Political risks and the associated ongoing uncertainties are weighing on the global growth outlook, and central banks have reacted by easing monetary policy further. Financial market volatility should remain high this environment. Growth in corporate profits is lending support to stock markets, and we continue to favor defensive sectors. In bond markets we recommend IG hybrid bonds in defensive sectors as well as BB-rated HY bonds.

**Investment Strategy Q4 2019:**

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<thead>
<tr>
<th>Govt. bond yields</th>
<th>Dec. 2019</th>
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<tbody>
<tr>
<td>Germany (10Y)</td>
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<th>Equity Performances</th>
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<tr>
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<tr>
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<tr>
<td>USA</td>
<td>0%/+5%</td>
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**Economic Outlook**

The trade war and the associated uncertainty are weighing on the economic outlook in the US. We nevertheless expect US GDP growth to remain close to the potential growth rate (2019e: +2.2%; 2020e: +1.8%). Labor market conditions are strong and inflation remains slightly below the Fed’s target. In view of the persistent political chaos prevailing in the United Kingdom, we continue to expect a hard Brexit at the end of October 2019. We believe this short term shock will trigger slightly negative GDP growth in the euro zone in Q4 2019 (-0.2% q/q), with stronger growth of +0.4% per quarter resuming from Q2 2020 onward. Overall, we are forecasting GDP growth of 1.1% for the euro zone in 2019, followed by +1.0% in 2020. Price pressures in the euro zone remain too weak, and are keeping the inflation rate significantly below the level targeted by the ECB.

**Bonds**

Political crises are generating persistent uncertainty and are weighing on the global economic outlook. Both the Federal Reserve and the ECB have responded by easing monetary policy further. We expect one more rate cut in the US this year. By the end of the year yields on US treasuries should be at slightly higher levels than recently, as market tensions should ease after Brexit. The ECB has cut interest rates further in September and announced that it would provide additional liquidity. We expect one more cut in the deposit facility rate to -0.6% this year. This expectation is contingent on a hard Brexit in line with our forecast. Thereafter, we expect only a mild correction in government bonds, as a stuttering economy and the expansionary policy of the ECB will continue to support bond prices. Thus we continue to recommend IG hybrid bonds (in defensive sectors) and bonds in the BB rating class, the highest credit quality level within the speculative grade (high yield) segment.

**Currencies**

Due to the threat of an impending hard Brexit, we recommend maintaining exposure to the US dollar – the classic safe haven currency - and adopting a wait-and-see stance for the time being. The Swiss franc could potentially still appreciate against the euro as well. Only after the United Kingdom’s exit should the situation ease and the euro regain a little ground. The gold price should only advance moderately in Q4, in a range from approximately USD 1,500 to 1,540.

**Equities**

As a result of the weaker growth outlook and ongoing political risks we expected high stock market volatility to persist. Rising corporate earnings estimates and expansionary monetary policy by central banks are lending support to stock markets. We prefer defensive to cyclical sectors in this environment and expect global stock indexes to post moderate gains in the fourth quarter, at the lower end of a range from 0% to +5%.
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Global Strategy Team

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<thead>
<tr>
<th>Investment Strategy</th>
<th>Friedrich Mostböck, CEFA, Gudrun Egger, CEFA</th>
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Email: firstname.lastname@erstegroup.com
Phone numbers: listed in the appendix.
## Investment Strategy Q4 2019

### Yields

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<th>Country</th>
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Source: Erste Group Research estimates

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Source: Erste Group Research estimates

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Source: Erste Group Research estimates
Euro Zone Economic Outlook

Outlook Driven by Politics

Germany at risk of a technical recession

The Eurozone economy weakened noticeably in Q2 2019, recording growth of just 0.2% q/q (previously +0.4% q/q). After a bout of weakness in Q1 2019, the momentum of capital spending picked up somewhat, while the growth contribution of consumer spending stabilized. This was offset by foreign trade, which weighed on growth in the Eurozone in Q2. On the country level above all Germany (-0.1% q/q) and Italy dampened economic growth in the Eurozone. Germany continues to suffer from the fallout of the global trade war, the threat of a Hard Brexit as well as profound structural problems in the automotive sector. Due to deteriorating industrial production in combination with a further decline in sentiment indicators, Germany faces the risk of sliding into a technical recession in Q3. Italy suffers from a combination of structural deficits coupled with an up until recently populist government. The latter situation has in the meantime changed, due to a surprise decision of the social democrats (who are staunch supporters of the EU) to join a government coalition, as a result of which risk premiums on Italian government bonds have declined substantially. However, we do not expect any far-reaching structural reforms under Italy’s new government either. After all attempts to form a government have failed, Spain will hold new elections on 10 November. Given the country’s stable economic performance this is no reason for concern in our view.

Hard Brexit – our base case scenario – should weigh on the Eurozone economy, particularly in Q4 2019 and Q1 2020

In light of the political chaos prevailing in the United Kingdom we continue to expect a Hard Brexit at the end of October 2019 (probability >50%). Triggered by this short-term shock, we expect slightly negative GDP growth in the Eurozone in Q4 2019 (around -0.2% q/q); from Q2 2020 onward economic growth in the Eurozone should once again level out at its potential growth rate (around +0.4% q/q). For 2019 as a whole we are forecasting GDP growth of +1.1% in the Eurozone followed by +1.0% in 2020.

DE and IT are weighing on growth

GDP growth q/q on the country level

Foreign trade weakens growth in Q2

Weighted GDP growth (q/q) by components

Source: Eurostat, Erste Group Research
US Economic Outlook

We expect stable economic growth in the US

Economic data released to date suggest US economic growth of 2% annualized in the third quarter. That would correspond to the second quarter GDP growth rate as well as the long-term potential growth rate. Thus the US economy has shown resilience in a very difficult environment characterized by the escalation of the trade war with China. The trade war and the uncertainty associated with it undoubtedly weigh on the US economy. However, so far the negative impact remains confined to the manufacturing sector. This has led to weakness in capital spending. The uncertainty has hitherto not affected consumers, whose spending grows at strong, stable rates that continue to buttress economic output. How the trade war will evolve from here depends on the decisions of a few individuals and is therefore unpredictable. We assume that the dispute will at least not escalate further and consequently no additional pressure will be put on the economy. A stabilization of the conflict may even lead to a slight improvement in sentiment. We currently see no reason to expect a further significant slowdown of the US economy. In our view growth in the fourth quarter will most likely be close to the growth rate posted in the third quarter.

After a surprise decline in the pace of inflation (PCE core inflation) at the beginning of the year, the inflation rate has recently recovered somewhat. The monthly trend reveals the reasons for this. A strong decrease in monthly rates of change was seen at the beginning of the year. However, in recent months there was a significant rebound. This suggests that the downturn in inflation was merely temporary. By the time the weak data from the beginning of the year drop out of the calculation, the inflation rate should at the very least come quite close to the Federal Reserve’s 2 percent target. The trade war with China also suggests that inflation rates will accelerate, although the extent to which tariffs will ultimately increase is unpredictable. From 10 May onward tariffs on Chinese imports worth USD 200bn were raised from 10% to 25%. The next step was a hike to 15% on imports worth USD 112bn from 01 September. Additional tariff increases threaten from 15 October (from 25% to 30% on imports worth USD 250bn) and from 15 December onward (from 10% to 15% on imports worth USD 160bn).

Source: Bureau of Economic Analysis, Erste Group Research
CEE Economic Outlook

2Q19 GDP data confirmed that some growth slowdown was inevitable in the CEE region. Negative signs from German industrial sentiment had been apparent for quite some time. That said, EU’s best performer came from CEE, as Hungary achieved real GDP growth of 4.9% y/y, above our expectation of around 4.6%.

Fears of an upcoming recession in the US have increased visibly, with the US yield curve becoming inverted. In Germany, ever-more voices have been raised saying that the country may enter technical recession. Should we worry about CEE as well? While risks of a major slowdown have increased also in CEE, we think we are still not in such a scenario. Of course, in the upcoming quarters, the export sector could face increasing difficulties. So far this year, manufacturing sentiment indicators have indeed fallen strongly for the CEE region. However, industrial production held up relatively well. Some evidence in the automotive sector suggests that this could have partially happened due to a reallocation of production from more expensive Western-European factories to cheaper manufacturing sites in CEE. There are also good news on the domestic demand front as both household consumption and investments are having supportive factors. Unemployment rates are still low, meaning that labor markets are tight, which could keep upward pressure on wages. Additionally, investments could be underpinned by EU fund inflows, as EU budgeting periods tend to be back-loaded, while we are just about to enter the last year of the 2014-2020 period. Furthermore, there are no such large imbalances (in most cases) as there were before the 2008-09 recession broke out.

As the first half of the year was still relatively good for the region, we expect Poland, Romania and Hungary to post growth above 4% this year; however, it is likely to fall below this rate for the next year. Still, the growth differential over the Euro area could be on average above 2 percentage points.
China

China's economy is increasingly affected by the negative repercussions of the trade war. For example, industrial production slowed to +4.4% y/y in August, a multi-year low. The official business climate index for the manufacturing sector also continued to weaken slightly in August. The government is countering the unfavorable trend in the manufacturing sector with fiscal (inter alia tax cuts) and monetary support measures. By contrast, sentiment in the services sector remains stable at a strong level. After the US announced plans to impose tariffs on all imports from China in the wake of the most recent escalation, the two rivals have begun to hesitantly move closer to each other again in recent weeks.

We expect that the trade dispute will continue to weigh on China's growth in the 4th quarter. Any rapprochement in the trade war should improve China's growth prospects, which should also benefit the euro zone economy through rising export momentum. In the medium term, China will have to push ahead with structural market reforms in order to prevent a too rapid decline in the economy's growth momentum.

India

India's GDP grew by 5.0% y/y in Q2 2019. According to a forecast released in July, the IMF has revised its GDP growth estimate for the year as a whole to just +7.0% (previously +7.3%). Next year GDP growth is expected to accelerate to +7.2%.

In order to boost growth in light of the recent deterioration, India's government has announced a surprise tax cut for corporations totaling around EUR 20bn. The effective corporate tax rate will decline from 30% to around 25%, which aligns Indian tax rates with those of competing nations in Asia. The measure will come into force retroactively from 01 April.

India's manufacturing purchasing managers' index (PMI) for August fell to a 15-month low of 51.4 points. The disappointing reading was primarily attributable to weakness in international orders. Indian exports decreased by -6% (y/y) in August. The PMI for the services sector fell to 52.4 points in August after a strong July reading.

The August inflation rate of 3.1% remains at a very low level for a fast-growing emerging market economy. India's central bank (RBI) has responded by cutting its repo rate by 35 basis points to 5.40% at the beginning of August. This was the fourth rate cut this year. The Indian rupee weakened slightly against the USD following the announcement. However, since the beginning of the year the rupee is actually stable against the USD.
Brazil

Economic growth is expected to amount to just +0.9% (y/y) this year, followed by +2.0% (y/y) in 2020. Thus Brazil is likely to exhibit below average growth compared to other emerging market economies.

Industrial production is forecast to decline by -0.7% (y/y) this year and should only resume growing in the coming year (2020e: +2.6%). By contrast, consumer spending is expected to show moderate growth this year (+1.4% y/y), which should accelerate next year (+2.5% y/y).

Companies assess current conditions as slightly negative, while their expectations of future business conditions remain positive. The unemployment rate is expected to reach 11.8% at the end of 2019. According to consensus estimates consumer prices should rise by +3.8% both this year and next year.

Brazil has a large budget deficit. This year it will probably reach -6.1% of GDP and seems set to stay at a high level next year as well (2020e: -5.6% of GDP). A current account deficit of -1.0% of GDP is also expected in 2019. It is estimated that it will deteriorate to -1.5 of GDP in 2020. Brazil's central bank has cut the SELIC rate to 5.5% in September. Consensus forecasts are currently calling for a further rate cut to 5.2% by year-end. The Brazilian real is expected to appreciate moderately against the USD until the end of the year.

Russia

According to consensus estimates the Russian economy will grow +1.1% (y/y) this year. Next year GDP growth is expected to reach +1.6% (y/y). The estimated growth rates are below-average compared to those of other emerging market economies.

Consumer spending growth is likely to remain muted this year (2019e: +1.4%). Next year it should accelerate to +2.3%. The outlook for industrial production growth has slightly improved in recent months. According to consensus estimates industrial production will grow by +2.3% (y/y) this year, followed by an increase of +2.5% (y/y) in 2020.

Government consumption is likely to grow by just +1.0% in both 2019 and 2020. A budget surplus of +2.1% of GDP is expected. The country's current account balance is positive as well. A surplus of +5.6% of GDP should be posted this year.

Consumer prices are forecast to rise by +4.7% (y/y) this year. An inflation rate of +4.0% (y/y) is expected in 2020. In September Russia's central bank lowered its refinancing rate to 7.0%. According to consensus estimates further reductions in the refinancing rate are expected in 2020. The ruble is benefiting from the country's sound fundamentals and has moved sideways in recent months. Consensus estimates are calling for the ruble to remain stable against the USD in the medium term.
Environment for government bonds remains favorable

The economic outlook for the euro zone has deteriorated in recent months. Political crises such as Brexit and the trade war between the US and China remain unresolved and monthly economic data releases suggest that weakness in economic growth is likely to persist. In September the ECB Council responded to this environment with a plethora of measures. The deposit facility rate was cut from -0.4 to -0.5%. However, at the same time a portion of the excess reserves deposited by banks with the ECB will be eligible for a 0% interest rate from the end of October for an amount of up to six times required minimum reserves. Starting in November, the ECB will purchase securities at a monthly pace of EUR 20bn. The program is open-ended and its termination is linked to the first rate hike (“shortly before”). The latter is still a long way off, as the ECB confirmed indirectly. According to the ECB’s interest rate guidance there will be no rate hike before there are clear signs of a sustainable change in the trend of inflation. We believe therefore that net asset purchases will continue for a minimum of two years. However, this measure in particular met with considerable resistance within the ECB Council. Thus the debate over QE may well continue under the new chair Christine Lagarde (from 01 November). Lagarde has announced a review of the ECB’s strategy. In the course of this both the central bank’s targets and its measures, such as negative interest rates and said securities purchases are to be discussed. However, none of this should become an issue before next year. This year we expect one more cut in the deposit facility rate to -0.6%. This expectation is contingent on a hard Brexit, which we continue to regard as the outcome with the highest probability.

In the environment we expect over coming months, government bonds should be well-supported. In the weeks preceding the Brexit decision, uneven news flow should set the stage for volatile markets. Once expectations become facts, we expect a correction in the bond market. However, it should be moderate in extent. A stuttering economy and a central bank pursuing a highly expansionary monetary policy will continue to support bond prices.

Only a moderate increase in yields expected

Source: Market information systems, Erste Group Research
FOMC divided on future path of interest rates

The environment still fails to furnish the Federal Reserve with unambiguous clues. The trade dispute with China remains unresolved, while the economies of the euro zone and China are weakening. At the same time the US economy continues to hold up well, even though the manufacturing sector is suffering. Overall, an economic growth rate similar to that of the second quarter is to be expected in the third quarter, which corresponds roughly to the potential growth rate of the US economy. After two rate cuts of 0.25% in July and September, it is not easy to predict what will happen next. According to Fed chair Jerome Powell future rate-setting decisions will depend both on incoming data and the evolution of various risks (crises) and their effect on the economic outlook. As before, this leaves members of the rate-setting Federal Open Market Committee (FOMC) with broad scope for interpretation. This was already reflected in the outcome of the last FOMC meeting in September. Two of the 10 voting members voted against a rate cut, while one voted for a bigger rate cut of 0.50%. We expect one more rate cut in October this year, contingent on a hard Brexit scenario. We are taking the FOMC at its word in this context and believe that a no-deal exit of the United Kingdom from the EU will affect the outlook to such an extent that there will once again be a majority in favor of a preemptive rate cut. However, that should mark the end of the rate cutting cycle. Solid US economic data in conjunction with a stabilization of the environment and an inflation rate that is approaching the Fed’s target should subsequently set the stage for a stable federal funds rate.

By year-end we expect yields on US treasuries to trade at slightly higher levels than recently, as market tensions should ease after Brexit. Markets are pricing in one more rate cut for next year. These expectations are likely to be disappointed, which should affect bond markets as well. We therefore expect yields on US treasuries to rise moderately further next year.

Interest rate expectations should rise slightly further

Consumer spending strong, manufacturing weak

Little movement in bond markets expected

Source: Bureau of Economic Analysis, ISM, Erste Group Research

Source: Market information systems, Erste Group Research
CEE Government Bonds

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</table>

Looking at market developments overall in the third quarter, yields have fallen substantially and currencies have weakened in CEE. This statement alone would not fully and correctly describe the developments, however. In September, after markets have anticipated substantial monetary easing steps from major central banks, the US Fed and the ECB delivered the expected easing but the outlook was left more uncertain. This resulted in yields going north in most of September. However, regional currencies failed to recover, which is especially true for the Polish zloty and for the Hungarian forint. The substantially worsening economic outlook meant that cuts were starting to be priced in in many CEE countries in August, but this reversed in September.

As for the outlook, countries could show a somewhat divergent pattern. The latest central banker comments in the Czech Republic, for example, reveal the preference of the bank board to keep rates unchanged or even to hike, while any easing is completely off the table to them. This is at odds with longer-dated yield levels on the market, which continue to remain well below short-term rates. However, this makes us think that Czech yields could go somewhat up in the upcoming quarters. As far as central bank policy is concerned, Hungary is at the other end of the spectrum as it just delivered some easing in the form of increased surplus liquidity, acknowledging downside risks in (core) inflation. Longer-dated yields are unlikely to go much down further, however, as central bank actions have a lower impact on this segment. As for Poland, short-term rate stability remains an important anchor, while we expect a rather similar yield development than in Hungary, going forward. Romania is a special case as fiscal and political issues continued to remain in the limelight. Political uncertainty, coupled with worries around a budget deficit overrun, were likely an important cause in problems around bond auctions in September, when the Ministry of Finance needed to scrap three bond auctions amid insufficient demand. Due to that fundamental factors that currently weigh on the bond market seem difficult to be solved quickly, we see Romanian yields edging up in the upcoming months.
In August the EUR corporate bond market suffered a brief correction due to the renewed escalation in the US-China trade dispute. The surprise announcement of new tariffs by President Trump in early August led directly to a surge in credit risk premiums.

A reversal, particularly in the high yield (HY) segment, was triggered by the monetary policy easing measures adopted by the ECB on 12 September. In the course of the quarter the change in Italy’s government and the planned resumption of negotiations between the US and China also provided support. In addition to monetary policy, the trade dispute remains a major market driver.

The ECB’s package of measures includes a new asset purchase program. It begins in November 2019 and envisages net purchases of EUR 20bn monthly. Since an average of around 12% of the ECB’s purchase volume historically comprised investment grade (IG) corporate bonds, we expect purchases of corporate bonds in the amount of EUR 2.0bn monthly (excl. reinvestment). Proceeds from maturing bonds to be reinvested until August 2020 will range from EUR 74mn (in August 2020) to EUR 3.2bn (in March 2020). Thus a small tailwind for corporate bond prices can in principle be expected from November onward. While the announcement of corporate bond purchases in March 2016 had the strongest positive impact, spreads continued to tighten after the purchase program actually started in June 2016. This year the impact of the net purchases, if there is one at all, is likely to be less pronounced.

This is because trends that normally weigh on the performance of corporate bonds continue to be underway. Although leading economic indicators deteriorated further, risk premiums in the HY segment kept declining for quite a long time in the third quarter. This is historically unusual. It is open to question whether monetary policy can counter an economic slowdown in the short term and/or can paper over the cracks lastingly. A number of defaults of prominent issuers such as that of travel agency Thomas Cook at the end of September can dampen investor risk appetites abruptly. Moody's is forecasting rising default rates for the speculative grade segment in the EMEA region over the coming 12 months. The consensus expectation is that the net debt/EBITDA ratios of European companies are going to rise. Risk factors apart from the trade dispute, such as the conflict between Iran and Saudi Arabia/US, the strained fiscal situation of Italy and the risk of a hard Brexit have to date not affected the EUR corporate bond market to a significant extent. However, particularly a hard Brexit at the end of October could well unsettle investors in the fourth quarter.

Despite the support provided by monetary policy we believe that the above-mentioned market developments and risks suggest a certain degree of caution is warranted. It seems not sensible to lower one’s requirements regarding credit quality ever further for the sake of nominal return targets. We continue to recommend IG hybrid bonds and bonds in the BB rating category, the highest credit quality level within the speculative grade (HY) rating segment. We favor defensive sectors.
Currencies

Environment continues to argue in favor of the US dollar for the time being

In view of the deteriorating environment, the US dollar has steadily gained ground against the euro in recent months. The dollar remains the classic safe haven currency. Apart from this, the trade dispute between the US and China and the uncertainty about the form Brexit will ultimately take are having a more pronounced impact on the euro zone economy. The balance of risks thus suggested relatively stronger monetary easing measures in the euro zone than in the US. For the time being the environment is not going to improve. In coming weeks it will be decided whether a hard Brexit will happen, or whether the deadline for the exit will once again be extended. From our perspective, the third option – namely an exit with a negotiated deal – can be ruled out by now. We expect a hard Brexit on 31 October. Events in coming weeks should increasingly point to this outcome. This argues in favor of the US dollar, which could well appreciate slightly further. Once the divorce between the EU and the United Kingdom is completed, markets should begin to focus on the time thereafter. Although it may well take several months, the euro zone economy will eventually recover from this shock. In light of this the euro should firm slightly again and end the year at 1.10 vs. the US dollar. Should the deadline be extended, the euro could react favorably. However, we believe such a rebound would not last long, as the risk of a hard Brexit would remain in place in this case. Other drivers such as the simmering trade war between the US and China and the possible initiation of impeachment proceedings also argue in favor of the US dollar. We continue to recommend maintaining exposure to the US dollar and adopting a wait-and-see stance for the time being.

US dollar remains strong for now

Source: Erste Group Research, market information systems
Swiss Franc

SNB adjusts calculation basis for negative interest rates on sight deposits

At its September meeting, the Swiss National Bank kept the interest rate on sight deposits at the central bank at -0.75%. However, the basis for calculating negative interest rates on sight deposits was adjusted. The adjustment works as follows: Negative interest rates will continue to be charged on the portion of sight deposits that exceeds a certain exemption threshold. However, this exemption threshold will henceforth be updated monthly and reflect developments in bank balance sheets over time. The adjustment to the calculation basis takes into account that the low interest rate environment around the world has recently become more entrenched and could persist for some time to come. The adjustment leads to an increase in the exemption threshold for the banking system and a reduction in negative interest income for the SNB. The new exemption threshold calculation comes into effect on 01 November 2019.

The SNB continues to regard expansionary monetary policy as necessary in light of recent international developments and the inflation outlook for Switzerland. It considers the situation on foreign exchange markets to be fragile, and the Swiss franc has appreciated in trade-weighted terms. The conditional inflation forecast for 2019 and 2020 was lowered to +0.4% (previously +0.6%) and +0.2% (previously +0.7%), respectively. The main reasons for lowering the inflation forecast were weaker growth and inflation prospects abroad and the stronger Swiss franc.

The Swiss franc has recently strengthened to a level of around 1.084 vs. the euro, in line with generally declining risk appetites in financial markets. As a result of the ongoing political chaos in the United Kingdom, our base case scenario continues to be that there will be a Hard Brexit at the end of October. Thus we expect the Swiss franc to strengthen slightly further against the euro, toward 1.08 until the end of October. Tensions should ease again in the course of the first half of 2020, which should result in the Swiss franc weakening somewhat against the euro. Since a minimum exchange rate is no longer enforced, the Swiss franc could appreciate strongly against the euro at any time if other risks were to materialize (e.g. geopolitical conflicts, escalation of the global trade war or turmoil in Italy).
The gold price rose by +7% in USD terms and +11% in EUR terms in the third quarter. The price increase since the beginning of the year amounts to +23% in EUR terms. An important driver of the strong rally in the gold price was above all the decline in bond yields and the growing amount of negative-yielding sovereign bonds outstanding globally. The depreciation of the euro against the USD boosted the advance of the gold price additionally in euro terms.

Another factor exerting a favorable effect on gold prices was the slowdown in global economic growth, which led to growing uncertainty in financial markets. Moreover, political tensions between the US and Iran increased. The trade dispute between the US and China remains to date unresolved as well. This fact put pressure on stock markets in irregular intervals and the gold price often gained ground on these occasions.

According to the World Gold Council gold demand increased by +8% (y/y) in the second quarter. Global central banks have been net buyers of gold since 2010. In the second quarter they purchased 224 tons of gold, which represents a 47% increase compared to the previous year. Their demand reached 374 tons in the first half of the year, the highest level since 2010.

Investment demand rose by +1% to 286 tons in the second quarter. It developed unevenly. Demand for coins and bars amounted to 218 tons (-12% y/y). By contrast, gold demand driven by the creation of Gold ETF share baskets rose to 67.2 tons (+99% y/y) in the second quarter.

Outlook:

In the final quarter of the year a hard Brexit in line with our forecast will probably trigger more uncertainty and support a slight increase in the gold price. On the other hand, the moderate rise in US yields we are forecasting should limit the upside potential for gold prices. We therefore expect only a marginal price increase in the fourth quarter. Until the end of the year the gold price should trade in a range from approximately USD 1,500 – 1,540.
In the third quarter, the World Stock Index gained +2.8% in EUR terms. The performance of the US stock market exceeded that of the European market by almost two percentage points. Emerging markets suffered from persistent weakness in commodity prices and the unresolved trade dispute between the US and China. The global emerging markets index lost -2.9% in EUR terms.

According to consensus estimates, earnings at the world's largest companies are expected to decline by -1.4% this year and grow by +7.6% next year. The decrease in earnings estimates for this year is attributable to very strong earnings declines at just a few companies. These outliers are currently distorting the average. As a result of this, the slightly negative earnings growth rate for 2019 is not representative of the global stock market in the broader sense. Given this situation, the median of +2.3% provides a better indication of prospective earnings growth this year.

A look at next year's figures reveals that earnings growth in the technology sector, which is the largest global sector, is set to resume in 2020. Consensus estimates are calling for earnings growth of +12.4%. Defensive sectors such as health care (2020e: +7.6%) and food & beverages (+7.6%) are expected to post solid earnings growth as well.

Global equities currently trade at moderate valuations

The forward P/E ratio of the World Stock Index stands at approximately 15.9x. The 2019 forward dividend yield amounts to 2.6%. Compared to government bonds, the valuation of stocks remains very attractive. In the US the forward dividend yield (2019e: 1.9%) also stands above the yield on 10-year treasury notes. The latter currently amounts to 1.7%.

Moderately positive outlook for global equities in Q4 2019

We expect defensive sectors to outperform cyclical sectors in the fourth quarter. Currently extant political and economic uncertainties are favorable for investments in the sectors health care, food & beverages as well as high quality technology stocks. Cyclical sectors should continue to be underweighted. This applies in particular to the energy, commodity, chemical and automotive sectors. We expect a moderate advance in global equity indexes in the fourth quarter, at the lower end of a range from 0% to +5%.
Global Sectors (1)

**Energy**
Consensus estimates are currently calling for earnings in the sector to fall by -10.7%. Revenues are also expected to decline (2019e: -3.6%). Next year earnings are supposed to improve (2020e: +8.8%). Revenues are expected to grow by +2.1%. We believe the consensus estimates of earnings growth are too optimistic. Moreover, they were already subject to downward revisions for several weeks. In an environment characterized by a slowdown in global economic growth momentum, we consider this sector to harbor more risks than opportunities. We expect the sector to deliver a negative performance in the fourth quarter in a range of -5% to 0%.

**Chemicals**
Forecasts of earnings and revenue growth rates for the sector are negative this year. According to consensus estimates, revenues will probably stagnate, while earnings will decline by -5.5%. Next year the sector finds itself in a comparatively unfavorable situation as well. Amid estimated revenue growth of +3.9%, earnings are expected to decline by -0.7%. We expect this cyclical sector to post a loss between -5% and 0%.

**Commodity Producers**
The smallest global sector in terms of market capitalization will report stagnating revenues next year (2020e: +/-0%). Earnings growth is negative this year (2019e: -14.2%). Next year earnings are expected to increase again (2020e: +12.8%). Given the downtrend in commodity prices, we believe this estimate is probably too high. We expect the sector to post a loss in the fourth quarter in a range from -5% to 0%.

**Construction and Building Materials**
According to consensus estimates, earnings per share are expected to grow by +6% this year. In 2020 revenue growth of +1.6% and earnings growth of +10.3% are expected. All companies in this sector that are constituents of the Erste Global Index are forecast to report growing earnings. We expect the sector index to post a gain ranging from 0% to +5% in the fourth quarter.

**Industrial Goods and Services**
Estimates of global revenue growth have deteriorated. It is expected to amount to +2.3% this year. Next year the growth rate is likely to accelerate to +4.7%. The -5% decline in earnings expected this year is attributable to a pronounced downturn in the earnings of European companies. By contrast, US companies are likely to achieve high double digit earnings growth rates next year (2020e: +17.5%). Expected earnings growth of the global sector in 2020 amounts to +12.5%. We expect a moderately positive performance in a range of 0% to +5%.

**Car Makers and Car Part Suppliers**
Companies in this sector have to contend with stagnating revenues. In 2019 revenues are expected to decline by -1.3%, followed by moderate growth of +1.6% in 2020. According to consensus estimates, earnings are likely to decline by -6.5% this year and grow by +11.4% next year. The bulk of the expected increase in earnings is attributable to just a few companies (e.g. Daimler, Toyota Motor and Tesla). We expect the sector to deliver a moderately negative performance in a range of -5% to 0%.
Global Sectors (2)

Food & Beverages
Revenues in this non-cyclical sector are expected to grow by +2.3% in 2019, followed by an acceleration to +3.4% in 2020. Earnings are expected to remain unchanged this year and grow by +7.6% next year. The biggest profit growth is expected to be posted by Nestle, Unilever, Coca Cola, Kirin and PepsiCo. The sector's 2019 forward dividend yield amounts to 2.4%. This is slightly below the global average of 2.6%. The valuation in terms of the 2020 forward P/E ratio stands at 21.2x, which is significantly higher than the global average of 14.8x. We expect the sector index to post a gain at the lower end of a range from 0% to +5%.

Household Appliances and Personal Care Products
Revenues in this sector are stagnating this year. In 2020 they are estimated to grow by +4.3%. Marginal earnings growth this year (2019e: +1.5%) is expected to be followed by earnings growth of +6.7% in 2020. The largest earnings increases are likely to be achieved by Procter & Gamble, LVMH, Nike, Nintendo, Kering and L'Oreal. The dividend yield of the sector amounts to 2.5%, its valuation in terms of the forward P/E ratio stands above the global average (2019e: 20.6x). We expect a performance in a range from 0% to +5% in the fourth quarter.

Health Care & Pharmaceuticals
The sector's revenue growth exceeds the global average both this and next year. Expected revenue growth in 2019 is +10.6%, followed by +6% in 2020. Earnings growth is estimated to amount to +2.5% in 2019. It will therefore probably come in below the global average, but is expected to accelerate to +7.6% next year. The largest earnings increases in 2020 are expected for Takeda, United Health Group, Johnson & Johnson, Novartis, Merck & Co. and Celgene. We are forecasting that the sector will advance between 0% and +5% in the fourth quarter.

Retail Trade
The sector has generated an above-average return since the beginning of the year (+27% in EUR terms). Its revenue growth rates are strong. Revenues are expected to grow by +6.4% in 2019, followed by +5.6% in 2020. According to consensus estimates a small decline in earnings of 0.7% is expected for this year, followed by an increase of +12.9% next year. In 2020 companies such as Amazon and its Chinese competitors Alibaba and Meituan Dianping are likely to achieve the strongest earnings growth rates. We expect the outperformance of the sector to continue and anticipate a gain in a range of 0% to +5%.

Media
Revenue growth in this sector is expected to exceed the global average this year (2019e: +8.3%, 2020e: +5.5%). Earnings are forecast to decline slightly this year (2019e: -0.8%). Above-average earnings growth is expected next year (2020e: +12.3%). The sector index should post a gain at the lower end of a range from 0% to +5% in the fourth quarter.
Global Sectors (3)

Travel & Leisure
According to consensus estimates, revenue growth will amount to +5.8% in 2019 and +6.2% in 2020. Earnings growth is expected to amount to +1.6% this year and +6.4% in 2020. The sector's valuation in terms of the forward P/E ratio (2019e: 15.9x) is at the same level as that of the broad global stock market, while the forward dividend yield is lower (2019e: 1.8%). We expect a performance in a range of 0% to +5%.

Technology
The sector has generated a year-to-date return of almost +30% in EUR terms. This year revenues are expected to grow by 2.2%, while earnings are expected to decline by -9%. The biggest declines in earnings are likely to be reported by Samsung Electronics, SK Hynix, Micron Technology, Facebook and Apple. In 2020 earnings growth is expected to resume at these companies (with the exception of Micron Technology). In 2020 the sector is expected to achieve both revenue growth (2020e: +7.4%) and earnings growth (2020e: +12.4%) at above average rates. We are forecasting a gain in a range of 0% to +5% in the fourth quarter.

Utilities
As a result of their high leverage ratios, utilities are benefiting from low global yield levels. According to consensus estimates, in 2019 revenues will grow by +3.1% and earnings by +2.7%. In 2020 revenues are expected to grow by +10.7% and earnings by +9.9%. Companies such as Korea Power, CLP Holdings, RWE, Enel and NextEra are likely to achieve the strongest earnings growth next year. The sector has an above-average dividend yield of 4.3%. We expect the sector index to deliver a performance in a range of 0% to +5% in the fourth quarter.

Telecommunication
Expected growth rates for 2019 are negative. Revenues are estimated to decline by -0.7% and earnings by -5.9%. Below-average growth rates are expected in 2020 as well. Revenues are expected to grow by +0.9% and earnings by +3.3%. The largest profit increases are likely to be posted by AT&T, China Mobile and Vodafone. The sector trades at a low valuation. The 2019 forward P/E ratio stands at 14.2x, the forward dividend yield amounts to 4.1%. We expect a moderately negative performance in a range of -5% to 0%.

Banks
Since the beginning of the year the sector has generated a return of +10% in EUR terms. A moderate decline in earnings of -0.6% is expected this year. Next year earnings are expected to grow by +4.7%. Due to its below-average growth prospects, particularly in a number of developed markets, the sector trades at low multiples. The 2019 forward P/E ratio stands at 9.3x while the 2019 forward dividend yield amounts to 4.4%. We expect a negative performance in a range of -5% to 0%.

Insurance Companies
The very strong earnings growth of +38.2% posted by the sector this year is attributable to just a few large groups. According to consensus estimates, revenue growth of +1.5% is expected in 2020, while earnings are expected to decline by -2.8%. The sector's valuation in terms of the 2019 forward P/E ratio stands at 12.1x, which is below the global average. We expect the sector to deliver a performance at the lower end of a range from 0% to +5%.
The Erste Research Europe Index rose by +2.4% in EUR terms in the third quarter. Since the beginning of the year the index has gained +16%. Regions that outperformed were Switzerland (+3.4%) and France (+2%), due to the large weighting of consumer staples stocks in their country indexes. Overall, 17 of 19 sectors posted a positive return in the third quarter. Energy stocks (oil & gas) and commodity stocks lost ground.

Estimates of 2019 earnings and revenue growth for different sectors continue to diverge widely. For the overall European stock market earnings are expected to grow by +0.2% this year. Revenues are estimated to grow by +3.8%. The divergence of earnings estimates for individual sectors is extraordinarily large, as five of the 19 sectors are struggling with declining earnings. The automotive sector (-11%) is particularly strongly affected, as are banks (-9%) and commodity producers (-36%). By contrast, growing earnings are expected in the technology (+13%), consumer goods (+8%) and food & beverages (+12%) sectors. The following chart shows the history of earnings estimates for European stocks overall and for selected sectors over the past 12 months.

Due to its lack of earnings growth momentum, the European stock market trades at an average valuation by global standards. The 2019 forward P/E ratio stands at 15.3x (World Stock Index: 15.9x). The forward dividend yield amounts to 3.6%. European stocks are attractively valued in comparison to German Bunds (10-year yield: -0.5%).

**Europe**

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*Source: Erste Group Research Index, FactSet.*

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**Outlook**

As indicated by forward earnings estimates, selective sector allocation remains crucial for investors in European equities. Thus we recommend stocks in growth sectors such as food & beverages, consumer goods and technology. For the European stock market overall, we expect an advance in a range from 0% to +5% in the fourth quarter.
In the third quarter, the US stock market rose by +5.2% in EUR terms (+1.3% in USD terms). Since the beginning of the year its return amounts to +24.4% in EUR terms (+19% in USD terms). The technology-heavy Nasdaq Index gained +5.3% in EUR terms. The bank index outperformed the broad market in the third quarter. It advanced by +5.8% in EUR terms.

After the strong gains posted in the first half of the year, the upside momentum of the S&P 500 Index has waned somewhat. The prospects for a moderate advance in the fourth quarter remain intact.

US economic growth is solid, even though its pace has slowed somewhat. This trend is particularly obvious in the manufacturing sector. The ISM manufacturing purchasing managers’ index has recently decreased to a level of 49.1 points. The indicator calculated by subtracting inventories from new orders fell slightly below neutral territory in August.

By contrast, the services ISM Index remains at quite a favorable level. The indicator has recently increased to 56.4 points. This illustrates that the services sector – which is very important for the US economy – continues to expand and is in a very robust condition.

Forward estimates for corporate earnings and revenue growth this year are positive. Consensus estimates are calling for revenue growth of +5.8%. Earnings are expected to grow by +1.7% this year. Consensus estimates for next year indicate that earnings growth momentum is likely to strengthen. Earnings at the largest listed corporations are expected to grow by +7.8% in 2020. Revenues are estimated to grow by +5.2%.

The forward P/E ratio of the US stock market stands at 18.9x for 2019 and 17.5x for the coming year. The forward dividend yield of the stock market amounts to 1.9%. The valuation of US stocks is attractive in view of low yields on US treasuries (1.71% on the ten-year note) and favorable growth prospects.

Given that global economic growth momentum is waning, we prefer defensive sectors such as e.g. health care (pharmaceutical, biotechnology and medical technology stocks), food & beverages and less cyclical segments in the technology sector (software, internet, payment processing). Utility stocks are benefiting from low bond yields and should continue to outperform the S&P 500 Index. Strongly cyclical sectors should preferably be underweighted.

**Outlook**

Due to the positive outlook for earnings growth, we expect US stock market indexes to moderately advance in the fourth quarter. As yet unresolved political and economic conflicts (e.g. the trade dispute between the US and China, the conflict between the US and Iran) and the likely impending hard Brexit are going to weigh on the market. It should post a gain in a range from 0% to +5%.
As in all other markets world-wide, political risks continue to loom in the CEE region as potential accelerators of a fundamental economic slowdown. However, since these remain political rather than economic crises, any change in news flow can have immediate favorable effects, exposing possibly overdone negative expectations to upside corrections.

This seems to be happening currently, as various leading indicators such as purchasing managers’ indexes as well as the OECD Composite Leading Indicator display tentative signs of bottoming out and stabilizing. However, this development mainly appears to be evident in Asian markets, while recent weak data releases in the euro area are not encouraging for Central and Eastern Europe.

Recent economic growth data for the region and the fact that we had to revise our GDP estimates some time ago already appear to confirm that there is a chance that exaggerated recession fears are taking hold.

Signs of a correction of possibly overdone expectations of weakness are also hinted at in consensus estimates for corporate profits. While earnings growth at cyclical companies in particular remains relatively weak, even this sector exhibits signs of stabilization. This is more pronounced in Central and Eastern European markets than in EuroStoxx sectors. Especially in financial stocks improving trends are beginning to emerge. The relative performance of cyclical vs. defensive stocks thus shows signs of approaching a possible trend reversal as well – fragile, but nevertheless worth noting. Consequently, while we remain chiefly focused on defensive stocks, we are increasingly adding financial stocks, particularly those with solid dividend payouts.

Our country allocation continues to include a highly speculative and risky position in Turkey. It appears the economy will bottom out in 2019 and corporate profit growth should begin to emerge. It is crucial in this case that further political interference is avoided. Poland continues to fall short of its potential, and the country’s new pension funds so far have not generated the expected improvement in liquidity. Hungary and the Czech Republic remain markets one can confidently bet on. Romania may lose some momentum, as the market has already performed strongly this year, while fundamental factors do not exactly support a continuation of this positive trend.
India

The Indian stock market suffered a -3% correction in EUR terms in the third quarter. Year-to-date the Index has posted a gain of +7%, which is a slightly below-average performance compared to the Emerging Markets Index (+9%).

Our medium-term outlook for the Indian stock market remains positive. A slowdown in India's economic growth led to a moderate correction in the stock market. The government has recently countered this with a substantial tax cut for companies. Since the cut in the corporate tax rate from 35% to 25% was announced on 20 September, the stock market index rallied by 7%. Adjusted net earnings are expected to grow by +12% in 2019 and +16% in 2020 in USD terms. Revenue growth is expected to amount to +1.5% this year. The forward P/ ratio stands at 19x for 2019 and 17x for the coming year. The forward dividend yield is estimated to amount to 1.9% this year.

The Indian stock market is characterized by strong earnings and revenue growth rates, as well as numerous innovative and highly profitable technology companies. This justifies the market's high valuation. India's stock market remains our favorite emerging market. We expect Indian stocks to deliver a positive performance in Q4 2019 in EUR terms, at the upper end of a range from 0% to +5%.

China | Hong Kong

The Chinese stock market including Hong Kong came under pressure due to the trade tensions between the US and China as well as the protests in Hong Kong and fell by -2.4% in the third quarter. However, since the beginning of the year the performance of the index remains strongly positive with a gain of +8%.

The important manufacturing purchasing managers' index (PMI) rose to 50.4 points in August (July: 49.9). Conditions for Chinese manufacturers have slightly improved in August, with companies reporting the fastest increase in production in five months. New orders have largely stabilized, despite a more rapid decline in export sales.

According to consensus estimates, revenue growth will amount to +2.5% this year and +8.5% in 2020. Earnings are expected to grow by +2.6% (2020e: +9%). The two technology companies Alibaba and Tencent, which have a large index weighting (22% of the index), should achieve significantly higher revenue growth rates. The market's 2019 forward P/E ratio stands at 10.7x and the forward dividend yield amounts to 3.1%.

In view of corporate revenue growth and neutral valuation levels relative to the historical average, the risk/return profile of the market is favorable. We expect the Chinese stock market to post a gain in Q4 at the lower end of a range from 0% to +5%.
The Brazilian stock market lost -7% in EUR terms last quarter. Financial and cyclical stocks, particularly commodity stocks, suffered the strongest declines. By contrast, stocks in non-cyclical sectors posted moderate gains.

The outlook for corporate earnings growth in 2019 is mildly negative. Consensus estimates are calling for a decline of -3.3%. In 2020 earnings are expected to grow by +6.6%. By contrast, revenue estimates for next year have deteriorated in recent months. Sales are expected to stagnate in the coming year (2020e: +/-0%).

Revenue and earnings growth at Brazilian companies are likely to come in below the comparable figures of the World Stock Index next year. This is inter alia reflected by the low valuation of the Brazilian stock market. The 2020 forward P/E ratio stands at 10.1x (vs. 14.8x for the World Stock Index). The trailing dividend yield amounts to 3.7% (vs. the 2.6% yield of the World Stock Index).

We expect the Brazilian stock index to post a slight gain in the fourth quarter. It should deliver a performance at the lower end of a range from 0% to +5%.

Russia

The Russian stock market rose by +3.4% in EUR terms in the third quarter. The stocks of oil and natural gas producers posted the biggest advances. Stocks in the cyclical steel sector delivered a negative performance.

There was little change in the consensus estimates of corporate earnings and revenue growth for 2019 in recent months. Thus revenues are expected to decline by -5.2% and earnings by -6.5%. By contrast, the outlook for 2020 is moderately positive. Growth in corporate revenues and earnings is expected to resume next year. Revenues should grow by +2.9% and earnings by +5.5%.

The valuation of the Russian stock market remains low. It stands significantly below the global average. The market's forward P/E ratio stands at 6x in 2019 and at 5.6x in 2020. The 2019 forward dividend yield amounts to 6.8%. Due to this low valuation and the moderately positive outlook, we expect that the stock market will rise slightly in the fourth quarter. It should post a gain at the lower end of a range from 0% to +5%.
### Tables & Appendix

#### Economic indicators

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Source: IMF, EU Commission, Erste Group Research estimates
Forecasts

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*Mid of target range

Source: Bloomberg, Erste Group Research

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1 By regulations we are obliged to issue the following statement: Forecasts are no reliable indicators for future performance
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<td>11.0</td>
<td>8.0</td>
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<tr>
<td>Basic Resources</td>
<td>EUR</td>
<td>32</td>
<td>727</td>
<td>1.7</td>
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<td>Chemicals</td>
<td>EUR</td>
<td>32</td>
<td>817</td>
<td>1.8</td>
<td>4.8</td>
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<tr>
<td>Construction &amp; Mat.</td>
<td>EUR</td>
<td>16</td>
<td>361</td>
<td>0.8</td>
<td>5.2</td>
<td>2019</td>
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<tr>
<td>Real Estate</td>
<td>EUR</td>
<td>47</td>
<td>1,157</td>
<td>2.6</td>
<td>0.6</td>
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<td>Financial Services</td>
<td>EUR</td>
<td>41</td>
<td>1,249</td>
<td>2.8</td>
<td>4.7</td>
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<tr>
<td>Food &amp; Beverage</td>
<td>EUR</td>
<td>48</td>
<td>2,283</td>
<td>5.1</td>
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<td>Health Care</td>
<td>EUR</td>
<td>80</td>
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<td>Industrials</td>
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<td>119</td>
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<td>Media</td>
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<td>18</td>
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<td>Energy</td>
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<td>68</td>
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<td>49</td>
<td>2,194</td>
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<td>Retail</td>
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<td>48</td>
<td>3,163</td>
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<td>Technology</td>
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<td>98</td>
<td>8,215</td>
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<td>Telecom</td>
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<td>35</td>
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<td>Travel &amp; Leisure</td>
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<td>32</td>
<td>883</td>
<td>2.0</td>
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<td>Utilities</td>
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<td>19</td>
<td>488</td>
<td>1.1</td>
<td>2.5</td>
<td>2019</td>
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Source: FactSet, Erste Group Research Calculations.
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