CENTRAL & EASTERN EUROPE FUND, INC.
Form N-CSR
January 04, 2019
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

FORM N-CSR

Investment Company Act file number: 811-06041

The Central and Eastern Europe Fund, Inc.

(Exact Name of Registrant as Specified in Charter)

345 Park Avenue

New York, NY 10154-0004

(Address of Principal Executive Offices) (Zip Code)

Registrant's Telephone Number, including Area Code: (212) 250-2500

Diane Kenneally

One International Place

Boston, MA 02110

(Name and Address of Agent for Service)

Date of fiscal year end: 10/31

Date of reporting period: 10/31/2018

ITEM 1. REPORT TO STOCKHOLDERS

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October 31, 2018

Annual Report

to Shareholders

The Central and Eastern Europe Fund, Inc.

Ticker Symbol: CEE

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The Fund seeks long-term capital appreciation through investment primarily in equity and equity-linked securities of issuers domiciled in Central and Eastern Europe and invests more than 25% of its total assets in the energy sector.

Investments in funds involve risks, including the loss of principal.

The shares of most closed-end funds, including the Fund, are not continuously offered. Once issued, shares of closed-end funds are bought and sold in the open market. Shares of closed-end funds frequently trade at a discount to net asset value. The price of the Fund s shares is determined by a number of factors, several of which are beyond the control of the Fund. Therefore, the Fund cannot predict whether its shares will trade at, below, or above net asset value.

This Fund is non-diversified and can take larger positions in fewer issuers than a diversified fund, increasing its potential risk. Investing in foreign securities presents certain risks, such as currency fluctuations, political and economic changes, and market risks. Any fund that focuses in a particular segment of the market or in a particular geographical region will generally be more volatile than a fund that invests more broadly.

The European Union, the United States and other countries have imposed sanctions in response to the Russian military and other actions in recent years. These sanctions have adversely affected Russian individuals, Russian issuers and the Russian economy. Russia, in turn, has imposed sanctions targeting Western individuals, businesses and products. The various sanctions have adversely affected, and may continue to adversely affect, not only the Russian economy but also the economies of many countries in Europe, including countries in Central and Eastern Europe. The continuation of current sanctions, or the imposition of additional sanctions, may materially adversely affect the value or liquidity of the Fund s portfolio.

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Letter to the Shareholders **(Unaudited)**

Dear Shareholder,

For its most recent fiscal year ended October 31, 2018, the Central and Eastern Europe Fund, Inc. (the Fund) delivered a total return in U.S. dollars (USD) of -0.18% based on net asset value (NAV) and -4.49% based on market price. The Fund s benchmark, the MSCI Emerging Markets Eastern Europe Index, returned 1.57% during the same period.[1] Emerging European equity markets registered mixed returns during the reporting period.[2] The top performers were Russia and the Czech Republic, with gains of 12% (MSCI Russia Index in USD terms) and 4% (MSCI Czech Republic Index in USD terms), respectively.[3,4] Conversely, Hungary returned -12% (MSCI Hungary Index in USD terms) and Poland returned -17% (MSCI Poland Index in USD terms).[5,6] All local currencies depreciated against the USD during the period mainly due to a stronger USD, which had a negative impact on the Fund s absolute performance. The Fund s relative underperformance during the period was primarily due to its positioning within Russia, in particular its underweight in Tatneft PAO. The Fund s discount to NAV averaged 12.28% for the period in review, compared with 12.26% for the same period a year earlier.

On the political front, in Russia the government introduced new measures during the period such as VAT (value-added tax) hikes, the raising of the retirement age and tax law changes affecting the oil industry, with the intent of introducing a new spending plan and boosting economic growth. The Central Bank of Russia raised its key policy rate in September by 25 basis points to 7.5%, but decided to leave the rate unchanged in October.[7] Russia s new budget rule, which directs the Ministry of Finance to use additional oil and gas revenues (arising out of oil prices above USD40 per barrel) to buy foreign currency, makes the ruble less oil price dependent. During the reporting period, Russia s equity market largely decoupled from emerging markets and proved to be rather resilient against geopolitical turmoil. Russian equities performed strongly until the end of February 2018, led mainly by an increase in the price of oil and the stabilization of Russia s domestic economy. However, in March the market began to correct, and worsened in April following the imposition of U.S. sanctions on some market-listed Russian companies. Since then, the Russian market gradually recovered but remained below its February highs through the end of October. Strong returns for the MSCI Russia Index stemmed mainly from the energy sector, where the performance

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Country Breakdown (As a % of Net Assets)	**10/31/18**	**10/31/17**
Russia	61%	63%
Poland	14%	22%
Hungary	7%	8%
Czech Republic	3%	3%
Turkey		1%
Other	1%	2%
Cash*	14%	1%
	100%	100%

* Includes Cash Equivalents and Other Assets and Liabilities, Net.

of Tatneft PAO, Novatek PJSC and Lukoil PJSC benefited from oil price increases, strong free cash flow and reasonable dividends. In contrast, banks and consumer stocks in Russia suffered: Financials underperformed, due mainly to sanctions-related concerns regarding loan book quality and the weakening of the ruble. In terms of consumer stocks, the environment in 2018 has been difficult as retail sales grew only modestly and price inflation was weak due to a high level of competitive pressure. During the 12-month period, the Fund s exposure to the Russian oil industry had mixed results: While an overweight in Rosneft Oil Co PJSC contributed positively, an underweight to the high-dividend-paying company Tatneft continued to detract from relative performance.

Elsewhere, concerns surrounding Europe s slowing GDP growth weighed on Poland s equity market.[8] This was in spite of the fact that Poland is a relatively closed economy with exports-to-GDP levels of only 40%. For the second quarter 2018, Poland s growth rate exceeded 5% year over year. However, October s economic data showed some signs of deceleration in the Polish economy, albeit from a high base. Hiring levels have weakened and wage growth proved to be softer than expected. The National Bank of Poland remains dovish, with a view toward keeping short-term interest rates unchanged until the end of 2020. On the political front, in December 2017 the European Union (via its Parliament) launched Article 7 of the EU Treaty against Poland for undermining the rule of law with its recent judicial reform acts. In October the European Court of Justice ordered the Polish government to immediately suspend the application of this retirement law. The most significant equity underperformers in the Polish market during the period were state-owned industrial companies and utilities. Privately-owned retailers lagged based on high valuations and a slowdown in sales due to market saturation.

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From a portfolio perspective, the performance contribution from Polish equities was positive, in particular a positioning in the oil refiner Polski Koncern Naftowy ORLEN SA.

In Hungary, GDP growth expanded by nearly 5% during the second quarter, driven mainly by domestic demand. Hungary s unemployment rate remains at an all-time low, with very tight labor market conditions. The Central Bank of Hungary kept interest rates unchanged in October. However, any further acceleration in inflation may represent a hawkish signal for the country s central bank and could force it to tighten credit. On the political front, the European Parliament voted to open an Article 7 sanctions procedure against Hungary, the first step in the so-called Rule of Law procedure. The European Union s (EU s) sanctions process is long, and EU member unanimity is needed in order to impose sanctions. All of the Central and Eastern Europe Fund s Hungarian holdings ended the reporting period in negative territory.

For the Czech Republic, growth slowed to 2.4% year over year during the second quarter from 4.1% in the first quarter, but upward pressure on prices remains. The Czech National Bank has stated that the economy needs higher interest rates in order to dampen the potential overheating of the Czech economy. The main contributor to the positive performance of the Czech equity index was the utility company CEZ AS, based on rising power prices. The contribution from the Fund s Czech exposure was slightly negative. The main drivers were positions in Komercni banka AS, which the Fund built up over time, as well as in CEZ AS, which continued to perform though the position was trimmed too early.

Sector Diversification (As a % of Equity Securities)	**10/31/18**	**10/31/17**
Energy	43%	40%
Financials	28%	24%
Materials	9%	13%
Communication Services	8%	7%
Consumer Staples	7%	6%
Health Care	2%	3%
Utilities	2%	4%
Consumer Discretionary	1%	3%
Information Technology	0%	0%
	100%	100%

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Ten Largest Equity Holdings at October 31, 2018

(55.8% of Net Assets)		Country	Percent
1.	**Sberbank of Russia PJSC**	Russia	**11.6%**
2.	**Lukoil PJSC**	Russia	**11.6%**
3.	**Gazprom PAO**	Russia	**8.9%**
4.	**Rosneft Oil Co PJSC**	Russia	**4.0%**
5.	**MMC Norilsk Nickel PJSC**	Russia	**4.0%**
6.	**MOL Hungarian Oil & Gas PLC**	Hungary	**3.6%**
7.	**Magnit PJSC**	Russia	**3.3%**
8.	**Tatneft PAO**	Russia	**3.0%**
9.	**Mobile Telesystems PJSC**	Russia	**2.9%**
10.	**Powszechny Zaklad Ubezpieczen SA**	Poland	**2.9%**

Portfolio holdings and characteristics are subject to change and not indicative of future portfolio composition.

For more details about the Fund s investments, see the Schedule of Investments commencing on page 10. For additional information about the Fund, including performance, dividends, presentations, press releases, market updates, daily NAV and shareholder reports, please visit dws.com.

Economic Outlook

During the reporting period, Russia was one of the top performers globally thanks to rising oil prices (which have recently corrected) and a solid macroeconomic environment. In the aftermath of the U.S. mid-term elections in early November, we believe that Russian equities will become more volatile and vulnerable to geopolitical developments due to intensified discussions regarding U.S. sanctions. The Fund is currently underweight Russia at approximately 60% of portfolio assets. Within the banking sector we prefer Czech banks, which offer a defensive profile coupled with high dividends. In Poland, we are emphasizing the insurance sector over banks for valuation reasons. In the oil sector, we remain underweight. However we prefer upstream to downstream companies, as refining margins remain under pressure.

The Fund ended the reporting period with a relatively high cash position, as we await more favorable entry points for select names.

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Sincerely,

Christian Strenger	Sylwia Szczepek	Hepsen Uzcan
Chairman	Portfolio Manager	President and Chief Executive Officer

The views expressed in the preceding discussion regarding portfolio management matters are only through the end of the period of the report as stated on the cover. Portfolio management s views are subject to change at any time based on market and other conditions and should not be construed as recommendations. Past performance is no guarantee of future results. Current and future portfolio holdings are subject to risk, including geopolitical and other risks.

[1] The MSCI Emerging Markets Eastern Europe Index is a free-float weighted equity Index that is designed to capture large- and mid-cap representation across four emerging market countries in Eastern Europe (Czech Republic, Hungary, Poland and Russia). MSCI Inc. (formerly Morgan Stanley Capital International) is a provider of equity and fixed income market indices. Index returns assume reinvestment of dividends and, unlike Fund returns, do not reflect any fees or expenses. It is not possible to invest directly in the MSCI Emerging Markets Eastern Europe Index.

[2] Emerging markets and countries of various sizes (in Europe as well as around the world) are defined as emerging (as opposed to developed) because they have embarked on economic development and political and economic reform programs, and have begun to open up their markets and emerge onto the global scene. Emerging Europe makes up the European portion of the emerging markets.

[3] The MSCI Russia Index is designed to measure the performance of the large- and mid-cap segments of the Russian market. With 22 constituents, the Index covers approximately 85% of the free float-adjusted market capitalization in Russia. It is not possible to invest directly in the MSCI Russia Index.

[4] The MSCI Czech Republic Index is designed to measure the performance of the large- and mid-cap segments of the Czech Republic market. With four constituents, the Index covers approximately 85% of the free float-adjusted market capitalization in the Czech Republic. It is not possible to invest directly in the MSCI Czech Republic Index.

[5] The MSCI Poland Index is designed to measure the performance of the large- and mid-cap segments of the Polish market. With 23 constituents, the Index covers approximately 85% of the Polish equity universe. It is not possible to invest directly in the MSCI Poland Index.

[6] The MSCI Hungary Index is designed to measure the performance of the large- and mid-cap segments of the Hungarian market. With three constituents, the Index covers approximately 85% of the Hungarian equity universe.

It is not possible to invest directly in the MSCI Hungary Index.

[7] A basis point is equal to one hundredth of a percentage point and is often used to illustrate differences and changes in fixed-income yields.

[8] GDP is the monetary value of all finished goods and services produced within a country during a specific time period.

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Outlook Interview with the Portfolio Manager **(Unaudited)**

Portfolio Manager

Sylwia Szczepek, Vice President

Portfolio Manager since December 22, 2014.

Question: Russian consumer stocks have recently underperformed the broader market. Do you foresee an improvement going into 2019?

Answer: The brunt of the current economic hardship in Russia has been felt most by Russian consumers, unlike the 2008 crisis when corporations suffered the most. Real income has been falling for the past three years, though we are likely to see this trend change in 2018. However, we believe that this will be inadequate to sufficiently revive consumption to once again become an economic driver. At present, we believe that stabilization is the best outcome that one can expect. In order for Russian consumer stocks to recover, margins need to stabilize and companies sales growth has to rebound.

Question: The Polish government has approved regulations regarding the establishment of a new Employees Pension System (PKK). Is there any positive impact on the Polish equity market expected from this?

Answer: This new pension system will be voluntary and the obligatory minimum contribution rate will be at 3.5% of salary (1.5% paid by employer and 2% by employee). The equity/fixed-income mix of PPK-based funds will change as the retirement year approaches. There are incentives from the government in the form of a welcome contribution of Polish zloty (PLN) 250 and annual subsidies of PLN 240 for each account holder. It is difficult to calculate a precise impact, as the size of inflows to the new pension system will vary depending on the rate of contribution as well as the number of participants. We believe that it is likely to increase the propensity to save among the population.

Question: Why are massive wage increases in CEE countries not translating into a spike in inflation?

Answer: Wage growth in the region has been strong. However, this pressure is related to labor-intensive sectors, and these items constitute a small part of the basket. So the pass-through from wages to inflation is very gradual.

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Performance Summary **October 31, 2018 (Unaudited)**

All performance shown is historical, assumes reinvestment of all dividend and capital gain distributions, and does not guarantee future results. Investment return and net asset value fluctuate with changing market conditions so that, when sold, shares may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. Please visit dws.com for the most recent performance of the Fund.

Fund specific data and performance are provided for informational purposes only and are not intended for trading purposes.

Average Annual Total Returns as of 10/31/18

	1-Year	**5-Year**	**10-Year**
Net Asset Value[(a)]	**(0.18)%**	**(2.75)%**	**4.87%**
Market Price[(a)]	**(4.49)%**	**(3.91)%**	**5.39%**
MSCI Emerging Markets Eastern Europe Index[(b)]	1.57%	(2.22)%	4.06%

a Total return based on net asset value reflects changes in the Fund s net asset value during each period. Total return based on market value reflects changes in market value during each period. Each figure includes reinvestments of income and capital gain distributions, if any. Total returns based on net asset value and market price will differ depending upon the level of any discount from or premium to net asset value at which the Fund s shares trade during the period. Expenses of the Fund include investment advisory and administration fees and other fund expenses. Total returns shown take into account these fees and expenses. The annualized expense ratio of the Fund for the year ended October 31, 2018 was 1.30%.

b The MSCI Emerging Markets Eastern Europe Index is a free-float weighted equity index that is designed to capture large and mid cap representation across four emerging markets countries in Eastern Europe (Czech Republic, Hungary, Poland and Russia).

Index returns do not reflect any fees or expenses and it is not possible to invest directly in the MSCI Emerging Markets Eastern Europe Index.

Net Asset Value and Market Price

	As of 10/31/18	**As of 10/31/17**
Net Asset Value	$ 26.98	$ 27.58
Market Price	$ 22.96	$ 24.52

Prices and Net Asset Value fluctuate and are not guaranteed.

Distribution Information **Per Share**

Twelve Months as of 10/31/18:

Income	$	.56
Capital Gains	$	

Distributions are historical, not guaranteed and will fluctuate. Distributions do not include return of capital or other non-income sources.

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Schedule of Investments **as of October 31, 2018**

	Shares	Value ($)
Russia 60.8%		
Common Stocks		
Banks 12.0%		
Sberbank of Russia PJSC	2,400,000	6,929,114
Sberbank of Russia PJSC (ADR)	1,229,191	14,504,454
VTB Bank PJSC (GDR) (Registered)	512,869	646,215
		22,079,783
Chemicals 0.1%		
Phosagro PJSC (GDR) (Registered)	6,319	**82,779**
Food & Staples Retailing 5.3%		
Lenta Ltd. (Registered)*	375,000	1,342,500
Magnit PJSC (GDR) (Registered)	449,755	6,001,981
X5 Retail Group NV (GDR) (Registered)	105,000	2,467,500
		9,811,981
Interactive Media & Services 0.1%		
Mail.ru Group Ltd. (GDR) (Registered)*	9,487	**252,734**
Metals & Mining 7.2%		
Alrosa PJSC	1,920,000	2,917,676
Magnitogorsk Iron & Steel Works PJSC (GDR) (Registered)	100,000	944,000
MMC Norilsk Nickel PJSC (ADR)	440,000	7,295,200
Polyus PJSC (GDR) (Registered)	70,468	2,159,844
		13,316,720
Oil, Gas & Consumable Fuels 30.4%		
Gazprom PAO (ADR)	3,498,242	16,514,301
Lukoil PJSC (ADR)	286,844	21,389,957
Novatek PJSC (GDR) (Registered)	31,440	5,329,080
Rosneft Oil Co PJSC (GDR) (Registered)	1,062,997	7,472,869
Tatneft PAO (ADR)	77,548	5,464,032
		56,170,239
Specialty Retail 0.7%		
Detsky Mir PJSC	1,000,000	**1,361,424**
Wireless Telecommunication Services 2.9%		
Mobile Telesystems PJSC (ADR)	680,000	**5,372,000**
Preferred Stocks		
Oil, Gas & Consumable Fuels 2.1%		
Surgutneftegas PJSC (Cost $3,903,980)	6,600,000	**3,828,581**
Total Russia (Cost $82,061,774)		**112,276,241**

The accompanying notes are an integral part of the financial statements.

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	Shares	Value ($)
Poland 14.0%		
Common Stocks		
Banks 5.0%		
Alior Bank SA*	67,985	1,025,047
Bank Pekao SA	120,371	3,290,388
Powszechna Kasa Oszczednosci Bank Polski SA	376,090	3,920,754
Santander Bank Polska SA	10,934	971,733
		9,207,922
Chemicals 0.5%		
Ciech SA	82,649	**915,781**
Diversified Telecommunication Services 0.6%		
Orange Polska SA*	1,019,456	**1,155,146**
Electric Utilities 1.0%		
PGE Polska Grupa Energetyczna SA*	667,719	**1,832,209**
Entertainment 1.0%		
CD Projekt SA*	43,000	**1,777,166**
Insurance 2.9%		
Powszechny Zaklad Ubezpieczen SA	521,735	**5,336,948**
Media 0.9%		
Cyfrowy Polsat SA*	285,000	**1,644,431**
Oil, Gas & Consumable Fuels 1.3%		
Polski Koncern Naftowy ORLEN SA	104,101	**2,506,991**
Software 0.3%		
Asseco Poland SA	40,000	**504,412**
Wireless Telecommunication Services 0.5%		
PLAY Communications SA 144A	210,000	**904,652**
Total Poland (Cost $29,855,160)		**25,785,658**
Hungary 6.9%		
Common Stocks		
Banks 1.3%		
OTP Bank PLC	66,478	**2,386,045**
Diversified Telecommunication Services 0.7%		
Magyar Telekom Telecommunications PLC (ADR)	909,194	**1,238,787**
Oil, Gas & Consumable Fuels 3.6%		
MOL Hungarian Oil & Gas PLC	638,336	**6,686,546**