

CEE equity markets move up, Asia is taking a break

- Sentiment gets a second wind in CEE, supported by liquidity
- CEE investors' risk appetite increasing – growth stocks boost their momentum
- Supportive forces for asset price increases are losing steam

With Asia and Latin America seemingly taking a break, this might turn out to be an advantage for emerging markets in the CEE region. The world's growth engine, China, is stepping on the brakes over its lending growth, which starts to be visible in fund flows. On the other hand, CEE has been catching up a lot compared to the fourth quarter of 2009. All markets in the region continued to move up towards positive spreads. Russia and Turkey remain the hot spots, with Russia still leading, based on the still high oil price¹. Hungary continues to lead core CEE markets, confirming its remarkable achievements in budget consolidation, but also proving that it is still the most fragile story. Romania has been a star in terms of flows and also posted a strong performance, coming from still thin levels. The Czech Republic and Poland again posted a healthy picture, while Austria has been flattening a bit as of late.

The positive sentiment for CEE was again confirmed by the ZEW-Erste sentiment indicator, after a dip in February. Also, economic expectations recovered strongly, and here the improvement for CEE is out-performing the balance for the Eurozone quite substantially, with an increase in the positive balance almost three times higher than that seen for the Eurozone. The strongest gains for the current situation were reported in Hungary, the Czech Republic and Poland, while Poland is the only market where the balance of views on the current situation is already positive. On economic expectations, the biggest increases were seen for Hungary, Romania and Croatia. Consequently, the outlook for stock exchange performance is seen improving soundly for April.

When viewing the results of equity analysis, it becomes evident that investors in CEE had above-average total returns by following the fundamental analysis of consensus analyst recommendations. *"Thereby, the target price upside is the favorable strategy, in contrast to just the Buy and Sell ratio. High-risk stocks showed a similarly strong performance in the recent months (Beta vs. Stoxx 600, Volatility 12 months, Total Liabilities/Assets). This shows the continued risk appetite of investors in the CEE region,"* explains Henning Esskuchen, Co-Head of CEE Equity Research.

One recent interesting development has been the increased interest of investors in stocks that show a high growth profile and high estimate momentum. Erste Group analysts believe that these stocks will continue their positive relative performance as the economic growth in CEE improves. While stocks with low valuations were the clear out-performers for most of 2009, this trend has changed in 1Q10. Only stocks with low price-to-book values showed a clear out-performance. Large Caps showed once again a relative under-performance.

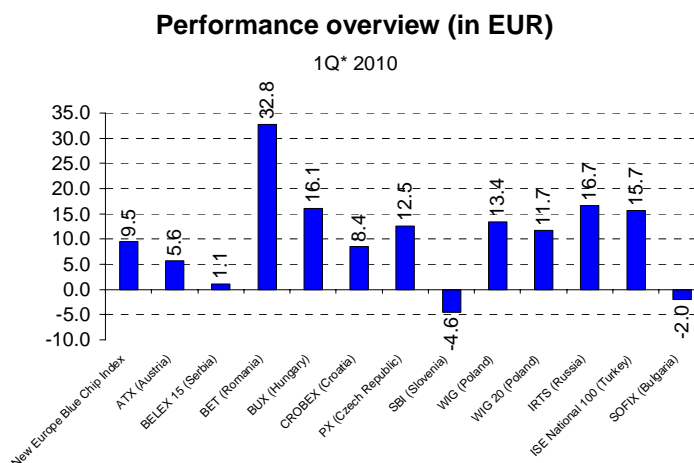
Outlook

The current environment does not provide a clear case for traditional approaches, such as defensive or growth stocks investments. Recent performance data by sector indeed shows real estate as benefiting from removing discounts. Other cyclical areas have also benefited from recovery expectations, while the food and beverage segment has performed well. Overall, Erste Group analysts still see the performances of certain sectors as a mix of recovery/growth and making up for previously overdone discounts. The global recovery and the development in CEE will remain fragile. Hence, cyclicals (as well as banks) will continue to react strongly to any positive news flow, but should suffer most whenever the opposite hits.

The overarching trend for the major economic regions is that, as public stimuli start to fade, loan growth is decelerating as we move into 2010. Additionally, China is also slamming on the brakes with regards to further loan growth in 2010. With public lending growth slowing down in 2010 in major western economies, investors have to be prepared for total loan growth to turn negative in 2010. Using total loan growth as a predictive tool for asset price development, investors should not expect further rising asset prices.

¹ The latest data is only available for January 2010

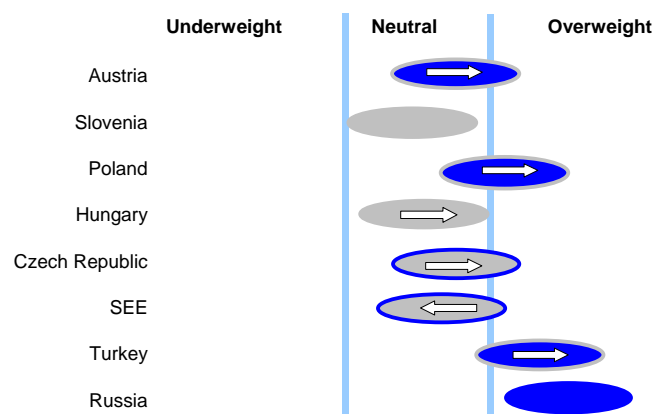
Country allocation



* 1Q 2010 = 3month performance, close price 30.03.2010; Source: Factset Partners, Erste Group Research

- **Romania** proved Erste Group analysts' bullish view (the BET posted the highest performance in the Erste regional universe). With a P/E of 11, it remains one of the cheapest markets in the region, just about the opposite of Croatia, coming in with a P/E of 17. With more potential rate cuts ahead and the lowest valuation, the market should have further headroom, even though most likely not as much as in 1Q.
- **Austria's** positioning indicates a neutral to overweight allocation model. The EPS consensus trend does not show a strong slope, admittedly, but at least a quite stable development. The market shows some consensus EPS growth of 19%, 34% and 24% for 2010, 2011 and 2012, respectively.
- **Turkey and Russia** are both on overweight. For Russia, the oil price (and other commodities) presents a fragile - but still valid - scenario. Based on fund flows, it might slow down a bit. Turkey, as the second largest market in the region, has suffered from political turmoil, but relative to Russia, Erste Group analysts remain a fan of that market.
- **Poland** (moderate overweight) and the **Czech Republic** (sound neutral) are both posting appealing mixes of consensus growth and implied valuations (both undervalued at about 10%). Interest rates for both markets should remain unchanged, potentially further into 2010 than we initially thought.
- **Hungary** - a possible further rate cut might be an argument for the Hungarian (sound neutral) market. The growth story and (consequently) the strong pricing in of the recovery remain a fragile issue and implied valuations indicate just a flat situation.

Country allocation proposal



Source: Erste Group Research

Sector allocation

EVA² (economic value-added) overview by sector

	Value Creation Spread			Mean	EVA momentum	
	2008	2009 e/p	2010e		2009 e/p	2010e
Media	20.5%	8.2%	9.9%	12.9%	2.5%	1.5%
Retail & Distribution	3.9%	4.3%	6.6%	4.9%	5.4%	-0.3%
Personal & Household Goods	1.3%	5.4%	6.5%	4.4%	-0.7%	-1.0%
Basic Resources	8.8%	-1.2%	3.3%	3.6%	-4.7%	2.3%
Industrial Goods & Services	2.2%	1.9%	2.0%	2.1%	3.1%	3.9%
Telecommunications	2.7%	1.1%	0.0%	1.3%	-2.3%	-0.4%
Utilities	2.6%	-0.1%	-0.1%	0.8%	0.5%	3.2%
Construction & Material	1.8%	1.2%	-1.1%	0.6%	-3.2%	3.7%
Chemicals	4.9%	-7.3%	-4.4%	-2.3%	-6.2%	0.3%
Travel & Leisure	-3.0%	-4.0%	-2.8%	-3.3%	-3.2%	0.2%
Healthcare	-5.8%	-5.1%	-4.7%	-5.2%	-6.0%	5.6%
Oil & Gas	-6.3%	-6.3%	-4.4%	-5.7%	-0.6%	1.5%
Food & Beverage	-9.3%	-7.7%	-5.5%	-7.5%	1.1%	2.1%
Technology	-12.1%	-10.1%	-0.4%	-7.5%	6.9%	4.0%

Media is certainly boosted by Polsat, which appears to be able to create more than strong returns on an apparently minimal asset base. Industrial goods and services confirm their positive stance as growth exposure, by positing appealing EVA momentum figures as well.

² EVA (economic added value) is a measure of a company's financial performance, calculated by deducting the cost of capital from its operating profit.

Value Creation Spread indicates how much excess return a company earns with its operations over the cost of capital.

EVA momentum is the change in EVA, divided by the prior period's sales.

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