

Europe continues to set the agenda for global markets...**Strong liquidity support from ECB to European banks...**

Europe continued to stay on top of the agenda last month. EU leaders, except England, agreed on a plan in the beginning of December aimed at a fiscal union to which the financial markets stayed indifferent. Towards the end of the month, strong liquidity support comprising a three-year loan to Eurozone banks totaling €489 billion combined with the traditional year-end movement shifted the market sentiment positively. Better-than-expected economic data from the US also supported the mood. On the other hand, ongoing concerns regarding the risks of contagion and speculation that credit-ratings may be cut for European sovereigns limited the upward movements.

MPC maintains flexibility...

The CBRT's Monetary Policy Committee left the policy rate at 5.75% and the walls of the interest rate corridor unchanged at 5.00% for the O/N borrowing rate and 12.50% for the O/N lending rate for December, in line with the market consensus and our in-house forecast. The Monetary Policy Committee said that the rebalancing between domestic and external demand is continuing as envisaged, attested by the Q3 data. The Committee added that monetary policy flexibility should be maintained due to uncertainties in the global economy. We think that the CBRT will continue its current strategy for a while.

Economic activity accelerated in third quarter contrary to expectations ...

Real output grew by 8.2% YoY in the third quarter, higher than the market consensus of 6.7% and our in-house forecast of 7.3%. Adjusted for seasonal and calendar effects, economic activity accelerated as output rose by 1.7% QoQ following 1.1% growth in the second quarter. Year-to-date, economic activity surged by 9.6% YoY following the 9.0% growth figure of 2010. The contribution of net external demand turned positive in Q3 thanks to the rebalancing in economic activity. Net external demand made its first positive contribution to growth (0.6 pp) since Q3 2009 as the exports under GDP rose 10.8%, higher than the 7.3% in imports. Meanwhile, domestic demand made a 9.3% contribution to the Q3 growth figure, while stock changes erased 1.6 pp off the headline figure.

ISE underperformed its peers again...

High volatility in global markets continued in biggest part of December. Selling pressure dominated the stock markets in the first half of the month as the market participants were disappointed from the results of the European Leaders' Summit on December 9, 2011. Then we saw some reactionary buying in the second half thanks to ECB's strong liquidity support to the Eurozone banks. The ISE underperformed its peers again in December, mainly stemming from volatility in bond rates and the lira, combined with the negative biased among foreign institutions' reports about Turkey.

Our portfolio recommendations for January 2012

We believe that volatility will continue in the markets in the first few months of the new year due to the ongoing concerns over contagion and the Eurozone debt crisis. In this context, we advise our investors to keep their cautious stance despite valuations becoming more attractive, particularly in the stock market.

We make a minor change in our portfolio coverage by increasing government securities to 60% and decreasing equities to 30% while keeping 10% weight in FX.