Semiannual report

Equity Outlook

Trade war opportunities

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- **Increasing interest rates in the United States and the escalating trade war:** Uncertainty on markets stemming from these factors as well as from negotiations about Brexit and the situation concerning Italian public finances resulted in a sharp increase in volatility. At the end of 2018, there were significant sell-offs, and stock indices closed the year in the red.

- **An expected recession in the United States will send stock markets down:** After a short-term recovery of stock indices, this year should eventually end up failing. We believe the Prague PX Index has the potential to overcome the major world indices thanks to its sectoral composition.

- **The trade war continues to be a significant influence on equity markets:** For all of last year, the escalation of the trade war damaged equity markets. At the beginning of 2019, news of the successful meeting between US and Chinese representatives helped markets to recover.

- **The car industry, miners, and steel and aluminium producers suffered the most from the trade war:** Producers of steel and aluminium have suffered due to the imposed tariffs, whereas investors are losing faith in the car industry as the threat of tariffs remains.

- **Interesting investment stock tips:** Aperam, ArcelorMittal, Constellium, Faurecia, Renault, Volkswagen


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SOCIETE
GENERALE
GROUP

Prague Stock Exchange statistics

	2013	2014	2015	2016	2017	2018
PX Index (eoy)	989	947	956	922	1,078	987
Change (CZK)	-4.8	-4.3	1.0	-3.6	17.0	-8.5
Change (USD)	-8.9	-16.7	-7.0	-6.9	41.1	-13.6
Traded volumes (CZK m)	184,571	158,222	169,202	163,580	140,741	142,125
Traded volumes (USD m)	9,461	7,648	6,941	6,687	6,002	6,557
Market capitalization (CZK m)	1,074,426	1,018,162	1,011,989	1,020,891	1,208,467	1,095,553
Market capitalization (USD m)	54,189	44,434	40,696	39,844	56,888	48,753

Source: PSE, Bloomberg, Economic & Strategy Research, Komerční banka

KB/SG recommendations for the PSE titles

Company	Price	Target price	Recomm.	From date	Year high	Year low
Avast	85.5	98.2	Buy	14.VI.18	89.0	62.5
CEZ	538.0	620.0	Buy	11.VI.18	590.0	491.0
CME	73.5	113.8	Buy	27.VII.17	99.5	62.0
Erste Bank	761.2	1,241.3	Buy	12.II.18	1,057.9	710.4
Kofola	292.0	484,0	Buy	26.IX.18	426.0	267.0
Komercni banka	874.0	-	-	-	975.0	812.5
Moneta Money Bank	72.4	93.0	Buy	6.III.18	86.3	71.3
O2 CR	242.5	298.0	Buy	12.XII.18	289.8	216.5
PFNonwovens	808.0	924,0	Hold	26.X.18	940.0	798.0
Philip Morris CR	14,500.0	18,308.0	Buy	22.VIII.17	18,060.0	13,980.0
Stock Spirits	62.3	-	-	-	91.5	55.2
VIG	541.0	668.0	Buy	11.IX.18	731.0	512.0

Source: PSE, Bloomberg, Economic & Strategy Research, Komerční banka; *prices as of 16 January 2019, 11:22 am CET

Companies overview

	Price	Monthly	year-to-date change		Avg. daily volumes	
	CZK	change	CZK	USD	2018	2018
Company	16-Jan-19	(%)	(%)	(%)	(CZK m)	(USD m)
Avast	85.5	11.8	4.9	4.9	5.6	0.3
CEZ	538.0	-2.2	0.6	0.6	163.5	7.3
CME	73.5	0.5	18.0	18.0	5.3	0.2
Erste Bank	761.2	-8.3	1.9	1.9	86.8	3.9
Kofola	292.0	2.1	3.2	3.2	4.5	0.2
Komercni banka	874.0	-1.8	3.2	3.2	132.1	5.9
Moneta Money Bank	72.4	-3.7	-0.1	-0.1	96.8	4.3
O2 CR	242.5	-0.2	0.6	0.7	35.5	1.6
PFNonwovens	808.0	-7.1	0.2	0.3	1.8	0.1
Philip Morris CR	14,500.0	0.8	3.0	3.0	17.2	0.8
Stock Spirits	62.3	0.3	1.5	1.5	2.2	0.1
VIG	541.0	-0.6	2.7	2.7	5.7	0.3

Source: PSE, Bloomberg, Economic & Strategy Research, Komerční banka; *prices as of 16 January 2019, 11:22 am CET

2018 should be quickly forgotten

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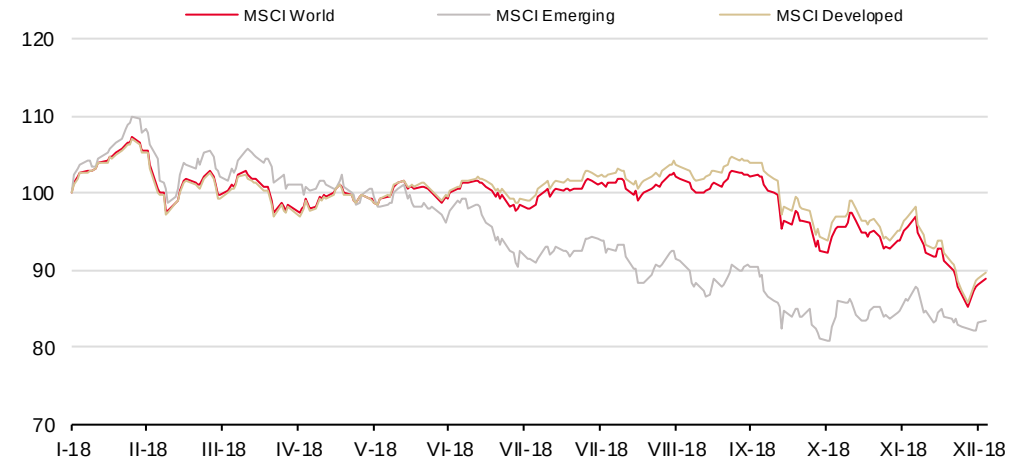
Last year was definitely not among the favourites for shareholders. Major world stock indices closed in the red, and the last quarter of the year was the most painful period. The global MSCI index lost more than 11% last year. Shares of developed markets were slightly better with losses amounting to less than 10%, while the MSCI index for emerging markets lost roughly 17%. Looking at specific regions, the European Stoxx 600 index (-13%) and the Japanese market (Nikkei 225 -12%) were worse than the global MSCI index. The honour of emerging stock markets was defended against the original expectations until the beginning of December by the US S&P 500, which eventually collapsed under the pressure of global sales and closed roughly 6% below the level of early January 2018.

Global equity market

Source: Bloomberg, MSCI World index

Development of main equity indices in 2018

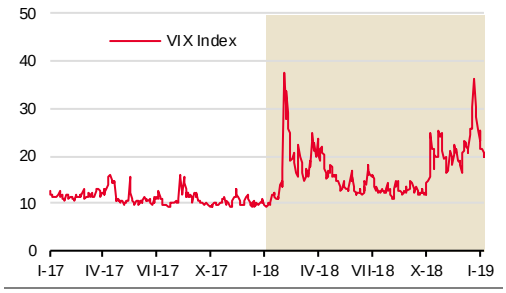


Source: Economic & Strategy Research, Komerční banka, Bloomberg; *data as of 14 January 2019

The calm period ended last period, and markets experienced several waves of purchases and sales.

Nevertheless, the predictions for significantly higher volatility on financial markets were evidently fulfilled, as evidenced by the VIX index showing volatility and the prevailing uncertainty among investors. There were several factors behind this. The new American trade policy against imports of foreign goods was felt most, resulting in countermeasures by the governments of affected countries. Negotiations about duty barriers influenced markets for the whole of last year, and their effects will be felt this year, as well. The monetary policy of the US central bank was the second factor. The Fed continued to raise interest rates. Especially in the first half of 2018 thanks to favourable macroeconomic indicators, there were rising speculations about higher than originally expected interest rates on financial markets, and investors doubted the level at which central bankers see neutral rates, respectively. However, at the end of last year, fears of the need for tighter monetary conditions have dampened. It has to be noted that the reason was and still is the anticipated development of the global economy for 2019 and 2020, when predictions of a recession in the United States in 2020 start to emerge among analysts more often. The softer rhetoric of US central bankers could also be caused by a sell-off on global stock markets as they wanted to calm the situation to some extent and not add oil to the fire.

The fear index



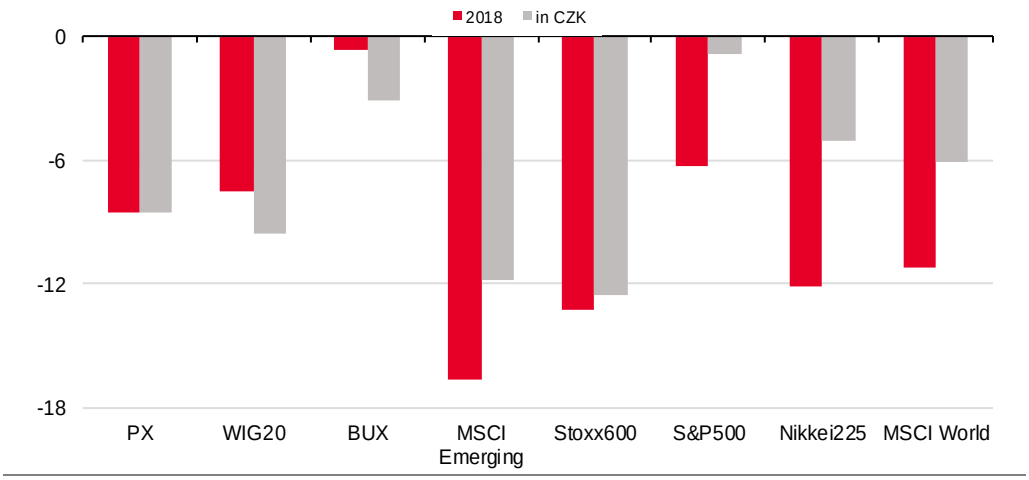
Source: Bloomberg

The approval of the Italian state budget and negotiations about the conditions for the United Kingdom's exit from the European Union were also important events for financial markets. Italy was threatened by the excessive deficit procedures of the EU, but eventually the government managed to avoid it, at least temporarily. Brexit will remain one of the main topics at the beginning of this year, when it will be realised at the end of March. How it will happen remains unclear. A consensus does not even exist in the British Government itself, let alone arrangements for specific Brexit conditions with the European Union and individual European governments.

The US earning seasons brought better results over the whole year.

US stocks benefited from a solid macroeconomic environment during the year. In addition, earning seasons supported them. The reported company results exceeded expectations altogether, and the third quarter was no exception when the reported earnings of companies within the S&P 500 index outperformed the consensus by nearly 7%. Not just some selected sectors but better results were presented in most of them. On the other hand, net profit and revenues for European and Japanese companies came as a disappoitment. As a positive factor for US stocks, we can also note the relaxed fiscal policy and implemented import duties on some commodities, which have helped domestic producers.

Comparison of stock indices in 2018 (%)



Source: Economic & Strategy Research, Komerční banka, *data as of the end of 2018

The Czech market did not keep its profits from the first half of the year and ended with a loss.

After a good beginning of the year, the Prague market ended in losses in several waves. For the whole of last year, the PX index wrote off almost 9%, which was the second-worst year in the past decade after 2011. Compared with global indices from developed and emerging markets, however, it showed smaller losses. On the other hand, regional comparisons do not sound so positive when the Polish WIG 20 declined 8% and the Hungarian BUX by less than 1%. It is clear from the graph that none of the above indices was successful last year. In CZK terms, the US dollar was able to erase almost all losses, and the crown investor in the US market realised a loss of under 1%, including the FX gain.

Avast as a debutant became the star of the Prague trading floor last year.

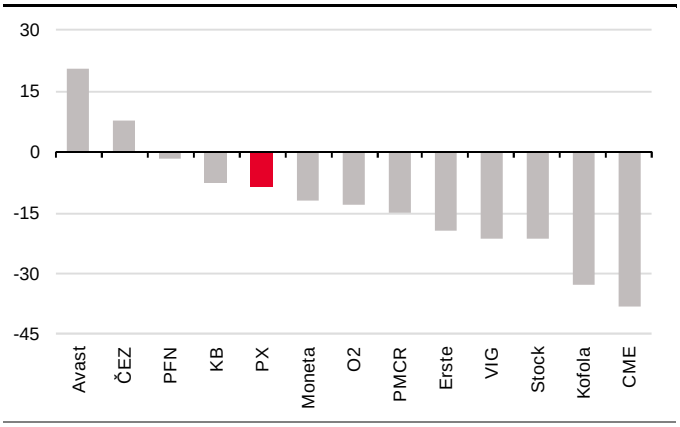
On the Prague trading floor, only Avast and CEZ shares increased the value of investment for their owners. The market capitalisation of the antivirus developer, which debuted on the Prague Stock Exchange in mid-May, rose more than 20% (in CZK terms). The company has pleased investors with its economic results, and since the company's entry into the market only the *Buy* recommendations of analysts with relatively high growth potential have gradually emerged. Shares of the electricity producer and distributor, CEZ, improved almost 8%, mainly due to its developments in the first half of the year. Its second half, when stocks attacked a three-year high, eventually brought only minimal gains. Rising electricity

prices were the main driver, as they were supported in addition to coal prices by higher emissions allowance prices. On the other hand, the debate about the construction of a new nuclear block and its financing sowed doubt among investors, which did not allow CEZ shares to grow significantly. At the same time, the sale of Bulgarian assets is prolonging. In addition to the winner of the tender, Inercom, the second bidder, India Power, has again entered into play. Last but not least, there is a question mark over the litigation between CEZ and SZDC about ordered but uncollected electricity in 2010 and 2011. CEZ is even at risk of having to refund the amount of more than CZK1bn already paid by SZDC for 2010.

The media group CME and soft drinks producer Kofola CeskoSlovensko experienced the hugest drop.

Other equities traded on the Prague floor closed last year at lower values than those traded at its beginning. **The least profitable investment was CME media group, which dropped 38%.** Markets ignored its good economic results and continuing decrease in indebtedness and focused instead on the ongoing sale of Slovenian and Croatian assets. While the sale of Croatia has already taken place, in the case of Slovenia the company is still waiting for an antitrust decision. The whole process is being dragged out, which raises fears whether the transaction will be realised at all. The Kofola beverage group was the second biggest dump. Its shares fell one-third of their value as a result of the sale of the share of the CED Group for CZK270 per share, which was a discount of 26% compared with the price before the announcement.

Performance of equities on the PSE in 2018 (%)



Source: Economic & Strategy Research, Komerční banka, *data as of the end of 2018

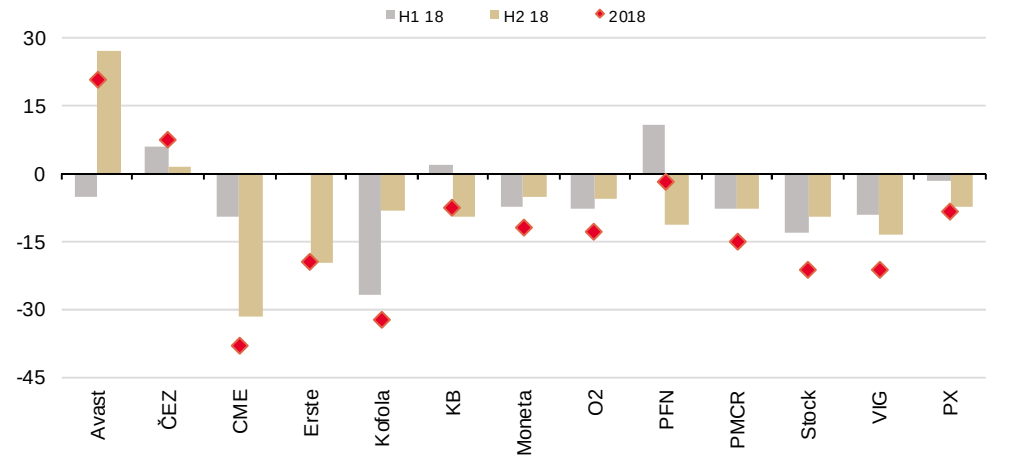
Eight stocks lagged behind the Prague benchmark in 2018.

As the chart above shows, only four stocks were able to overcome the PX index. **The remaining eight companies lagged behind the performance of the entire market.** In some cases, corporate factors have contributed to the decline in value rather than just sentiment on the market. Erste, with almost a 20% loss, was influenced by the government's plans of sectoral taxation in Romania, which would lead to a 9% drop in net profit of the entire group. Shares of O2 Czech Republic (-13%) hit exclusion from the prestigious MSCI index. The company results were decent, but high investments may reduce investor interest in this dividend title. The forthcoming acquisition of Air Bank and Czech and Slovak Home Credit by Moneta Money Bank was the largest announced event. The transaction should be completed by mid-year. Moneta's shares fell around 9% after the announcement (8 October 2018), but most of the losses were erased in November. December's sales on global stock markets also influenced Moneta, and the bank closed the year with a total loss of 12%.

Fortuna and Unipetrol left the Prague Stock Exchange.

In addition, we had to say goodbye to two titles last year. The betting company Fortuna and the petrochemical concern Unipetrol agreed to withdraw their shares from the stock market. This influenced overall trading activity on the market, as these two shares were attractive among investors. In the case of Fortuna, this was due to realised acquisitions, and for Unipetrol it was thanks to a new polyethylene unit and dividend policy.

Development of stocks traded on the PSE in both halves of 2018 (performance in %)

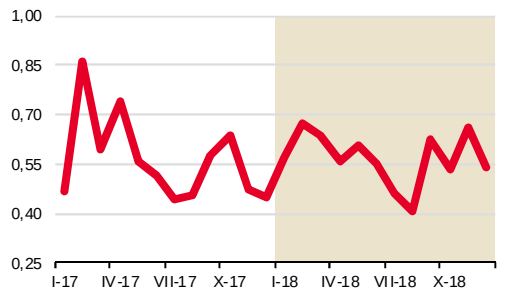


Source: Economic & Strategy Research, Komerční banka

Trading activity stabilised last year.

Last year brought a stabilisation in traded volume on the Prague floor. The average daily volume was CZK570m, a comparable result with 2017. The five most traded titles accounted for more than 90% of total traded volume. CEZ confirmed its position as the most attractive stock with a 29% share. Komerční banka, with 24%, ranked second in the ladder of most traded titles on the Prague Stock Exchange. Moneta Money Bank, with a 17% stake, followed, and the third bank traded on the PSE, Erste Group, reached 16%. O2 Czech Republic rounded out the five most interesting titles with 6%.

Average daily trading volume (CZKbn)



Source: PSE, Bloomberg, Economic & Strategy Research, Komerční banka

Equity markets outlook

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Société Générale keeps the weight of equitites in its global portfolio at 40% with an *Underweight* recommendation.

Our outlook for equity markets is based on the forecasts and recommendations of Société Générale's reports *Multi Asset Portfolio – Synchronisation is back* (published on 27 November 2018, 6:56 am CET) and *The Big Picture – Still here* (published on 21 November 2018, 5:32 pm CET). Société Générale didn't significantly change the structure of the risk profile of its global asset allocation portfolio. The last meaningful change occured at the end of 2017, when SG reduced the weight for equities from 50% to 40% and changed the recommendation to *Underweight* in its asset allocation portfolio. **Société Générale confirmed this weight and recommendation in its last November outlook.** Within equities, there was a slight change in favour of European stocks excluding the United Kingdom at the expense of EMG shares.

A decrease in the weight on EMG markets was also evident in bonds denominated in local currencies. The total bond exposure thus decreased 2pp to 28%. Société Générale still holds an *Overweight* recommendation for them. On the other hand, the commodity exposure increased as its weight went up 2pp together with the new recommendation of *Overweight*.

SG/KB outlook for equity indices

Index	Last price	III/19	VI/19	IX/19	XII/19	XII/20	change
	16-Jan	*est.*	*est.*	*est.*	*est.*	*est.*	*1 year (%)*
S&P 500 (USA)	**2,610**	**2,700**	**2,650**	**2,550**	**2,400**	**2,400**	**-8.1**
DJ Stoxx 600 (Europe)	**349**	**360**	**365**	**340**	**300**	**290**	**-14.1**
FTSE 100 (UK)	6,857	7,000	7,200	6,600	6,000	5,800	-12.5
CAC 40 (France)	4,796	5,100	5,200	5,000	4,500	4,400	-6.2
DAX 30 (Germany)	10,892	11,500	11,750	11,250	10,000	9,800	-8.2
FTSE MIB (Italy)	19,270	18,500	18,000	17,500	16,000	15,500	-17.0
IBEX 35 (Spain)	8,849	9,000	9,000	8,700	8,000	7,800	-9.6
Nikkei 225 (Japan)	**20,443**	**23,000**	**24,000**	**23,500**	**21,400**	**24,000**	**4.7**
MSCI China	75	76	80	78	71	77	-4.9
KOSPI 200 (South Korea)	271	270	270	260	250	260	-7.8
Nifty50 (India)	10,890	11,200	11,200	11,400	11,200	12,200	2.8
MSCI AC Asia ex-Japan	615	620	650	605	565	620	-8.1
PX (KB/SG, market prices)	**1,010**	**1,080**	**1,120**	**1,190**	**1,250**	**1,300**	**23.7**
PX (KB/SG, consensus)	**1,010**	**1,090**	**1,130**	**1,210**	**1,290**	**1,342**	**27.7**

Source: SG Cross Asset Research (Multi Asset Portfolio from 6 June 2018); Economic & Strategy Research, Komerční banka; *prices as of 16 January 2019, 11:22 am CET

The beginning of the year should experience a recovery of equity markets.

Although 2018 should be quickly forgotten, this year may bring reminders. **After strong sell-offs in December, stock prices seem attractive for new purchases.** The first half of the year should be characterised by a strengthening of stock indices, which should be positively affected, in addition to a favourable valuation, by postponing the expected recession in the United States, better macroeconomic conditions in Europe, and ending the trade wars and finding an optimal trade policy between the United States and China. At the same time, we expect politicians to find a compromise on Britain's departure from the European Union and that the country will not be forced to go through the so-called hard Brexit. This should also provide relief for equity markets. Last but not least, the Fed's monetary policy should not lead to tighter monetary conditions over the expected double rate hike this year. In the second half of the year, the anticipated recession in the United States in the mid-2020s should be increasingly felt on the market. As stock markets usually overtake the economic cycle by roughly six to nine months, the impact of the expected economic downturn should be visible by the end of this year.

The US stock market will head south again after a temporary recovery at the beginning of the year.

In the United States, after a wave of the short rise, the stock market should return to a downward trend. The positive effects of relaxed fiscal policy should already dampen and

firms' costs should grow under pressure from higher wages and more expensive debt financing. The decline in operating margins, which indicates the last phase of economic expansion, should continue. Companies' profitability should be similar to last year's net profit, according to Société Générale; however, this is expected to drop in 2020. The US stock market should hit its local bottom during 2020. The S&P 500 should lose nearly 8% this year, falling to a level of 2,400 points, around which it remain a year later, as well.

French and German stocks should better resist sell-offs than the rest of Europe.

The European market as a whole should record a two-digit decline this year. The Stoxx 600 index should fall about 14% to a 300-point border. The expected increase in interest rates by the European Central Bank in the second half of the year should be reflected both in the rising interest costs of firms and in the strengthening European currency. This will dampen the profitability of European exporters. On the Continent, Italian and Spanish stocks should experience a deep fall, while decreases in French and German stocks should be relatively smaller due to lower indebtedness and higher profitability. A soft Brexit should lead to a strengthening of GBP, which would be an unfavourable factor for the British FTSE 100 index, being full of exporters. The subsequent year 2020 should bring even moderate declines in the order of small percentage units due to the economic slowdown in Europe in connection with the recession in the United States.

Switch to defensive stocks.

In sectoral composition, Société Générale directs more toward defensive stocks. From this point of view, it has upgraded its recommendation for the consumer staples sector from *Underweight* to *Neutral*, particularly thanks to companies operating in household and personal care. On the contrary, it downgraded its recommendation for consumer discretionary from *Overweight* to *Underweight*, where the subsector of durables, apparel and luxury played the most significant role. The automotive subsector is still one of the preferred ones.

Insurance companies are the most preferred European sector.

Financial institutions are the most preferred sector, especially **insurance companies,** thanks to strong profitability and low valuation. **Commodity companies,** whose shares were one of the most affected by the recent sell-offs, should also fare well. Thirdly, **pharmaceutical companies** are a popular defensive sector.

Rising interest rates do not bode well for highly leveraged telecoms, real estate companies and utilities.

Among the potential losers in the current environment are real estate developers, utilities, telecoms and other sectors for which the expected increase in bond yields will be a big headwind.

A real increase in Asian equity indices next year.

While we expect Asia equities to recover in 2020, 2019 could be another challenging year due to an extended growth slowdown in China, a bear market in tech hardware and a correcting US equity market. A ceasefire in the US-China trade conflict is the upside risk. Our market picks in the region are Japan (inflation rising), China (valuation) and India (earnings).

Our outlook for the Czech equity market remains positive.

We adopt a bottom-up approach because the PX index consists of only 12 issues, with the five largest usually having a combined weight of almost 80%. Besides shares of Komercni banka and Stock Spirits, we actively cover (including SG) all of them. For valuing stocks that we do not cover, we use two approaches, i.e. the actual market price and the market consensus. **An average of these two estimates shows potential growth of around 25% over the one-year horizon** (see the table above) **with an estimated dividend yield of 5.0%.**

The sectoral composition of the PX index favours its growth during this year.

An attentive reader will surely argue that the Czech stock market should add a quarter of its value this year, while European equity indices should record a double-digit drop in some cases. With the exception of textile company PFNonwovens, we keep *Buy* recommendations for all of our covered titles. All four financial institutions have very high growth potential. Their weight in the PX index is 55%. Our sectoral recommendation for the financial sector is *Overweight*. We consider Avast shares, whose weight in the index is the fourth-highest (10.5%), to be fundamentally undervalued, and we still believe in our *Buy* recommendations.

The sectoral recommendation by Société Générale is *Neutral*. CEZ's share can be the most questionable, as SG keeps the *Underweight* recommendation for the utility sector. We have taken this sectoral recommendation into account in our latest analysis by discounting our fair value. We still see significant potential for growth due to favourable electricity price developments. Therefore, this stock should also contribute significantly to overall growth of the PX index. Erste Group's shares should be the biggest contributor as our SG's colleagues keep the target price of €48, representing potential growth of 60% in comparison with the current market price. Owing to Erste's high weight in the PX index, the contribution should be more than 10pp of the anticipated quarter growth of the index. We have to admit that 60% growth is really enormous and probably hard to meet in the horizon of this year. **However, we believe that the PX index is able to surpass the development of West European competitors and achieve double-digit growth.**

The announced corporate events in the coming months

Date	Company	Event
29 January	O2 Czech Republic	Company results for 4Q18
6 February	Moneta Money Bank	Company results for 4Q18
7 February	Komerční banka	Company results for 4Q18
14 February	Stock Spirits Group	Annual General Meeting
28 February	Erste Group	Company results for 4Q18
13 March	Avast	Company results for 2018
21 March	Vienna Insurance Group	Company results for 2018
25 March	Kofola ČeskoSlovensko	Company results for 4Q18

Source: Bloomberg, companies

Foreign markets

S&P 500 (USA)

Source: Bloomberg

Stoxx 600 (Europe)

Source: Bloomberg

Nikkei 225 (Japan)

Source: Bloomberg

MSCI China (China)

Source: Bloomberg

WIG 20 (Poland)

Source: Bloomberg

BUX (Hungary)

Source: Bloomberg

Trade war creates opportunities

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The trade war that accompanied us in 2018 and had a major influence on the development of global stock markets, has its origins in the 1980s. At the time as a successful businessman, Donald Trump criticized Japan and other countries for using the United States trade policy to enrich them. In 2016, during his presidential campaign, Trump repeatedly endorced proposals to renegotioate agreements concluded by the United States with other countries. Last year, the whole process of real actions began.

Stock indices development in 2018

Source: Economic & Strategy Research, Komerční banka, Bloomberg

The Chinese stock market lost over 25% of its value in 2018.

The chart above shows the performance of stock indices of certain countries that are the main participants of changing the trade policy of the United States. Despite very good macroeconomic condititons and expectations of growth of revenues and rentability of companies, the year 2018 wasn't very successul for stock markets. The US index S&P 500 ended the turbulent year with the least amount of harm, as it dropped 7% in value. The European and Japanese stock markets were hit harder. The losses were between 12% and 13%. The worst the situation was for China. Its CSI 300 stock index lost more than 25%. The reason for this plummet was that Trump focused mainly on China in his efforts to change the trade policy. Other countries are affected too, but not with such an impact as China.

Tension grows

The current situation regarding trade policy of the United States started in January 2018, when the first real actions occured. At the time, Trump introduced 30% import tariffs on solar panels, out of which the majority comes from China, and 20% tariffs on washing machines. After a one-month pause a second wave of tariffs came in March, 25% on steel and 10% on aluminium. A temporary exception for these tariffs, until the end of May, was provided to the most important trade partners of the US, i.e. the European Union, South Korea, Canada and Mexico. A permanent excemption was given to South Korea, Argentina, Australia and Brazil. The European Union threatened it would impose tariffs on selected US goods like bourbon, jeans or Harley-Davidson motorcycles. Trump promptly replied that the US would impose import tariffs on automobiles from the EU.

In April 2018, there was a massive escalation of tensions in trade policy between the United States and China.

In April, China responded as it was hit the most by the tariffs. China created a list of 120 American products (e.g. fruits, nuts, wine or steel pipes), for which they imposed 15% import tariffs and 25% tariffs on pork and aluminium. Trump's administration reposnded quickly with

a threat of imposing import tariffs on select Chinese goods (e.g. televisions, medical devices and batteries) in a total amount of $50bn. China prepared a list of American goods (e.g. soybeans, chemicals and cars) in the same amount of $50bn in retaliation. Trump responded with another threat that he would increase the amount of affected Chinese goods by another $100bn. The whole escalation of tariffs lasted only four days.

After a calm May, there was a stormy June full of threats and an escalation of tensions.

In May, there was a short period of fragile peace. It seemed the US and China would come to a deal on mutual cooperation. China agreed on increased purchases of American products and services. The US, on the other hand, was ready to postpone or even cancel the imposition of import tariffs on Chinese goods in the total amount of $150bn. In mid-June, the US announced new tariffs on Chinese goods in a total amount of $34bn effective July 6, and at the same time the US suggested another list of Chinese goods in the amount of $16bn. In a reaction, China prepared a list of goods in the amount of $50bn on which it was ready to impose tariffs. Trump retaliated with the threat to impose 10% tariffs on Chinese goods in the amount of $200bn. In the second half of June, the European Union imposed import tariffs on select American goods (e.g. motorcycles and bourbons) in the amount of more than $2bn. Trump threatened immediately to impose 20% import tariffs on European cars.

The trade war begins!

The trade war between the United States and China began during the summer holidays.

As the United States announced in June, **on July 6 they imposed the first wave of 25% tariffs** on Chinese goods in the amount of $34bn. China immediately retaliated with tariffs on American goods in the same scale. **July 6 is officially the beginning of the trade war between the United States and China.** Only a few days later, the US administration published a list of 6,000 Chinese goods in the amount of $200bn on which it was ready to impose a 10% tariffs. Subsequently, there was a period till mid-August when both countries were revising their lists of goods in the amount of $16bn. **The second wave of mutual 25% tariffs came into action on August 23.** At this point, there were valid tariffs in a total amount of $50bn on both sides.

At the beginning of September, the United States revised the list of Chinese goods in the amount of $200bn. In response, China created a list of American goods in the amount of $60bn. Chief economic adviser of the White House Larry Kudlow announced on September 12 that he invited China to meet and discuss a trade agreement before the new tariffs on $200bn of goods would be introduced. A few days later, the United States have finalised their list of goods in the amount of $200bn and they announced that the new 10% tariffs would be imposed since September 24. Trade talks between the two countries didn't take place as China withdrew from the meeting on September 22. **Two days later, a third wave of import tariffs occured: $200bn of Chinese goods and $60bn of American goods.**

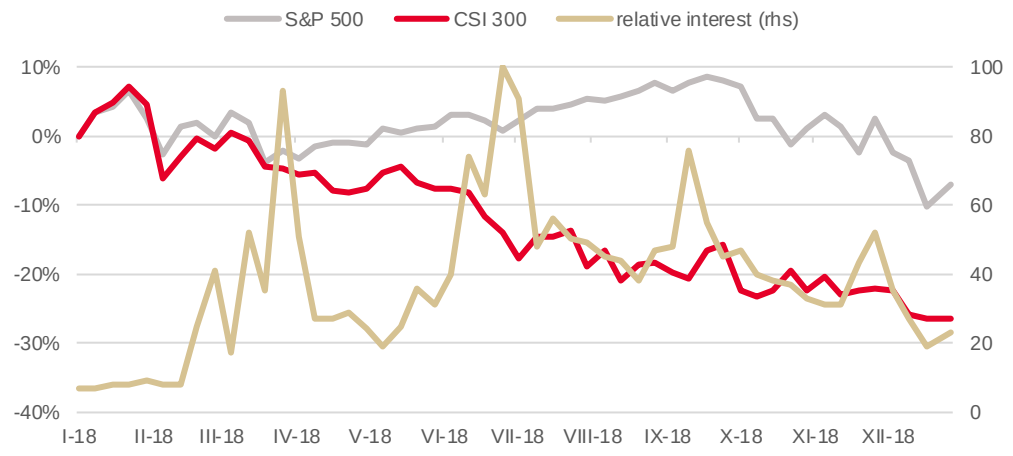
The break-through meeting at the G20 meeting was preceded by the threat of imposing tariffs on all Chinese goods in an aggregate value over $500bn.

After a month of relative calm, news emerged of an upcoming meeting at the November G20 summit between US President Donald Trump and his counterpart, the Chinese president Xi Jinping. Most likely, in order to strengthen Trump's negotiating position, he announced at the end of October the intention to impose tariffs on all remaining Chinese imports to the US worth more than $250bn starting in the first quarter of 2019. At the G20 summit, a breakthrough happened. Both presidents agreed on a 90-day peace period when they would not escalate the trade war. The main goal was to find a way to make a new trade deal that would end the trade war. Trump subsequently announced that if these efforts failed, the US would increase the current 10% tariffs to 25% on Chinese goods in the amount of $200bn.

At the beginning of 2019, there was a meeting of representatives of both countries. Between January 7 and 9, they discussed options for cooperation in the trade area. The meeting was in the centre of interest of investors as it was the first visible activity after almost 40 days of

peace. After the meeting, both China and the United States have only modestly commented on the outcome. No concrete conclusions were published until now. Both countries had highlighted the importance of cooperation, especially the Chinese representatives. Even due to this, we can assume that both countries intend to make a trade deal that will end the trade war.

Interest in trade war



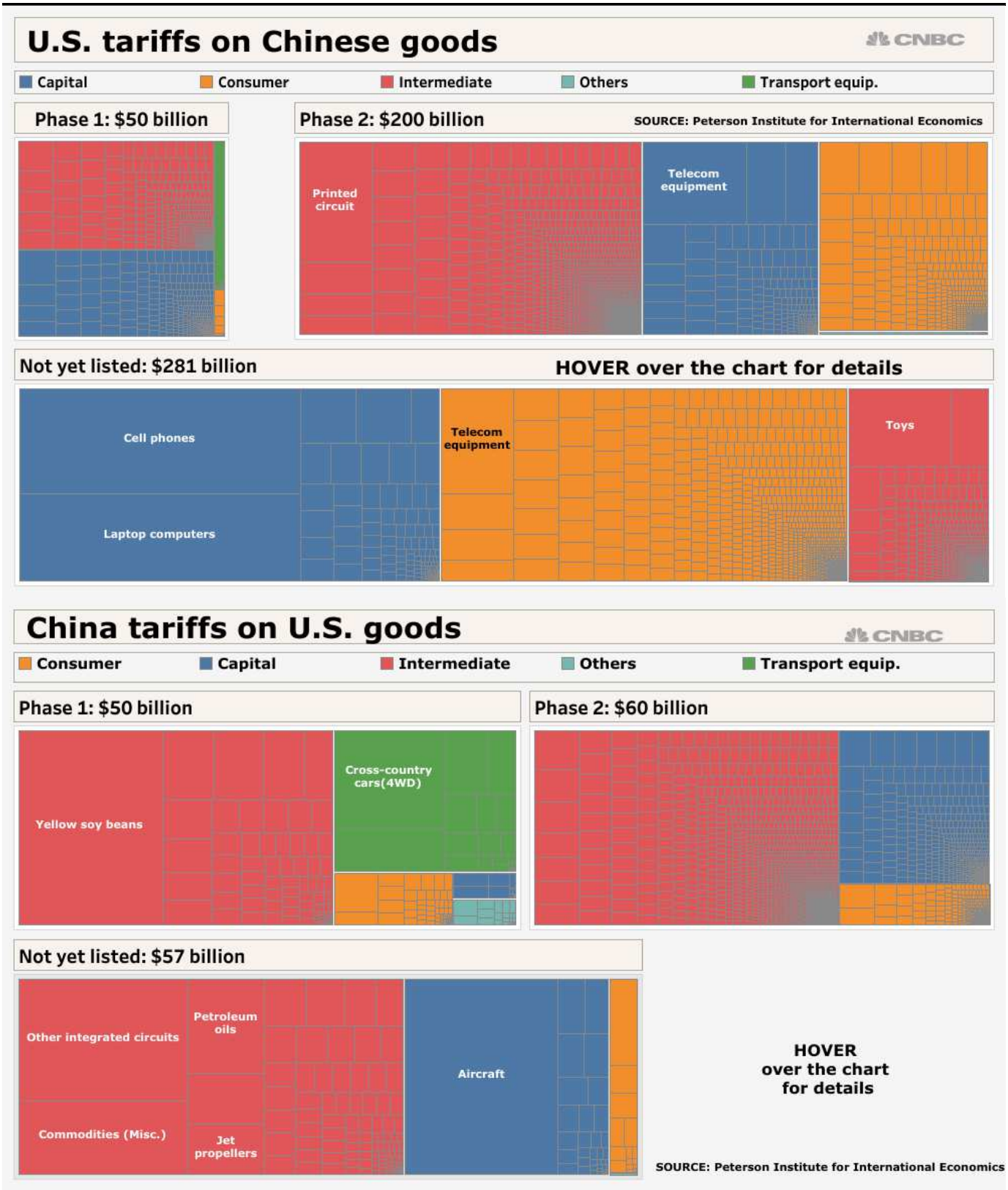
Source: Economic & Strategy Research, Komerční banka, Bloomberg, Google Trends

The chart above shows the relationship between the performace of equity indices of the United States and China and the relative interest in the trade war in Google searches. The value 100 on the right axis represents the highest popularity of "trade war" in Google searches. The value 50 means that the term "trade war" had half the popularity. It is clearly visible as all the spikes in the relative interest line correspond with events of the trade war.

The successful lobby of Apple helped protect Chinese mobile phones production against the tariffs.

The pictures on the following page show the structure of already imposed tariffs between the United States and China. Every single field represents a group of goods and its size represents the weight in certain tariff package. It concerns for hundreds of types of goods. The sum of phase 1, phase 2 and the not yet listed part comprise the whole production of each country that could be burdened with tariffs. As can be seen, the trade war didn't affect the exports of mobile phones from China. That is the outcome of Apple's successful lobbying, as almost all of its production takes place in China.

Structure of mutual tariffs between the United States and China



Source: CNBC[1]

[1] Source of the graphics is webpage: https://www.cnbc.com/2018/11/30/timeline-of-us-china-trade-war-as-trump-and-xi-meet-at-g-20-in-argentina.html

What to expect and how to win the trade war

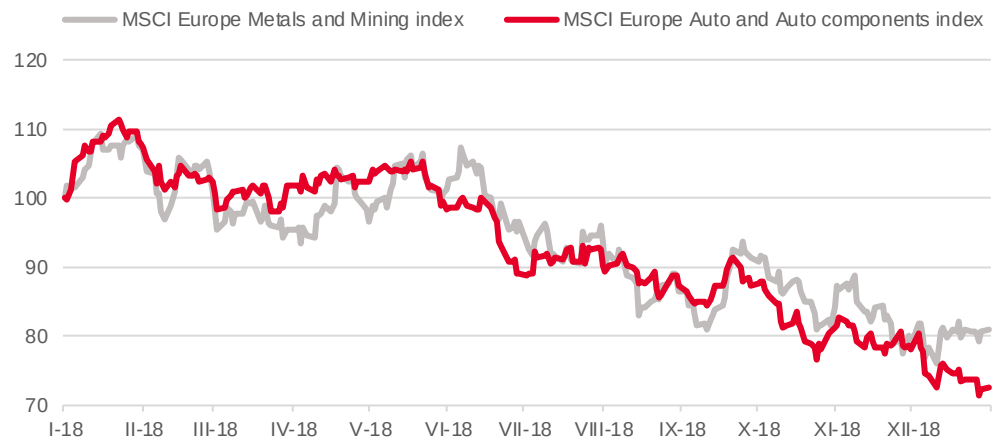
Despite the result of the last meeting between representatives of the United States and China, the trade war can continue. We consider this scenario unlikely. I fit fails, US President Donald Trump is ready to increase the already-imposed tariffs from 10% to 25% on goods in a total value of $200bn.

The car industry and steel producers are our preferred sectors with interesting potential for appreciation after the end of the trade war.

If the trade war between the United States and China ends, we can assume tensions with other countries will gradually decrease as othe separate bilateral trade deals are made. This applies specifically to the European Union, over which there is a threat of imposing import tariffs on cars. The car industry and steel production are the sectors most affected by the ongoing trade war. The stock price of these companies suffered considerably during 2018. Steel producers have difficult circumstances when exporting production to the United States: therefore they have lowered their expectations for financial results in many cases. European car producers and their suppliers have suffered due to investor fears over imposing import tariffs. This is exactly the way investors can profit from the end of the trade war: by choosing proper companies that have significant potential for appreciation. These are often strong and stable companies that lost value only in the short-term due to difficult external circumstances. As we expect the scenario in which the trade war ends and global tensions in the area of trade policy decrease, we see this as an interesting opportunity for investment. The chart below shows the performance of the two mentioned sectors in Europe in 2018. Both industries have lost between 19% and 28%, which is significantly more than the EuroStoxx 600 index itself. The car industry and steel producers are undervalued due to the trade war.

Commodity companies, carmakers and financial institutions belong among the preferred sectors.

Sectors hit by the trade war



Source: Economic & Strategy Research, Komerční banka, Bloomberg

Interesting investment opportunities

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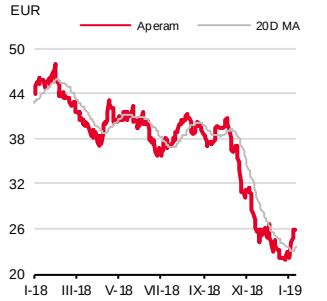
Above, we introduced sectors that might benefit from the anticipated end of the trade war. In this chapter, we would like to offer tips of specific stocks that we assign an attractive evaluation in the case of fulfillment of our scenario. Recommendations and target prices are based on a fundamental analysis by our colleagues from Société Générale. Among the titles we would like to recommend is also the car producer Daimler and diversified natural resource company Glencore. We introduced these companies in our last Equity outlook, published on 26 July 2018. You can download the whole report on http://bit.ly/EQ_H218eng.

Aperam (Buy, 12m target price = €46.7, exp. return = 84.5%)[2]

Aperam stock price

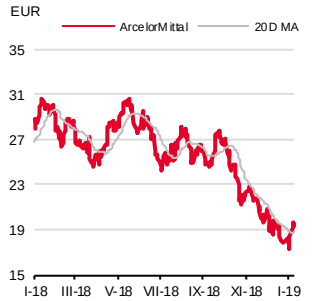


Source: Bloomberg

Aperam is a Luxembourg-based company that manufactures specialty steel and nickel alloys. Revenues in 2017 amounted to almost €4.5bn and net profit of €320m. For the whole year 2018 the market expects revenues in the amount of €4.7bn and net profit of €340m. The company's broad range of products serves customers in industries like automotive, construction, medicine or aerospace. Aperam operates six plants located in France, Belgium and Brazil. Created in 2011, Aperam is a spinoff of ArcelorMittal. The company reports three major segments. Its main segment, Stainless & electrical steel, accounts for 80% of company revenue. The other two segments are Services & solutions and Alloys & specialities. Approximately 75% of sales comes from developed markets, primarily Europe. The last reported financial results were from the third quarter of 2018, when the company exceeded market expectations of net profit. Net profit reached €72m, i.e. 20% more than was expected. However, revenues decreased almost 10% to €1.1bn yoy. According to the last analysis of Société Générale published on 1 November, approximately 30% of steel production is burdened by 25% tariffs. Should the trade war end and tariffs be cancelled, it would represent a huge impact on the financials of the company. SG has a *Buy* recommendation for Aperam stocks with a target price of €46.7 per share.

ArcelorMittal (Buy, 12m target price = €44.4, exp. return = 132.9%)[3]

ArcelorMittal stock price



Source: Bloomberg

ArcelorMittal is another Luxembourg-based company primarily involved in steel production. The company is the largest steel-making entity in the world, producing more than 90 million metric tons of crude steel annually, about 6% of the world steel output. ArcelorMittal operates in more than 60 countries and manufactures the full range of steel products: slabs and coils, coated steel, tinplate or wire rod. The company also has 15 mining operations and is one of the world's largest iron-ore producers. In 18 countries the company has over 50 steel-making facilities. CEO and founder Lakshmi Mittal controls about 39% of ArcelorMittal. ArcelorMittal reports five reportable segments: NAFTA (North America), Europe, Brazil, Africa and Mining. Europe is ArcelorMittal's leading segment, bringing in almost half of company revenue. Second place belongs to NAFTA, which represents approximately 25% share of revenue. In 2017, ArcelorMittal reached almost $69bn in revenues out of which it generated $4.6bn of net profit. For 2018, the market expects total revenues in the amount of $77bn and net profit of $5.1bn. The last published financial results as of the third quarter of 2018 didn't please investors, who had great expectations. However, revenues grew 6% to $18.5bn yoy (the market expected growth to $19.6bn). SG has a *Buy* recommendation for ArcelorMittal stocks with a target price of €44.4 per share.

[2] Société Générale's analysis: " Aperam – Stronger market protection expected" published on 1 November 2018 at 7:27 a.m.

[3] Société Générale's analysis: " ArcelorMittal – 3Q18 results and management roadshow takeaways support constructive view" published on 3 November 2018 at 7:27 a.m.

Constellium (Buy, 12m target = $12.1, exp. return = 56.3%)[4]

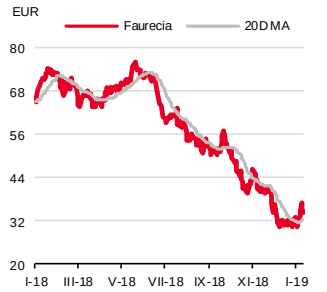
Constellium stock price

Source: Bloomberg

Constellium is a global manufacturer of aluminum rolled products, extruded products and components based on a wide range of advanced alloys. More than half of its revenues come from premium products with a high added value where the company holds the first or second position in the market. The company does not deal with mining, refining or melting itself, which can flexibly respond to structural changes in the demand for aluminum from the automotive and aerospace segment. Beyond these industries, it also operates in the field of packaging. Major clients include Mercedes-Benz, Audi, BMW, Fiat Chrysler Automotive, Ford, Airbus, Boeing and Bombardier. Its headquarters are in Amsterdam, the Netherlands, employing about 12,000 people and manufacturing at 24 plants. One of the lines is also located in the Czech Republic in Děčín. Société Générale, despite the reduced target price at the end of October, has increased its recommendation to *Buy*. The reason was higher net debt, which offset an increase in EBITDA estimates. Société Générale expects solid cash flow generation that could lead to dividend payments starting with this year's net profit and amounting to 33% of the generated free cash flow, which would represent about 4% yield.

Faurecia (Buy, 12m target = €60, exp. return = 71.0 %)[5]

Faurecia stock price



Source: Bloomberg

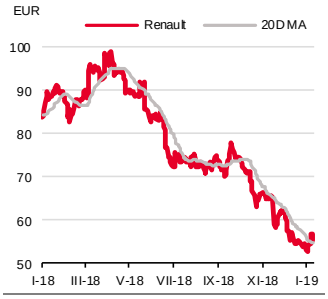
Faurecia is one of the world's leading suppliers of various automotive components based in Nanterre, France. Every third car in the world is equipped with parts and components of this company. It is a leading supplier of seats, exhaust systems, internal systems such as dashboards, center consoles, door panels and acoustic modules, and decorative elements made of aluminum and wood. Faurecia's customers include Volkswagen, PSA Peugeot Citroën, Renault-Nissan, Ford, General Motors, BMW, Daimler, Fiat Chrysler, Toyota, Hyundai-Kia and BYD. Faurecia employs about 109,000 people. The company operates approximately at 300 manufacturing plants and in 30 R&D centres in 35 countries around the world. Approximately half of these production lines operate on a just-in-time basis. The company also does business in the Czech Republic, where it operates seven plants in Písek, Plzeň, Pardubice, Bakov nad Jizerou and Mladá Boleslav. The results for 3Q18 slightly exceeded expectations. What is important is that the company performed much better than its competitors, and the management was able to confirm its full-year guidance. Nevertheless, especially considering the circumstances of negotiations of the US-China trade agreement and the stricter emissions limits with a negative impact on some carmakers, SG has cut the target price from €70 to €60 per piece. The stock offers a decent dividend yield of 3.5%. Société Générale holds a Buy recommendation despite the reduced target price.

[4] Société Générale's analysis: Constellium – Riding the slowdown published on 30 October 2018 at 8:40 am

[5] Société Générale's analysis: Faurecia – Still outperforming a challenging environment published on 12 October 2018 at 6:56 am

Renault (Buy, 12m target = €87, exp. return = 54.9 %)[6]

Renault stock price

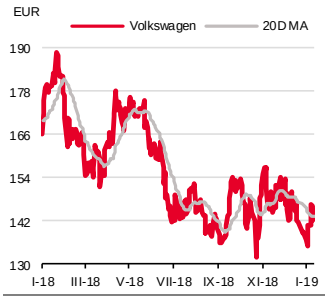


Source: Bloomberg

Renault belongs among the most famous French car producers. It employs 181,000 people worldwide. Renault operates a full range of activities: design, manufacturing, marketing, vehicle repairs and financial services for financing its new and used passenger cars and light commercial vehicles. The company manufactures small to midsize cars and light trucks under three brands: Renault, Dacia and Renault Samsung Motors (Renault holds 80%, Samsung 20%). The company owns Automobile Dacia (Romania's leading automaker) and holds just under half of the Renault-Nissan Alliance. It also participates in an alliance with Russian car maker AvtoVAZ and helps Germany's Daimler build smart cars. Renault has an international presence and operates some 40 manufacturing facilities in more than 15 countries and sells in 120 nations. The company generates 95% of revenues from automotive activities. The remaining 5% comes from sales financing. Renault's native France is the company's largest single market and accounts for around 22% of revenues. Europe excluding France accounts for around 36%. In 2017, Renault generated €58.7bn in revenues, out of which it made €5.1bn of net profit. The year 2018 should represent a stagnation for revenues. Renault offers an attractive dividend yield of more than 6% in comparison with its current market price. Société Générale has a *Buy* recommendation for Renault stocks with a target price of €87 per share.

Volkswagen (Buy, 12m target price = €208, exp. return = 43.1%)[7]

Volkswagen stock price



Source: Bloomberg

VW Group is one of the world's leading automobile manufacturers and the largest automaker in Europe. In 2017, the VW group delivered 10.74 million vehicles to customers; last year, it was almost 100,000 more. The group has so far booked €25.8bn of provisons relating to the diesel cheating scandal, with the bulk of the cash out occurring in FY17 and FY18. The group is made up of 12 brands, from the cheapest entry-level cars (Up! range) to the most rarefied super-luxury Bentley, Lamborghini and Bugatti sports cars, and a wide range of commercial vehicles through its Scania and MAN subsidiaries. The group is planning an IPO for its VW Traton Truck & Bus division this year, when the management said last year that cost synergies between freight and passenger cars are only on the order of some inputs and that the split of the division makes economic sense. Maybe it is also one of the company's long-term strategies; VW's CEO, Herbert Diess, said in October that if German car manufacturers want to survive as leading carmakers, radical changes are needed. In this context, the IPO of a partial stake in Porsche is also mentioned. Colleagues hold Volkswagen shares on their Premium List of the most preferred shares with a *Buy* recommendation and a target price of €208. At the same time, SG believes the emissions scandal is gradually eroding and that investors will once again focus on the value of the company as such.

[6] Société Générale's analysis: " Renault – Going through a tough quarter" published on 24 October 2018 at 7:47 a.m.

[7] Société Générale's analysis: Volkswagen – Bringing VW's deep value to the fore published on 1 November 2018 at 10:01 am

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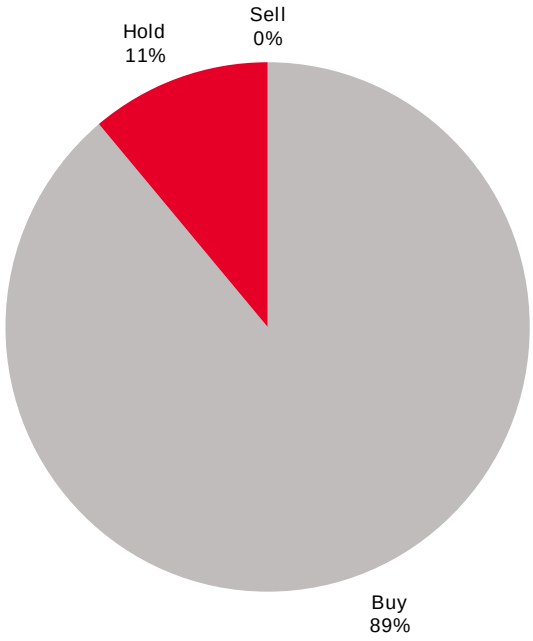
The chart below shows the structure of grades of valid investment recommendations of equity research of KB Economic & Strategy Research (9 recommendations).

Investment recommendations of KB equity research



Source: Economic & Strategy Research, Komerční banka

KB Equity Research ratings on a 12 month period

BUY: absolute total shareholder return forecast of 15% or more over a 12 month period.

HOLD: absolute total shareholder return forecast between 0% and +15% over a 12 month period.

SELL: absolute total shareholder return forecast below 0% over a 12 month period.

Total shareholder return means forecast share price appreciation plus all forecast cash dividend income, including income from special dividends, paid during the 12 month period. Ratings are determined by the ranges described above at the time of the initiation of coverage or a change in rating (subject to limited management discretion). At other times, ratings may fall outside of these ranges because of market price movements and/or other short term volatility or trading patterns. Such interim deviations from specified ranges will be permitted but will become subject to review by research management.

Overview of recommendations published by KB and relationships with particular issuers

	Avast	CME	CEZ	Fortuna	Kofola	MONETA Money Bank	O2 CR	PFNon-wovens	Philip Morris CR	Vienna Insurance
Overview of last investment research and recommendations related to stocks of particular issuers										
Recommendation	Buy	Buy	Buy	End of	Buy	Buy	Buy	Hold	Buy	Buy
Target price	GBp 342	USD 5	CZK 620	coverage	CZK 484	CZK 93	CZK 298	CZK 924	CZK 17546	EUR 27
Date	15.6.2018	27.7.2017	11.6.2018	9.5.2018	26.9.2018	6.3.2018	12.12.2018	26.10.2018	22.8.2017	11.9.2018
Price on the day of the publication	GBp 214	USD 4.3	CZK 557	CZK 206	CZK 282	CZK 84.4	CZK 239	CZK 888	CZK 15500	EUR 23.2
Investment horizon	12 months	12 months	12 months	12 months	12 months	12 months	12 months	12 months	12 months	12 months
Author	J. Kostka	J. Kostka	M. Frayer	J. Kostka	J. Kostka	M. Frayer	M. Frayer	M. Frayer	J. Kostka	M. Frayer
Overview of investment researches and recommendations for last 12M (quarterly)										
Recommendation		Buy	Buy	Sell		Buy	Hold	In revision	Hold	Buy
Target Price		USD 4.2	CZK 542	CZK 198		CZK 90	CZK 270	In revision	CZK 13500	EUR 26
Date		27.4.2017	20.9.2017	4.1.2018		17.8.2017	18.9.2017	17.5.2018	25.5.2017	3.3.2017
Recommendation		Buy	Hold	Buy		Buy	Hold	Sell	Buy	
Target Price		USD 3.7	CZK 44	CZK 198		CZK 95	CZK 267	CZK 876	CZK 13500	
Date		10.3.2017	14.9.2016	30.11.2017		9.6.2017	31.1.2017	13.9.2017	13.6.2016	
Recommendation			Buy	In revision		Buy	Buy	Sell		
Target Price			CZK 420	In revision		CZK 90	CZK 267	CZK 876		
Date			12.2.2016	9.11.2017		6.9.2016	9.12.2016	13.9.2017		
Recommendation				Hold			Hold	Hold		
Target Price				CZK 128			CZK 260	CZK 876		
Date				12.6.2017			22.3.2016	19.4.2017		
Valuation methods	DFCF	DFCF	DFCF	DFCF	DFCF	DFCF DDM ERM	DFCF DDM	DFCF	DDM	DDM ERM
Frequency of rec. (per year)	twice	twice	twice	twice	twice	twice	twice	twice	twice	twice
Direct or indirect share (5% or more) of the issuer of the registered capital of KB	no	no	no	no	no	no	no	no	no	no
Other significant financial interest of KB and/or its linked persons in the issuer	no	no	no	no	no	no	no	no	no	no
KB direct or indirect share (0.5% or more) of the registered capital of the issuer.	no	no	no	no	no	no	no	no	no	no
Author's direct or indirect share (0.5% or more) of the registered capital of the issuer.	no	no	no	no	no	no	no	no	no	no
Signific. fin. interest in the issuer of the persons partic. in elaboration of inv. research and rec.	no	no	no	no	no	no*	no	no	no	no
Relationships of Komerční banka with particular issuers										
KB Management or co-management of public offerings in the past 12 month	no	no	no	no	no	no	no	no	no	no
Agreements or contractual relations for providing investment services with the issuer	KB can have concluded agreements with the issuer for providing investment services. This information is protected by bank secret and could not be disclosed.									
Agreement with the issuer on production and dissemination of the research	no	no	no	no	no	no	no	no	no	no
KB market making for common stocks of the issuer	no	no	no	no	no	no	no	no	no	no

Note: DFCF – Discounted free cash flow model, DDM – Discounted dividend model, ERM – Excess return model
* The author of the investment recommendation owns 635 shares of the issuer Moneta Money Bank. The author is not entitled to acquire any further shares of any issuer listed here.
Source: Economic & Strategy Research, Komerční banka

We do not include our one-off short-term recommendations based on Société Générale's analyses to this overview.

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