

## CEE stocks earnings to climb by 20% in 2011

- **Erste Group analysts recommend: stock picking rather than sector allocation**
- **Cyclicals and commodities (especially oil&gas) to post solid performance; underweight defensives (telecoms and utilities)**
- **Improved investor sentiment towards CEE; 2011 to be a positive year for equity investments**

*“2011 will be a positive year for equity investments based on positive company results, attractive valuations, low bond yields and decreasing risk aversion which will generate a positive environment for riskier assets. The consensus expects some 23% EPS (earnings per share) growth for 2011 in the CEE region,”* comments Henning Esskuchen, Co-Head of CEE Equity Research.

*“As an investment strategy, we recommend stock picking, rather than sector allocation. We prefer companies in cyclical sectors with dynamic sales development in the emerging markets and which will thus benefit from the economic growth in those regions. We also expect companies from the oil & gas sector to show a good performance in the first quarter. Overall, commodities should do fine, liquidity should keep prices inflate.”* Erste Group analysts also recommend underweighting defensives such as telecoms and utilities in view of their clearly declining earnings expectations.

### **Investors improve sentiment towards CEE due to renewed focus on fundamentals**

Sentiment seems to have recovered again. The fundamental outlook has begun to drive market performance again along with sound sentiment developments and a diminishing avoidance of riskier assets. The positive sentiment for CEE was again confirmed by the ZEW-Erste sentiment indicator<sup>1</sup>. While the evaluation of the current economic conditions in the CEE region and Austria improved in December 2010, the indicator for the Eurozone decreased by 7.2 points to minus 1.7 points.

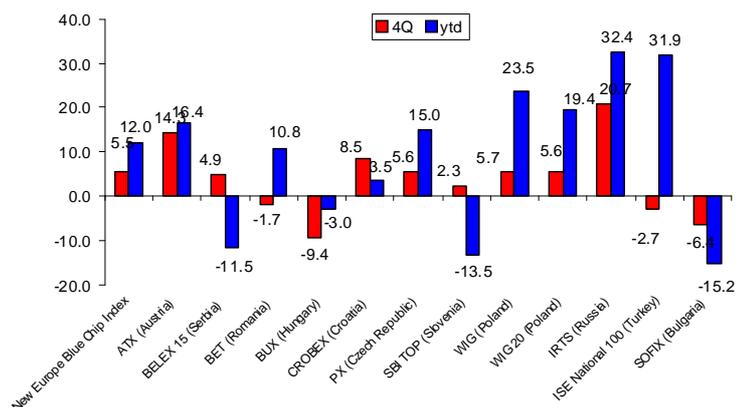
Looking ahead for this year, the CEE region should gather steam but this will significantly depend on the levels of private consumption. Domestic consumption is becoming increasingly important in CEE markets, offsetting the potential weakening demand from Germany's export-driven economy. Unemployment rates, while not showing any clear downturn, have remained stable for some time now, which has reduced the uncertainties facing many households and should improve consumer sentiment. Thus, *“one has to keep in mind the fact that risks do remain in the market. The two biggest ones are probably the future development of the debt crisis in Southern Europe and possible troubles especially in China”*, Esskuchen concludes.

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<sup>1</sup> The ZEW-Erste Group Bank Economic Sentiment Indicator for Central and Eastern Europe including Turkey (CEE) is calculated as the balance of positive and negative expectations for the economic development on a six-month time horizon.

## Country allocation

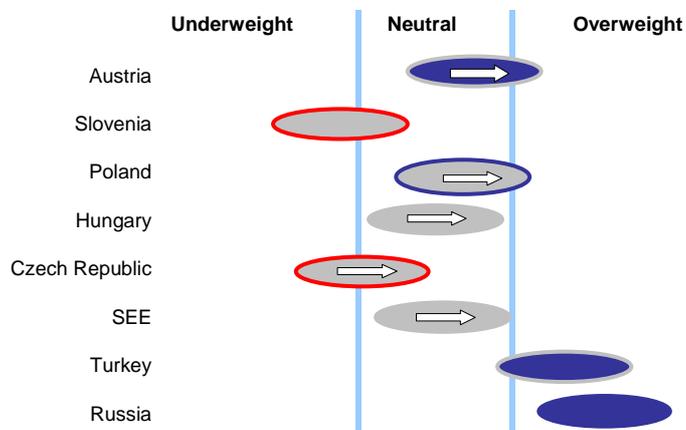
### Performance overview (in EUR)



\*3Q 2010 = 3month performance, closing price 24.09.2010; Source: Factset Partners, Erste Group Research

- Austria – sound neutral to overweight.** Even though Erste Group analysts tend to be a touch more positive for the Austrian market, its sound performance – potentially also triggered by flows ahead of new tax burdens coming with 2011 – might put the market a bit on hold at the start of 2011. However, valuation remains a strong argument for Austria, as it is not only still well below its historical averages, but also posting some 20% undervaluation based on the analysts' comparison between earnings and bond yields.
- Hungary – neutral (wait and see).** A clear call for the Hungarian market remains difficult. Growth remains an argument with some delayed recovery, posting consensus earnings growth rates above 20% for both 2011 and 2012. Valuation as a comparison to historical averages is okay, but earnings yields compared to high bond yields indicate quite little upside for the market. For the first quarter, rate cuts appear rather unlikely. Finally, the market will depend on the package of consolidation measures to be delivered by the government in early 2011. So far, the public authority's creativity has turned out to be quite a burden for the market, but if the policy package is well received by rating agencies, this could turn into a nice trigger for the market – or the other way around.
- Czech Republic – neutral to underweight.** The model suggests a strong underweight for the Czech market. Admittedly, the market has not had much to offer in terms of appealing stories. Consensus earnings growth confirms this view, with some 10% seen for both 2011 and 2012.
- Southeastern Europe – sound neutral.** Valuation is certainly positive for SEE markets, since overall risk considerations for markets as such have pushed price levels well below a fair level. Removing political and economic concerns should remain the biggest hurdle (trigger) for these markets to perform.
- Poland – neutral with an uncertain trend toward overweight.** Poland remains a difficult case. Valuation relative to other regional markets is certainly not cheap, while compared to its own historical averages there is still upside. However, the economic growth comes at the cost of structural deficits and dealing with this has led to unpopular measures such as the reduction of contributions to pension schemes. Consequently, 1Q could be a bit undecided for the market.
- Russia – overweight.** Confirming our model's overweight call for Russia is straightforward. The current oil price and a stable growth outlook, with enough liquidity in the system, should continue to deliver support.
- Turkey – overweight.** We also accept the overweight decision for Turkey, which is weaker than the Russian call, however. The market might still need more time to digest its recent weakness and we would not expect fireworks already in January.

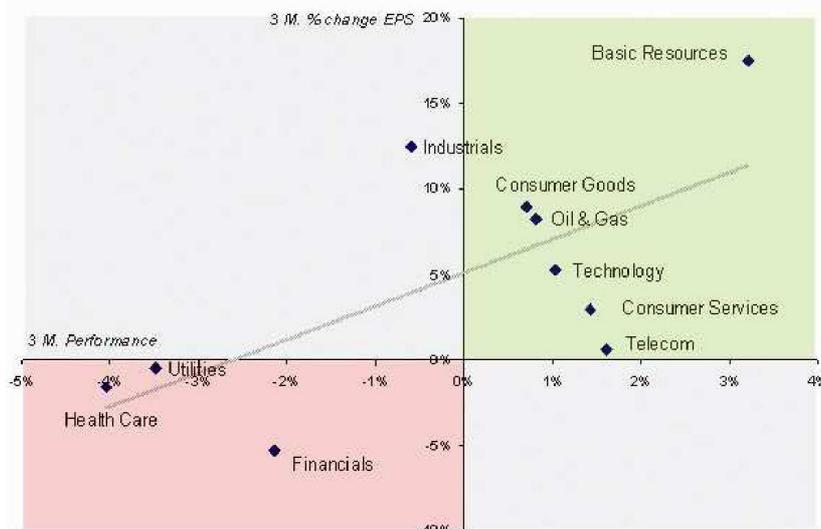
## Country allocation proposal



Source: Erste Group Research

## Sector allocation

### Sectors in Europe: performances vs. changes in earnings estimates in Q4



Global market trends show that investors are looking for shares with a good fundamental outlook and prefer sectors with positive earnings growth. In this respect, cyclicals are expected to perform further, since it seems that a rather positive growth outlook globally is being priced in. While commodities are expected to perform well, financials should be impacted by valuation which is still undergoing changes in terms of asset quality and regulations.

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