Erste Bank Analysts: Very attractive ATX valuation, but financial crisis not yet over

- ATX is clear underperformer YTD in 2008
- Very attractive valuation level; P/BV ratio hits low
- Equity returns are 1,300 bps higher than on 10-year bonds
- Growing signs of relative ATX strength
- ATX companies indirectly affected by financial crisis
- Vienna Stock Exchange top picks: Andritz, EVN, Intercell, Post, Verbund, Vienna Insurance Group, Kapsch

The Vienna Stock Exchange, and its leading index the ATX, have come under enormous pressure as a result of the 2008 global financial crisis. Compared to other international benchmark indices, the ATX has clearly been underperforming since the start of 2008. It appears that international investors are equating CEE's growth story with the same risks evident in today's slumping stock markets. It is for this reason that markets with a lower capitalization are under greater pressure as a consequence of equity weightings in portfolios being slashed. Despite the revisions to earnings, which have already been carried out, valuations are extremely attractive. The downtrends are fully intact; should a phase of stabilization emerge, then a short-lived recovery seems possible even in 2008. Erste Bank analysts believe that there are basically two realistically feasible scenarios: the economy slipping into temporary or lasting recession, with the chances being 50:50.

International stock markets and the Vienna Stock Exchange: Downtrend fully intact

Stock markets are generally at historically attractive levels, but there are also sharp revisions of earnings and sales revenues. Preference should be given to the markets in the euro zone over US markets, and the higher spread of 780 bps, which results from the earnings yield vs. yields on 10-year government bonds, also favours European stocks. Overall, Erste Group analysts expect a short-lived countermovement in 2008 should the currently extremely negative environment on the markets stabilize temporarily.

"Fundamentally, the much higher returns, i.e., earnings yields, indicate a preference for European equities, especially for Austrian stocks over 10-year government bonds. In Austria, this spread is an amazing 1300 basis points despite the earnings revisions already carried out. Unfortunately, no one is really interested in this right now. However, a time will come again when investors will remember the fundamentals," said Fritz Mostböck, Head of Group Research.

Vienna Stock Exchange absurdly inexpensive, CEE countries still growing

The historically inexpensive valuation of the ATX of around 5 (PE 08e and 09e) speaks for itself. More potential earnings revisions are already being negatively priced in now on the capital market. The current GDP forecast of Erste Group Research on the economic situation of the CEE8 countries still states 2.1-% growth for 2009, while the euro zone is shrinking at -0.4%. "On the whole, this means that although the economy will develop more weakly in CEE in 2009, it will still remain robust in comparison to the euro area average," said Fritz Mostböck.

Erste Group analysts recommend focusing on stock-picking

"As an investment strategy in an extremely difficult environment in the industry, we would recommend focusing on stock-picking," said Günther Artner, Co-Head of CEE Equity Research. Because the financial crisis is not yet over, Günter Artner recommends a very selective investing strategy with the following focus:

- Defensive stocks that have undergone a strong correction despite stable earnings (Verbund, EVN) or that have high dividend yields (Österreichische Post)
- Growth stocks that develop independently of the business cycle (Intercell)
- Industrial stocks with a focus on energy technology that are reporting only moderate earnings losses (Andritz)

- Other stocks that have been excessively punished by the stock markets (Vienna Insurance Group, Kapsch TrafficCom)
- Liquid blue chips with a strong capital structure and less liquid small/mid-caps or highly indebted companies

Two scenarios are possible for 2009

The Erste Group analysts believe that two scenarios are possible in the coming year. Scenario 1 is a temporary recessionary phase with the financial crisis ending in 2009. Scenario 2 is a lasting recession with the crisis spreading to more areas. “In the first scenario, the price losses would be largely priced in. Sentiment would reverse in 2009 and positive performance would be feasible of up to +15% to 20%. In the second scenario, the valuation ratios reached would still not be favourable. In the best of cases, performance for 2009 would be zero or negative once again,” explained Fritz Mostböck.