following the existing practice in the academic literature. For example: Dissanaik, G., and Lim., K. (2010). The sophisticated and the simple: the profitability of contrarian trading strategies. *European Financial Management*, vol. 16, no. 2, pp. 229-255. Past performance is not indicative of future performance. Source: Bloomberg, TKB Investment Partners; December 2020

³ DeBondt, W., and Thaler, R. (1985). Does the stock market overreact? *Journal of Finance*, vol. 40, no. 3, pp. 793-805

⁴ In USD terms using geometrical formula

Russian equities are the EM equities with the highest dividend yield, which bodes well for 2021

There is a 100% base rate probability that EM high dividend yield stocks will outperform general EM equities in 2021, which is helpful for the Russian equity market:

- The Russian market has been offering the highest dividend yield within EM equities since the end of 2014 (see Table 1)
- Russian equities normally perform better than EM high dividend stocks overall (Table 2)
- The Russian market dividend pay-out ratio is not excessively high (Graph 3), which suggests the dividend yield is relatively sustainable.

Table 1. Average expected dividend yield for the next three years

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
South Korea	1.3%	1.5%	1.2%	1.2%	1.5%	1.9%	1.9%	2.0%	2.8%	2.5%	1.9%
China	3.0%	3.9%	3.2%	3.6%	3.4%	3.0%	2.4%	2.1%	2.9%	2.3%	1.7%
Taiwan	3.9%	4.4%	3.2%	3.1%	3.2%	4.2%	4.0%	4.0%	4.7%	3.7%	3.0%
Brazil	3.4%	4.5%	3.7%	4.1%	4.5%	4.9%	3.2%	3.4%	4.0%	3.2%	3.3%
South Africa	3.5%	4.3%	3.8%	3.6%	3.3%	3.5%	3.4%	3.0%	3.7%	3.8%	3.5%
India	1.3%	1.8%	1.6%	1.7%	1.7%	1.7%	1.8%	1.6%	1.8%	1.7%	1.4%
Russia	2.4%	3.8%	4.2%	4.5%	6.3%	5.5%	4.7%	6.3%	7.7%	7.9%	6.2%
Mexico	2.1%	1.9%	1.8%	1.6%	1.8%	2.2%	2.4%	2.6%	3.3%	3.5%	3.1%
Hong Kong	2.6%	3.4%	2.9%	2.9%	3.3%	3.6%	3.7%	3.2%	3.5%	3.4%	3.0%
Malaysia	2.9%	3.7%	3.4%	2.9%	3.4%	3.3%	3.1%	3.2%	3.4%	3.6%	3.4%
Indonesia	2.9%	3.1%	2.9%	3.2%	2.7%	2.7%	2.6%	2.5%	2.9%	2.8%	2.8%
Thailand	3.6%	4.2%	3.6%	4.0%	3.4%	3.8%	3.1%	2.9%	3.4%	3.1%	2.7%
Turkey	3.1%	3.9%	3.2%	4.2%	3.1%	3.6%	3.7%	4.4%	6.0%	5.1%	4.3%
Chile	3.0%	3.2%	2.6%	2.7%	2.9%	3.4%	3.3%	2.5%	3.0%	3.5%	3.0%
Poland	4.0%	6.1%	4.8%	4.7%	4.2%	4.4%	3.3%	2.8%	3.3%	3.9%	2.9%
EM	2.8%	3.5%	2.9%	3.1%	3.1%	3.1%	2.8%	2.7%	3.4%	3.0%	2.4%

Based on Bloomberg consensus forecasts for MSCI country indices. Data as at 27-29 December of a particular year depending on the data availability. We did not take 30-31 as sometimes not all of the country indices had data for that dates. We took average expected dividend yield for the next three years.

Sources: Bloomberg, TKB Investment Partners, December 2020

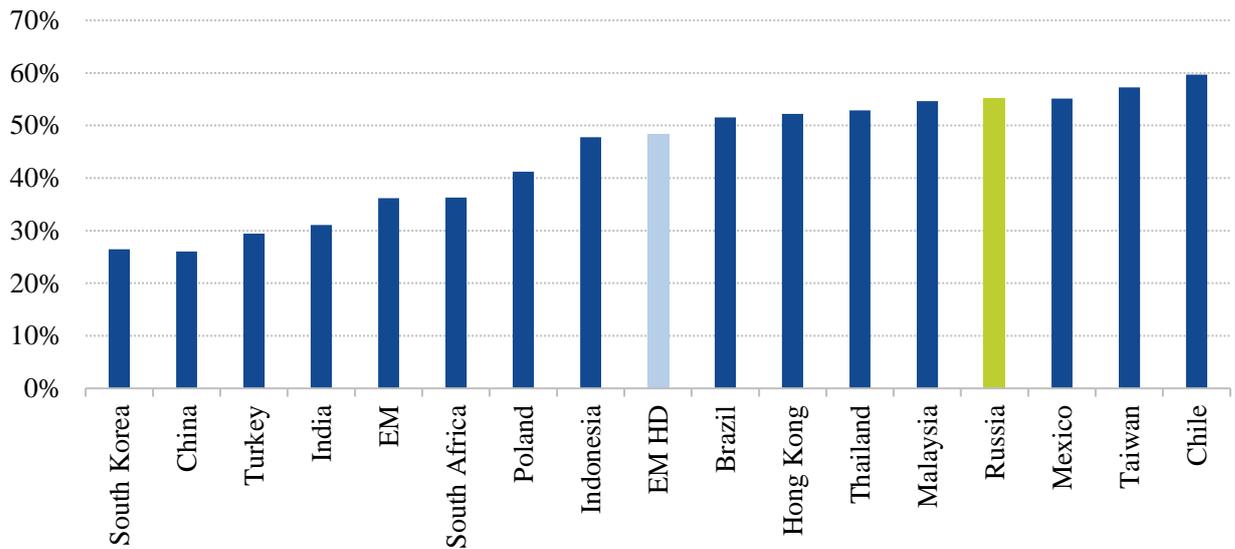
Table 2. Annual performance of MSCI Russia and MSCI EM high dividend yield index

Year	Russia	EM HD	Russia - EM HD
2013	0.8%	-4.6%	5.3%
2014	-46.3%	-4.2%	-42.0%
2015	4.2%	-21.1%	25.3%
2016	54.8%	16.2%	38.7%
2017	5.2%	23.6%	-18.4%
2018	-0.4%	-7.6%	7.2%
2019	50.9%	16.0%	34.9%
2020	-12.5%	-4.6%	-7.9%

Based on MSCI net total return indices; in USD terms.

Sources: Bloomberg, TKB Investment Partners, December 2020

Graph 3. Average expected pay-out ratio for the next three years



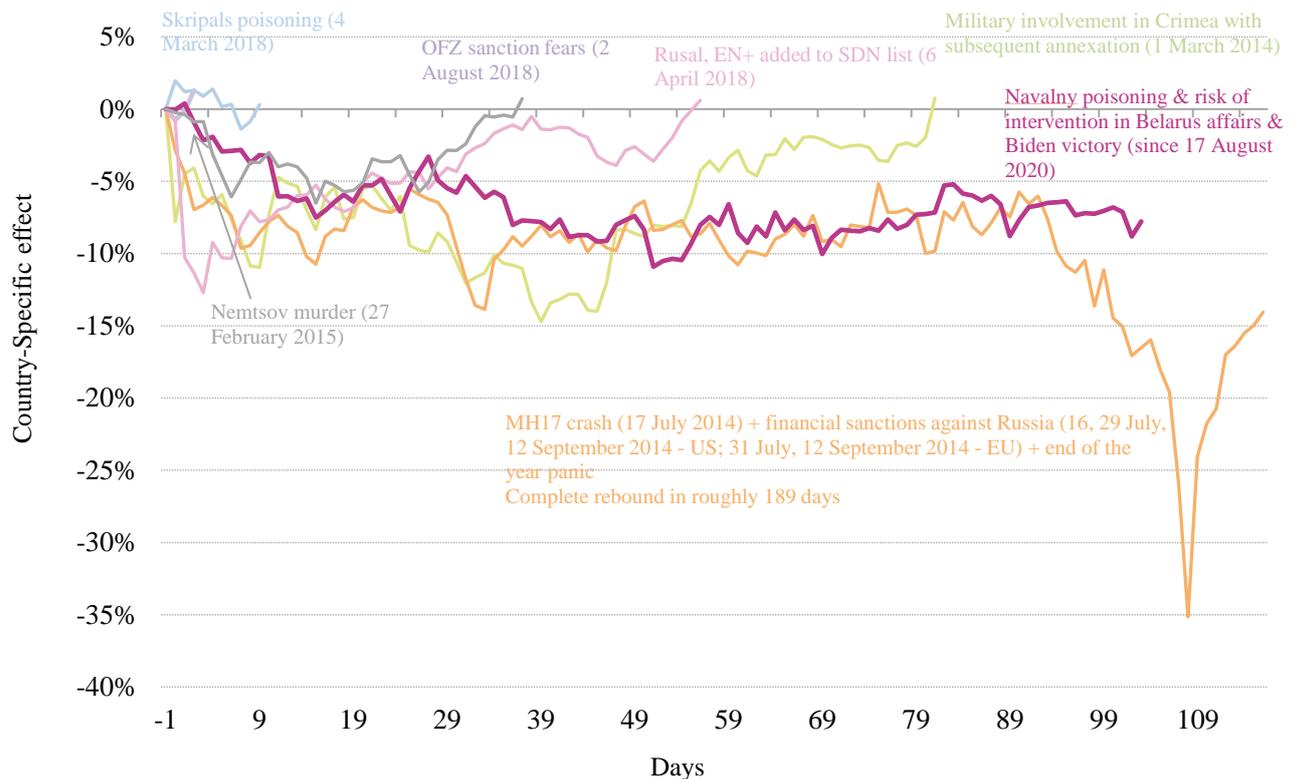
Based on Bloomberg consensus forecasts for MSCI country indices. Data as at 29 December 2020. We took average expected dividend yield for the next three year and divided it by average expected earnings yield for the same period.
Sources: Bloomberg, TKB Investment Partners, December 2020

Moreover, Russia-specific factors and sector bets are likely to help Russian equities to outperform broader EM equities in 2021:

- Potential inflows into the Russian equity market from local private investors could reach USD 35-50 billion in the long run.** The higher figure of USD 50 billion could be realised should the proportion of Russian people's savings represented by equity investments reach 11%, which is the level in China. The lower estimate of USD 35 billion would be likely if the savings proportion comes to match that in Turkey – 7%. The proportion of Russian people's savings that is in equities is around 3%. In 2020 net inflows from Russian individual investors into the Russian equity market have totalled **more than USD 4 billion**. The number of individual investors on the Moscow Exchange **has doubled to more than eight million** over the same period. The traditional place where Russian people put their savings, bank deposits, has become less attractive compared to the equity market: **The average interest rate from rouble deposits in banks is 3.7%, while the average dividend yield from the Russian equity market is expected to be 6.2% over the next three years.** This factor is likely to continue pushing Russia people into equities. Please see more details in our recent white paper: [Russian individual investors: Source of significant inflows into the Russian equities](#)
- The Russian market has an additional growth potential of 8% in outperformance relative to that of EM over the next 12 months.** From mid-August to beginning January 2021, the MSCI Russia 10/40 index lost 8% in USD terms in relative performance to EM due to Russia-specific factors - mainly the expectations of new sanctions based on news coverage regarding Navalny, Belarus and Biden becoming US president. In similar situations **in the past, the relative performance has always reversed within several months.** The crucial factor this time is whether or not material sanctions are imposed. We believe that the possibility of new material sanctions is minimal. There have been more than 55 sanction actions against Russia by the US and EU since 2014 and none has been significant. **Any material sanctions are likely to have a dramatic boomerang effect** due to the deep integration of the Russian economy within

the global one. Russia is the world's second largest net exporter of crude oil and has a 60% share of overall gas exports to Europe. It is one of the top 20 countries in terms of international trade volumes. Please see more details in our flash-notes: [‘Navalny’ and ‘Belarus’: How large can the impact be on Russia vs. EM performance?’](#); [Biden, Russian equities and sanction fears](#).

Graph 4. Cumulative Russia-specific effect on excess return of Russian equities vs global EM equities after sanction risk-related events



Note: To calculate the country-specific effect, we constructed an index from the EM sector indices with the structure of the MSCI Russia 10/40 index. For example, we took the MSCI EM Energy index and weighted it at 35%, the MSCI EM Materials index at 35%, etc. Therefore, the excess return due to Russia-specific factors equals the MSCI Russia 10/40 minus the constructed index. The cumulative country-specific effect is demonstrated from the day before the sanctions risk-related event until the effect evaporates. Based on net return figures, in USD terms.

Source: Bloomberg, TKB Investment Partners; January 2021

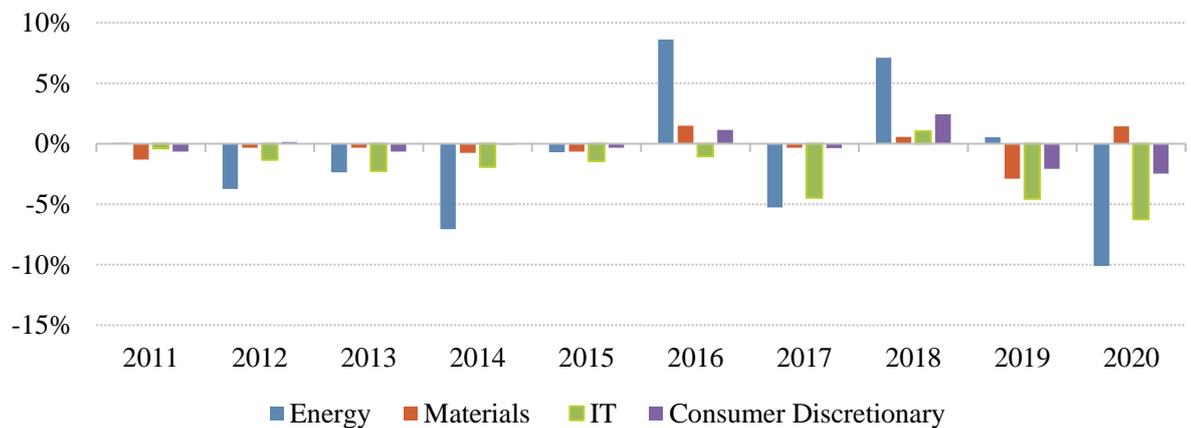
- Russian market sector bets are likely to have neutral effect or a positive contribution to Russian equities vs. global EM equities excess return in 2021⁵.** The major sector bets for Russia are: Underweight in IT and consumer discretionary and overweight in energy and materials. Over the last 10 years, the overweight in the energy sector contributed 459bp a year on average out of 834bp overall contribution from the Russian market sector bets to Russian vs. EM excess return. Second largest sector contributor IT had an average impact of only 241bp. The positive or negative overall impact from sector bets coincides with the type of impact from the overweight in energy in eight out of 10 years.

The “see-saw” effect mentioned earlier is likely to lead to a positive or neutral contribution to the Russia vs. EM excess return in 2021 from the overweight in energy. 2020 saw the biggest ever detraction effect from the overweight in energy to the Russia

⁵ We calculate sector bets as the difference between sector weights of the MSCI Russia 10/40 and MSCI EM indices

vs. EM excess return. In 2014 and 2017, there was also a relatively large negative impact from this sector bet. There was close to zero contribution from the overweight in energy in 2015 and a positive contribution in 2018. In 2015, this happened despite a relatively strong negative surprise in terms of oil prices. Positive surprises from oil price levels reinforced the positive contribution from the overweight in energy in 2018.

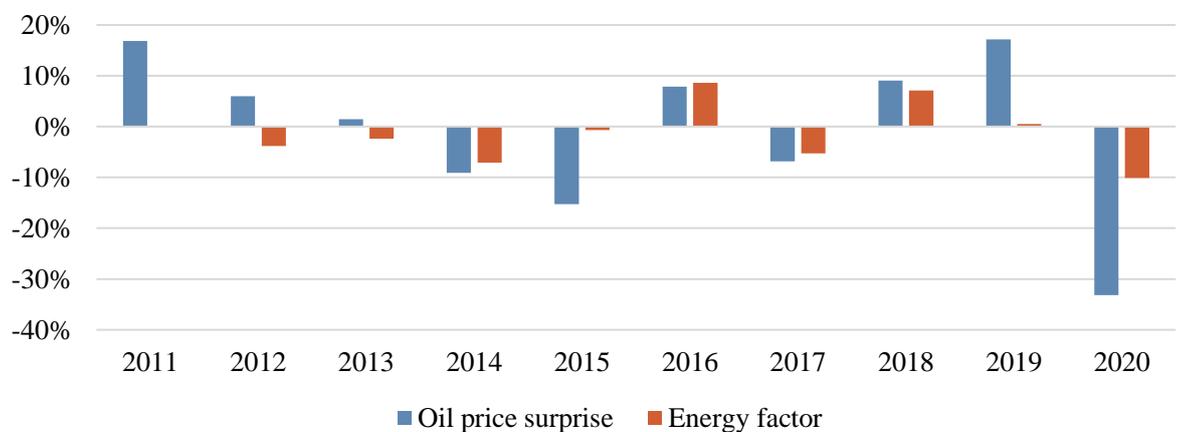
Graph 5. Sector factor attribution to Russian equities' relative performance



Note: Specific sector effect = EM sector index net return – MSCI EM net return, all weighted at the level of active Russian weight. Net return – return including dividends excluding taxes on dividends. All figures are in USD terms.

Source: Bloomberg, TKB Investment Partners; January 2021

Graph 6. Energy sector factor attribution vs oil price surprise



Note: Oil price surprise is calculated based on expectations from the 1-year oil futures curves vs. the spot price at the end of the year. All figures are in USD terms.

Source: Bloomberg, TKB Investment Partners; January 2021

- In 2021, we believe there will be a greater likelihood of material positive surprises on oil prices than materially negative ones.** The market expects oil prices to change only slightly in 2021⁶. The downside for this market forecast is limited. We believe oil prices are unlikely to fall below USD 40/bbl due to: 1) More than 70% of the new US shale oil projects require the oil price to be far above this level to be profitable. Production from shale oil wells normally drops by 40%-50% in the second year, so they need to be replaced quite rapidly with new ones; 2) OPEC+ appears firm in its aim to keep oil prices above USD 40/bbl. Statistically speaking, when market forecasts have been cautious – at close to the current oil price – in only 20% cases there was a material

⁶ On the base of data about December 2021 futures for Brent oil price – Bloomberg ticker: COZ1 Comdty

negative surprise the next year. Negative surprises happened much more frequently – in 67% of cases – when the market forecast was significantly higher than the current price. On the other hand, there are scenarios in which the oil price could surprise on an upside in 12 months' time as some experts expect [demand to outstrip supply for couple of years](#).

Conclusion

2021 is likely to be a good year for EM high dividend yield stocks. There is a 100% base rate probability of EM high dividend yield stocks outperforming general EM equities in 2021.

Russian stocks are likely to be among the top-performing EM high dividend yield stocks:

- The Russian market continues to offer the highest dividend yield among EM
- Potential inflows into the Russian equity market from local private investors could reach USD 35-50 billion in the long run. Relatively high dividend yield vs. bank deposit rates is likely to continue pushing investors into equities
- Should there be no further material sanctions against Russia, there can be an additional potential 8% of Russian equities' out-performance vs. global EM equities
- Russian market sector bets are likely to have a neutral or positive contribution to the excess return of Russian equities over EM equities in 2021.

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