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## What has become of the “oil x 20” rule?

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The oil and gas sector is the backbone of the Russian economy. It contributes roughly a quarter to the Russian GDP, and it accounts for almost two thirds of exports. Oil and gas companies represent almost 60% of the market capitalisation of the Moscow stock exchange. It therefore makes sense to analyse the performance of the Russian equity market in connection with the level and development of the oil price. For a long time, the “oil x 20” rule of thumb would suggest that the fair value of the RTS, the Russian equity index, was 20 times the price of crude oil (as measured in US dollar per barrel of Brent). Especially equity strategists – always suckers for simple marketing ploys – would take a liking to this relation.

And it is true – the RTS index has reached or exceeded this threshold of 20x only shortly in the past 15 years: from the beginning of 2006 to the beginning of 2008, i.e. right before the financial crisis. Since then the index has failed to rise to that level again. The new relation between oil and the Russian equity index is significantly lower, i.e. at an average of 15x over the past five years. Even that value has not been reached since 2011. It was only during the most recent rally that the market was able to approach the long-term average again. This is in line with the image that the more conventional valuation techniques are painting: the market PE (price/earnings ratio) of slightly above 6x and the valuation discount of 50% relative to other emerging markets are essentially where the historical average predicts they should be. A lot suggests that the level the index is currently at after the latest rally is roughly where one would expect it to be in view of the current oil price.

Perhaps the rule will be adjusted to “oil x 15” for the Russian market. This does not rule out that the most recent rally may continue, given that the rules of financial markets are sometimes amazingly elastic. However, without the sustainable recovery of the oil price and visible progress in the Ukrainian crisis the upward potential of the Russian equity market from here on out seems limited.

**RTS relative to the oil price (Brent, USD per barrel)**



Sources: Bloomberg, Erste Asset Management.

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