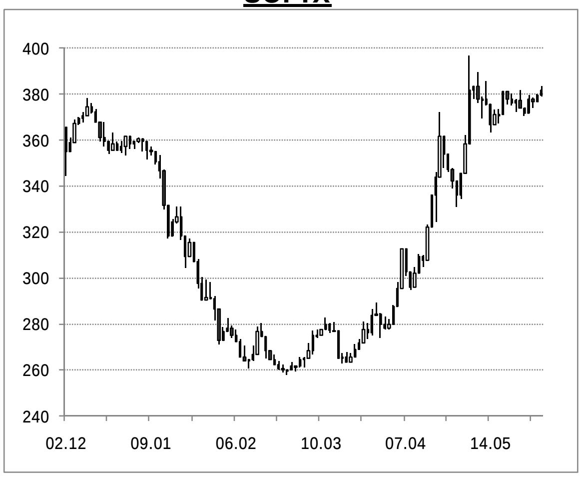
The market took a break

The summer lethargy came earlier this year. May was too calm and Bulgarian stock market moved sideways under the non-directional influence of the international markets. Indices made more than 40% from their February lows and the buyers stepped aside. However, the selling pressure was thin and even the news for the first quarter earnings and the capital increase of Chimimport had only slight impact on share prices.

SOFIX

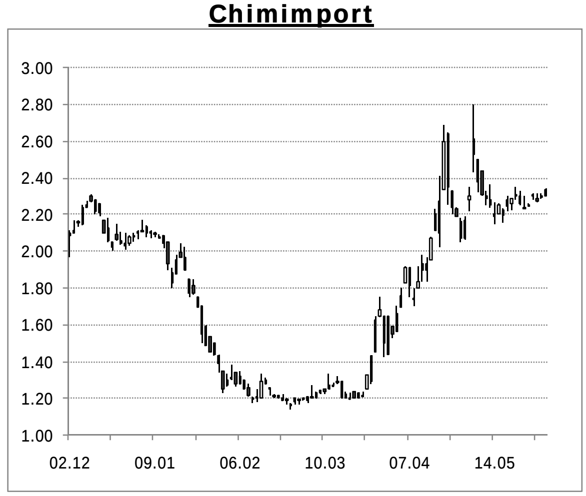


The month began with solid gains after the long holidays for Bulgarian market. Meanwhile, international markets jumped. Some Bulgarian investors, mainly individuals, followed the positive trend. The first signs that the rally on Wall Street is stalling pushed down the volumes and some investors started to take profits. Share prices dipped mainly due to the already broadened spreads between bid and ask prices. SOFIX remained in tight range for the rest of the month.

The good and the bad news from Chimimport

The preferred issue of Chimimport for total 90 million shares at BGN 2.22 each is having enormous impact on the market. Chimimport has almost 25% free-float and large foreign participation. The scale of the capital increase put some doubts in the success but the good news is that only 10 million unused rights remained for auction and all had been bought. Thus, the issue attracted good demand and is obviously a success in the difficult market environment.

Chimimport



Chimimport fell from its recent top several days after the announcement of the capital increase under supply concerns. Moreover, the whole market is affected by the forthcoming payments for the preferred shares as the sum is much higher than the average daily trading volumes. It is possible that some individual investors will sell to pay their new shares of Chimimport, which at the current market liquidity is a big risk.
However, the market proved that even the large capital increase and very weak earnings cannot change the primary trend. And it is on the upside from the end of February until proven otherwise.

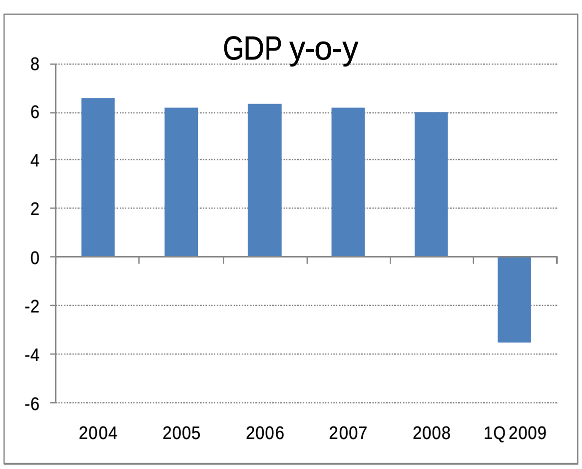
Consolidated earnings

We doubt that any market participant had better expectations for the consolidated reports comparing to the non-consolidated earnings a month ago. Most holdings have lots of subsidiaries from cyclical industries and are operating in very difficult business environment. Profits are diminishing, while sales are contracting by 30-40% on annual basis. The initial market reaction to the results was subdued. Most holdings shares weakened by several percents but the traded volumes were very low. However, the market conjuncture during this period was positive and could also contribute to the range-bound trading and the lack of selling pressure.

Stable business climate

With the earning season behind and the absence of guidance from most companies, investors are focusing their attention toward the macroeconomic development.
The indicator of the business climate was unchanged in May after its soft rebound during the previous two months. The current levels of the business climate correspond to 1999-2000. Managers of industrial companies are more pessimistic for the next three months, although they noticed some improvement in the current assessment. The pessimism is stepping aside but no improvement is on the horizon. New orders of industrial companies continued to shrink.
Although the business climate is at the levels of 1999-2000, the actual production and turnover indices fell to their 2006 levels as the utilities are not affected by the crisis. However, most manufacturing sectors are losing 30-50% as compared to year ago in terms of volumes. The deflationary forces are stronger during the last year and could continue to subdue the revenues of manufacturing companies. We remain confident that most public listed companies will emerge stronger from the crisis and will remain solvent despite the surging interest rates and the declining revenues.

GDP contracted by 3.5%



The contraction of Bulgarian GDP surprised on the downside and was due to the huge decline of industrial production. The service sector posted modest growth.
The Bulgarian stock market is not reacting to any macroeconomic news at the way developed markets are. However, investors are aware that overall trend for production and activity is down and will continue to pressure the sales and profits.

Outlook for the summer months

The elections for EU parliament in early June could have impact on the market, although the recent history suggests that this would be temporarily. The elections for Bulgarian parliament on July 5 would be more important for the market. So far the market is not giving any signal that elections would result to higher volatility.
Mutual funds posted only modest increase during the 40% rally of the stock market. Most of the funds are underperforming SOFIX year-to-date. The capital withdrawal from individual investors forced the fund management companies to sell liquid shares. Most funds have increased share of low-liquid stocks and REITs in their portfolios that outperformed the market during the slump. Those positions are lagging the market in periods of solid gains. Funds cannot restructure their portfolios to more risky assets as capital inflows are very low. Meanwhile, individuals are reluctant to put money into funds due to the low increase of their prices during March and April.
The outlook for the summer months should be more neutral for various reasons, including above-mentioned. Any weakness on international markets should put pressure on Bulgarian stocks and this could become the most important factor in short-term as investors are ignoring the corporate reports an elections.

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Outperform	More than 5% higher as compared to SOFIX and BG40 performance
Market Perform	Market performance, +/-5% as compared to SOFIX and BG40
Underperform	More than 5% lower as compared to SOFIX and BG40 performance

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