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Austrian stock market 2018: Flattish, with room to surprise on the upside

Peter Szopo



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Over the past three years (2015-2017) the ATX, Austria's main equity index, posted an annual return of more than 16%, making the Vienna Stock Exchange the best performing European stock market (or second best, if Eastern Europe is included).

In a way, this stellar performance simply reflected mean-reversion given the ATX' massive underperformance versus broader European indices over the previous four years. However, the rebound was not purely technical but backed by fundamentals. From 2015 to 2017, earnings of Austria's listed corporate sector more than doubled, mostly helped by a recovery of profits in the banking sector.

5 reasons why 2018 has been more muted so far

Year-to-date (to July 31), the ATX was flat, similar to the broader European market (Euro Stoxx 600), which posted a small gain of 0.6% over the same period. The weaker performance of the Austrian market in the current year does not come as a surprise. A number of factors that supported the market in recent years have faded:

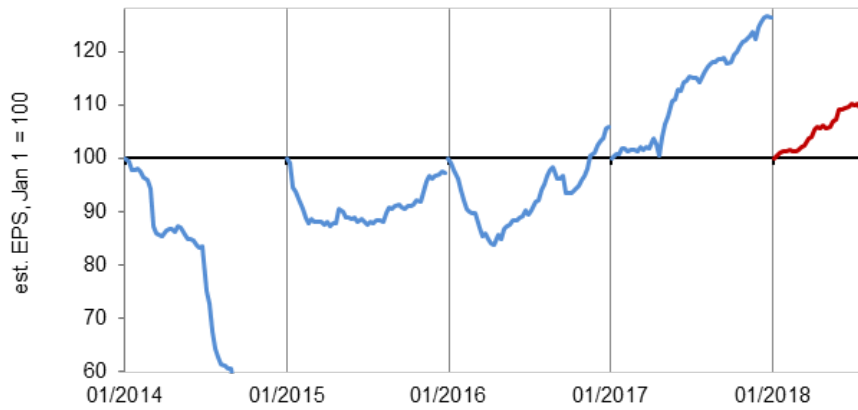
1. Earnings growth has slowed markedly and is expected to reach c.9% in 2018 and c.8% in 2019 according to Factset data, which is just in line with the European average.
2. On the growth-versus-value spectrum the Austrian market is tilted toward value relative to the broader European stock universe, reflecting the high share of financial stocks and the lack of technology stocks in the Austrian listed universe. Globally, as well as in Europe, the value-factor has underperformed the growth-factor this year.
3. Possibly related to the second point above: the ATX tends to underperform its European peers whenever interest rates are falling. Since February, German 10 year government yields shed more than 30 basis points, which has not helped the ATX.
4. Many investors view Austria as a play on Eastern Europe, which is no surprise, given the substantial exposure of many Austrian companies to the region. As a result, the ATX tends to outperform broader European indices whenever Central & East European stock markets do well - which has not been the case in 2018. The main Polish index has lost 6% in the first seven months, Hungary was down almost 9%, and Russia's RTS-Index (a USD-based index) was flattish.
5. For reasons that may have less to do with fundamentals but more with investor sentiment and risk perceptions, the relative performance of Austria's equity market tends to be negatively correlated with USD strength. The 7%-gain of the USD spot index since February, therefore, has not helped.

Improving near-term outlook

That said, for a number of reasons, the outlook for the remainder of year is encouraging. Austria's macroeconomic backdrop is sound and political conditions seem more stable than in some of the neighboring countries. Only recently, the central bank lifted its growth forecast for the current year to above 3%, which is well above the European average.

Moreover, while earnings growth has slowed relative to 2017, the earnings forecasts for 2018 have drifted higher during the year. At the beginning of August, the consensus index EPS (ATX) for 2018 was 10% above its initial level at the beginning of the year.

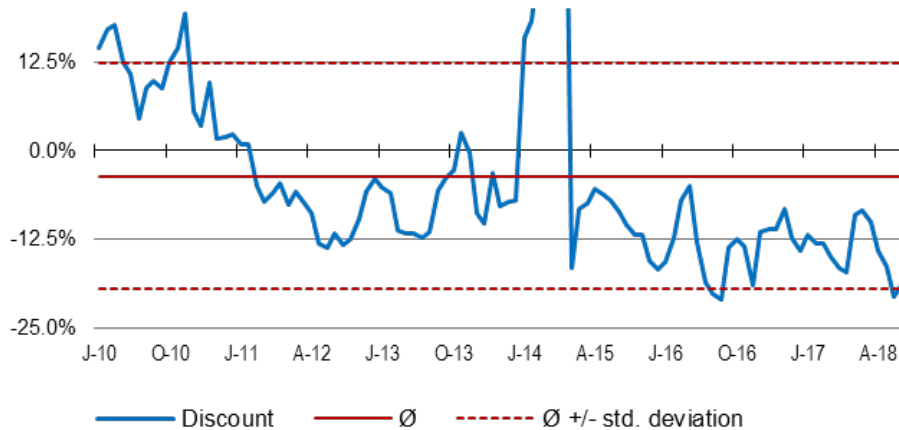
ATX: Consensus EPS, 2014-18



Source: Bloomberg; Erste Asset Management

As a result of the market moving sideways, while earnings have been upgraded, valuation has become more attractive for investors. With a forward price-earnings ratio of slightly above 12x, the Austrian market is cheap relative to its peers. To a certain degree, this reflects the fact that the market's underlying ROE has been the lowest in Europe. However, the current valuation discount (based on the earnings multiple) to the Euro Stoxx 600 universe is close to 20%, which is one standard-deviation below the average discount for the past eight years and stands at the highest level since August 2016.

ATX: P/E-discount vs. Euro Stoxx 600



Source: Bloomberg; Erste Asset Management

Bottom-line:

After three outstanding years, the Austrian stock market has fallen in line with its European peers in terms of earnings growth and performance. Sentiment in the first half of year was not supportive for a market with a value and a small-cap bias. However, country fundamentals, earnings revisions and valuation all suggest that Austrian stocks could fare well for the rest of the year - provided the global backdrop for risky assets will not be further hampered by trade wars, accelerating US inflation or Chinese economic woes - just naming the main risks that could derail markets in the near future.

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Peter Szopo

Peter Szopo has worked as chief equity strategist at the Erste Asset Management since March 2015. Before he already worked as a consultant for equity fund management at Erste Asset Management for Central and Eastern European equity markets. From November 2009 to April 2013, he was head of the research department at Alfa Bank in Moscow.

After his research work at WIFO (Austrian Institute of Economic Research) from 1978 to 1990, he worked as a securities specialist in various management functions at internationally renowned investment banks. During this time he held the position of Head of Research at such institutions as Creditanstalt Investmentbank, UniCredit Bank Austria, Robert Fleming Securities, and at Bank Sal. Oppenheim.

Along with his analysis activities, he worked from 1997 to 2000 at Eastfund Management as the fund manager for Central and Eastern European equity.