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CEE Equity Strategy

4Q 2009

Continuation of momentum strongly reliant on further improvement in outlook

Valuations at least partly fair, if not stretched; second-tier markets worth a look

SEE and Austria - insurance and financials might be an idea

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Summary

I) Perfomance review

After recovering strongly, markets might appear to be losing some of their momentum. Nevertheless, we expect equity markets to remain in a generally positive mood. A performance review shows that increasing risk-taking has again clearly supported cyclicals and financials. ***(Continued on page 3).***

II) Implied valuation analysis

When looking at indicative valuations based on normalized earnings, it becomes apparent that most cyclical sectors have used up most of their potential for the time being (valuations already stretched) and rely strongly on a continued further improving outlook on fundamentals. Hence, earnings revisions have to develop as nicely as they have been recently. Also, markets recovering from very low levels and benefiting from increasing risk appetite, such as Hungary, might find it difficult to perform as strongly as they have been. Hence, apart from further improving earnings outlooks, we would keep an eye on markets and sectors (or parts of them) that have been lagging behind the recent performance for reasons of still high risk or limited liquidity (e.g. Romania). Our proposed CEE country allocation reflects this, getting more positive on South-Eastern Europe. ***(Continued on page 5).***

III) Excurse on Austrian economics

Extending our excurse on Austrian economics, we see some potential trouble in public debt crowding out private debt, without providing the necessary stimulus for long-term growth. ***(Continued on page 10).***

Summary

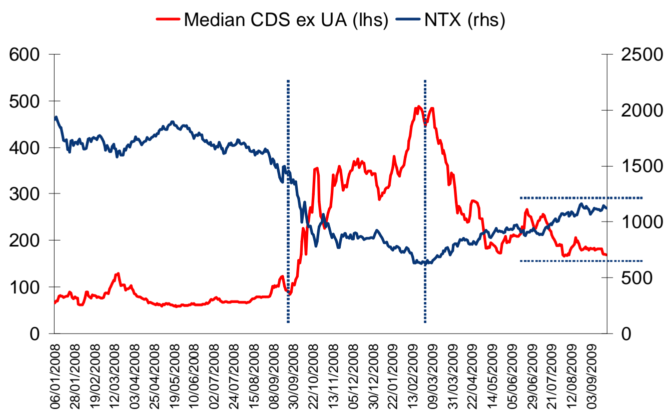
I) Perfomance review

Improving sentiment stretches further into real economy

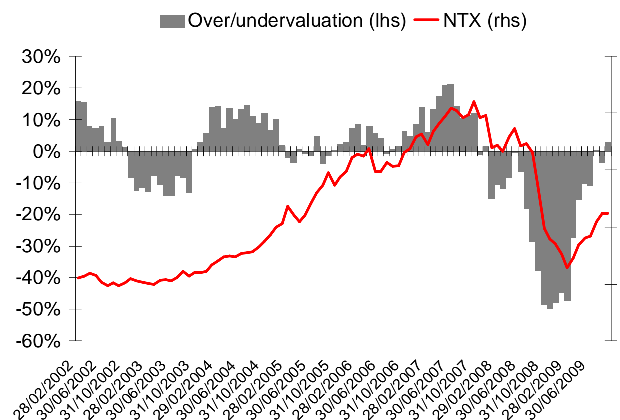
Sentiment has continued to improve and the notable factor here is that this improvement has already reached the real economy. Also, hard data coming in from the real economy has already provided the first indications that, although the situation is not bright, it is not as bad as previously expected. To some extent, we see a movement in the real economy similar to that seen in the financial markets, where panic has created a highly oversold situation. However, overreactions in the bits-and-bytes financial market are quicker to level out than in the bricks-and-mortar real economy. Hence, even if our earlier scenario of q/q improving numbers continues to work over the year, we should also be able to see a flat y/y development in 4Q.

For equity markets, we would also expect a period of stabilization, after markets finish being driven by the correction of the overdone risk aversion and a first wave of improving views on fundamentals. For the coming quarter, we expect rather cautiously optimistic markets, facing short-term weaknesses from time to time – two steps ahead, one step back. Generally, it might be worth taking a look at smaller companies and markets, which could “fall victim” to still growing flows into equity markets.

CEE CDS spreads* vs. New Europe Blue Chip Index



Implied valuation**



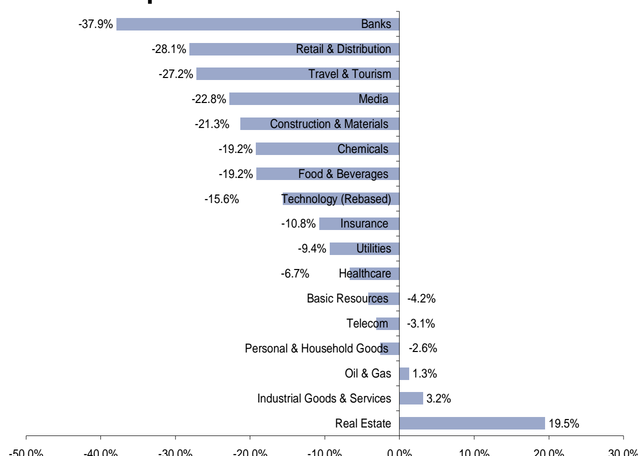
** regional spread calculated as median of A, CZ, HU, HR, PL, RO, **implied valuation based on equity risk premiums*
Source: Bloomberg, Reuters, Factset

A short comparison of equity markets by sectors and regions shows, that, throughout 2Q09 and 3Q09, ‘Risk was King’. The more leveraged and cyclical, and the more emerging and risky the regional market, the better. These developments over the last couple of months turned the investment world of 2008 upside down.

Comparing the performances sector-wise throughout 1-3Q09, it becomes apparent that, until the end of March 2009, stable, conservative sectors were outperformers. Thus, the trend of 2008 continued. Real estate was the only exception, gaining nearly 20% in 1Q09, despite its quite unfavorable risk profile.

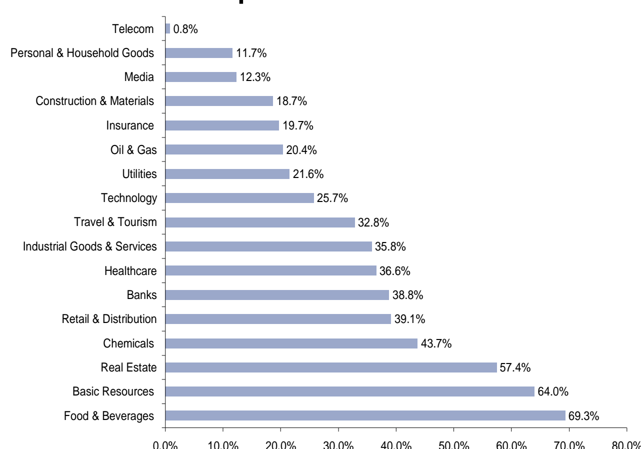
Summary

CEE sector performances 1Q09



Source: Factset, Erste Group Calculations

CEE sector performances 2Q09

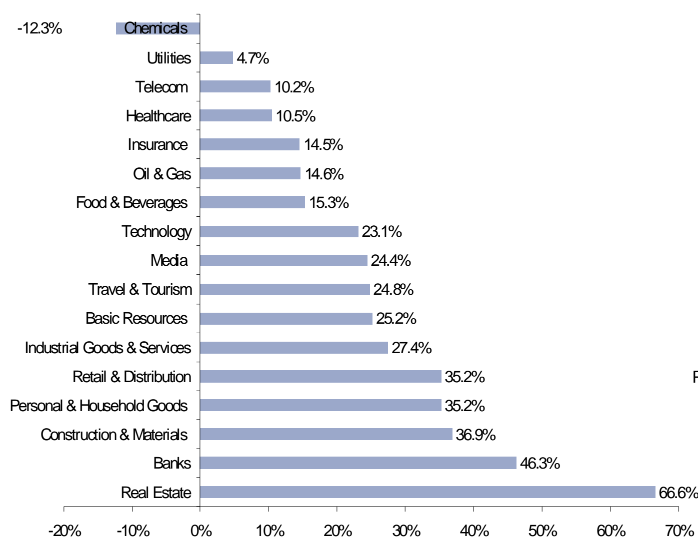


Source: Factset, Erste Group Calculations

Turnaround as of 2Q09…

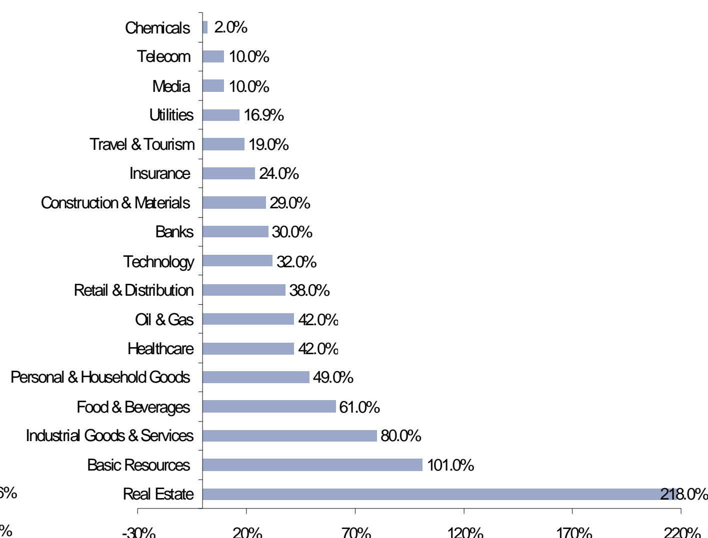
The second quarter, as can be see in the right-hand graph above, marked the turnaround. Cyclical sectors (basic resources, chemicals) as well as highly-leveraged sectors (banks, real estate) took over and were the clear outperformers. Declining risk premiums in the debt markets and declining volatility levels were the driving forces behind this turnaround in equity markets.

CEE sector performances 3Q09



Source: Factset, Erste Group Calculations

CEE sector performances 1-3Q09



Source: Factset, Erste Group Calculations

…trend continued throughout 3Q09

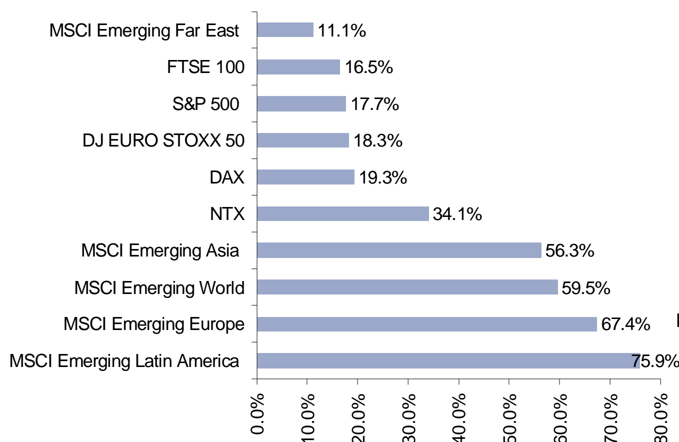
Throughout 3Q09, nothing changed and the trend towards more risk taking continued at full strength. Cyclicals, as well as real estate and banks continued to be the outperformers (left-hand graph above). Looking at the YTD 2009 performance, the right-hand graph above shows that real estate was far and away the best performing sector in our CEE universe, gaining 218.0%. Basic resources and industrial goods and services, delivering 101.0% and 80.0%, respectively, followed suit. The YTD performance analysis also reveals that the outperformers of 2008, like utilities and telecoms, are clear underperformers so far, which is not too great a surprise.

Emerging Europe and Latin America lead in 2009

On a regional basis, Emerging Latin America (+75.9%) and Emerging Europe (+67.4%) have been the hottest equity markets so far this year. We have to admit that Russia and Turkey have clearly played a vital part in this strong comeback of Emerging Europe. However, our core CEE

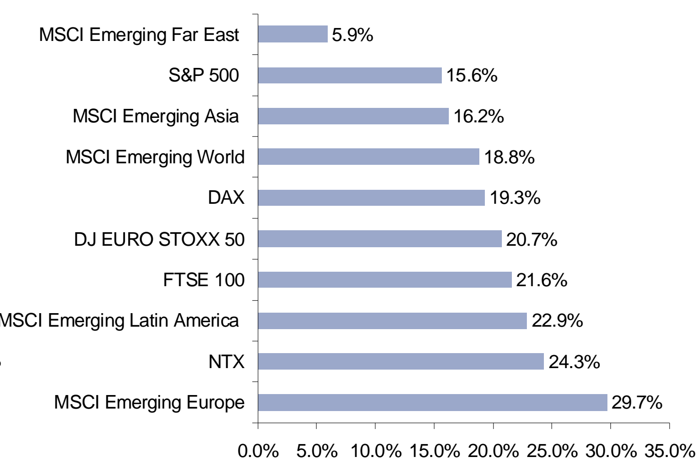
region (represented in our NTX), having gained 34.1% YTD, has also managed to outperform established Western equity markets.

Regional equity market performances 1-3Q09



Source: Factset, Erste Group Calculations

Regional equity market performances 3Q09



Source: Factset, Erste Group Calculations

Western markets catching up in 3Q09

Interestingly, in 3Q09, the outperformance of emerging vs. western markets became narrower when compared to the first half of 2009. The developments in 3Q09 seem to confirm our appraisal that, as of June / July 2009, emerging markets have closed their valuation gap compared to established western markets.

II) Implied valuation analysis

The performance review has revealed some interesting switches in sector and regional choices. With the basic assumption that most of the ammunition for any immediate outperformance of equity markets has been used up, we see the goal in identifying some relative opportunities for the rest of the year.

We once more follow our basic idea of looking at consensus data, providing an alternative view to our own forecasts. This time, we look at implied valuations based on several basic multiples and aggregate the result for markets and sectors. Within this approach, we are using historical numbers on the one side and estimates beyond 2010 on the other side, in order to limit the impact of the turbulent current period as much as possible and base our view more on “normalized” numbers.

The methodology:

Indicative valuation based on normalized earnings

We use P/E, P/BV and P/CF and calculate an average multiple based on historical numbers for 2000-08. In a next step, we calculate target values for 2011 based on the historical multiples. For the target value based on book values, we assume that the book value per share is not as volatile as a P&L item. Hence, we base it purely on average historical P/BV and estimated BV 2011. For P/E and P/CF, we similarly calculate historical averages. However, given the greater volatility of these items, we opted to use the average EPS/CFS for 2010-12 for computing the target values, in order to again get closer to the intended “normalized” view. Finally, we created an average of all three target values (for banks, the average obviously did not include P/CF). The target value for 2011 is discounted back, resulting in an implied net present value at the end of 2009. In a last step, we calculated market capitalizations based on current prices and based on the implied net present value at the end of 2009. We aggregate both numbers and compare them in order to get an indicative upside potential for the respective market or sector. As far as sectors are concerned, we used our own coverage universe for sector composition.

Summary

No index targets, but relative comparison

The interpretation:
Any interpretation of the model outcome needs to reflect the weaknesses of the approach. We use historical averages and rely on the assumption that current estimates up to 2012 already reflect some kind of again normalized business. Secondly, markets still depend on momentum and sentiment and, with current news flow getting a bit dryer, we would not expect markets or sectors to live up immediately to our somewhat impressive fair values. Indeed, we would use the outcome of our approach not in absolute terms, or for calculating index targets for the end of the year, but rather as a relative tool, identifying markets or sectors that might offer more opportunities than others.

Potential upside based on a simplified valuation by country

Index		# of ratings*	# of reasonable results**	Theoretical upside potential
BET	*(Romania)*	30	6	58%
ATX	*(Austria)*	234	20	40%
CROBEX	*(Croatia)*	17	8	25%
ISE 30	*(Turkey)*	303	23	24%
RTS	*(Russia)*	479	43	24%
WIG 20	*(Poland)*	201	20	16%
PX	*(Czech Republic)*	142	13	12%
SBI	*(Slovenia)*	20	4	9%
BUX	*(Hungary)*	74	7	3%

* number of analysts providing consenus data
** number of reasonable results based on available consensus estimtates
Source: Factset, own calculations

Romania, a relative outperformer

Interestingly, Romania is the clear winner based on this view. Indeed, the top scoring of that market does not come as a total surprise. Admittedly, the country is facing some severe economic difficulties and we do not expect it to be among the first to recover quickly. However, the country was hammered in the previous wave of risk aversion and was left at an extremely depressed level, with very thin volumes traded. However, with improving views on a stabilization/recovery of the global economy, Romanian companies should finally find their place in a better world again. Simply, the argument would be that Romania is lagging the recovery performance as seen in other markets.

Croatia, another interesting second-tier market

Austria, in the middle of any development within CEE, also presents an appealing case. While cyclicals have already used up most of their upside potential, financials (including insurance and defensive stocks) contribute to the indicated theoretical performance. Croatia might offer a case similar to Romania's, but it seems that flows ventured back into that market a bit earlier compared to Romania. Also, the solution to the deadlock over its EU negotiations should have already driven some positive market development.

Russia and Turkey have been quite prominent targets, once emerging markets in Europe started to lose their pariah status. However, there is still interesting potential left, paired with decent investable size.

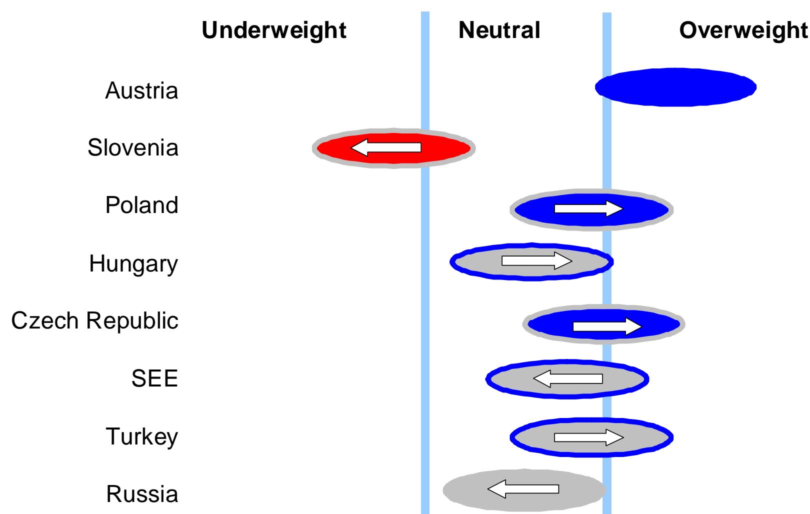
Moderate upside left

Poland and the Czech Republic have also been classic targets since the recovery in CEE set in. Hence, only moderate upside is left. We see a similar picture to that of Austria, with cyclicals taking over defensives and financials too quickly, leaving more upside for the latter. Also, real estate contributes to the positive part of the outlook. Finally, Hungary - as one of the markets in the region that indeed was just saved by an international bailout - recovered rapidly; consequently, not much upside is left here until fundamentals improve significantly.

We have also used the input from our simplified valuation tool for our proposed CEE country allocation. For more details on this, please refer to the chapter 'CEE country allocation' later in this report.

Summary

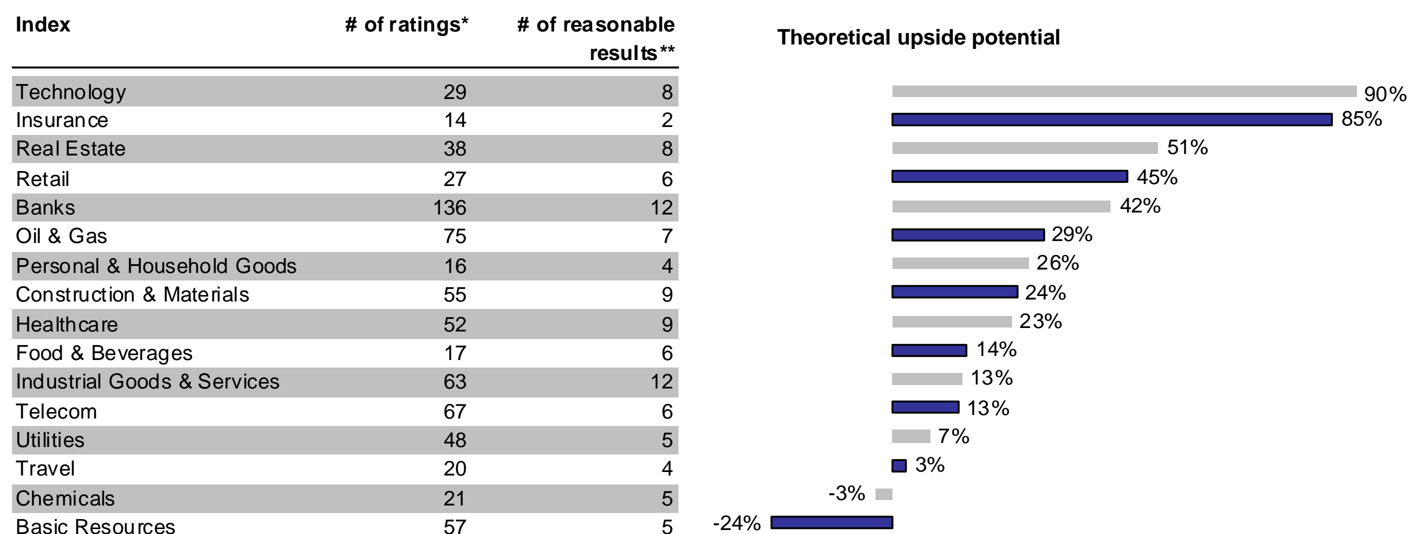
Country allocation proposal



Source: Erste Group Research

We also applied our valuation approach to sectors within the CEE region; technology had the strongest outcome. However, we would be careful with the result and would view the upside potential of permanent restructuring candidates such as Sygnity with a question mark. Our positive view on Asseco Poland, however, was nicely confirmed.

Potential upside based on a simplified valuation by sector



Index	# of ratings*	# of reasonable results**
Technology	29	8
Insurance	14	2
Real Estate	38	8
Retail	27	6
Banks	136	12
Oil & Gas	75	7
Personal & Household Goods	16	4
Construction & Materials	55	9
Healthcare	52	9
Food & Beverages	17	6
Industrial Goods & Services	63	12
Telecom	67	6
Utilities	48	5
Travel	20	4
Chemicals	21	5
Basic Resources	57	5

* number of analysts providing consenus data
** number of reasonable results based on available consensus estimtates
Source: Factset, own calculations

Strong upside for financials/insurance indicated

As previously mentioned, financials and real estate have a strong showing. Banks and insurance companies still have quite some recovery potential, having been the most prominent victims of the crisis in the region and elsewhere. Obviously, we have to stress the still imminent risks within the sector, but any indication that companies are managing to get closer to earnings again should be seen as a trigger. The rather weak performance outlook for industrials, chemicals and basic resources confirms our suspicion that these sectors were too much in favor once the euphoria of economic stabilization/recovery started.

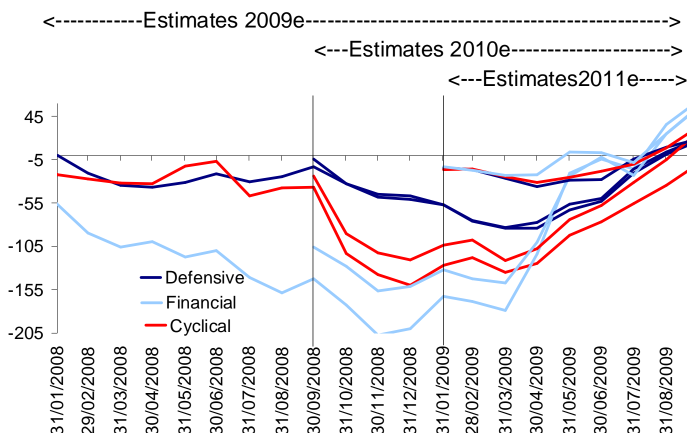
Summary

Further improvement needed

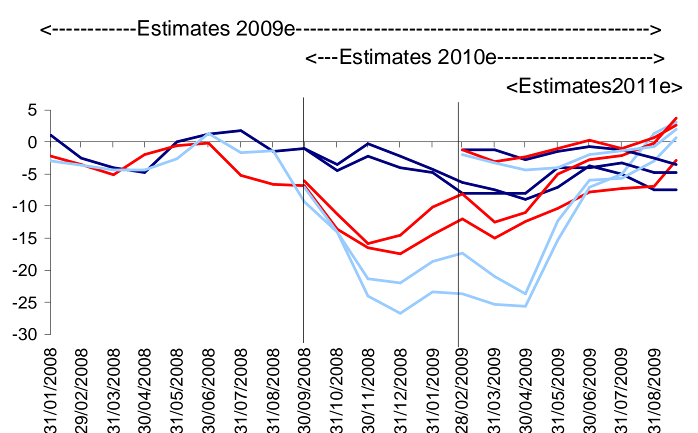
We are left with two further arguments that could still trigger performance. A continued decline in risk aversion - as expressed in further declining discount rates - should help sectors and companies that are still far below their previous price levels. The second factor would be evidence of further improvements in corporate fundamentals. Here, we switch back to the screening mechanism that we used in the previous issue of our CEE strategy report.

Earnings revision rate

DJ Euro Stoxx sector indices



CEE

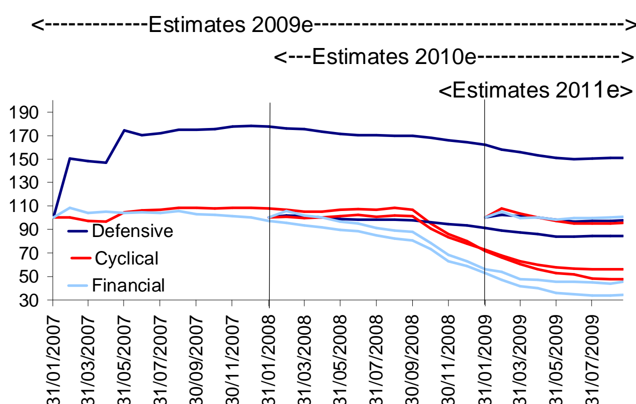


Source: Factset

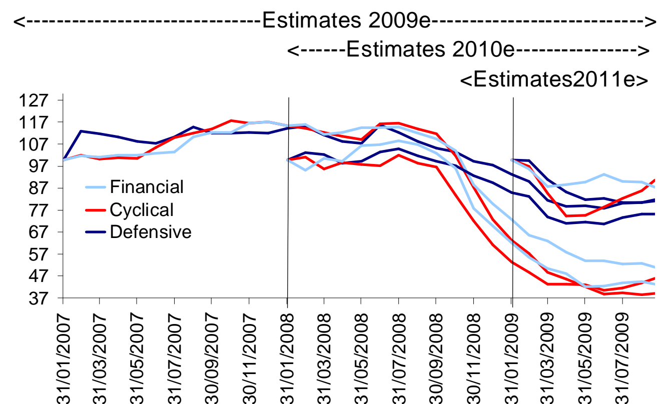
On earnings revisions, certainly financials have seen the strongest move, both for EuroStoxx and for the CEE region. A strong recovery of revision balances already started in 2Q, while balances finally turned positive more or less across the board in July/August. However, the strongest improvements (namely for 2010 estimates) can be seen for banks and cyclicals.

EPS consensus trend, indexed*

DJ Euro Stoxx sector indices



CEE**



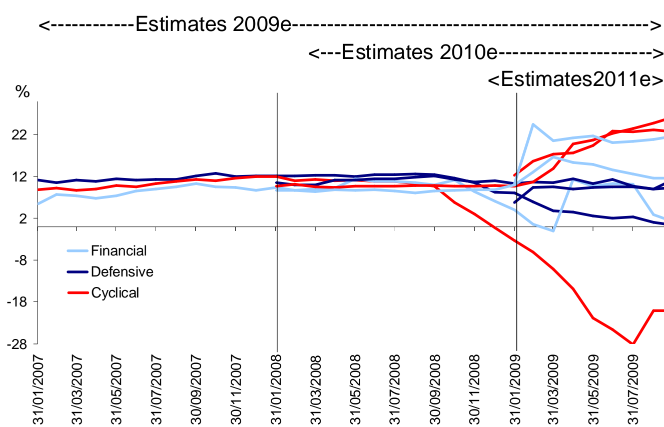
*indexed to Jan. 1 of year when forecasts where available
** based on Erste Group Research coverage - Source: Factset

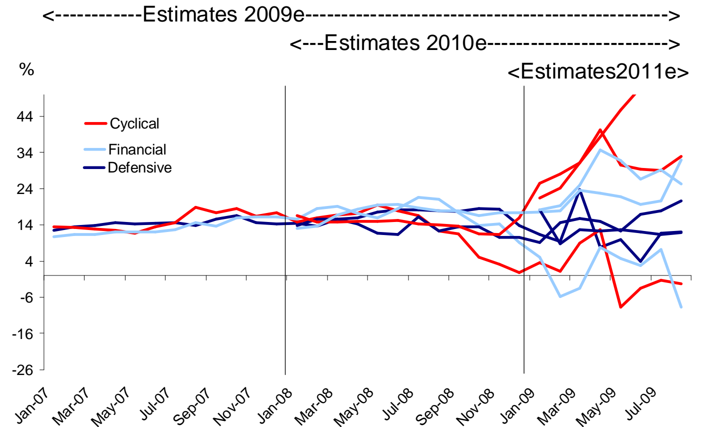
On EPS consensus trends, we still see a more pronounced development than in the EuroStoxx. Hence, the recovery is seen as setting in strongly only in 2011. Cyclicals show the strongest move here, at least in CEE. This outlook is in line with the already strong performance of cyclicals.

Summary

EPS growth consensus

DJ Euro Stoxx sector indices | **CEE**





Source: Factset

Growth favors cyclicals and financials

Finally, on EPS growth, cyclicals and financials show their real strength. Having initially been pushed down hard on growth expectations for 2009 (even here, we see improvement lately), the recovery from this low base is pushing both groups up strongly for 2010 and 2011. However, for financials, some sobriety has crept into the outlook lately and growth expectations were again somewhat reduced for 2009 and 2010, while 2011 is now seen as the year of final relief.

III) Excurse on Austrian economics

In our previous issue we have put forward an alternative point of view for discussion with a short excurse on the theoretical architecture of the Austrian School of Economics. We do not suggest using the approach to judge current governmental intervention and support measures, since these measures are the only solution to stabilize the situation right now. However, the Austrian approach might offer some interesting alternative explanations and potentially strategic approaches.

Is the worst behind us? Thoughts from an Austrian continued….

The key question for investors is whether that's it, whether the crisis is over and we can return to normal life, or whether this is just a temporary, artificial recovery that will soon be followed by another dip. We currently see two major threats that might bring the current recovery to a sudden stop:

- Asset price deflation was halted in March 2009 by governments around the globe via massive monetary efforts that will leave the public sector heavily indebted. This raises two questions: (1) What will happen to asset prices (especially shares) once the public sector itself cannot raise more debt? (2) Will the efforts of the public sector to jump-start the global economy work?
- The unregulated global OTC derivatives market, which remains huge, is a second permanent threat to global asset prices. Ultimately, it seems that this market has been at least as important in terms of the disruption of global financial markets as the inflated US housing market.

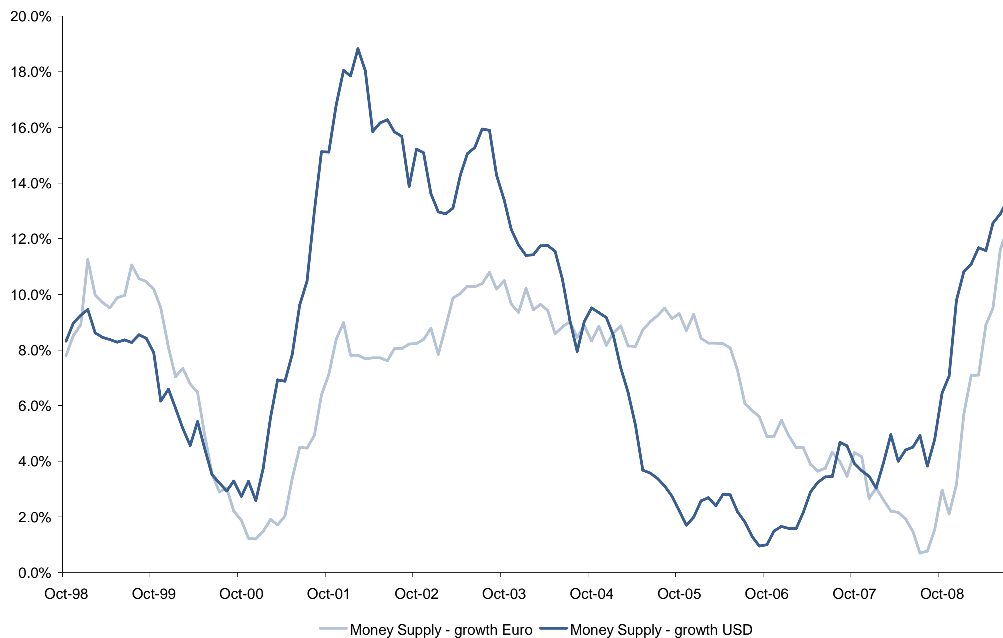
Printing money does not create prosperity

In our last strategy report we took the time to familiarize you with the basic ideas of Austrian economics, the main reason being that Austrian economics provides quite different explanations for the current global economic crisis. One of the pillars of Austrian economics is the mantra that printing money does not create prosperity. On the contrary, to cite one of the most influential Austrian economists of modern times, Murray Rothbard: "*Increasing the money supply will have far more unfortunate consequences for the economy than simple price level inflation. There will be other, permanent distortions of the economy away from the free market pattern that responds to consumers and property rights holders in the free economy.*"

However, since leading economists are of the opinion that printing money creates prosperity and dynamic economic growth, as of 4Q08, major central banks around the globe once again began increasing the basic money supply quite significantly. We have already explained in our CEE strategy for 3Q09 that the dot-com and US housing boom and bust cycles were preceded by such monetary stimuli set by major central banks (in 1997-98 and 2001-2004 respectively) around the globe. The graph below shows the growth in money supply for the US dollar and euro from October 1998 to July 2009. As of July 2009, the y/y growth rate for the US dollar amounted to 13.4% and 12.4% for the euro.

Summary

Basic money supply growth y/y US dollar vs. euro 10/1998 – 07/2009

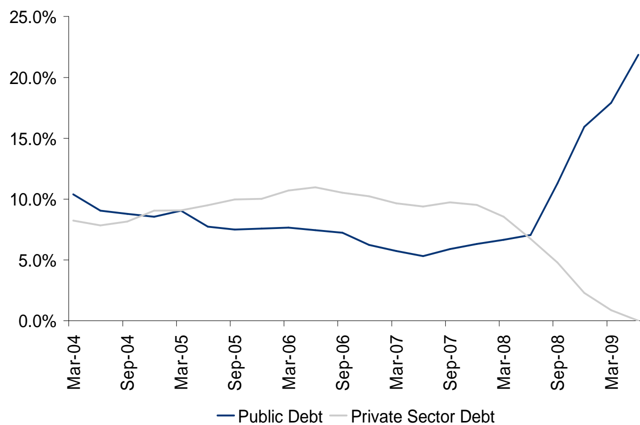


Source: ECB, Fed. St. Louis, Erste Group calculations
Basic money supply defined according to Austrian economists: Currency in circulation + demand deposits and savings accounts

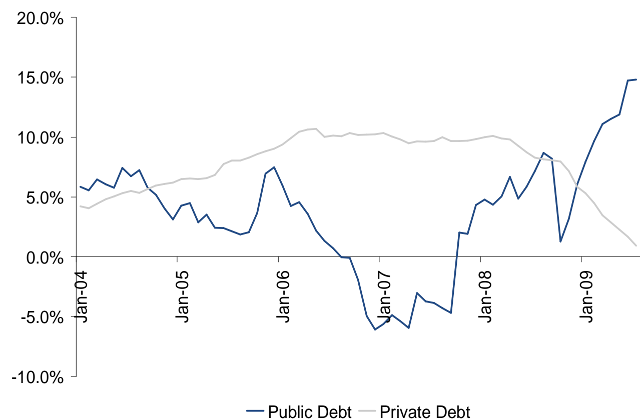
Debt shifts to the public sector

The key question is where does all the money go? Here it becomes evident that while debt levels of the private sector in the two largest global economies are stagnating or even declining, lending to the public sector has picked up quite significantly since 3Q08. Thus, instead of reducing total debt, global debt levels are being shifted from the private to the public sector. This is unlikely to lend support to the global economic recovery. The graph below shows that while the y/y growth in US private sector debt is close to 0%, the y/y growth of US public debt has increased quite significantly, reaching 21.0% as of June 2009.

Y/Y growth US public vs. US private debt March 2004 – June 2009 (on a quarterly basis)



Y/Y growth euro MFI public vs. private lending Jan 2004 – Jul 2009 (on a monthly basis)



Source: ECB, Comprises lending by MFIs to government and private

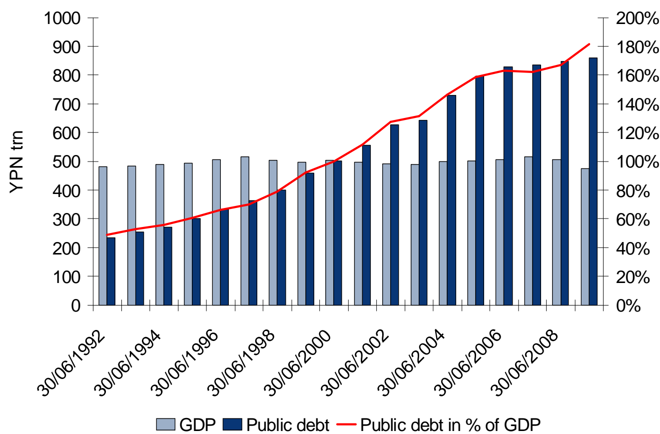
The graph on the right shows a similar picture for the euro zone, where lending by MFIs to the public has increased since March 2009, with y/y growth reaching 14.8% as of July 2009. In contrast, lending to the private sector nearly came to a halt in July 2009.

Summary

Japan's shift to public debt delivered no results

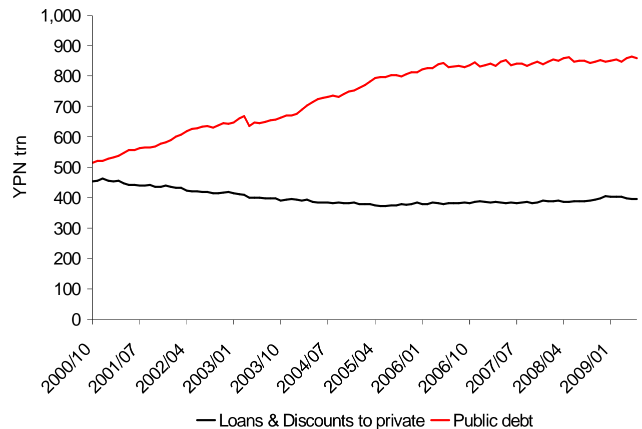
We doubt that this lending structure, where public debt issues are crowding out private sector debt, will trigger a vigorous, and more important, lasting economic comeback in global markets. On a global scale, Japan is a good example of how the gradual shifting of debt levels from the private to the public sector hasn't produced meaningful results. On the contrary, the Japanese economy, especially the Nikkei Index, has probably been equity investors' worst nightmare over the last two decades.

Japanese GDP, public debt development 06/1992-2009



Source: Datastream, Erste Group Calculations

Private vs. public debt development 2000-06/2009



Source: Datastream, Bank of Japan

Deficit spending failed to jump-start Japan's economy

The graph above shows that continuous, significant deficit spending in the public sector to jump-start the economy over nearly two decades delivered virtually no results. Japan's nominal GDP actually shrank over this time period, and the public sector is hopelessly indebted (nearly two times annual GDP). The graph on the left shows that by comparison, loans and discounts to the private sector (corporations and individuals) shrank by 12.9% to YPN 396.9trn, while public sector debt has skyrocketed by 67.7% since 2000 to YPN 860.3trn. Japan's destiny could have been predicted by Austrians as soon as it embarked on this course. Ludwig von Mises wrote about state intervention on a large scale: "*An essential point in the social philosophy of interventionism is the existence of an inexhaustible fund which can be squeezed forever. The whole doctrine of interventionism collapses when this fountain is shut off. The Santa Claus principle liquidates itself.*"[1]

Japanese bull market in cash

There has been one bull market in Japan since 1990 and that has been in cash, despite a virtual 0% interest regime. The graph below shows the performance of YPN 10,000 in cash (assuming 0% interest payments) vs. the performance of the Nikkei 225 average from 1990 until 2009.

[1] Ludwig von Mises, Human Action

Summary

YPN 10,000 cash vs. Nikkei 225 average 1990 - 2009

Source: Datastream

World awash in cash or debt?

For the time being it therefore seems as if public authorities are currently doing nothing to little in for initiating the necessary correction of mounting debt levels. Based on these considerations we would also like to question the common argument that the world is awash in cash. Upon closer consideration it becomes obvious that, apart from real cash at hand, everyone's "cash" is someone else's debt. Thus, in reality, the world is awash in debt. This is the way fractional reserve banking operates. Your cash deposited at a bank is owed by corporations, households and the federal government. Money deposited in a money market fund is someone else's debt. Even the physical euros and dollars you have in your pocket are ultimately the debt (IOU's) of the respective issuers. Each new euro, dollar or pound sterling which the ECB, the Bank of England or the Federal Reserve "manufacture" for the federal government or banks ends up in the system as debt that has to be served via interest payments. Thus, even if central banks are willing to support banks via cheap money and additional reserves, banks have to find people that are willing and able to take on more debt in order to get the money into circulation. However, it currently seems that apart from the public sector there is no one else left who is both willing and able to borrow.

From this perspective it becomes obvious that it might be more difficult to re-inflate the economy than commonly believed since, especially with regard to the US, it seems as if the corporates, financials, households and the public sector have accumulated a debt level that cannot grow any further.

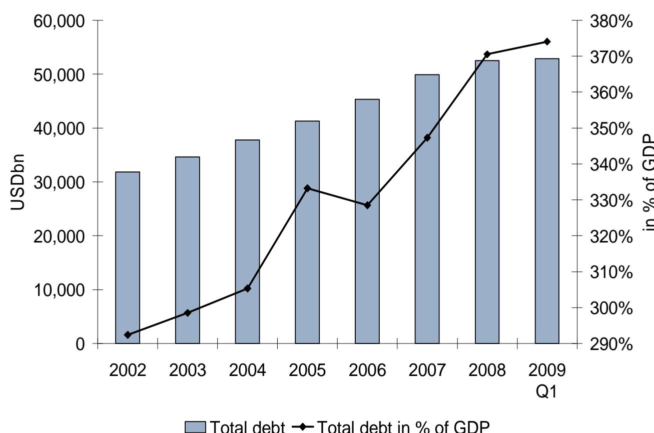
US economy buried under debt

As of March 2009, the total credit market debt outstanding in the US amounted to USD 52.9trn. This represents a staggering increase of 66% over the December 2002 level of USD 31.8trn, and means the US economy has to shoulder a debt burden of 3.7 times its annual GDP of around USD 14trn. Even during the onset of the great depression in 1930 and 1931 the debt burden reached its peak at around 2.5 times GDP.

As already indicated, in 1Q09 the only sector that was still able to increase its debt level was the public sector. All other sectors stagnated. Even the public sector found it increasingly difficult to place its debt with third parties at home and abroad. The only creditors that continued to buy US government bonds throughout 1Q09 without any doubt were government-regulated institutions (intergovernmental creditors) like the Federal Old Age & Survivors Insurance Trust Fund, the Civil Service Retirement and Disability Fund and the Federal Hospital Insurance Trust Fund. In June 2009 China's holdings of US government bonds dropped quite significantly for the first time, falling 3.1% in just one month. To put the dilemma of the US government into perspective: for the 12 months ended in August 2009 US government revenues amounted to around USD 2.2trn, whereas the outstanding public debt as of August 2009 stood at USD 11.8trn. Even the most aggressive auditor would be careful when facing a company that has a debt level of 5 times annual sales.

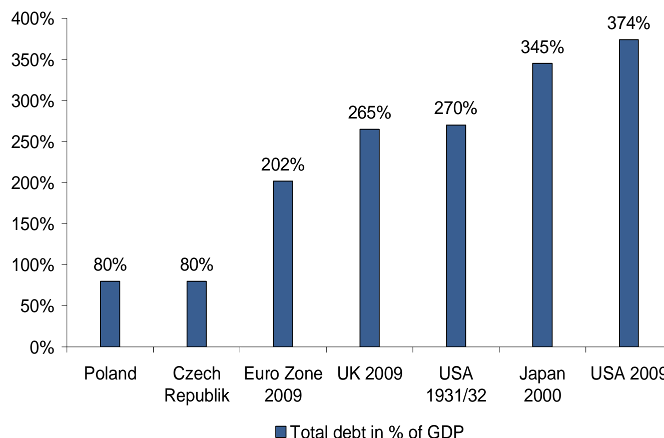
Summary

Development of total US debt 2002 – 1Q 2009



Source: Federal Reserve Bank, Erste Group Calculations

Total debt as % of GDP



Source: BoJ, Federal Reserve, Erste Group Estimates

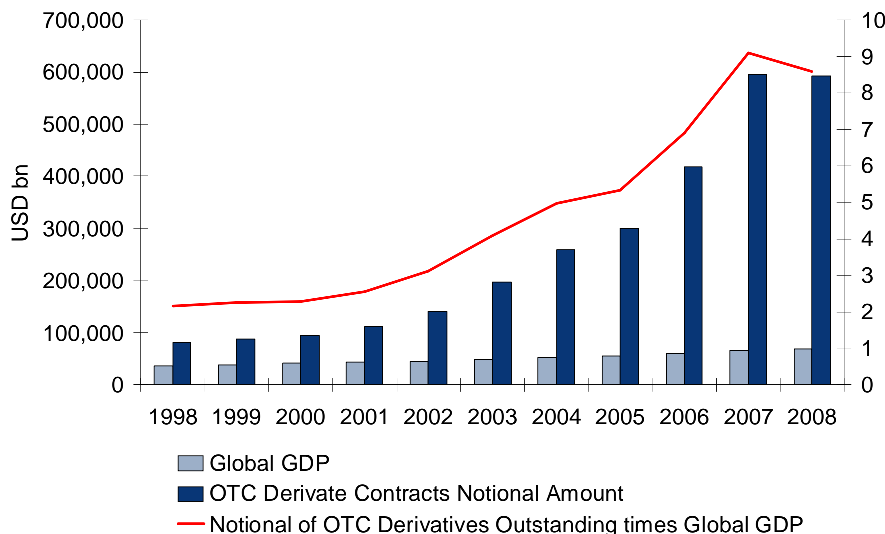
Modest debt levels in CEE

The left hand graph above shows that, in comparison to quite extreme debt-levels in the US or UK, major CEE countries like the Czech Republic or Poland have quite modest total debt levels to carry.

Notional amount of OTC derivatives reaches 8.5 times Global GDP

On top of massive debt levels, a bloated and compared to other markets still rather unregulated global derivatives market adds a further unresolved risk potential to global asset prices. The graph below shows that by the end of 2008 the notional amount outstanding of OTC derivatives, worth in excess of USD 600trn (according to estimates of the BIS), exceeded global GDP by nearly 8.5 times. It therefore seems as if the tail is still wagging the dog.

OTC derivative notional amount vs. global GDP 1998-2008



Source: BIS, IMF

Lack of fundamental property rights makes derivatives destructive

Economist Hernando de Soto recently pointed out in an interview with the Wall Street Journal that these unregulated derivatives are at the root of the financial crisis. This is because unlike all other property paper, derivatives are not required by law to be recorded, continually tracked and tied to the assets they represent. Since nobody knows how many there are, where they are or who is finally accountable for them, there is widespread fear that potential borrowers and recipients of capital with too many nonperforming derivatives will be unable to repay loans.

Summary

To sum up: Japan stands as proof that the current fiscal trend in the leading global economies, where debt levels are being shifted to the public sector, is unlikely to lead to positive results. The Japanese economy remained sluggish, while the entire economy inherited a mountain of public debt sucking ever more life and resources out of the private sector.

In addition, the huge, unregulated global derivatives market poses a permanent threat to the stability of the global financial system. Looking at the developments over the last few months from this perspective, there is no reason yet for any real enthusiasm.

CEE Macro Economy

Stabilization in most markets – Romania and Hungary seem to have not bottomed out yet

Seasonally-adjusted GDP data published for 2Q09 showed some signs of economic stabilization or even improvement in the Czech Republic (+0.1% q/q), Poland (+0.5% q/q) and Slovakia (+2.2% q/q), while Hungary and Romania contracted further, albeit at a less negative pace compared to the previous quarter. The Czech Statistical Office has revised GDP data series for the last three years downwards, dragging down the trajectory of GDP for this year. Reflecting the revision and relatively fragile growth in 2Q09, we expect the Czech economy to contract by 4.9% y/y this year. Similarly to the Czech Republic, we expect a revision of Slovakia's quarterly figures, which should smooth out the very volatile q/q growth rates (mainly in 4Q08 and 1Q09), but without a significant impact on full-year growth (which we expected at minus 5-6%). While we see q/q growth continuing in the Czech Republic, Poland and Slovakia in 3Q09, the leading indicators across various sectors indicate that the Romanian and Hungarian economies have not bottomed out yet and we can also expect negative q/q growth rates for 3Q09. This would keep the y/y growth rates for 3Q09 close to -9% and -7%, respectively. However, the dynamics of the y/y growth rate should reverse in the last quarter, due to the low base from 4Q08.

C/A deficit adjustment quicker than expected

The flipside of the GDP contraction is improvement of current account deficits. The speed of adjustment of imbalances is much faster than previously anticipated. The 'con' of the process is more condensed contraction of domestic demand, while the 'pro' is much faster narrowing of the current account deficit. The overall positive aspect is that countries will need less external financing, which supports their currencies and opens the door for monetary easing. Indeed, the current account deficit in Romania is to narrow to -5.1% of GDP, from the -12.4% of GDP reported last year, and it should be almost fully covered by FDIs. We recently revised down our CA deficit forecasts for most CEE countries.

Financing investments without capital inflows will be main challenge

The adjustment of external imbalances is realized primarily through the collapse of investment and partially through cuts of consumption. The severity of the cuts of investment and consumption was positively correlated with current account imbalances; thus, countries with the highest current account deficits were hit the hardest. However, going beyond the current cycle, the decisive factor will be how CEE countries manage to finance their investments without the huge capital inflows seen in the past decade. Potential output is to collapse to about 3.5-4%, assuming balanced current accounts, while countries with relatively good levels of national savings (the Czech Republic, Slovakia and Estonia) should outperform the region.

Fiscal targets are the interesting thing

Budget preparation will be under the spotlight in the next couple of months in all CEE countries. We expect a quite ambitious fiscal target in Hungary (3.8% of GDP), as this country seems to be the most dedicated to fiscal consolidation. Most CEE countries will run deficits of about 5-7%. Poland, the only country to have avoided recession, will double its deficit next year to 3.6% of GDP. Dropping the early elections in the Czech Republic (originally planned for October, then for November) brought more uncertainty regarding approval of the proposed austerity measures and the budget for next year. Elections are now likely to be held only next year, in May or June.

Inflation supports monetary easing

Inflation remains very low across the region. Increases of indirect taxes in Hungary and Croatia (VAT, excise taxes) have only marginally passed through into higher prices. Inflation dropped below 5% in Romania, approaching the inflation target (2.5-4.5%). Overall, subdued consumption, low inflation and stabilized currencies are supportive for further monetary easing in CEE, except for Poland and the Czech Republic, where we think the easing cycle is over. We expect the Hungarian and Romanian central banks to cut their key rates by 100bp by year-end.

Yields have stabilized

Expectations of further monetary easing and stabilized currencies were especially supportive for Hungarian yields. 10Y yields dropped below 8% and the yield on our favored 3Y bond collapsed by almost 100bp m/m to 7.5%. Recently, yields on Romanian T-bills fell below 10% and it seems that the huge liquidity surplus on the Romanian market will pull rates down further, despite the mounting fiscal deficit. It seems that, given the IMF financing and restrictive measures that hinder pulling liquidity out of local markets and the ability to borrow on international markets (with Eurobonds successfully issued by Croatia, the Czech Republic and Hungary; Polish and Romanian Eurobonds are in the pipeline), market conditions should stay supportive for government bonds. CEE currencies have stabilized, as capital outflows have been diminishing, global sentiment has improved and the narrowed current account deficits are supportive of CEE currencies.

CEE Macro Economy

Macro economic overview

Real GDP growth (%)	2007	2008	2009f	2010f
Czech Republic	6.1	2.6	-4.9	1.9
Croatia	5.5	2.4	-4.8	0.2
Hungary	1.2	0.6	-6.2	0.3
Poland	6.5	4.8	1.2	2.6
Romania	6.2	7.1	-8.0	0.2
Serbia	7.1	5.4	-5.1	1.0
Slovakia	10.4	6.4	-5.5	2.6
Ukraine	7.6	2.1	-12.0	2.0
CEE8 weighted average	**6.2**	**4.0**	**-4.3**	**1.7**

CPI (%), eoy	2007	2008	2009f	2010f
Czech Republic	4.9	4.7	0.8	1.5
Croatia	5.8	2.9	4.0	4.5
Hungary	7.4	3.5	6.9	2.4
Poland	4.0	3.3	3.2	2.3
Romania	6.6	6.3	4.4	3.1
Serbia	11.0	8.6	9.0	7.8
Slovakia	3.4	4.4	1.2	3.0
Ukraine	16.6	22.3	18.0	9.0
CEE8 weighted average	**6.8**	**6.7**	**5.5**	**3.5**

Unemployment (%)	2007	2008	2009f	2010f
Czech Republic	6.6	5.4	8.2	9.5
Croatia	9.7	8.9	12.0	13.5
Hungary	7.7	8.0	10.7	9.8
Poland	9.6	7.1	10.5	11.4
Romania	4.1	4.4	7.4	9.0
Serbia	18.1	14.0	17.5	19.0
Slovakia	11.0	9.6	12.1	13.3
Ukraine	6.9	7.5	12.0	10.0
CEE8 weighted average	**8.3**	**7.1**	**10.4**	**10.9**

3M rates (average, %)	2007	2008	2009f	2010f
Czech Republic	3.1	4.0	2.2	1.9
Croatia	5.6	7.0	9.8	7.5
Hungary	7.7	8.9	8.7	6.3
Poland	4.6	6.3	4.3	4.3
Romania	7.8	13.0	10.3	6.7
Serbia	11.3	15.6	14.6	12.5
Slovakia	4.3	4.2	1.2	1.4
Ukraine	9.6	14.8	18.0	11.0
CEE8 weighted average	**6.0**	**8.5**	**7.5**	**5.6**

C/A (%GDP)	2007	2008	2009f	2010f
Czech Republic	-3.2	-3.1	-1.4	-1.6
Croatia	-7.6	-9.4	-5.3	-4.4
Hungary	-6.5	-8.4	-3.0	-3.1
Poland	-4.2	-5.0	-0.1	-3.1
Romania	-13.5	-12.3	-5.1	-4.7
Serbia	-13.2	-17.4	-7.9	-9.1
Slovakia	-5.3	-6.5	-4.2	-3.2
Ukraine	-4.2	-6.7	0.0	2.0
CEE8 weighted average	**-6.0**	**-6.9**	**-1.9**	**-2.6**

Budget Balance (%GDP)	2007	2008	2009f	2010f
Czech Republic	-1.9	-0.5	-4.9	-4.0
Croatia	-1.4	-1.6	-3.0	-3.0
Hungary	-4.9	-3.4	-3.9	-4.0
Poland	-2.0	-2.2	-3.0	-3.8
Romania	-2.3	-4.9	-7.3	-6.6
Serbia	-1.9	-2.5	-4.5	-3.0
Slovakia	-1.9	-2.2	-6.0	-6.0
Ukraine	-1.1	-1.2	-4.0	-1.5
CEE8 weighted average	**-2.2**	**-2.3**	**-4.3**	**-4.0**

Source: Focus Economics, Erste Group Research

Global Markets

Europe

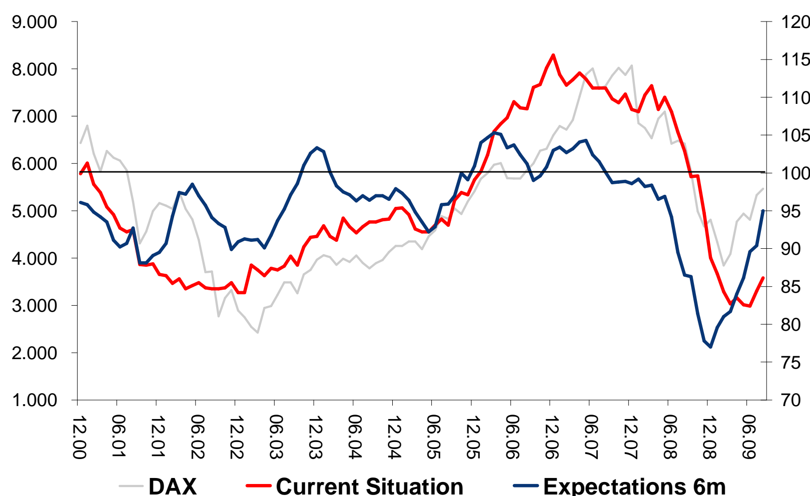
Valuations, rising PMIs, low yields

During the last three months, the European equity markets have seen another steep advance. The Stoxx 600 is up 19%. Low valuations, an increase in leading indicators (PMIs, basic materials prices), further declines in short-term yields and an advance in earnings and sales estimates have been the drivers for the market.

Financials, materials and industrials lead markets

The financial sector has been the strongest outperformer, as it rose by 30%, as the companies repeated their profit increases in 2Q, with banks again profiting from record-low interest rates. The performance of the financials was closely followed by industrials (+28%) and the basic resources sector (+24%), which profited from their early cyclical stance. Defensives, although showing further underperformance, also posted healthy gains. The healthcare sector rose by 8%, utilities by 13% and telecoms by 15%. The energy sector was also below-average, as the oil price showed no significant advance in the last three months.

Ifo Indices Germany and DAX, 2000-2009



Source: Bloomberg

Ifo, ZEW and Sentix Index climb higher

As shown in the graph above, the Ifo Index showed another strong advance in the last few months, with expectations almost turning positive. Additionally, for the first time in this recovery, an increase in the current situation component supported the move. Readings in the ZEW Index and the Sentix Index for the Eurozone confirm the positive economic outlook of business in Europe. However, the leading component of the ZEW Index is already as high as in 2005 and thus does not provide much more room for improvement or positive impulses for equity markets. Also, caution has to be exercised when looking at the Ifo, as in the last four “big” recessions in Europe (74/75, 80/82, 92/93 and 2001/03), the Ifo showed a reading similar to a “W”, and in two cases the second leg of the decline was lower than the first. The current improvements should therefore be viewed with caution, based on historical examples.

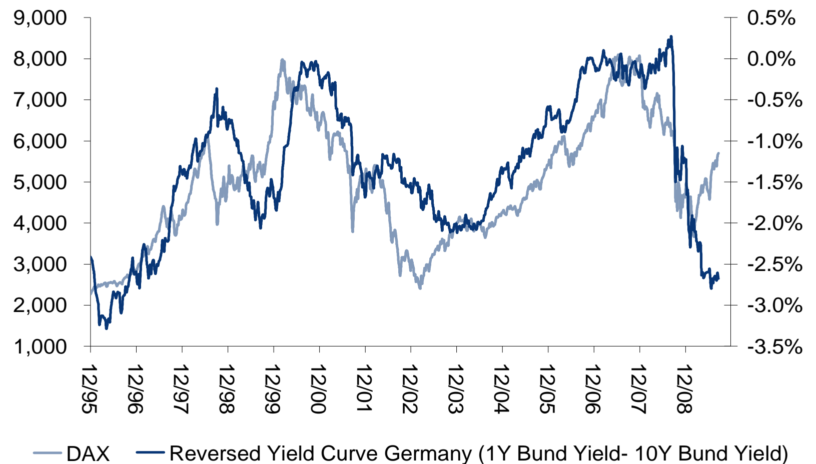
Low Bunds: 2Y at 1.18%, 10Y at 3.36% support stock markets

One of the main drivers of the recent rally in stocks has been the low yields on government bonds worldwide, with a yield curve as steep as in 1998. Steep yield curves have generally been very favorable for stock market gains, as can be seen below. Although the yield curve is lagging in the upturns, in the downturns, it is providing high support for equities at the moment. The overall development of the short-term Bunds and the longer-term Bunds is also positive for equities, as they have been steady and then slightly declining during the last quarter. 2-year Bunds are yielding 1.18% (-0.24 points) and 10-year Bunds currently trade at 3.36% (-0.13 points).

A comparison of the earnings yield of shares (inverse PE ratio) and the government bond yields in Europe also shows a favorable valuation of shares. The yield difference amounts to about

3.5% and is therefore in line with the 2-4% range in the bull market from 2003-07. This reading shows limited downside potential for shares.

Yield Curve Germany vs. Dax since 1995



Source: Bloomberg, Erste Group Research

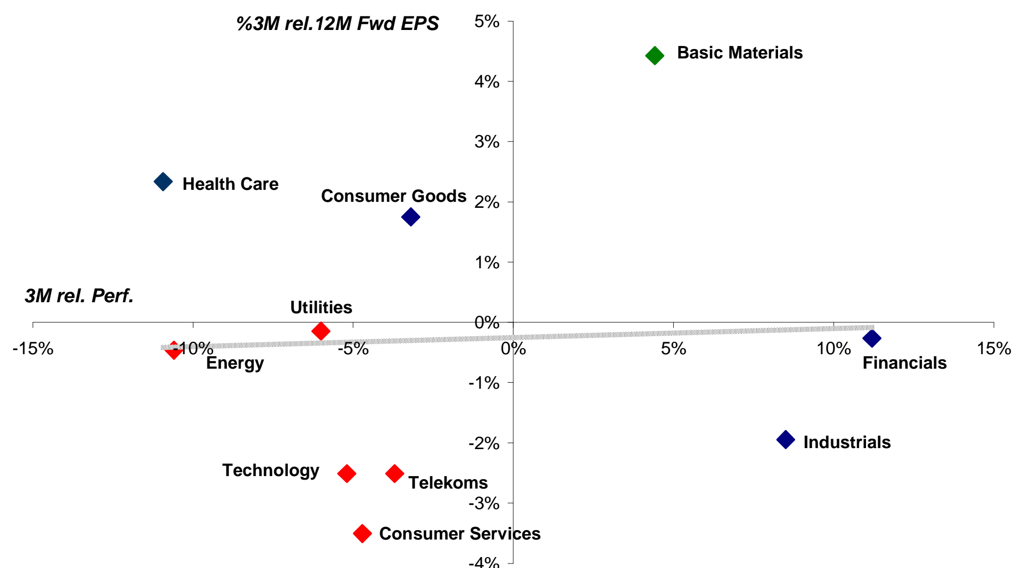
Stoxx 600 ex financials: +21% q/q profit in 2Q

The fundamentals of companies in the Stoxx 600 improved in 2Q. Apart from the positive surprises in the financial sector (64% of companies exceeded expectations), other sectors also provided generally positive results. Net profit of the Stoxx 600 ex financials rose to EUR 37bn (+21%) in total, which is the second increase after the overall loss of EUR 2bn in 4Q08.

Fundamentals come more into play

One of the most positive fundamental signs of the recovery has been the EPS revision ratio, which turned into positive territory this month for the first time since September 2007. Trends in this ratio are persistent, as the ratio stayed positive in the bull market until 2007, after switching from negative to positive. The EPS momentum, on the other hand, is still negative, with 12-month forward EPS revised down by 1.5%, on average, during the past three months. However, when comparing the relative performance of the sectors with their respective earnings revisions, a positively related relationship is observed, as shown below. This positive relationship is a good sign, since the market is in a more healthy state (as this relationship was upside down for more than a year).

Relative performance and relative EPS momentum, Sectors Stoxx 600



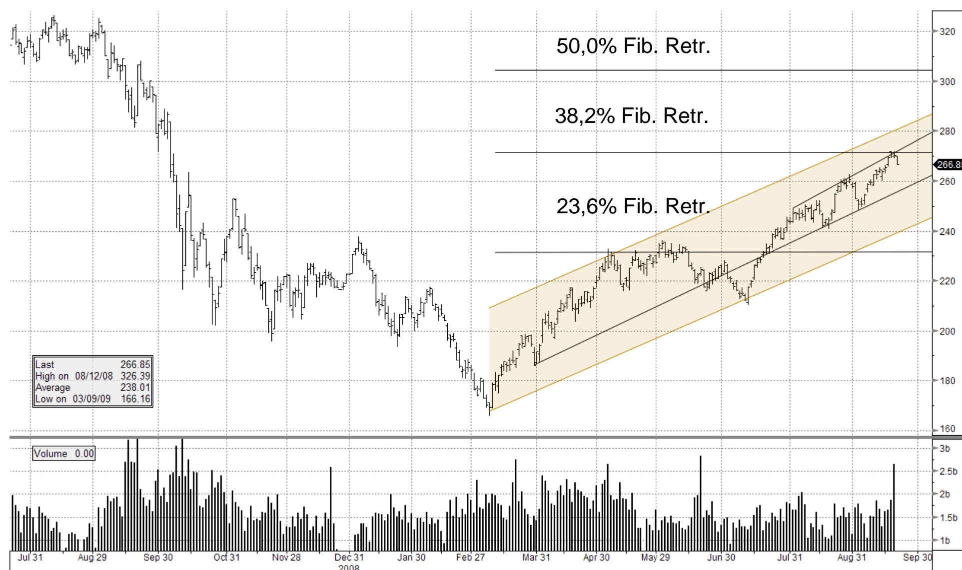
Source: Datastream, Erste Group Research

Global Markets

Sales still revised down

The revision ratio of sales remains at a low and shows only stabilization, with still two out of three estimates being revised downward. For the Stoxx 600, an overall sales growth of 0.8% is forecast for this year, with growth of 3.5% for 2010. The development in EPS and sales estimates is similar to the last cycle in 2003, during which EPS forecasts bottomed out before sales forecasts.

Technical Analysis Euro Stoxx



Source: Bloomberg, Erste Group Research

Solid technical uptrend thus far

The medium-term technical picture of the Euro Stoxx Index looks good. The index (consisting of the major 314 companies in the Eurozone) is in the middle of its upward trend channel. Currently, the 38.2% Fibonacci Retracement at 273 points from the high in July 2007 is an important resistance level that is unlikely to be broken in the first or second advance. Also, 95% of the stocks are currently above their 50-day moving average, which signals overbought conditions. However, the advance and decline line, as well as the on balance volume, show no divergences and support the medium-term trend up. MACD is still in positive territory and RSI is signaling a short-term overbought situation.

Outlook

Region Europe: Overweight

We raise our global weighting for Europe to ‘overweight’ as a region and recommend a ‘neutral’ stance towards equities in general. The overweight on Europe comes particularly as the US market seems expensive, with the S&P 500 currently trading at 2.2x price to book value and the Euro Stoxx with a price to book value of 1.45x.

Sentiment not bullish

The sentiment of market participants is still neutral to bearish (Dax Bull/Bear Index, Put/Call Ratios) and therefore the downside potential is limited. Further valuations are now just at their long-term averages and far from an overbought situation. Our main concern regarding this regional asset allocation is the increasingly strong euro. An acceleration of the current upward trend would certainly dent European firms’ export strength.

Global Markets

US

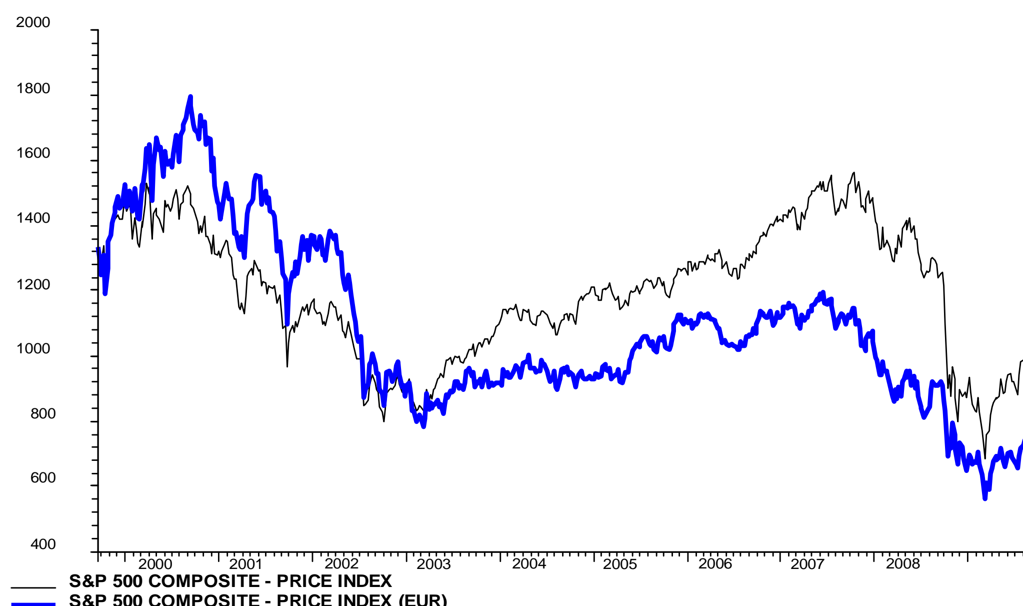
During the third quarter, the US stock market continued its upward trend. Most indices gained momentum, but the value of traded stocks was extremely weak. Our global analysis of volume developments in equity markets shows that the S&P 500 and Dow Jones were among those indices in which we found certain proof that investors have the least interest worldwide.

This important aspect can also be expressed in other words: Global investors are finding a lot of attractive opportunities outside the US and are allocating more and more funds to other parts of the world. The US stock market has definitely lost its appeal for growth investors.

The chart below shows the long-term picture of the S&P 500 in local currency and euro. Both time series document the dominant long-term declining trend:

Long term downtrend

S&P 500 – the long term picture (USD, EUR)

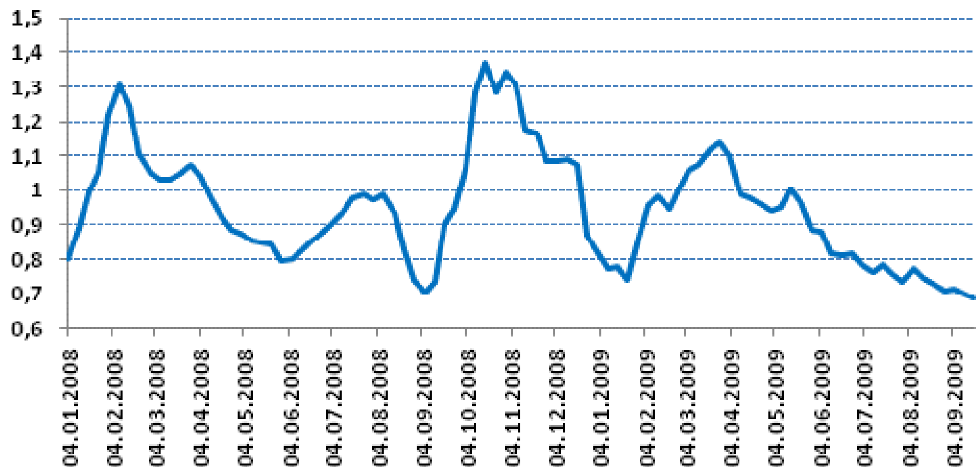


Source: Datastream

Extremely low trading volume in the

As mentioned above, investors' interest in US equities expressed in realized trading values has clearly decreased in recent years. Even when the major indices have moved up sharply, we could see a significant drop in trading volume and values. The chart below shows the relationship of trading values in 2009 compared with the average of the period 2000-07. The actual figure of 0.68 means that, even when we adjust our analysis for different index levels, the value of traded stocks has recently decreased by 32% compared with the period mentioned above.

S&P 500: Traded value of stocks compared with mean of the period 2000 – 2007



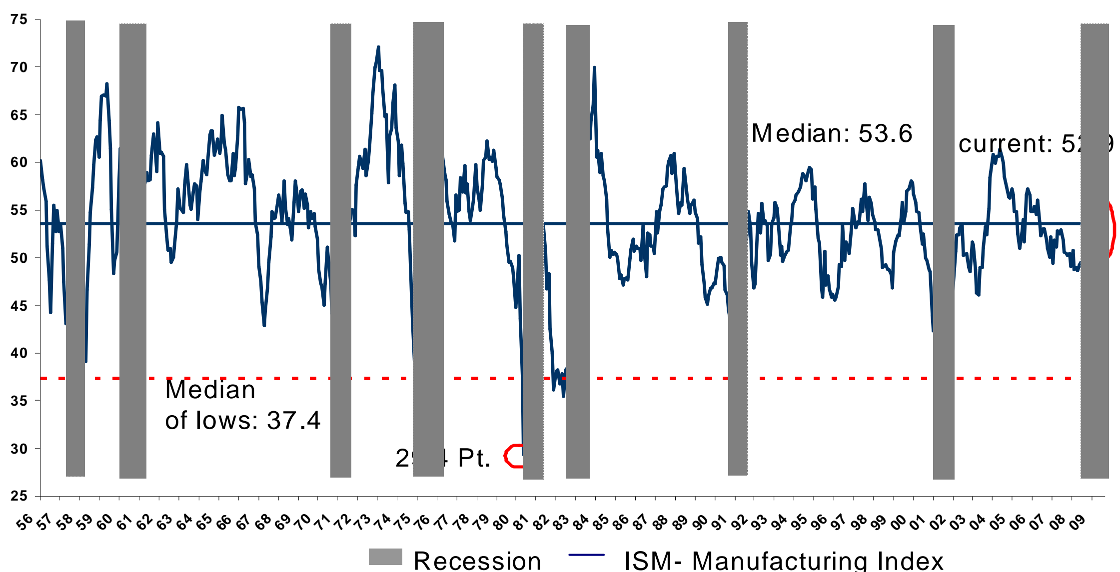
(already adjusted for different index levels). Source: Erste Group Research, Reuters

Nearly all equity markets around the world increased this ratio in recent quarters and now show ratios of 1 or higher. Even when we compare present trading activity in the US with the period 2003-04, we see the same picture. The conclusion is clear. The recent US equity rally does not have a solid basis. Most other indices worldwide also showed strength, but this was accompanied by increased volume.

ISM indices positive

We see some weak signs of improvement in the economy, especially regarding the sentiment of purchasing managers or market participants like analysts. The recent readings of the ISM manufacturing index have gone up sharply, as some relief was felt within certain parts of industry, especially in the automotive sector. After destocking, the "cash for clunkers" program led to increased production in the car industry. However, despite all of the short-term optimism, the prudent investor should not ignore that more than 30% of total industrial capacity (not just in the car industry) is currently unneeded!

ISM manufacturing index



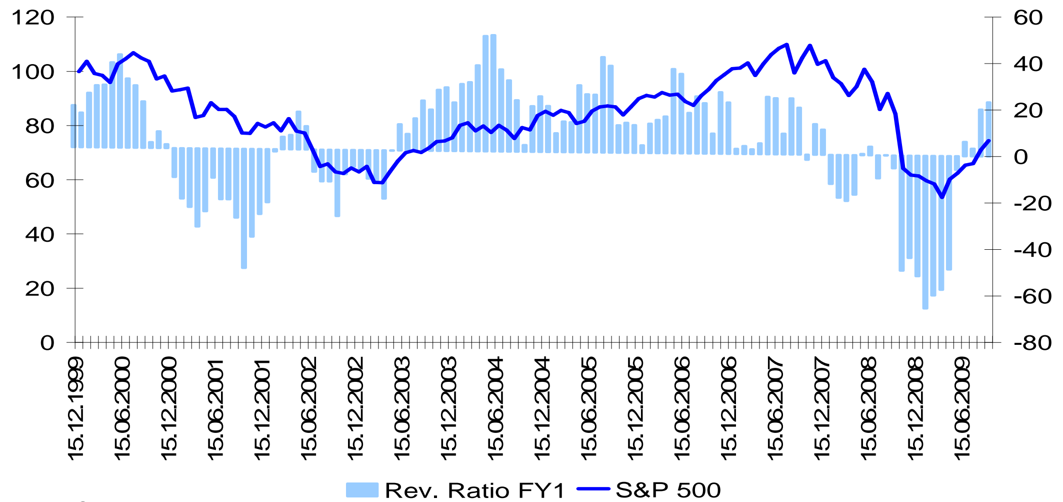
Source: Bloomberg, Erste Group Research

Global Markets

Earnings Revision Ratio is also positive

The earnings revision ratio for the S&P 500 continued to improve recently, as the number of upward revisions outpaced the number of downward revisions by a significant amount. The same observation can by made by analyzing this ratio for the NASDAQ Composite index. It remains unclear if this improvement can be sustained if the US currency shows increased volatility or for the case that energy and commodity prices move up. As the improvement of the revision ratio has been most distinct in the latest seven months, we expect that much better readings in the near future are unlikely.

S&P 500: Earnings Revision Ratio

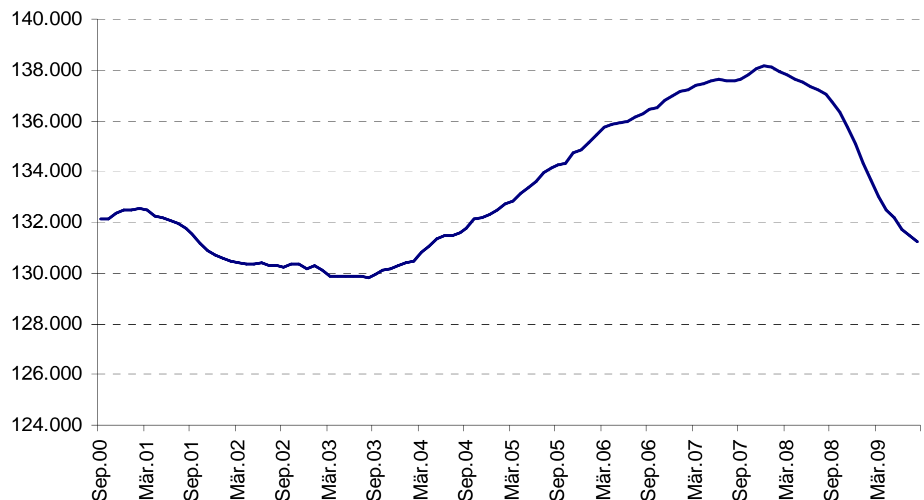


Source: Erste Group Research, Factset

The main problem in the US economy is the huge oversupply in the housing market and the extremely weak labor market. The next two charts show the time series of total non-farm payrolls and the development of unemployment, together with the consumer confidence index, which has a clear negative correlation to unemployment. It is no secret that the real unemployment rate in the US already is a double-digit figure, as official figures understate the problem.

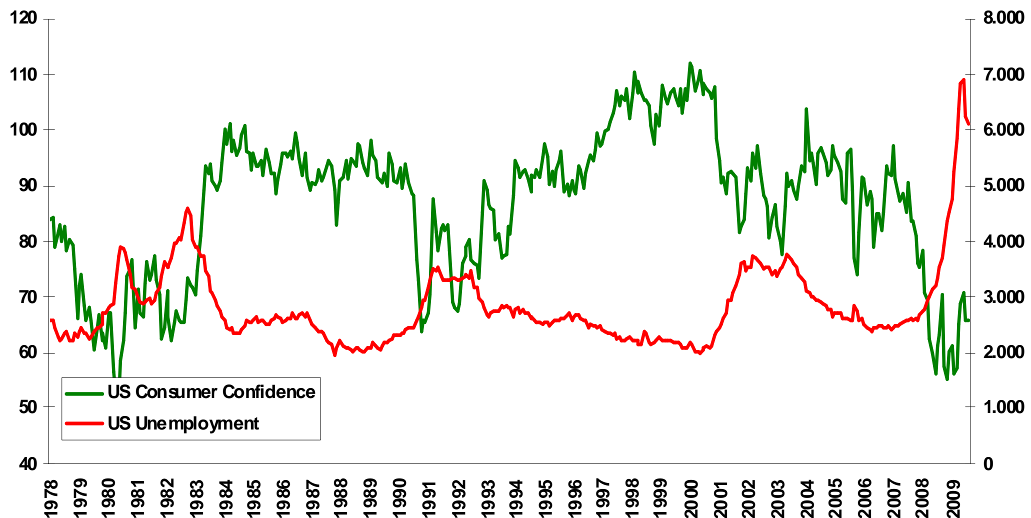
Non-farm payrolls signaling end of former growth story in US

Week labor market week is a drag for a consumer driven nation



Source: Bloomberg

Consumer confidence and unemployment



Source: Bloomberg

Outlook

Based on the fact that the actual dividend yield for the S&P 500 is just 2%, we definitely cannot see any value-based argument for this index, especially considering the fact that the possibility of a meaningful increase in dividend is not there until 2011 or even later. A growth-based argument for an investment in US equities also cannot be found.

The long-term trend of the index is down; the decreasing ratio of Price to Book Value also points in that direction and confirms the existence of a secular bear market.

Much better opportunities outside the US

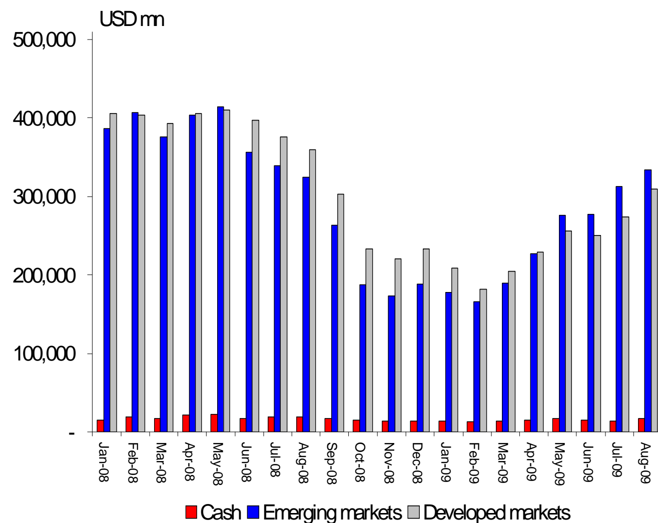
Considering the fact that there will not be much growth in the labor market in the US for many quarters, we see this consumer-driven economy more or less stagnating for a longer time. Investors can find much more attractive opportunities outside the US. On the other hand, it cannot be expected that the market will go significantly lower, because too much in the US (e.g. pension funds, etc.) depends on a more or less stable development, at least in dollars. Whereas the long-term outlook remains dull, we expect some further short-term improvement in the main indices. Our strategic recommendation for investors nevertheless is to underweight US equities; even in the short run, we are sure that there are much more interesting opportunities in Europe or Emerging Markets in general.

Fund Flow

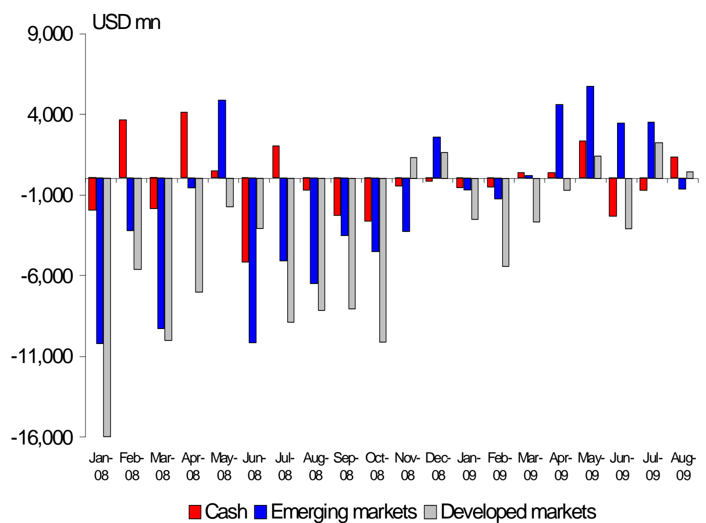
At the risk of becoming boring, the overall story on fund flows remains the same. According to Emerging Portfolio Research, money market funds continued to bleed, losing about USD 330bn altogether in 2009. Among others, emerging market equity funds were receivers of this fresh money, with GEM, EMEA and Latin America funds taking the lead in September. Interestingly, Asian funds lost somewhat on flows, due to profit taking and China's being on bad terms with the US customs right now.

Emerging Europe in August actually saw again some net buying in all fund categories after net selling in July. Also, as a common observation for July, Russia was by far the biggest loser in terms of net selling until July, while making up some of the losses again in August, while Turkey has seen quite some interest across all fund categories.

Total holdings, eop



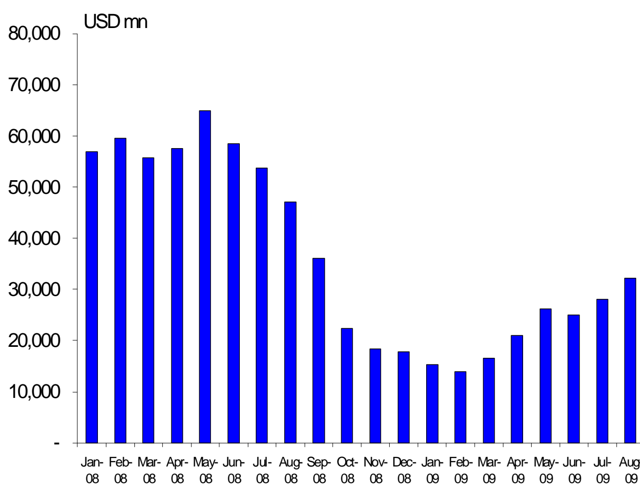
Net purchases/sales



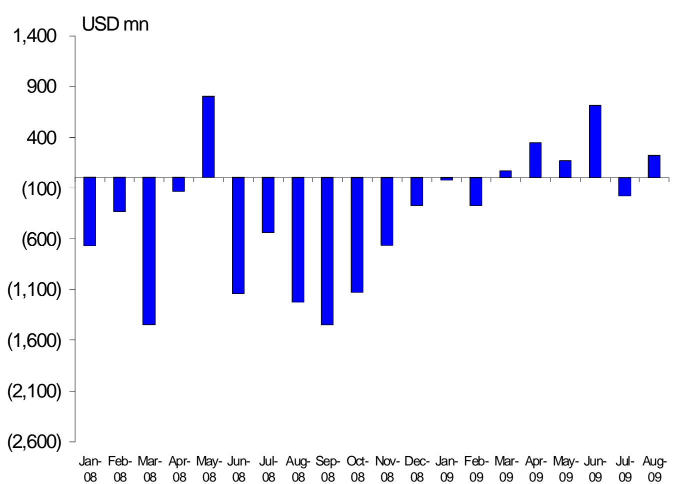
*Source: Emerging Portfolio Research; **Total holdings:** market value of all holdings for all funds covered; **Net purchases/sales:** change in market value of holdings - increase (decrease) of market value of holdings*

Poland enjoyed some reviving interest, while Hungary and the Czech Republic continued experiencing smaller amounts of net selling, After seeing quite some interest in July net buying in Greece calmed down again.

Emerging Europe: total holdings, eop...



...net purchases/sales

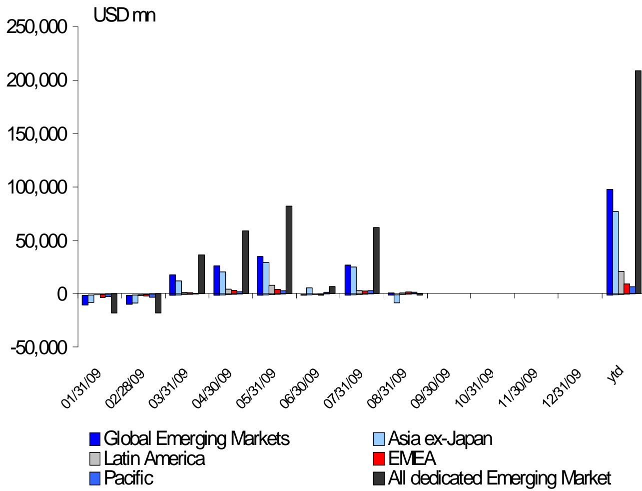


*Source: Emerging Portfolio Research; **Total holdings:** market value of all holdings for all Emerging Europe funds covered; **Net purchases/sales:** change in market value of holdings - increase (decrease) of market value of holdings for all Emerging Europe funds covered*

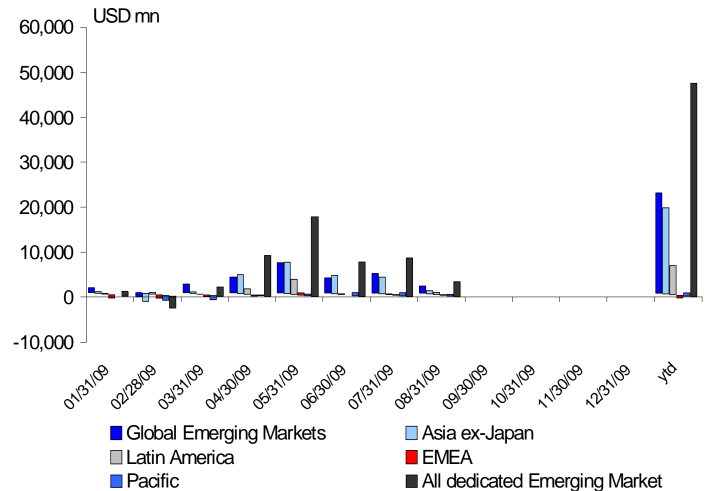
Fund Flow

Not only strong performance, but also continued inflows helped to further boost assets held by dedicated emerging market equity funds. While EMEA funds increased their assets by performance, net inflows were still negative in August. However, at least the trend of positive net inflows that started in May this year has continued, channeling another USD 300mn into EMEA funds in August. For all dedicated emerging market funds, accumulated inflows have almost made up for the USD 50bn lost in 2008, reaching about USD 47bn in August 2009.

Monthly net change



Monthly flows

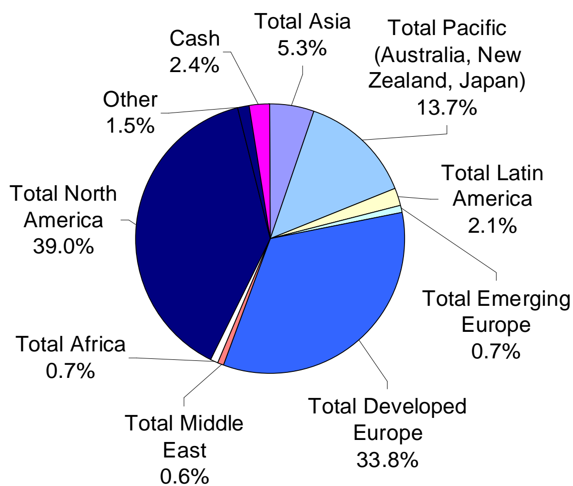


Source: Emerging Portfolio Research; ***Monthly net change:*** *change in assets minus forex change = portfolio change + monthly flows /* ***Monthly flows****: change in assets minus portfolio change, minus forex change = contribution/redemption to funds*

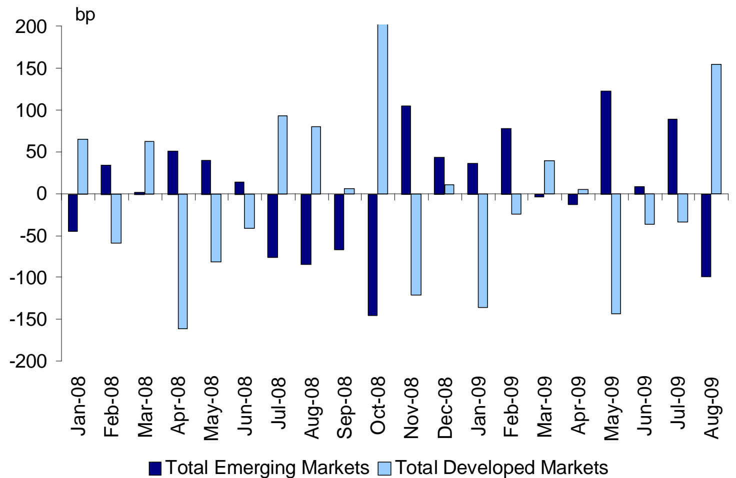
Driven by performance and inflows so far, the weight of emerging markets within global equity funds saw its first drop in weight again in August. Emerging markets' weight was pushed down by roughly 100bp, at the benefit of developed markets, but the cash weight also decreased to 2.4% in August, after 3.7% in June.

Emerging markets - weight in Global Equity Funds

Current...



...over time

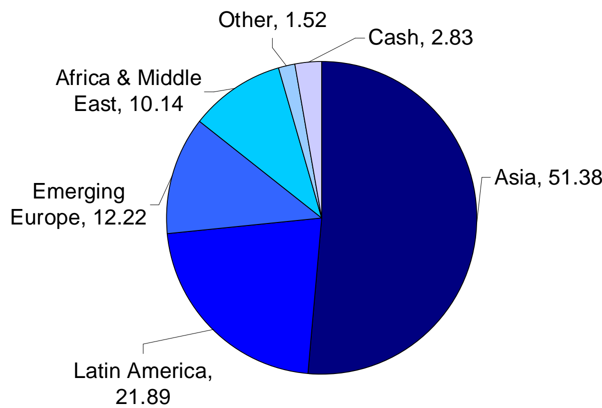


Source: Emerging Portfolio Research

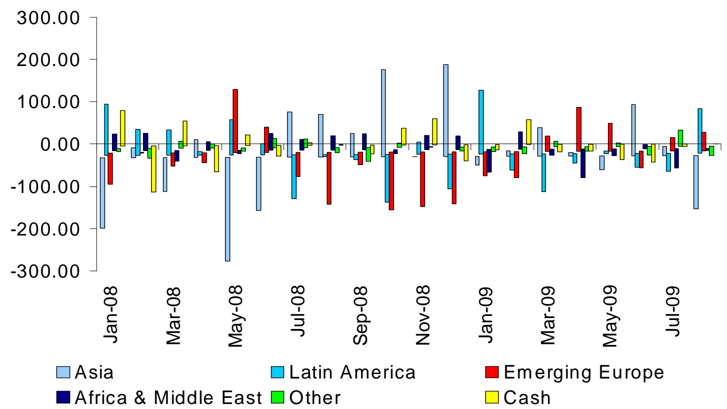
Fund Flow

Emerging Europe - weight in Global Emerging Market Funds

Current...



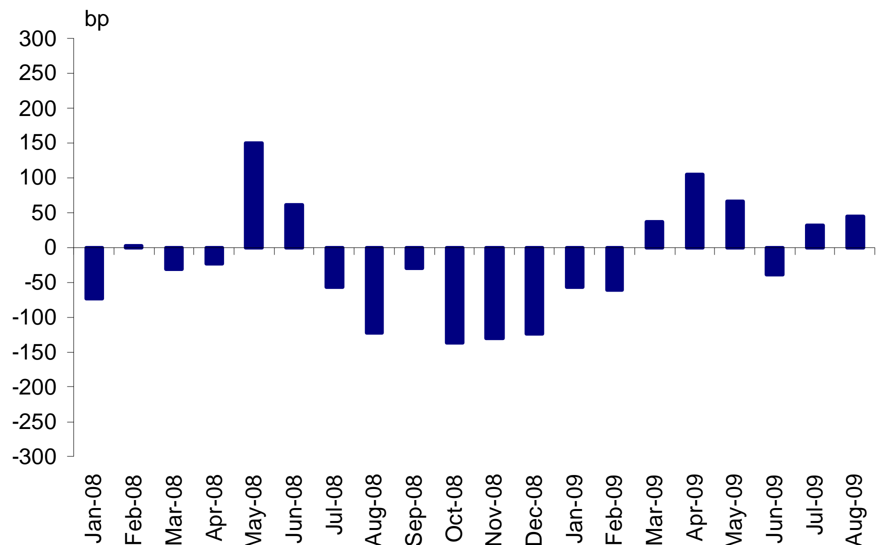
...over time (change in bps)



Source: Emerging Portfolio Research

Asia keeps its dominant weight in global emerging market funds, even though it has lost significantly in weight in August. Latin America took up most of the Asian losses, emerging Europe continued gaining moderately to 12%, which is about the level it had in early 2006.

Change in weighting - Emerging Europe within Global Emerging Market Funds

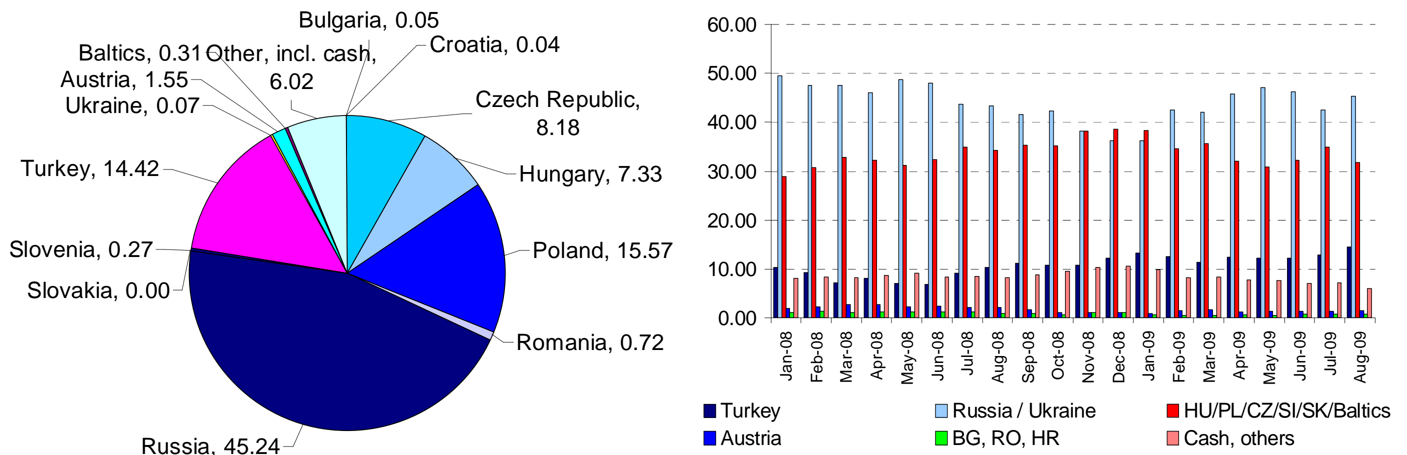


Source: Emerging Portfolio Research

Owing to returned net buying in Russia by various fund categories, the weight of Russia within emerging Europe funds has again increased after dropping significantly in July. After nearly reaching its highs again, Russia's weight fell to 42% in July, just to get back to 45% in August. Turkey again gained strongly (150bps) reaching a weight of about 14% in August. After being the clear winner in July Poland lost again some of its gains in weight. The Czech Republic was hit by net selling losing a touch more than Hungary.

Fund Flow

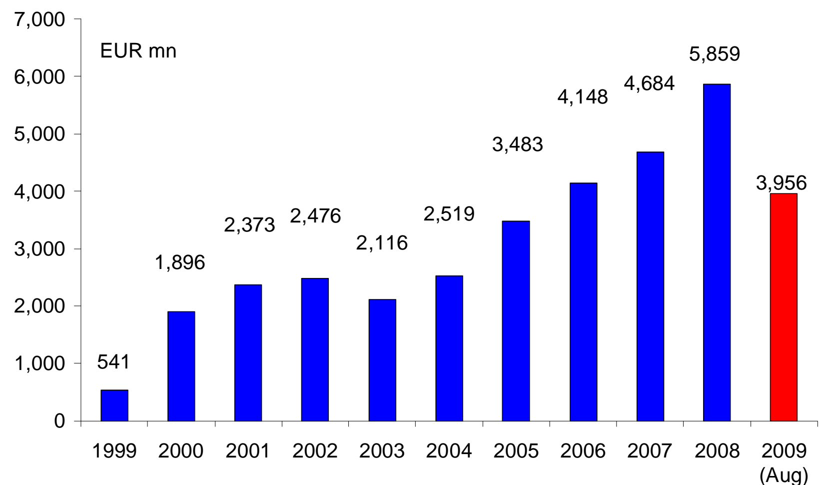
Emerging Europe - country weighting in Emerging Europe Funds



Source: Emerging Portfolio Research

While markets in CEE had some weaker moments in June and July in terms of m/m turnover development, in August, the region saw a bigger move again and turnover across the region increased by some 36% m/m. This is in quite some contrast to its western peers, such as Deutsche Börse, the London Stock Exchange and Euronext, which just posted stable m/m turnover, at best. On an accumulated basis, CEE markets continued to recover in a y/y comparison, even though this still means that decreases were reduced.

Transfers into Polish pension system



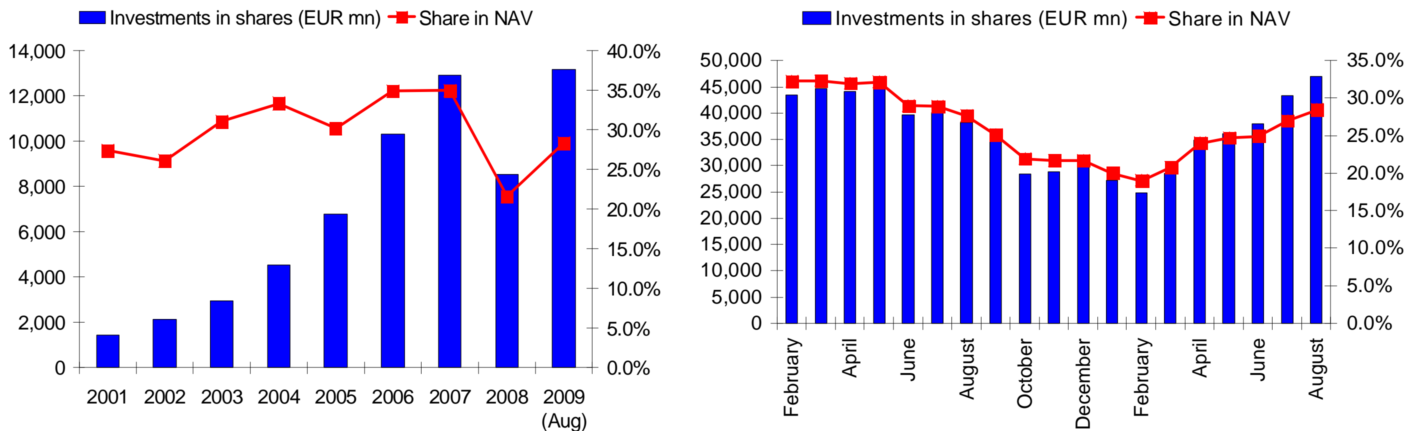
Source: ZUS

Transfers into the Polish pension system may already indicate some weakness in the Polish labor market, even though August 2008 also brought a y/y decline. In summary, accumulated inflows (including August) are about flat (+1.1% in PLN) compared to 2008.

Positively, NAVs of funds continued to recover and the weight of equity investments - also driven by an assumed greater risk-taking investment approach - reached 28.4%, a level seen last in July 2008.

Fund Flow

Polish pension funds - development in share investments

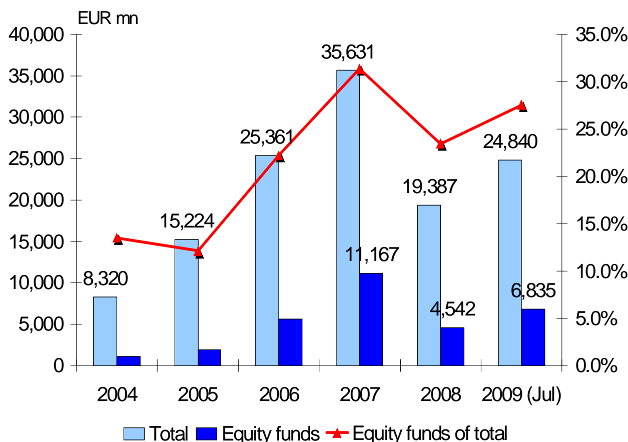


Source: Financial Supervision Authority of Poland

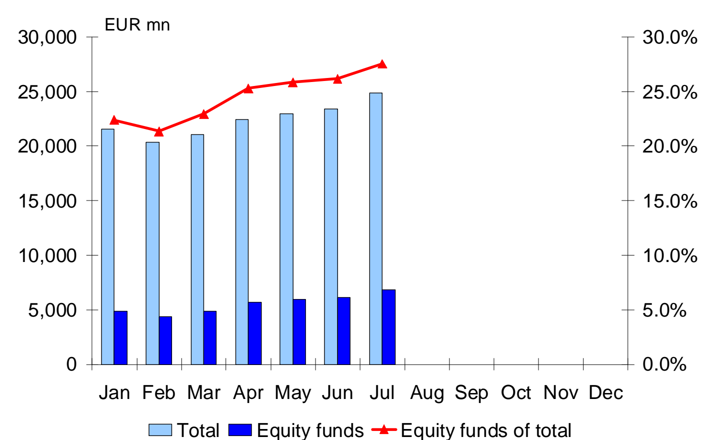
Even though August data for Polish mutual funds was not available yet, at least a positive trend was visible in the data until July. Total holdings increased by 6% m/m in July and the equity portion increased again to 27.5%, continuing the recovery seen since February 2009. The positive trend of net inflows continued. With the last cash outflows registered in April, increasing inflows ever since indicate an increasing risk appetite among these investors.

Mutual funds - development of equity portion*...

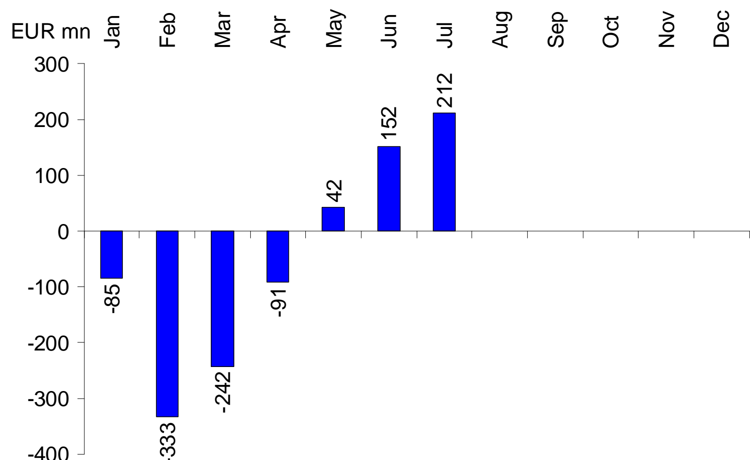
...annually...



...and on a monthly basis



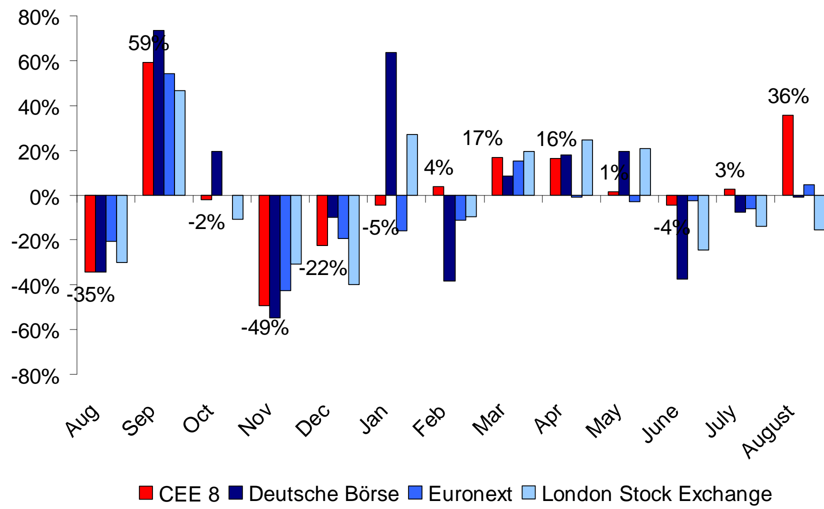
Net cash inflows (2009)



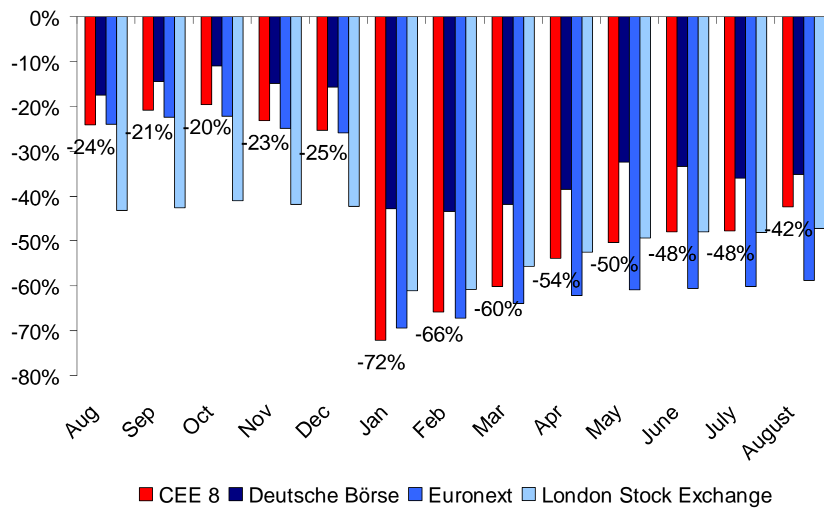
**Equity portion approximated based on equity funds, not including equity exposure in balanced funds, etc. Source: Analyze Online*

Fund Flow

Stock exchange turnover m/m



Stock exchange turnover accumulated y/y



CEE 8 = A, BG, CZ, HU, PL, RO, SLO,SK; Source: FESE

ZEW Indicator CEE

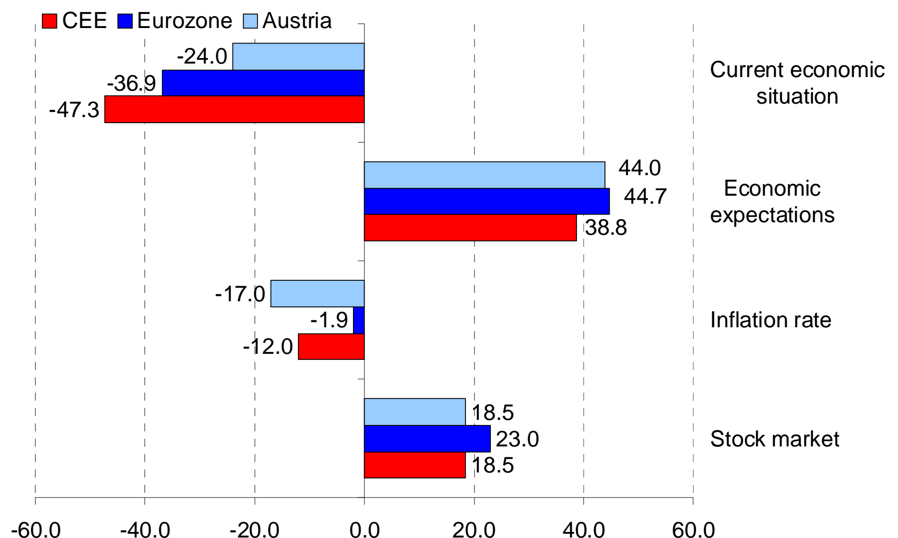
The CEE Economic Sentiment Indicator Continues to Rise

The upward trend of the ZEW-Erste Group Bank Sentiment Indicator for Central and Eastern Europe (CEE) continues in September 2009. The expectations of the financial market experts concerning the economic development within the next six months improve by 2.8 points with the indicator rising to 38.8 points. While the sentiment indicators both for Austria and the Eurozone have slightly deteriorated, the economic outlook for almost all analysed CEE countries has improved in September. The current economic conditions in the CEE region, in the individual CEE countries and in the Eurozone are assessed much better in September compared to the previous month. Nevertheless, all balances remain negative. The indicator reflecting the current economic condition in the CEE region shows minus 47.3 points. The expectations for the development of the CEE stock market index (NTX) improve by 1.5 points to a value of 18.5 points in the current survey.

Economic Outlook for CEE Countries, Austria and the Eurozone

The CEE Economic Sentiment Indicator, which is calculated monthly as the balance of positive and negative assessments of the economic development on a six months horizon, continues to rise in September. The analysts' expectations concerning the economic development over the next half year improve by 2.8 points and the indicator achieves 38.8 points. While 48.1 percent of the surveyed experts anticipate an improvement, only 9.3 percent of the participants assume the business activity in the CEE region to worsen within the next six months. The amount of experts anticipating no change has significantly increased to 42.6 percent. The expectations regarding the economic development both in Austria and in the Eurozone have deteriorated in September. The Austrian indicator decreases by 6.0 points to 44.0 points. The indicator for the Eurozone drops most strongly this month with a decrease of 7.3 points to 44.7 points. The current economic conditions in the CEE region, Austria and the Eurozone are assessed much better in September compared to the previous month. All balances achieve double-digit improvements. Despite that, the scores remain negative. The indicator reflecting the current economic condition in the CEE region shows minus 47.3 points in September. Austria's corresponding indicator stands at minus 24.0 points and the indicator for the Eurozone rises to minus 36.9 points. The balance indicating the expectations of the financial market experts on inflation in the CEE region rises in September by 4.3 points to now minus 12.0 points. This shows that the majority of the participants in the survey believe in declining inflation rates in Central and Eastern Europe. In contrast the majority of the financial market experts await inflation rates to be unchanged in both Austria and the Eurozone over the next six months. Consequently, 74.5 percent of the analysts think of the current key interest rate in the Eurozone as being appropriate and do not anticipate interest rate increases by the ECB over the upcoming six months. Expectations for the development of stock indices in CEE (NTX) and Austria (ATX) assimilate at 18.5 points in the current survey.

ZEW indicator



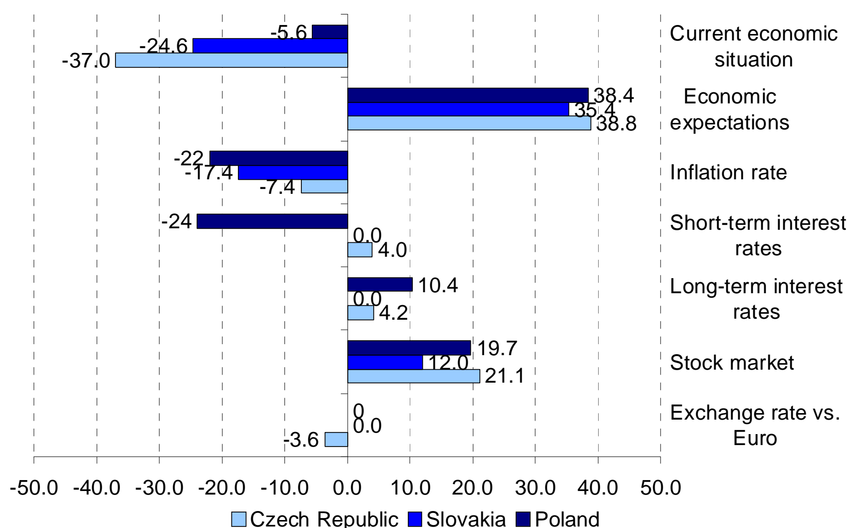
Balance of positive and negative assessment category chosen by respondents of the Financial Market Survey CEE; Source: ZEW

ZEW Indicator CEE

Czech Republic, Poland and Slovakia: Clearly improved current situation

The sentiment indicator for the Czech Republic remains unchanged at 38.8 points in September. Although the previous month's strong boost was not to be continued in September, the Czech indicator shows the best value among the CEE countries analysed in this survey. In September, Poland's economic outlook further improves. By rising 7.3 points, the Polish sentiment indicator now stands at 38.4 points which is the second best value across the analysed countries. After having shown the strongest increase in August, the Slovakian sentiment indicator stays nearly unchanged at35.4 points this month. 49.0 percent of the analysts expect an unchanged development of the economy over the next six months. The estimations of the analysts regarding the current economic situation in the Czech Republic, Poland and Slovakia clearly improve in September. The assessment for the Czech Republic recovers by 14.0 percent to minus 37.0 percent. The analysts evaluate the current situation in Poland most positive in September compared to all other CEE countries. The respective indicator reaches the strongest upswing in the current survey with an improvement by 40.4 points to minus 5.6 points. The appraisal of the current economic situation in Slovakia increases also strongly by 35.9 points to minus 24.6 points. The balances representing the analysts' expectations of inflation rates in the three countries remain negative in September. This indicates that more survey participants still expect decreasing inflation rates. After the cautious forecasts concerning the development of the Czech stock market in August, the indicator for the stock index PX50 improves significantly this month. With a current value of 21.1 points, the balance beats expectations for the stock markets of most other CEE countries. The expectations for the Slovakian stock index SAX improve by 4.1points to 12.0 points and for the Polish stock market index WIG by 4.7 points to 19.7 points in September.

ZEW indicator on country levels



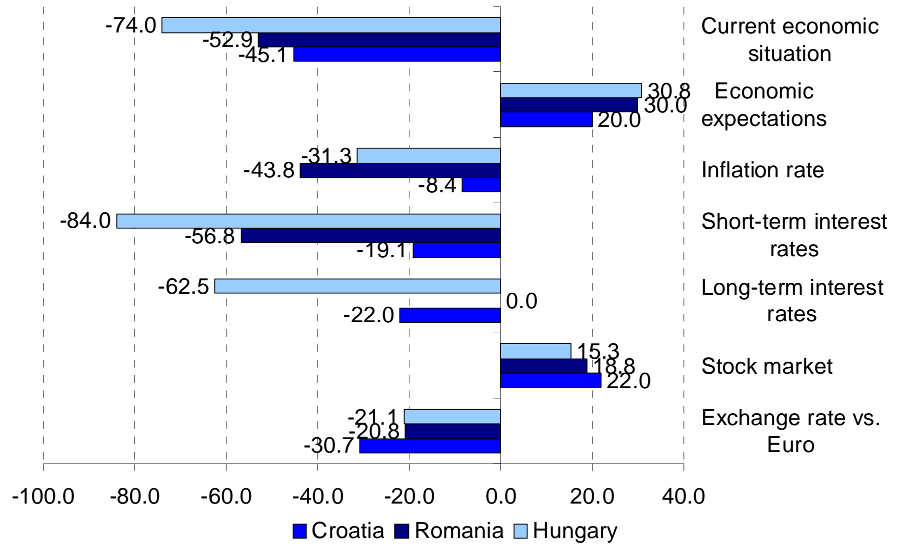
Balance of positive and negative assessment category chosen by respondents of the Financial Market Survey CEE; Source: ZEW

Hungary, Romania and Croatia: Depreciation of currencies expected

The assessment of the economic development in Hungary, Romania and Croatia within the next six months improves in September again. The Hungarian sentiment indicator rises by3.4 points to 30.8 points. The indicator for Romania increases by 7.8 points to 30.0 points. 50.0 percent of the participants in this month's survey assume the economic development in Romania not to change over the next six months. Although, he Croatian sentiment indicator climbs most strongly by 15.3points to a value of 20.0 points, it still achieves the lowest figure across the analysed CEE countries. Despite the improved economic expectations, the financial market experts continue to take a critical stance towards the current business conditions in the three countries. With a balance of minus 74.0 points Hungary ranks last among the CEE countries analysed in this survey. The balances for the current economic situation in Romania and Croatia in-crease significantly by 24.3 points and 21.5 points, however, they remain clearly negative at minus 52.9 points and minus45.1 points. Nevertheless, the majority of 54.9 percent of the survey participants evaluate the current business conditions in Croatia as acceptable. The majority of financial market experts expect decreasing inflation rates and in line with this decreasing short

term interest rates in Hungary, Romania and Croatia. The clearest picture arises for the Hungarian interest rates. 86.0 percent of the analysts assume a decrease in short-term interest rates in Hungary over the next six months. The participants in the September survey appraise the outlook for Croatia's domestic stock market most bullishly compared to all CEE countries covered. The balance showing the expected development of the CROBEX climbs to the highest value amongst all analysed countries. Considering the exchange rate expectations, a shift of the forecasts towards a depreciation of the Romanian and the Hungarian currencies compared to the Euro can be identified in September.

ZEW indicator on country levels



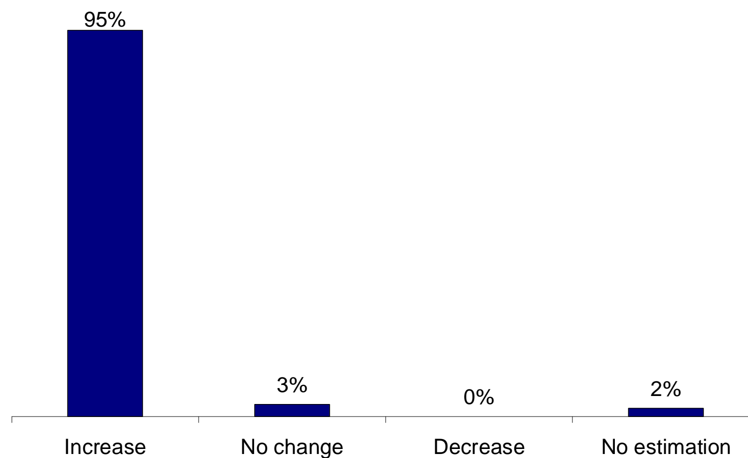
Balance of positive and negative assessment category chosen by respondents of the Financial Market Survey CEE; Source: ZEW

ZEW Indicator CEE

Special question: CEE labour markets

Following Eurostat, the harmonised seasonally adjusted un-employment rate in the Euro area has increased from 8.5 percent in January to 9.5 percent in July 2009. Interestingly, many the CEE countries achieve significantly lower unemployment rates than the countries from the Euro area (e.g. the Czech Republic with 4.6 percent, and Slovenia with 6.0 percent). Within the scope of the special question in the September survey, financial market experts were asked to analyse some aspects of the CEE labour markets. A similar survey was al-ready conducted in March 2008.While the overall perception of the participants regarding estimations of the unemployment rates was rather mixed in2008, a clear picture can be drawn for 2009. 95.0 percent of the financial market experts who answered the question expect the mean unemployment rate of the CEE region to in-crease by the end of the year of 2009. In March 2008, only22.1 percent of the participants had this opinion.

Estimations for the change of the average CEE unemployment rate in 2009

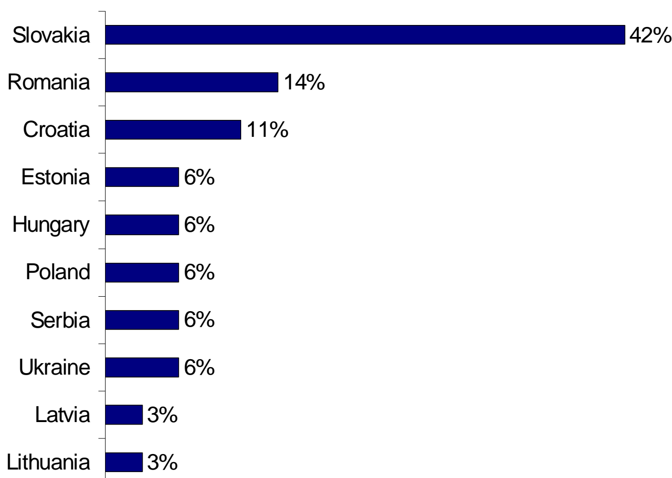


Source: ZEW

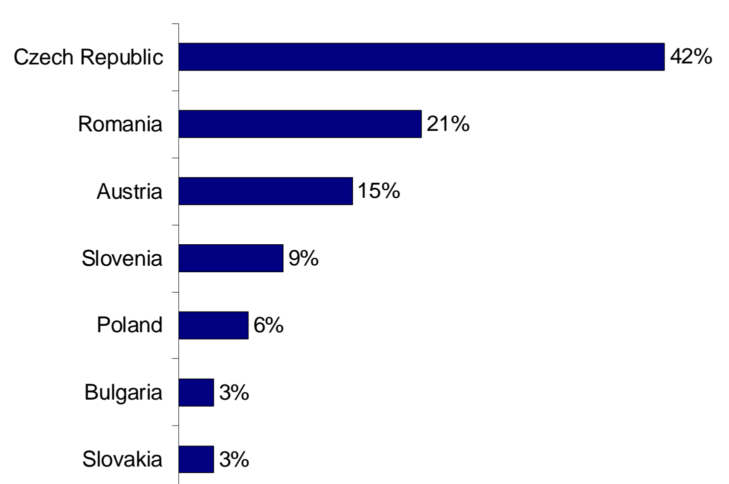
Considering the separate CEE countries, the participants' expectations differ from country to country. 41.7 percent of the financial market experts predict Slovakia's unemployment rate to be the highest one among all CEE countries at the end of 2009.This is also in line with the Eurostat figures which report an increase of the unemployment rate in the Slovak Republic from 9.7 percent in January to 12.0 percent in July 2009. With a clear gap, Slovakia is followed by Romania and Croatia with only approximately one out of ten participants ranking these two CEE countries as the ones with the highest unemployment rates at the end of this year. Poland, mentioned as the country with the highest unemployment rate in the March2008 survey, plays only a minor role in the current survey(5.6 percent).

Estimations for the CEE country with the…

… highest unemployment rate



… lowest unemployment rate



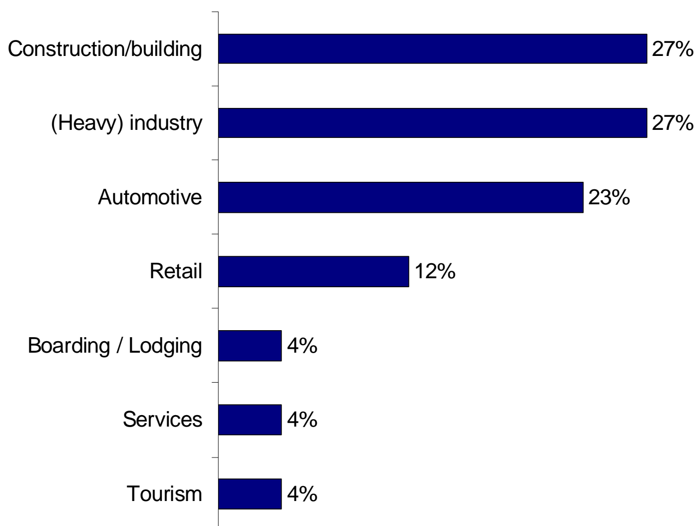
Source: ZEW

ZEW Indicator CEE

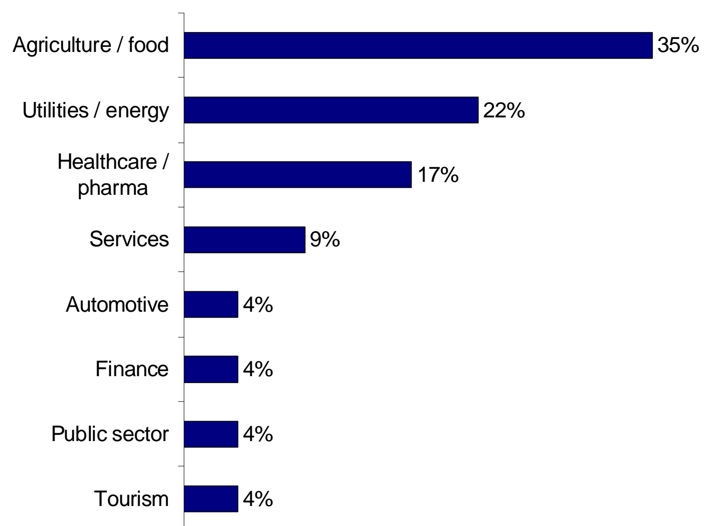
Concerning CEE countries not or very little affected by unemployment, the Czech Republic can defend its top position compared to the survey in 2008. 42.4 percent of the financial market experts believe that the lowest unemployment rate will be measured in Germany's Eastern neighbour. In the March 2008 survey this share was even 50.0 percent. Romania (21.2 percent) and Austria (15.2 percent) are allocated at the second and third position. For Romania participants seem to have very diverse opinions: As seen above, the country at the Black Sea ranks top both amongst the CEE countries least (21.2 percent) and most affected (13.9 percent) by unemployment. Regarding sectors and the impact of unemployment on certain industries, financial market experts draw a more common picture. According to the participants, construction and (heavy) industry are affected most by growing unemployment (both 26.9 percent each). The automotive sector also ranks amongst the industries heavily affected by unemployment due to the current economic crisis (23.1 percent). When asked for their estimation concerning sectors least affected by unemployment, most participants nominate the food sector and the agriculture industry (34.8 percent), followed by utilities/energy (21.7 percent) and healthcare/pharma(17.4 percent).

Sectors likely to be…

… most affected by unemployment



… affected little by unemployment



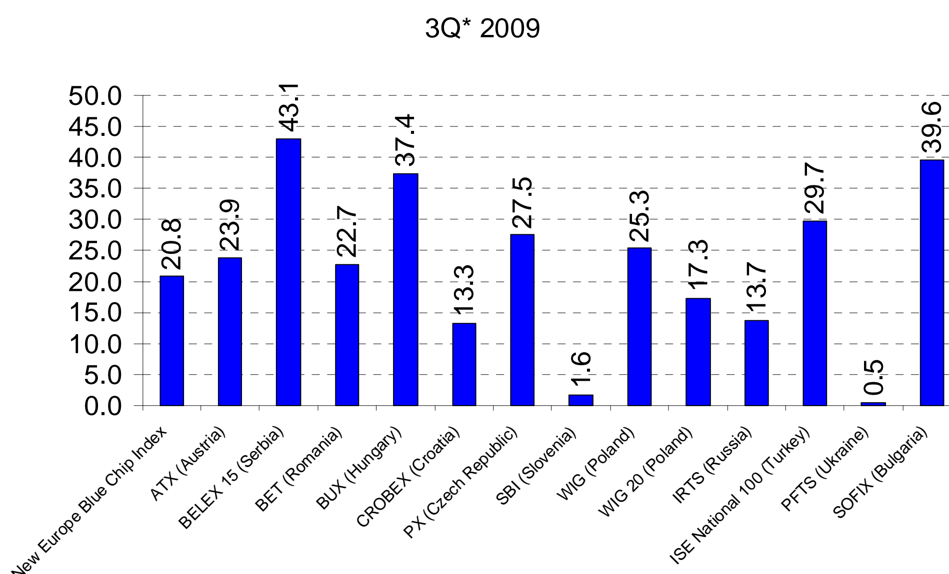
Source: ZEW

Text and charts – source ZEW

CEE Country Allocation

Southeastern Europe has performed quite strongly, when looking at Serbia and Bulgaria. Weaker performances were posted by Romania and Croatia. Hence, we do not regret our overall neutral/ underweight call on the region too much, even though the outcome of the quant model would have indeed indicated a stronger rating. However, performance - particularly in more than thin markets such as Serbia - is easy to achieve, with average daily turnover down as much as it was. Our overweight calls on Austria and the Czech Republic worked quite well – the decision to strengthen the quant-model outcome proved right. Also, improving the model outcome for Poland to neutral/overweight worked out quite nicely, while we could have been braver on Hungary. The decision to reduce the strong model outcome more towards the neutral zone has shaved off some performance. Ignoring the model and reducing Slovenia to underweight was definitely the right decision, with that market a clear underperformer in the region. Strengthening Turkey relative to the quant-model and softening the call on Russia were at least moves in the right direction, with Russia strongly underperforming Turkey.

Performance overview (in EUR)

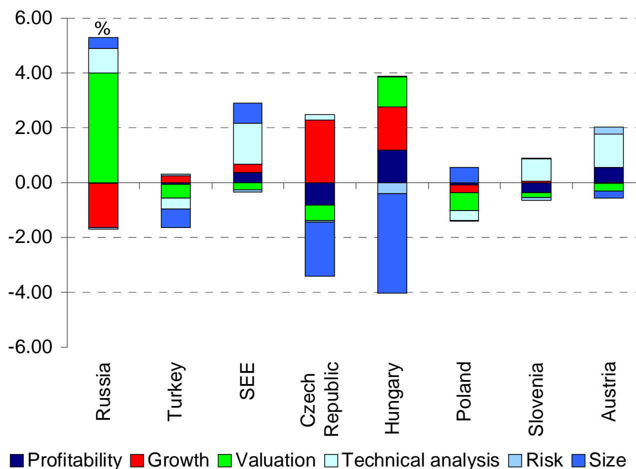


**3Q 2009 = 3month performance as of 22.09.2009; Source: Factset Partners, Erste Group Research*

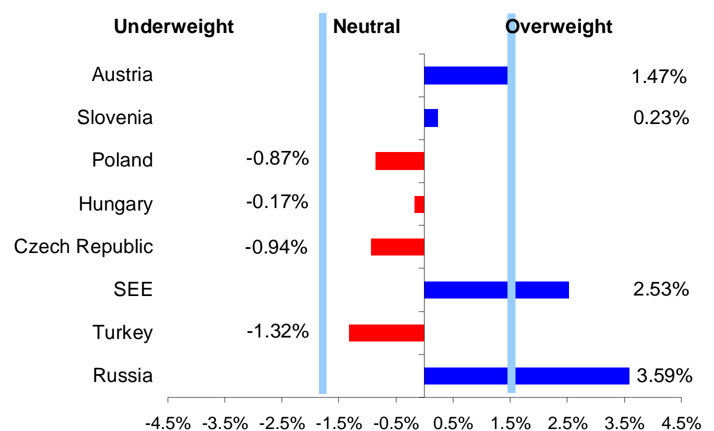
Russia gained strongly on valuation again. Also, for Hungary, we receive positive impetus from valuation for expected returns. However, in the case of Hungary, the valuation argument is also supported by positive expected returns stemming from growth, while for Russia the opposite is true. With the exception of Turkey and Poland, technical analysis gives a helping hand to all markets, while strongest expected returns on this measure are indicated for Austria, Slovenia and Southeastern Europe (SEE). While size always has been a natural argument for Poland and Russia, interestingly, positive returns are also expected for SEE on this measure. This would fit with the observation that Romania gained some 60% m/m in daily turnover in August. Despite this impressive gain, we should not forget that average daily turnover on the Bucharest Stock Exchange is still about EUR 2.4mn. Also, Prague and Budapest gained in terms of m/m turnover in August, but obviously not as dramatically as Romania. Hence, the model would indicate that size yields negative expected returns on this measure for both markets. As mentioned, growth is a strong argument for the Hungarian market, reflecting the market's obvious recovery potential. The Czech Republic also receives strong support from this indicator, although this is more or less the only category yielding positive expected returns for the Czech market.

CEE Country Allocation

Summary of return components



Allocation based on expected returns



Source: Erste Group Research

Austria - overweight

Not only does Austria have a relatively strong outcome in the quantitative allocation model, the market receives a good standing relative to all other markets in our simplified valuation approach, as well. The ZEW/Erste sentiment indicator puts Austria at the second-highest absolute score on expectation after the Eurozone and it has seen the strongest improvement on this indicator after Slovakia. In terms of relative valuation, the market shows a moderate overvaluation of about 4% based on implied P/E. However, earnings revision rates have improved considerably and Austria shows the highest positive balance in the CEE region for 2010 and 2011.

Czech Republic – neutral/ overweight

We have decided to veto the pure quant-model outcome. The model indicates quite negative expected returns based on size. Admittedly, the Czech Republic has never been the biggest market and never offered too much choice in terms of investable titles, but it did post a strong 44% m/m increase on turnover in August. Within our sentiment indicator, the Czech Republic has always been a bank, and it remained so in the latest issue. The simplified market valuation admittedly yields only moderate upside potential and the PX shows a similar slight overvaluation based on implied P/E. On earnings revision, the Czech Republic is somewhere in the middle, but interestingly shows a positive revision balance already for 2009 earnings.

Hungary – a decent neutral

In the last issue, the quant-model outcome was confirmed by actual performance and proved our more careful rating to be overly conservative. However, this time, other indicators would confirm the rather cautious quant-model result. Our simplified market valuation indicates the lowest upside potential for Hungary and consequently also the implied P/E indicates a decent overvaluation already. Earnings revision rates are still on a negative balance, too. The sentiment indicator would show the lowest balances on the current situation as well as on expectations, next to Romania. Certainly, the economy still has strong upside and 4Q should be fine. However, defensive pharmaceuticals had their appearance on stage already and all bigger performance hopes would rest on domestic financial titles.

Poland – neutral/ overweight

We veto the pure quant-model outcome, which would underweight the Polish market. Based on our simplified valuation model, the WIG 20 would still see some reasonable upside potential, higher than for the Czech Republic. While the broad market already shows an overvaluation based on implied P/E in a similar scope like Hungary, the blue-chip index WIG 20 is about fairly valued. The negative expected returns on valuation from the quant-model do not appear to be justified when focusing on the WIG 20. Earnings revisions show a bit of an uneven picture, with the 2009 balance negative, 2010 soundly positive and 2011 about flat.

Russia – neutral

Russia already disappointed in the last quarter, when measured against the quant-model outcome. Consequently, we again veto the overweight proposal based on expected returns. The strong standing is based on valuation arguments, while growth is seen as contributing negatively

to expected returns. Hence, in a commodity-driven market, we would be careful in believing that such a strong value story could happen. Our simplified valuation tool on multiples would indeed indicate some sound upside, although not higher than for Turkey. Earnings revision started to show positive balances already in June, but when looking at flows this seems not to have stimulated the market. After some strong repositioning in the market, flows into Russia have somewhat dried up.

SEE – speculative neutral/ overweight

Southeastern Europe has been the surprising winner in the quant-model approach. Markets are enjoying sound momentum after recovering from very depressed levels. Despite the fact that this performance was surfing on still very thin turnover, August indeed showed some nice increases in trading on markets such as Romania, Croatia and Bulgaria. Romania and Croatia are facing strong theoretical upside in our simplified valuation approach. We would argue that a certain base effect will remain for markets in the region and it will strongly depend on sentiment how quickly this treasure can be lifted. For those who dare, interesting exposure might be paying off. For risk and liquidity reasons, we slightly soften the outcome based on expected returns, but dare to place it as a speculative bet.

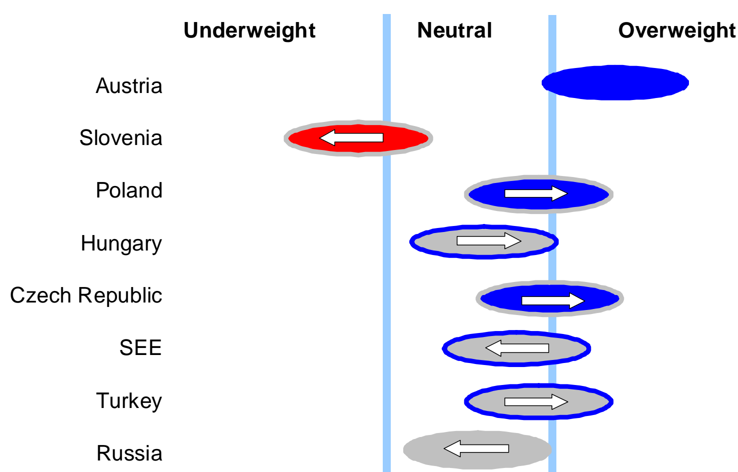
Slovenia – neutral/ underweight

Slovenia receives a rather good rating from the quant-model, as it did in the previous issue. We again intend to veto this rating and hope that this veto pays off as much as in the previous issue. The positive view of the technical model is based more or less purely on chart analysis; with an expected moderation of the lately improving sentiment, we would see it as difficult for the Slovenian market to live up to these positive expectations. Our simplified valuation approach indicates some moderate upside potential.

Turkey – neutral/ overweight

We see Turkey as a direct competitor to Russia. We again decide to veto the technical model rating. The simplified valuation yields an upside potential similar to Russia and revision rates show strongly positive balances already for 2009, 2010 and 2011 earnings estimates. Admittedly, the market has already had a strong showing in terms of YTD performance, but we would accept this merely as an argument for a more moderate performance, which should still be better than for a lot of other markets. Positive changes in the view held by Moody's should also not hurt and the Turkish economy seems able to do pretty well in a stand-alone mode, without much need for external financing.

Allocation proposal



Source: Erste Group Research

Appendix

Factor model description

In our approach to establishing a regional allocation, we employ a multi-factor model. The model screens a universe of the following countries:

- Austria
- Bulgaria (SEE)
- Croatia (SEE)
- Czech Republic
- Hungary
- Poland
- Romania (SEE)
- Russia
- Serbia (SEE)
- Slovenia
- Turkey

Due to data availability, we pooled Bulgaria, Croatia, Romania and Serbia into one region, which we called Southern and Eastern Europe (SEE). This was done because of the small number of available stocks in the data for this region.

The model refines its results by using a range of factors that are seen as significant in any asset allocation decision. Factors cover the topics of:

- Valuation
- Size/Liquidity
- Profitability
- Growth
- Corporate risk
- Technical analysis

In total, the model relies on 16 single factors.

We start our model view with Dezember 1998. Via a multiple-regression, we try to identify a relationship between our chosen factors at the end of a period and the observed return for the next period (in our case, we look at quarters). We run this multiple-regression for the first year of chosen history and summarize the results of the regression by calculating an average regression coefficient (b) for the first year for each factor.

As the next step, we use the average b from the past year (not including the current quarter) and the stock's current state for each factor to forecast an expected return for the next period. However, regression coefficients are estimated further on for all following periods. For each period, new forecasts are computed by calculating the past year's average of the regression coefficients for each factor.

To cut it short, the model yields expected returns for each stock in our universe, which we finally aggregate to country levels.

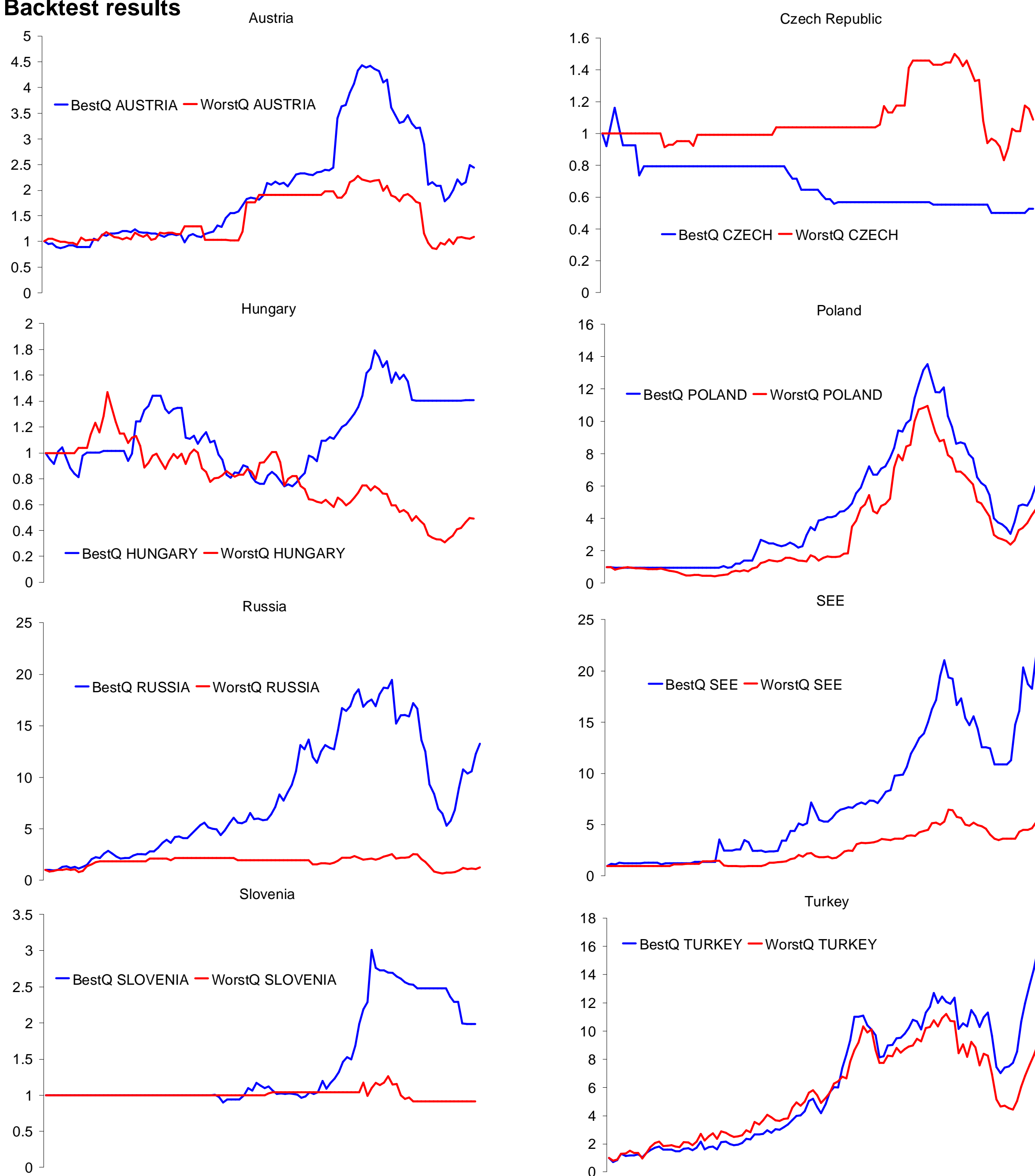
In order to check the outcome of our model, we run a forward looking back test, e.g. how much any portfolio based on the model outcome would have made in terms of return. We differentiate between quartiles and would expect the top quartile to have outperformed the bottom quartile. The outcome indeed indicates that the model works, at least for markets with rather good data quality and - even more importantly - a higher number of stocks being traded. Hence, this already demonstrates the downside of our approach, given the fact that some markets simply offer a limited amount of stocks, which are frequently traded and for which reliable data is available. However, based on this, we would not question the entire approach, but would clearly stress the functionality of our tool: It is an allocation indication, NOT a tradable mechanism. Hence, we allow ourselves to put the pure outcome of the model on a relative scale and use our own judgment to formulate a final view.

Appendix

Finally, for interpretation of the outcome of our model, we use the overall expected return by country, as well as the spread between the high and low (top - last quartile) expected return stocks. The expected return by countries is the forecast, which is the actual state of the factors for each stock in the universe multiplied by the average of the coefficients (b) for each factor from last year's regressions. Since the expected return of each stock is composed of the sum of the expected return components for each factor, we can extract the information regarding from which factor the largest contribution to the expected return comes. Knowing this for each stock and each factor and aggregating on a country level gives us the average contribution of the factor to the total expected return for a country.

We have run a backtest, checking what our allocation model would have yielded. The following charts show the expected returns both for the best and the worth quartile.

Backtest results



Source: Erste Group Research

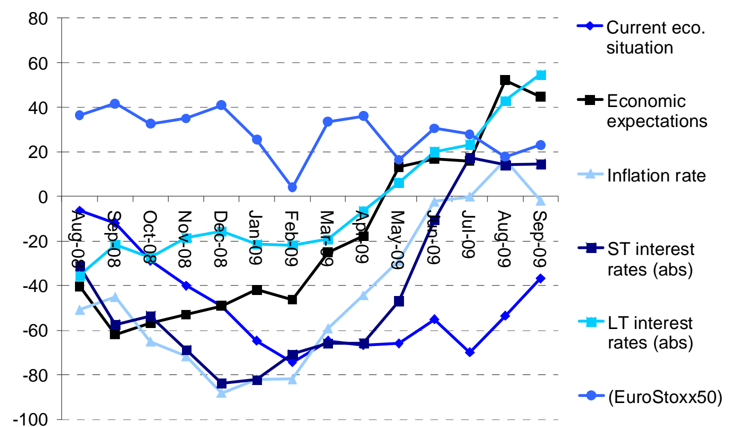
Appendix

ZEW sentiment indicator

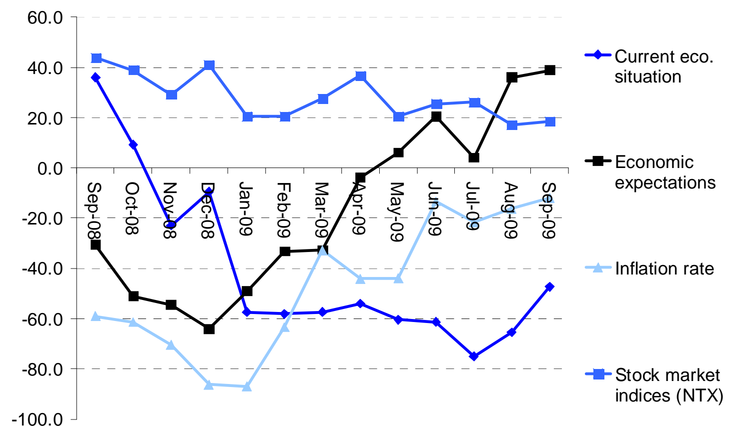
ZEW (Centre for European Economic Research, Mannheim, Germany) and Erste Bank joint established a sentiment indicator. Each month financial experts in the region are asked to give their assesment on various indicator for the CEE region. Here we show the development of the ZEW indicator over time, aggregated by region as well as on individual country levels. Since the first report was published in June 2007, history is just about to be built over time.

ZEW indicator development

EUROZONE	Sep-08	Oct-08	Nov-08	Dec-08	Jan-09	Feb-09	Mar-09	Apr-09	May-09	Jun-09	Jul-09	Aug-09	Sep-09
Current eco. situation	-12.0	-28.8	-40.1	-49.2	-64.9	-74.5	-64.8	-66.7	-66.0	-55.2	-70.0	-53.7	-36.9
Economic expectations	-62.0	-56.8	-53.1	-49.2	-42.0	-46.4	-25.1	-17.9	13.1	16.7	15.8	52.0	44.7
Inflation rate	-45.1	-65.1	-71.7	-88.3	-82.1	-81.9	-59.2	-44.4	-28.9	-2.2	-0.1	16.3	-1.9
ST interest rates (abs)	-57.5	-53.6	-68.9	-83.8	-82.3	-70.8	-66.0	-65.9	-47.0	-10.6	17.4	14.2	14.5
LT interest rates (abs)	-21.7	-27.5	-18.6	-15.7	-21.5	-21.9	-19.2	-6.6	6.2	20.0	23.2	42.9	54.8
(EuroStoxx50)	41.6	32.5	34.9	40.8	25.5	4.0	33.4	36.0	16.4	30.5	27.8	17.8	23.0
Exchange rates (vs. Euro)	-	-	-	-	-	-	-	-	-	-	-	-	-

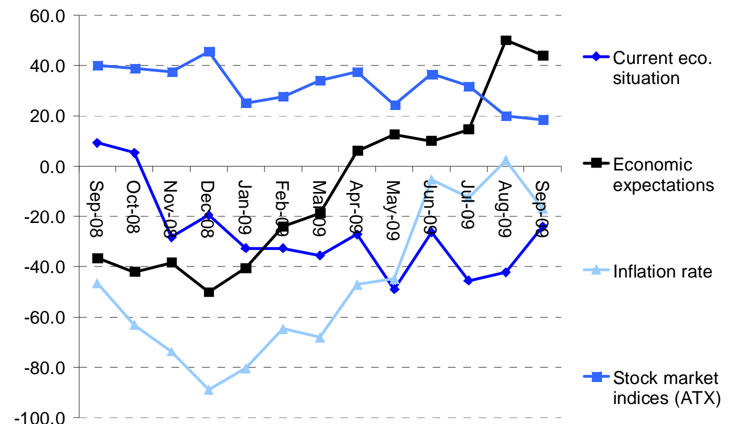


CEE	Sep-08	Oct-08	Nov-08	Dec-08	Jan-09	Feb-09	Mar-09	Apr-09	May-09	Jun-09	Jul-09	Aug-09	Sep-09
Current eco. situation	36.0	9.2	-23.0	-9.5	-57.4	-58.1	-57.4	-54.0	-60.4	-61.3	-75.0	-65.4	-47.3
Economic expectations	-30.6	-51.1	-54.5	-64.1	-49.1	-33.3	-32.7	-3.9	6.0	20.4	4.0	36.0	38.8
Inflation rate	-59.1	-61.4	-70.4	-86.3	-86.9	-63.4	-32.7	-44.2	-44.0	-13.3	-21.7	-16.3	-12.0
ST interest rates (abs)	-	-	-	-	-	-	-	-	-	-	-	-	-
LT interest rates (abs)	-	-	-	-	-	-	-	-	-	-	-	-	-
Stock market indices (NTX)	43.8	38.9	29.2	40.9	20.4	20.4	27.6	36.7	20.4	25.5	26.2	17.0	18.5
Exchange rates (vs. Euro)	-	-	-	-	-	-	-	-	-	-	-	-	-

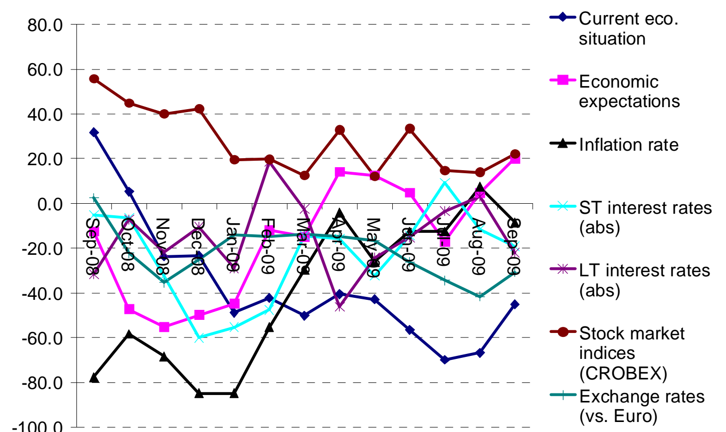


Appendix

AUSTRIA	Sep-08	Oct-08	Nov-08	Dec-08	Jan-09	Feb-09	Mar-09	Apr-09	May-09	Jun-09	Jul-09	Aug-09	Sep-09
Current eco. situation	9.3	5.3	-28.3	-19.5	-32.6	-32.7	-35.5	-27.1	-48.9	-26.3	-45.5	-42.2	-24.0
Economic expectations	-36.5	-42.0	-38.4	-50.1	-40.5	-24.0	-18.7	6.0	12.6	10.0	14.5	50.0	44.0
Inflation rate	-46.5	-63.1	-73.7	-88.9	-80.4	-64.7	-68.1	-47.1	-44.8	-5.3	-12.5	2.4	-17.0
ST interest rates (abs)	-	-	-	-	-	-	-	-	-	-	-	-	-
LT interest rates (abs)	-	-	-	-	-	-	-	-	-	-	-	-	-
Stock market indices (ATX)	40.0	38.9	37.5	45.6	25.1	27.7	34.0	37.5	24.4	36.6	31.7	20.0	18.5
Exchange rates (vs. Euro)	-	-	-	-	-	-	-	-	-	-	-	-	-

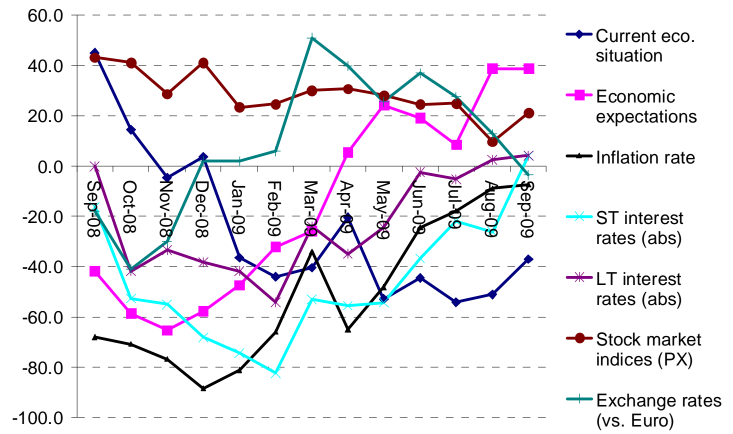


CROATIA	Sep-08	Oct-08	Nov-08	Dec-08	Jan-09	Feb-09	Mar-09	Apr-09	May-09	Jun-09	Jul-09	Aug-09	Sep-09
Current eco. situation	31.8	5.4	-23.7	-23.3	-48.8	-42.2	-50.0	-40.5	-42.8	-56.4	-69.8	-66.6	-45.1
Economic expectations	-12.5	-47.3	-55.2	-49.9	-44.7	-12.0	-14.9	14.0	12.5	4.8	-17.1	4.7	20.0
Inflation rate	-77.5	-58.3	-68.3	-84.7	-84.7	-55.3	-29.8	-4.0	-26.1	-12.5	-12.5	7.4	-8.4
ST interest rates (abs)	-5.2	-6.4	-32.3	-60.0	-55.3	-47.5	-14.3	-15.8	-32.3	-14.3	9.3	-11.4	-19.1
LT interest rates (abs)	-31.6	-7.1	-21.9	-10.5	-28.9	18.6	-2.5	-46.1	-24.2	-15.1	-3.5	3.1	-22.0
Stock market indices (CROBEX)	55.6	44.7	40.0	42.2	19.5	19.7	12.5	32.7	12.1	33.4	14.7	13.9	22.0
Exchange rates (vs. Euro)	2.5	-22.2	-35.3	-25.0	-14.2	-14.8	-13.9	-14.7	-16.7	-26.2	-34.3	-41.5	-30.7

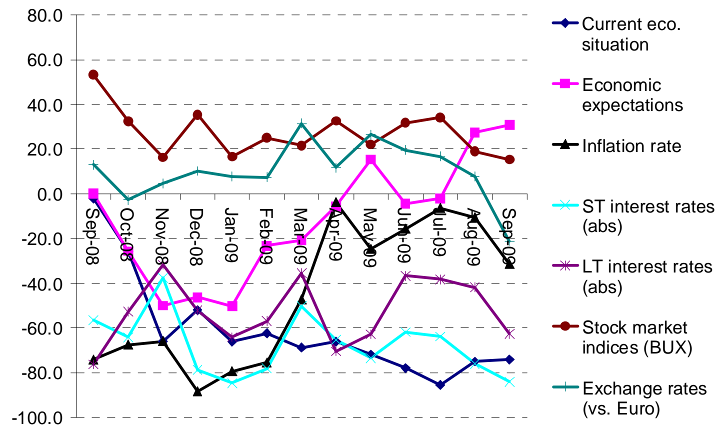


CZECH REPUBLIC	Sep-08	Oct-08	Nov-08	Dec-08	Jan-09	Feb-09	Mar-09	Apr-09	May-09	Jun-09	Jul-09	Aug-09	Sep-09
Current eco. situation	45.0	14.4	-4.7	3.7	-36.4	-44.0	-40.4	-20.4	-52.8	-44.5	-54.1	-51.0	-37.0
Economic expectations	-41.8	-58.5	-65.2	-57.7	-47.3	-32.1	-25.9	5.5	24.1	19.1	8.5	38.8	38.8
Inflation rate	-68.0	-70.8	-76.7	-88.4	-81.1	-66.0	-34.0	-64.9	-48.1	-24.4	-17.8	-8.9	-7.4
ST interest rates (abs)	-16.3	-52.7	-55.0	-68.1	-74.4	-82.3	-53.0	-55.5	-54.3	-36.7	-21.9	-26.1	4.0
LT interest rates (abs)	-0.1	-41.7	-33.4	-38.2	-41.7	-54.2	-24.0	-34.9	-24.4	-2.5	-5.2	2.5	4.2
Stock market indices (PX)	43.2	41.1	28.7	41.1	23.4	24.6	30.0	30.7	28.0	24.5	24.9	9.6	21.1
Exchange rates (vs. Euro)	-17.8	-40.9	-30.0	2.0	1.9	5.9	51.0	39.7	25.5	36.9	27.6	12.7	-3.6

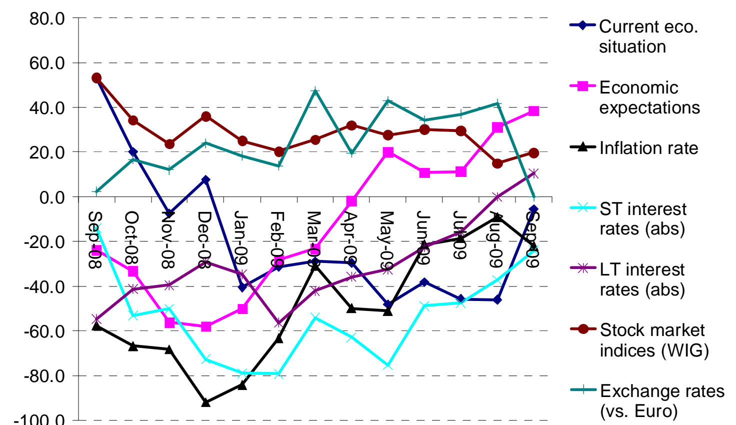
Appendix



HUNGARY	Sep-08	Oct-08	Nov-08	Dec-08	Jan-09	Feb-09	Mar-09	Apr-09	May-09	Jun-09	Jul-09	Aug-09	Sep-09
Current eco. situation	-2.0	-25.7	-65.9	-52.0	-66.0	-62.4	-68.7	-66.0	-71.7	-77.8	-85.4	-74.9	-74.0
Economic expectations	0.1	-25.6	-50.0	-46.2	-50.1	-23.2	-20.7	-5.6	15.3	-4.4	-2.1	27.4	30.8
Inflation rate	-74.0	-67.5	-65.9	-88.3	-79.3	-75.4	-47.1	-3.7	-24.5	-15.6	-6.3	-10.5	-31.3
ST interest rates (abs)	-56.4	-64.1	-37.5	-78.7	-84.6	-78.0	-50.1	-65.2	-73.4	-61.8	-63.7	-76.0	-84.0
LT interest rates (abs)	-76.2	-52.7	-31.7	-52.1	-64.0	-56.8	-35.4	-70.4	-62.7	-36.6	-38.2	-41.9	-62.5
Stock market indices (BUX)	53.2	32.5	16.3	35.4	16.6	25.0	21.6	32.6	22.0	31.8	34.1	19.0	15.3
Exchange rates (vs. Euro)	13.1	-2.6	4.7	10.2	7.7	7.4	31.4	11.8	26.5	19.6	16.7	7.8	-21.1

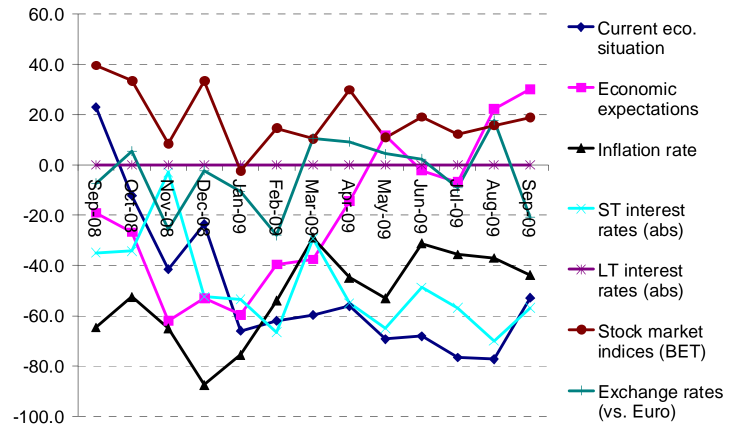


POLAND	Sep-08	Oct-08	Nov-08	Dec-08	Jan-09	Feb-09	Mar-09	Apr-09	May-09	Jun-09	Jul-09	Aug-09	Sep-09
Current eco. situation	53.2	20.0	-7.5	7.6	-40.4	-31.4	-28.8	-29.6	-48.0	-38.1	-45.6	-46.0	-5.6
Economic expectations	-23.8	-33.2	-56.1	-58.0	-50.0	-28.2	-23.2	-1.8	20.0	10.8	11.3	31.1	38.4
Inflation rate	-57.5	-66.7	-68.2	-91.9	-84.0	-63.2	-30.8	-49.9	-51.0	-21.4	-18.6	-9.1	-22.0
ST interest rates (abs)	-14.0	-53.0	-50.0	-72.6	-78.8	-79.1	-54.0	-62.9	-75.1	-48.8	-47.5	-37.2	-24.0
LT interest rates (abs)	-54.6	-41.2	-39.5	-29.0	-34.7	-56.3	-42.0	-35.8	-32.5	-22.5	-15.7	0.0	10.4
Stock market indices (WIG)	53.2	34.2	23.7	36.0	25.1	20.4	25.5	32.0	27.6	30.1	29.5	15.0	19.7
Exchange rates (vs. Euro)	2.3	16.7	12.1	23.9	18.4	13.8	47.2	19.5	42.8	34.1	36.9	41.7	0.0



Appendix

ROMANIA	Sep-08	Oct-08	Nov-08	Dec-08	Jan-09	Feb-09	Mar-09	Apr-09	May-09	Jun-09	Jul-09	Aug-09	Sep-09
Current eco. situation	22.9	-12.2	-41.5	-23.6	-66.0	-62.0	-59.7	-56.2	-69.2	-68.1	-76.6	-77.2	-52.9
Economic expectations	-19.1	-26.8	-62.0	-53.0	-59.6	-39.6	-37.6	-14.4	11.7	-2.2	-6.8	22.2	30
Inflation rate	-64.6	-52.5	-65.0	-87.5	-75.5	-54.0	-28.9	-44.8	-53.0	-31.2	-35.6	-37.0	-43.8
ST interest rates (abs)	-34.9	-34.3	-2.9	-52.4	-53.4	-66.6	-29.2	-55.0	-65.0	-48.7	-56.8	-70.0	-56.8
LT interest rates (abs)	-	-	-	-	-	-	-	-	-	-	-	-	-
Stock market indices (BET)	39.5	33.4	8.4	33.3	-2.4	14.5	10.4	29.8	10.9	19.0	12.2	15.7	18.8
Exchange rates (vs. Euro)	-7.4	5.5	-25.7	-2.3	-10.5	-28.0	10.6	9.1	4.4	2.4	-9.2	17.7	-20.8



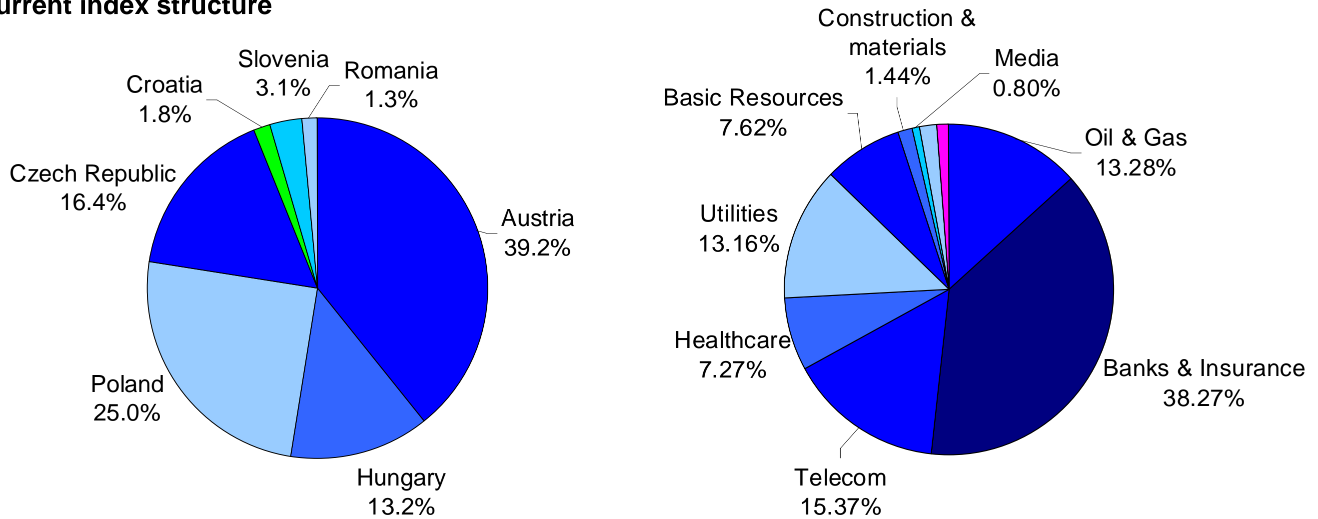
Note: Financial experts were asked about their expectations for the next 6 months. Balances refer to the differences between positive and negative assessments. Source: ZEW

Appendix

New Europe Blue Chip Index (NTX)

In September 2005 Erste Bank together with the Vienna Stock Exchange launched the New Europe Blue Chip Index (NTX). The NTX was designed to summarize the regional convergence theme in Central and Eastern Europe by also offering an investable universe. The index includes the top 30 regional stocks ranked by free float. The NTX is calculated by the Vienna Stock Exchange, quoted real-time and in EUR (.NTX; NTX index <GO>).

Current index structure



Rank	Company	Country	Sector	Free float EUR	Weight
1	CEZ	Czech Republic	UTILITIES	7,964,284,117	9.75%
2	Erste Group	Austria	BANKS	7,153,314,435	8.76%
3	Bank Pekao	Poland	BANKS	4,926,218,120	6.03%
4	OTP Bank	Hungary	BANKS	4,201,167,894	5.14%
5	OMV	Austria	OIL & GAS	4,080,000,000	5.00%
6	PKO BP	Poland	BANKS	4,019,836,812	4.92%
7	Telekom Austria	Austria	TELECOMMUNICATIONS	4,000,290,000	4.90%
8	KGHM	Poland	BASIC RESOURCES	3,096,968,738	3.79%
9	Raiffeisen International	Austria	BANKS	3,062,416,500	3.75%
10	Voestalpine	Austria	BASIC RESOURCES	3,048,626,674	3.73%
11	MOL	Hungary	OIL & GAS	3,039,623,139	3.72%
12	Telefonica O2 CR	Czech Republic	TELECOMMUNICATIONS	2,818,122,940	3.45%
13	Verbund	Austria	UTILITIES	2,642,815,000	3.24%
14	Komercni banka	Czech Republic	BANKS	2,617,599,034	3.21%
15	TP SA	Poland	TELECOMMUNICATIONS	2,552,251,967	3.13%
16	Krka	Slovenia	HEALTH CARE	2,539,344,282	3.11%
17	Vienna Insurance Group	Austria	INSURANCE	2,456,320,000	3.01%
18	PKN Orlen	Poland	OIL & GAS	2,414,415,255	2.96%
19	Richter Gedeon	Hungary	HEALTH CARE	1,992,694,124	2.44%
20	Magyar Telekom	Hungary	TELECOMMUNICATIONS	1,564,553,357	1.92%
21	T-Hrvatski Telekom	Croatia	TELECOMMUNICATIONS	1,455,445,335	1.78%
22	BZ WBK	Poland	BANKS	1,376,352,278	1.69%
23	Andritz	Austria	INDUSTRIAL GOODS & SERVICES	1,367,340,000	1.67%
24	Intercell	Austria	HEALTH CARE	1,326,819,998	1.62%
25	PGNiG	Poland	OIL & GAS	1,175,638,181	1.44%
26	Wienerberger	Austria	CONSTRUCTION & MATERIAL	1,158,478,108	1.42%
27	BRD-Group SG	Romania	BANKS	1,044,555,927	1.28%
28	bwin	Austria	TRAVEL & LEISURE	1,033,570,121	1.27%
29	Asseco Poland	Poland	TECHNOLOGY	882,093,890	1.08%
30	Austrian Post	Austria	MEDIA	645,127,693	0.79%
	Total			**81,656,283,916**	**100.00%**

Source: Vienna Stock Exchange, Erste Group Research

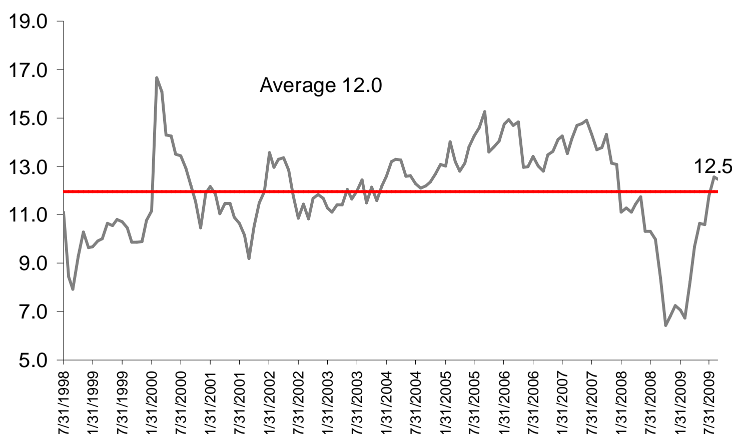
Appendix

Regional valuation and sentiment

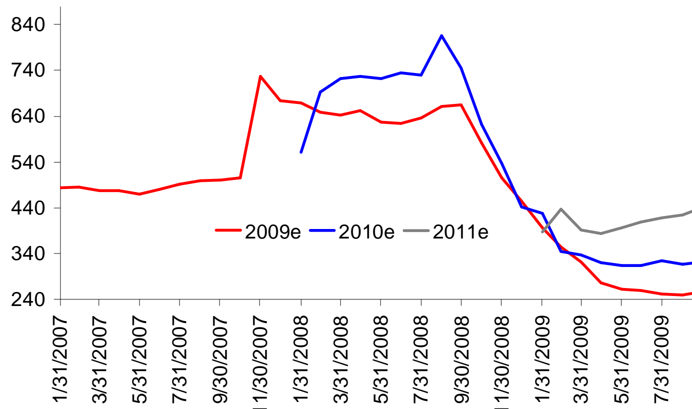
In order to get an overview on valuation, growth and risk premiums, we have summarized the region via the markets of Poland (WIG 20), the Czech Republic (PX), Hungary (BUX), Austria (ATX) and Romania (BET, not included in risk premium calculation). Admittedly, the overview is also somehow dictated by the availability of reliable consensus data.

CEE Region

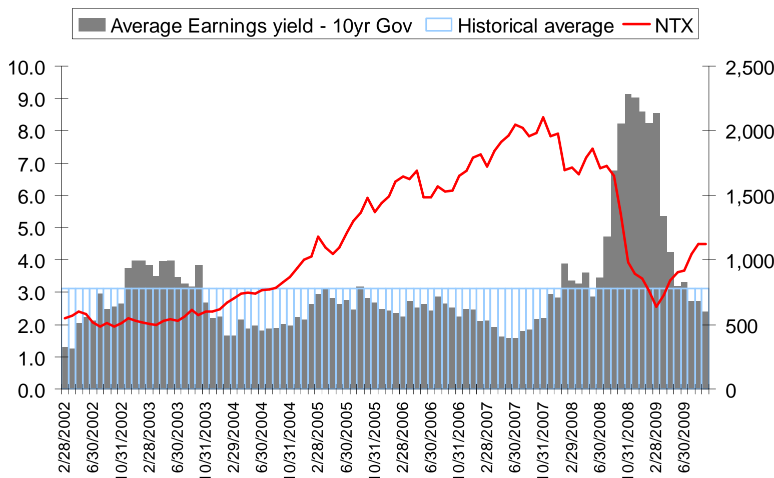
Regional forward PER vs historical average



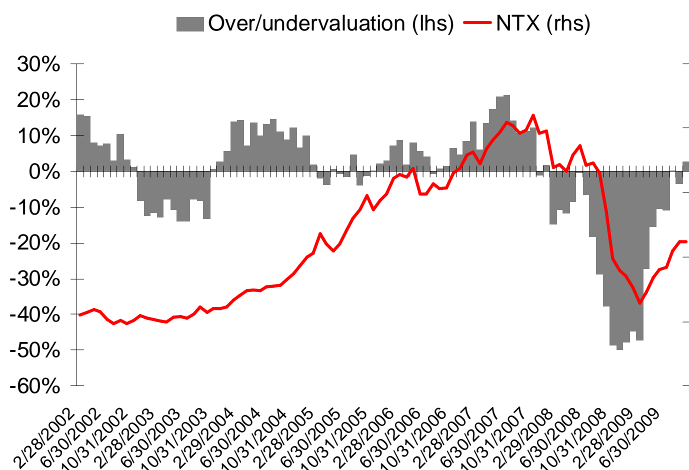
Development of EPS consensus estimates



Development of risk premium CEE Region



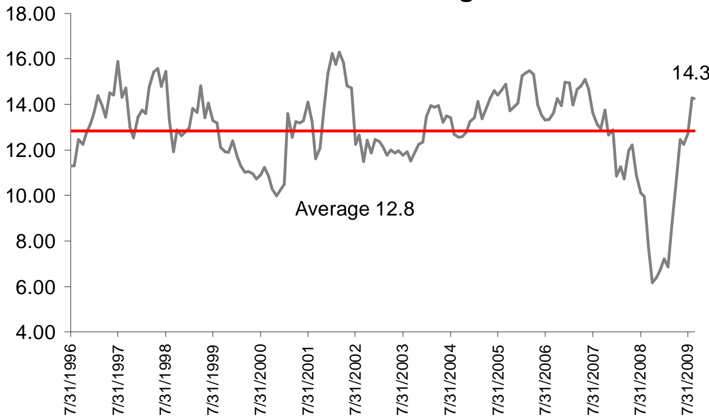
Implied valuation CEE Region



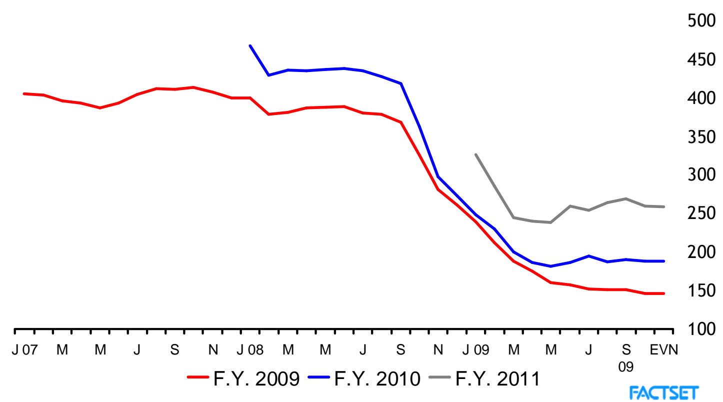
Source: Factset, Erste Group Research

Appendix

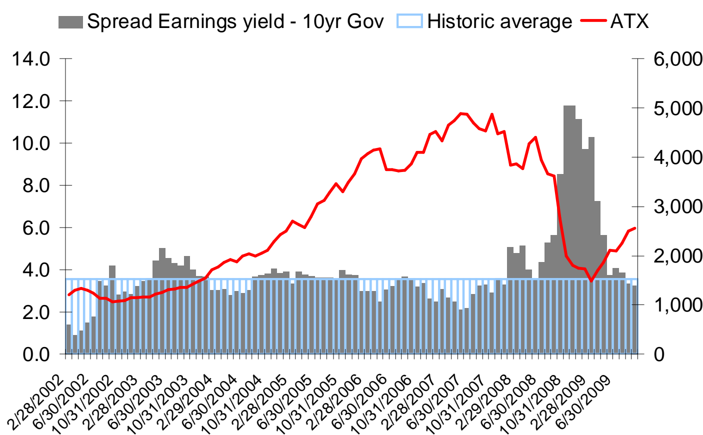
Forward PER vs historical average – ATX



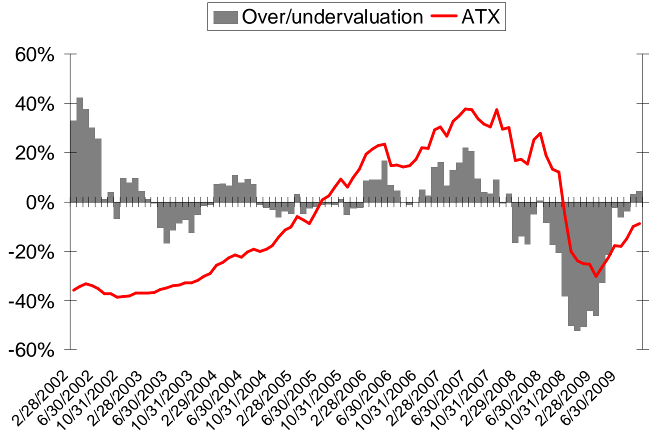
Estimates Earnings Per Share for ATX (AT) in EUR as of 21/09/09



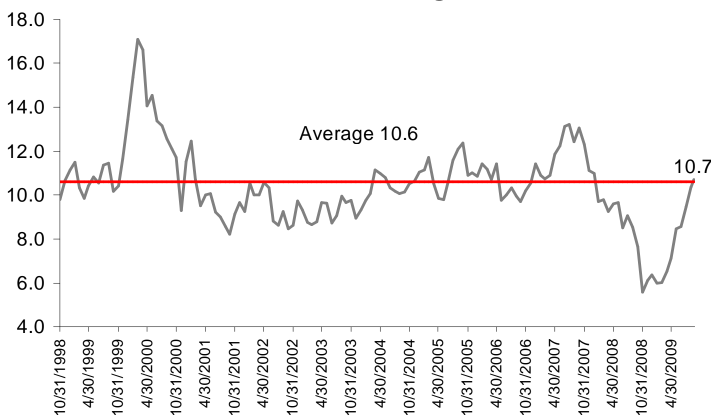
Development of risk premium – ATX



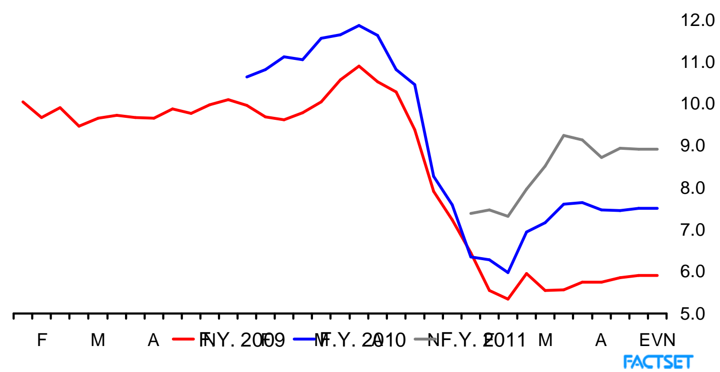
Implied valuation – ATX



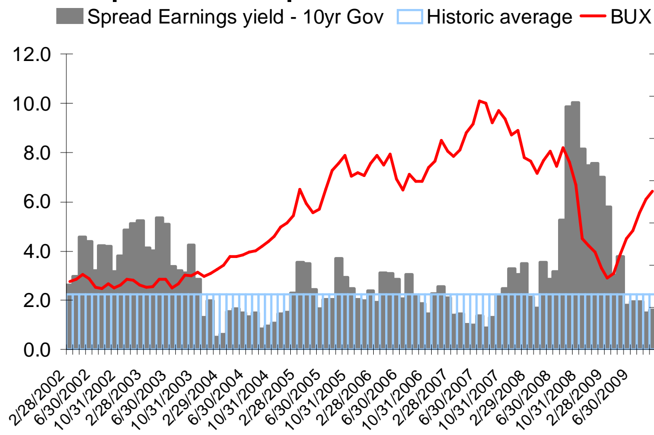
Forward PER vs historical average – BUX



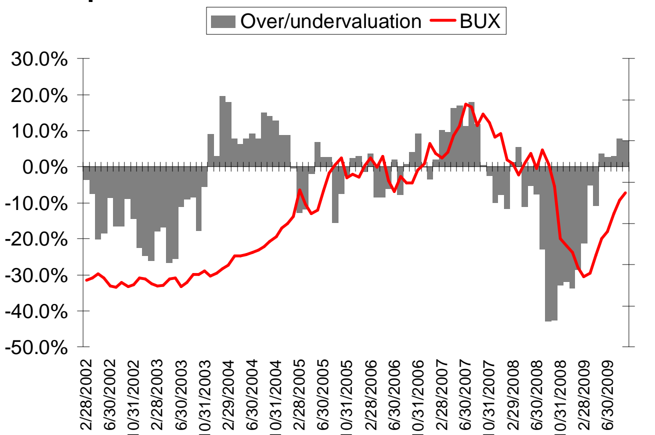
Estimates Earnings Per Share for BUX (HU) in EUR as of 21/09/09



Development of risk premium – BUX

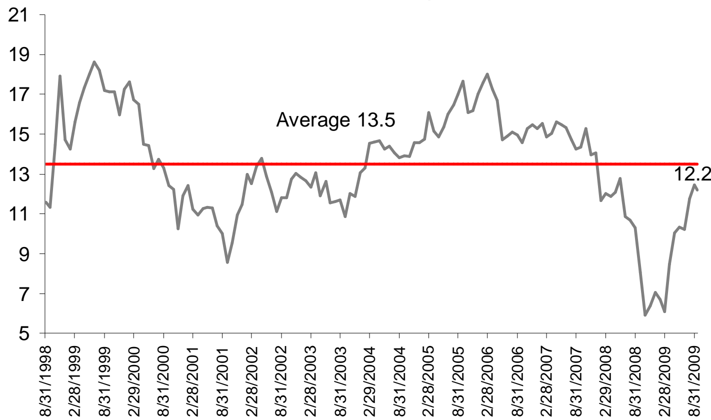


Implied valuation – BUX

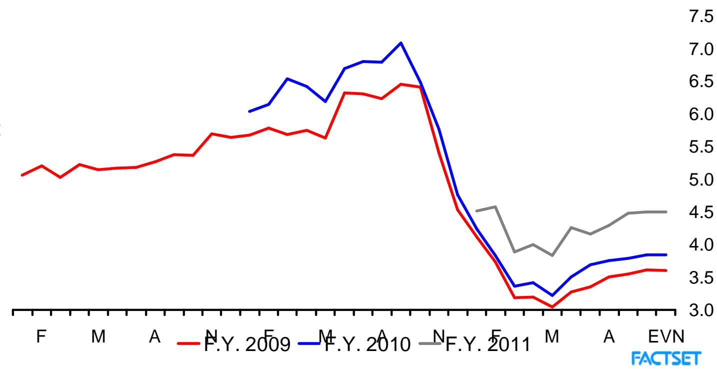


Appendix

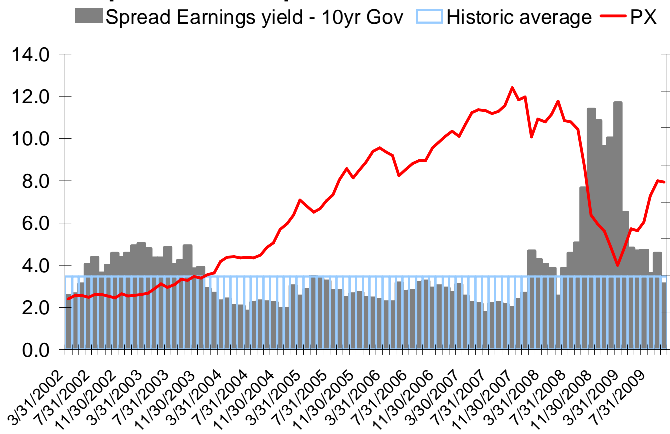
Forward PER vs historical average – PX



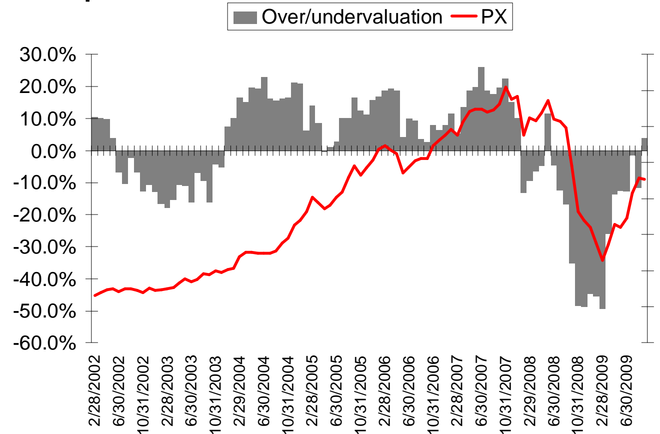
Estimates Earnings Per Share for PX 50 (CZ) in EUR as of 21/09/09



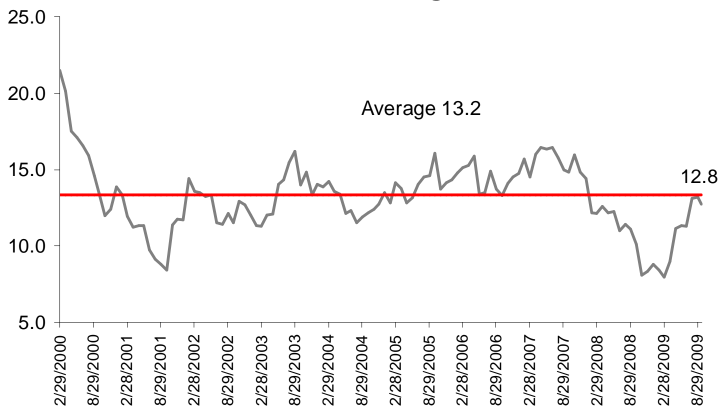
Development of risk premium – PX



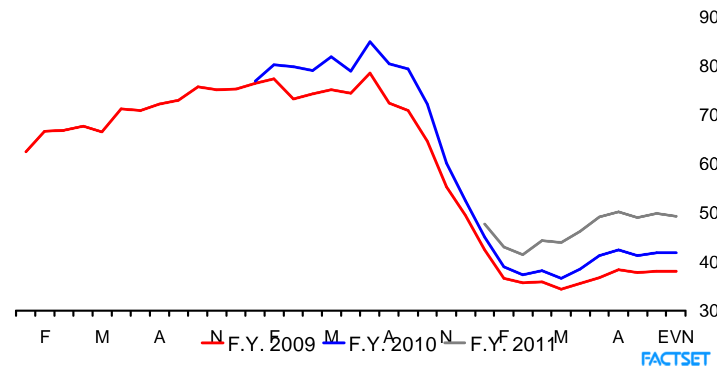
Implied valuation – PX



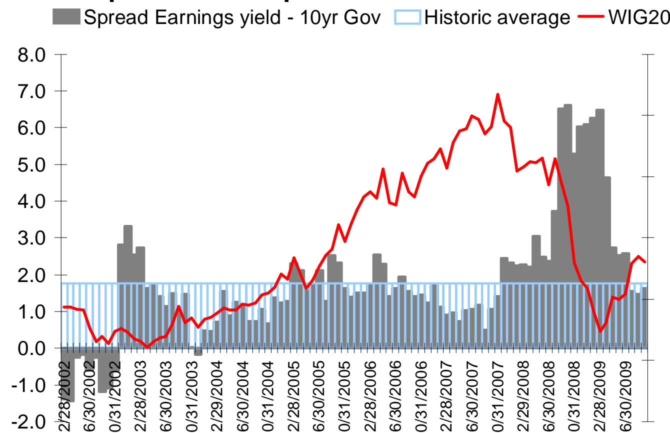
Forward PER vs historical average – WIG20



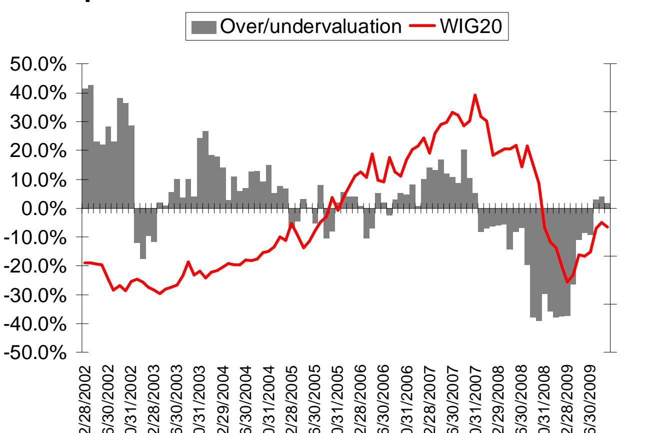
Estimates Earnings Per Share for WIG 20 (PL) in EUR as of 21/09/09



Development of risk premium – WIG20

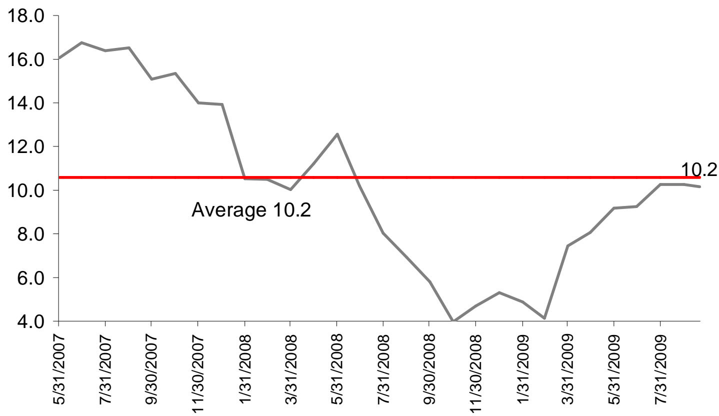


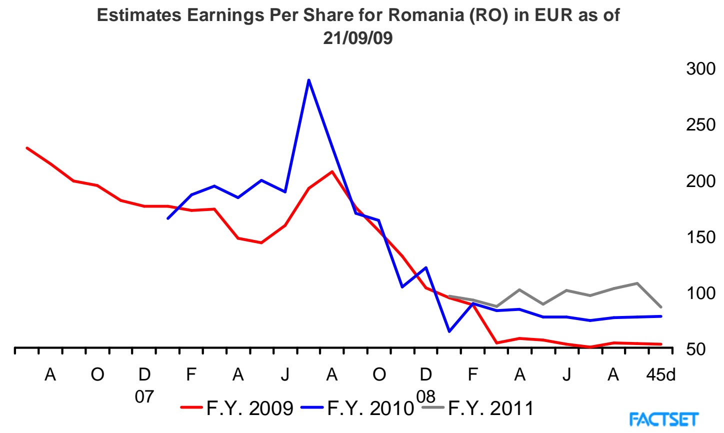
Implied valuation – WIG20



Appendix

Forward PER vs historical average – Romania





Source: Factset, Erste Group Research

Appendix

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Appendix

Notes