



### How do I see matters?

Most American companies reported great results last year. The average year-on-year growth in profits was 28% against 2002. So why are the markets not continuing in this form? Last year's bull market was driven by the expected resurgence. What will drive stock in 2004? Expectations again? And if so, expectations of what? Well, they may not be so optimistic but they are not terribly pessimistic.

In order for stock to record a significant growth, companies would have to announce better results than expected or at least be more upbeat in their prognosis for the immediate future. And they are not doing this. For instance Cisco, the technology giant, reported better than expected profits, but accompanied them with a cautious commentary. Shares fell by 9%. Intel had a similar experience.

In the nineties investors were used to companies exceeding expectations which they had set at a low level in their commentaries. The pleasant surprise (on the day results were announced) provoked a growth in the price of stock. Old habits die hard, and now expectations are higher than the anticipated profits which make for success. Moreover, the current price of stock is, given the profitability of companies, relatively high. In my opinion the PE ratio of American shares is not markedly below average, and so the market is not in any mood to tolerate the mere fulfilment of expectations or even disappointment.

It is possible that expectations will have to uncouple from underlying causes (growth underpinned by a company's profitability) and depend on different reasons (growth supported by the flow of new resources onto the market). For all concerned it would be better if growth were backed up by strong fundamentals, i.e. if growth were smaller but stronger. If I may, I'll take the liberty of closing with a comment on investor tactics. It should already be clear. It would be the same mistake to avoid stock as to gamble everything on stock. I would recommend finding other types of assets, such as company bonds, etc. A diversified portfolio is a must.

Petr Šimčák



## HOW WILL THE YEAR 2004 SHAPE UP?

**We can now look back on 2003 as a year of renewal and resurgence. The global economy got its act together and after suffering three consecutive years of losses stock investors finally got their reward. What is in store for 2004? In our opinion the outlook is reasonably optimistic.**

The key drivers of the stock markets include positive economic indicators, the improved profitability of companies, and demand on the side of the investors, who have so far remained cowering behind the harbour walls not daring to venture onto the open seas.

The global economic revival has been confirmed, business trust is high, and company cash flow has improved considerably. Economic growth in the USA will probably not continue as forcefully as last year. However, the USA will clearly remain the driver of the world economy and its growth is good news for shares.

Economic growth also supports the profitability of companies, which is another stimulus for shares. The positive effect of a lowering of costs is already making itself felt, and companies have to push for a growth in revenues in order to boost their profits. Recently most companies have given their investors pleasant surprises, but when estimating the growth in revenues they are cautious. Moreover, even though growth in the investment activities of companies is clear, it is concentrated mainly on modernisation and not on expansion. For this reason we expect a moderate growth in share prices, and one that correlates closely to the speed of growth of company profits.

We believe that this year there will be a shift in the interest of investors toward companies with high quality profits (which was not the case last year) and companies with a good balance sheet and an attractive dividend. The potential of poorer companies is, in our opinion, already exhausted, since the



prices of their shares already take account of very optimistic expectations which it will be difficult to match. Stock markets offer reasonable value in absolute terms and are attractive even when set against other investments, such as government bonds and money-market instruments. Volatility is falling and will remain low given the reliable footings of the economic resurgence. The significant pickup in the sphere of mergers and acquisitions should also have a favourable effect. For these reasons we expect shares to out-perform bonds.

As far as allocation of assets is concerned, we prefer American stock, since we expect higher economic growth in the USA. Given the possibility of a further weakening of the dollar we are maintaining a cautious approach. As far as European stock goes we are applying a neutral allocation policy overall. The lower than anticipated growth on the local economies is already included in share prices, which might me-

an that European stock is ready to give us a pleasant surprise. In Japan we shall continue to adopt an under committed position. The Japanese market is not expensive, but there is the threat of deflation and the negative effect of the strengthening Yen on the economy is not going away. In contrast, Asia without Japan offers a combination of an attractive valuation and the potential for growth. We are fully committed in this region. We generally expect higher performance on developing markets than on advanced markets. One risk is currency fluctuations and a potential increase in interest rates. The collapse of the dollar would have a very destabilising effect on the global economy and business trust, as would an increase in interest rates. We are bearing in mind both risks but do not consider them a serious threat. The dollar shouldn't carrying on losing ground at the same rate as last year. Open communication on the part of the central banks vis-à-vis interest rates should serve to soothe nerves.

### FROM THE PIONEER INVESTMENTS WORLD

■ As of 31 January 2004 the Pioneer Investments groups managed EURO 121.2 billion, a growth of 1.7% on the

start of the year. The New Europe Division, to which both the Pioneer česká investiční společnost, a.s. and ŽB –

Trust, investiční společnost, a.s. both belong, at present manages more than EURO 2,636 billion.

## FONDSHOP ANALYSIS PART II

We publish the second part of the comparison of pension funds and mutual funds published in the prestigious magazine FondShop. The authors are Petr Šimčák and Milan Šmíd.

Note: The information is based on tables published in the latest issue.

As calculations show, in the case of savings of CZK 500 a month which are drawn down in one go the results do not dramatically differ, even though investing in a mutual fund is somewhat more profitable in terms of the specified parameters. In the case of **higher** sums being saved the difference between the valuation of pensions funds and that of mutual funds is **considerably** in favour of the latter. If we then increase the anticipated average annual rate of growth in the market from 6% to 8%, savings in mutual funds fare even better. With savings of CZK 500, the sum saved after thirty years in a mutual fund allowing for growth of 6% would be some CZK 19,000 higher than in a pension fund, but this figure leaps to CZK 50,000 if 8% market growth is factored in. This difference is even more dramatic if CZK 1,500 is being put aside per month: the figure this time is some CZK 200,000.

Also confirmed is the thesis that the invisible hand of the market leads pension funds to transform all advantages to their benefit, the overall effect being very similar to what it would have been had investors decided to invest in mutual funds. Massive advertising campaigns thrusting home state support and the tax benefits of saving in a pension fund must cost something: in fact we can say that it costs precisely the same as the advantages enjoyed, and yet there is still enough left over for the manager of the pension fund. Without the support of the state the same invisible hand would continue to operate to the benefit of pensioners. But people saving for their pension do not know this, because they are massaged by advertising and also because it is difficult to realise that you do not necessarily have to use pension funds to improve your pension (though with state support so high ...).

#### ■ Gradual drawing down of the pension

How do things look in the case of the gradual drawing down of the pension after a person reaches the age of 60? Calculations show that with savings of CZK 500 a month with 6% annual growth, we could draw down a life pension of CZK 2,412. If we wanted to draw down the same amount gradually from resources saved in a mutual fund, the money saved would last us until we turned eighty two. How is it



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possible that pension funds are above to pay out these pensions for life without regard for whether we die on reaching fifty years or one hundred years? The calculation of a life pension is based on the mathematics of insurance, which works with relative life expectancy figures, and the fact that a certain number of people will die before they reach seventy, another percent of people will die by the age of eighty, and so on. The resources which would have been paid to those who have died serve to finance the pensions of those who are still living. This is the difference between drawing down your pension from a pension fund and drawing it down from an open-end unit trust. Pension funds actually create a kind of **communal cake** out of which all pensioners gradually take their bites, whereas a mutual fund apportions each investor his or her **own cake**. This means that survivors do not have a right to the remainder of the unpaid pension from the pension fund. The remainder in the mutual fund enters the inheritance proceedings.

**Is there a variant by which a pension fund would be more advantageous than a mutual fund? Yes. If you start saving CZK 500 monthly when you only have five years left before retirement. This maximises the effect of state support when converted into a percentage return. The absolute sums are negligible, which simply serves to confirm the perversity of the present system – support savings only when it has become too late.**

#### ■ So what does this mean?

Looked at cynically, if you believe that you will die before you are eighty two, it is better to choose to save in a mutual fund, since the assets remaining in the trust will go to your heirs. And if you want the security of knowing you can draw down your pension no matter how old you live to be, it is better to put your savings in a pension fund and then **not to collect your pension in one go, but gradually**. This applies to savings of CZK 500 per month.

How do things look in the case of savings of CZK 1,500 per month? All things being equal, a pension fund would pay a life pension of CZK 6,124 monthly. A pensioner could draw down this sum from a mutual fund until they were ninety three, before the money dried up. From this it ensues that if we wanted to calculate the maximum possible amount which could be withdrawn every month from the resources saved in a mutual fund from the age of sixty to ninety, then logically this sum would come to more than the pension paid out by a pension fund. In fact the figure would be CZK 6,379. The question we have to answer for ourselves is: is it worth two hundred a month for me to avoid the "risk" of living longer than to the age of ninety and not being able to draw down a pension?

#### ■ Important advice

From the calculations above several important facts ensue.

● If you are planning simply to save and then at the end to collect on your resources, it is best to forget state support and the possible tax relief linked with saving in a pension fund, because a pension fund will eat these premiums up in its operating costs. It is better to choose a mutual fund which, given lower costs and zero tax, will earn the investor more in the end, though it goes without saying that you must avoid the expensive options when choosing the specific fund! It is also worth looking at how the situation would change if tax on the revenues of a pension fund were to be cancelled in the event of a one-off drawing down of the resources at the end of the savings period, which is something which might happen. Given savings of CZK 500 per month and 6% growth in the markets,

the advantage of a pension fund would be of only minor significance and this advantage would be lost entirely in the event of higher growth on the markets. We are again at the balance point of both variants. In the case of savings of CZK 1,500 the mutual fund is more advantageous, even allowing for zero end tax in the case of pension funds.

● If the future pensioner wants the security of a genuinely lifetime pension drawn down gradually, pension funds are more advantageous, even were they to die at the age of hundred and three. But if we use average life expectancy, which in the case of men is 72, and fix the drawing down of a pension

**The calculations for the drawing down of a pension apply only to men. Women live longer, and so the amounts they draw down from a pension fund are lower.**

from a unit trust for a horizon of between sixty to seventy two years of age, the same pensioner could draw down a monthly pension some CZK 1,200 higher from a unit trust than a pension fund, given the same savings of CZK 500 a month, and as much as CZK 5,000 higher in the case of savings of CZK 1,500. The longer the pensioner lives, the more the advantages of drawing down a pension from a unit trust decrease to the point where a pension fund is more advantageous.

#### ■ Mutual fund or pension fund?

Mutual funds might not have state support, but investments are not as subservient to them as in the case of pension funds, where premature collection is penalised. The resources of a trust fund can be realised anytime. Another advantage is that the investor can adapt his strategy to his preferences over the course of time. A young person can begin saving in stocks and in time shift over to bonds. The cushions for investing in pension funds are getting softer with an amendment to the law, but they will still stifle investment strategy. It is clear that the advantages of saving in a pension fund against a mutual fund depend on several variables which we have specified in this text, but generally we can conclude by saying that if we live to the age of eighty four, which some fifth of men do, there is no clear winner.

Milan Šmíd, Petr Šimčák

Source: Authors provided calculated figures from official's data.

## CURRENCY AND YOUR INVESTMENTS

Every day we are prey to the changing strengths and weaknesses of currencies. We tolerate them and become reconciled to them. There is not a sufficient choice of stock on the koruna market and it is therefore necessary to invest in foreign currencies. And such investments are obviously exposed to currency risk. This brings both danger and opportunities. Currency risk can significantly impact on valuation and for this reason it is a good thing to get acquainted with it. If certain advantages seem to you to be complex, make no mistake, that's because they are. However, it is not necessary to know the ins and outs of all the subtleties, but at least to know what it's about. We will begin with what is important and what is not.

### ■ What is not important?

Each mutual fund announces the rates of its shares in a certain currency (the so-called denomination of the fund). Many investors mistakenly believe that if the fund in which they have invested is denominated, for instance, in koruna, that a growth in the rate of the koruna will not have a negative impact on the development of their investments. In short, they believe that they hold assets in koruna.

Not true. If the fund is denominated in koruna, but its investments are concentrated on stock in Europe or the USA, you do not hold koruna, but dollars, euros, etc. And how does currency risk manifest itself in a fund denominated in koruna? A strengthening koruna will lead to a lowering of the rate of a fund denominated in koruna while the price of shares contained in the fund may not change at all vis-à-vis their local currency. It is therefore decisive to focus on investments and not on the currency in which the fund rate is calculated and for which the fund buys and sells.

### ■ What is important?

You can defend yourself against currency risk on the level of the fund. The fund manager can relieve you of currency risk by hedging. For instance, certain of the funds of the Živnobanka family are fully hedged. This means that Živnobank holds American and European stock but eliminates inevitable currency-related movement linked

with this using currency derivatives. Although the fund owns non-koruna securities, the fluctuations of the koruna against other currencies will not impact directly on its rate. The reason being that someone else is prepared to accept this risk on derivative markets. Why? Because hedging is not always positive. If the koruna weakens, it is an advantage to be exposed to currency risk and to make a profit by holding foreign currency stock. However, in the case of conservative investments especially, this risk is undesirable.

But not even by hedging against currency risk can the fund manager entirely get rid of the risk. For this reason the fund frequently invests in the shares of companies doing business on a global scale. An American company (quoted in USD on the bourse) may have many of its assets and liabilities tied up outside of the dollar market. A weakening or strengthening dollar will then impact on its profitability. If it does business in Europe and the dollar weakens, the profits of the company as expressed in USD will grow thanks to this weakening. And when profits grow the price of the shares increase – in dollars. So the investor with the euro or koruna as their reference currency will suffer by holding stock in this company and at the same time profit since the price of the stock will rise precisely because of the weakened dollar. If the price of shares rises by more than the rate at which the dollar drops, this has a positive effect for the non-dollar investor.

The company can also hedge using currency derivatives, in which case the price of stock would not grow because of the weakened USD. In the case of a weak dollar the ideal situation is when a company doing business in European has not hedged itself against currency risk, while the portfolio manager of the fund holding shares in this company has. This way the manager retains all the advantages for himself. As you may yourself be feeling, however, there are very many possible combinations and it is not easy to pin down currency risk. This somewhat complex example shows what mistakes can be made by someone with a simplistic view on the matter.

### ■ Prior to the introduction of the euro

Given the planned introduction of the euro, a Czech or Slovak investor is in an atypical and unenviable situation. It is risky to hold onto koruna and risky to offload them! The reason being that in the future the koruna will be converted into the euro at a certain rate (which is not known at present). It is normal to hold domestic currency and not to make changes to the currency risk or not to hold domestic currency and to change the currency risk. Investors whose currency disappears are exposed to currency risk whatever they do. So what is the best way to deal with this situation?

### ■ Concluding recommendation

Let's say that our referential currency is the koruna. Sometime in 2010 the

euro is introduced at a rate which we do not know at present. Interest rates in CZK and EURO are practically identical and in this respect the euro almost exists already in this country.

Generally it applies that it is suitable to hold short-term investments conservatively, i.e. on the money markets and in government bonds. It is important to eliminate all currency risks, including currency related, provoked by fluctuations in value.

We recommend holding these securities in the local currency, i.e. in koruna, up until the introduction of the euro. The investor who wants to pursue a conservative investment policy all the way to 2010 should transfer part of their resources to the euro. This is the simplest way of reducing the currency risk.

A long-term, higher-risk investment policy concentrating on stocks should be distributed globally, i.e. to dollar, euro, sterling and other currencies.

**A multi-currency portfolio put together in accordance with the rules above must be compiled for each investor on an individual basis by an advisor who knows the needs of each investor. It is difficult to get rid of currency risk totally, but when all is said and done, maybe it is not necessary to. Even within the context of currencies the healthy principle applies: DIVERSIFY.** dš

## TOP products of Pioneer Funds Peers and Fund's Rating

(13. 2. 2004)

Sub-fund	date of Inception	NAV	(This overview is published monthly according to actual data.)												Rating (31. 1. 04)		
			3 months*		6 months*		1 Year*		2 Years*		3 Years*		Since Inception*		Mornigstar Rating	S&P Star Rating	S&P Fund Management Rating
			The place of the fund/ number of funds	Quartil	The place of the fund/ number of funds	Quartil	The place of the fund/ number of funds	Quartil	The place of the fund/ number of funds	Quartil	The place of the fund/ number of funds	Quartil	The place of the fund/ number of funds	Quartil			
PF Top Top European Players	07.07.00	1047,87	95 / 232	2	107 / 228	2	124 / 220	3	19 / 198	1	9 / 179	1	8 / 161	1	*****	*****	A
PF U.S. Small Companies	05.10.01	60,98	2 / 35	1	4 / 35	1	12 / 35	2	5 / 33	1			8 / 33	1	****	-	-
PF U.S. Mid Cap Value	05.10.01	125,72	35 / 175	1	16 / 171	1	13 / 168	1	6 / 142	1			6 / 133	1	****	-	AA
PF U.S. Value	05.10.01	104,45	40 / 175	1	60 / 171	2	47 / 168	2	25 / 142	1			39 / 133	2	*****	-	-
PF Global Telecoms	07.07.00	116,93	13 / 116	1	93 / 116	4	107 / 114	4	21 / 110	1	21 / 103	1	9 / 87	1	****	***	-
PF Pioneer Mix 2	05.11.99	773,06	26 / 101	2	31 / 101	2	52 / 96	3	36 / 84	2	20 / 73	2	19 / 58	2	***	****	-
PF Euro Short Term	30.6.00	7878,56	18 / 124	1	13 / 124	1	62 / 124	2	27 / 111	1	51 / 106	2	60 / 104	3	**	**	-
PF U.S. High Yield Corporate Bond	7.7.00	815,16	2 / 23	1	1 / 23	1	3 / 23	1	5 / 21	1	1 / 16	1	1 / 12	1	****	****	-

If figures in the table are not enough friendly understandable, woun't hesitate to ask us. Thank you for your opinion.

\* The figures in the table represent only subfunds of categorie E, non - distributed, EUR currency. Peers of subfunds are based on calculation of the NAV subfund's performance. Kvartil means 1/4 of the whole group of funds and the less number of the "1/4" then the better position of the subfund is.