Russian securities lending heats up

Chris Benedict, vice president and lead analyst of DataLend, takes a look at how geopolitical instability has affected securities lending activity in Russian stocks and ETFs

After years of government corruption and mismanagement, a dearth of employment opportunities, a weak currency and a steadily growing crime rate, the citizens of Ukraine staged a series of widespread protests later called "the Ukrainian revolution of 2014", erupting in January and escalating in February. Then-President Viktor Yanukovych fled Kiev to Russia in late February, and a new interim Ukrainian government was installed in the aftermath. This new government was immediately denounced by Russia President Vladimir Putin as a "coup d'etat".

With authorisation from the Russian Parliament, Putin sent Russian troops into the Crimean region, taking control by early March. Within a few weeks, Crimea held a referendum to secede from Ukraine and join Russia. Amid widespread allegations of voter fraud, the US and Europe responded with economic sanctions and threats of military action.

Government instability is never welcomed by capital markets, and Russia's incursion into Ukraine is no exception. We reviewed top Russian exchange-traded funds (ETFs) and stocks across various sectors to see how both the cash and securities lending markets reacted to these geopolitical events.

Market Vectors Russia ETF (RSX), for example, sold off by more than 20 percent during the onset of the Ukraine crisis in January and February. But it wasn't until Russian troops entered Crimea that the short sellers really got involved. Volume weighted average fees (VWAF) to borrow the ETF spiked considerably to reach a high of almost 550 basis points (bps) on 6 March. Utilisation reached a high of 98 percent during that same timeframe. Fees to borrow have dropped recently in conjunction with the ETF's sell-off, although utilisation in the name remains very high.

Market Vectors Russia Small Cap ETF (RSXJ) followed a similar pattern, although it exhibited more volatility than RSX prior to the crisis. Fees to borrow the ETF were around 300 bps before Russia entered Crimea and rose to 500 bps immediately after. Unlike RSX, fees to borrow RSXJ have continued to climb even higher more recently. Utilisation is also very high at 98 percent.

In the energy sector, Russian giant Gazprom also saw significant volatility in the aftermath of the situation in Crimea. Prior to the Ukrainian revolution, the stock was trading at very general collateral levels of around 16 bps. But by the end of March, fees had shot up to 600 bps and still traded in a hot range more recently. Lukoil followed a similar pattern: very little securities lending trading going on in the name before March, then fees to borrow skyrocketed from a general collateral 10 bps to 500 bps as the stock cratered. This stock also traded in a volatile warm/hot range more recently.

But it was more than just Russian energy firms feeling the wrath of the short market: Russian financial services firms were also adversely affected by the situation in Crimea. Sberbank, for example, traded sporadically in a general collateral to warm range prior to the Russian occupation. Share prices fell by 30 percent while fees to borrow jumped to 100 bps in the weeks thereafter. JSC VTB Bank also slumped in the wake of the crisis (down more than 20 percent), with fees rising from 28 bps to around 135 bps.

Shares of Aeroflot airlines fell as the company announced it would reroute its flights to avoid flying over Ukraine. The stock price plunged by almost 40 percent while fees to borrow soared from a warm 100 bps to a red-hot 2000 bps. Although borrowing fees have eased since then, utilisation in the name remains at almost 100 percent.

In the Russian consumer staples industry, Dixy Group saw its share price collapse as fees to borrow the stock soared to 765 bps in March. For competitor Magnit, fees to borrow jumped from a warm 200-to-400 bps range with utilisation staying north of 80 percent.

In the mining industry, the share price of AK Alrosa was not as badly affected (and actually rebounded amid the crisis), though fees to borrow the stock increased to more than 700 bps and utilisation reached a high of 70 percent.

Even Russia's nascent telecommunications sector could not escape the brutal sell-off as investors fled the country. Shares of AFK Sistema plummeted by more than 30 percent after Russia entered Crimea, and fees to borrow jumped from general collateral levels to 400 bps immediately after as short sellers borrowed any shares they could get their hands on. MegaFon also traded in the hot range for some time, although it has not sold off in the cash markets as badly as other Russian stocks.

There is an old saying that "Wall Street climbs a wall of worry", implying that although times may be tough or uncertain, investors remain confident that the problems will be resolved in the long run. Red Square is not Wall Street. If the situation in the Ukraine intensifies, fees to borrow Russian ETFs and thinly traded Russian equities could continue to climb as share prices remain stagnant or drop to new lows as a result of higher capital outflows, additional economic sanctions and growing condemnation of Russia's tactics.