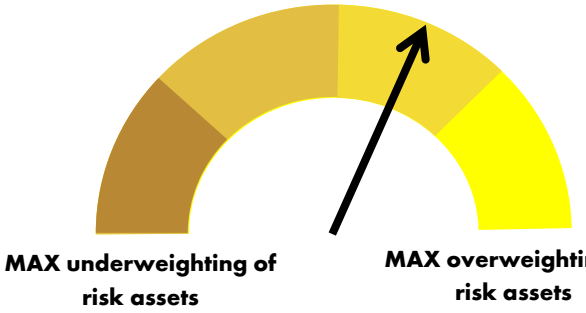
ASSET ALLOCATION

RB Asset Management 2Q/2022

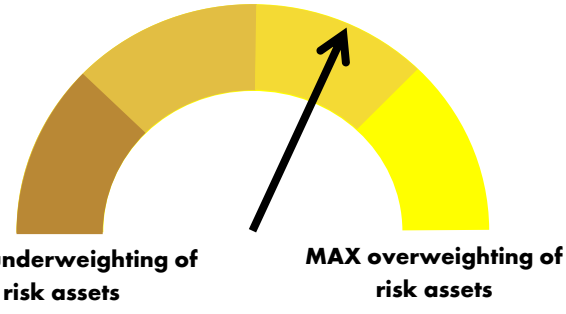
PĚTIHVĚZDIČKOVÁ BANKA K VAŠIM SLUŽBÁM

KLIENTSKY NEJPŘÍVĚTIVĚJŠÍ BANKA 2015–2019

Current Asset Allocation



Expected Asset Allocation in 2Q/2022



Source: Raiffeisenbank a.s., Asset Management, data as of 12 April 2022

Dear Clients,

High volatility prevailed in the financial markets throughout the last quarter. The invasion of the Russian troops in Ukraine has moved the prices of almost all instruments, commencing with equities and bonds, up to currencies and commodities. The period of uncertainty boosted interest in so-called 'safe harbours', such as the Dollar, U.S. sovereign bonds or gold. On the contrary, equities and bond prices in the emerging economies, including the Czech economy, were losing. From the historical point of view, impacts of similar geo-political factors on financial markets have been rather short-term ones, and we can witness a similar development also in this case. Financial markets have calmed down over the past weeks and, for example, U.S. equities have already been trading for units of percentage points above their values prior to the invasion.

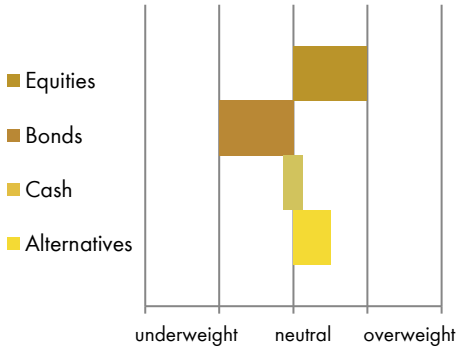
Investors nowadays focus their attention more on economical data; some of the old-new topics have come to the fore, such as the soaring inflation and interest rates hikes. It has been in particular the topics of inflation and interest rates that will be of key importance also in the coming period. While the cycle of rates increasing in the United States still is at its beginning, it has probably been nearing its top in the local scene. The attractiveness of Czech-crown-denominated bonds has increased significantly and they now offer the highest yields in the last twenty years. Having taken a glimpse across the ocean, the latest data from the U.S. labour market confirm that its local economy finds itself in a very good condition. The season for disclosing companies' earnings for the first quarter of 2022 is approaching, which may bring further new impulses.

At the times characterised by high inflation, we believe in stock markets, especially those with values that have a low debt ratio and that possess business models that can reflect higher costs in the prices they charge for their products and services. We continue to overweight shares against bonds. At the same time, we overweight U.S. equities, in particular the so-called 'blue chips', which typically are the most valuable titles contained in the S&P 500 Index. Higher interest rates may lead not only to future slowing down of the economic growth but also to a cooling down in the equity markets. We take into consideration this scenario as well. As regards our bond strategies, we give preference to sovereign bonds against corporate bonds; we gradually moderately extend the average term to maturity, so-called 'duration'. We still expect higher price volatility which – at the same time – may bring about certain interesting investment opportunities.

We wish you much success in the coming period.

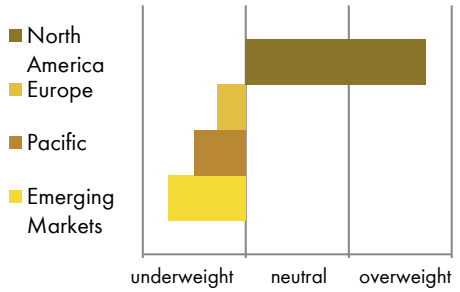
Mr Michal Ondruška
Manager, Asset Management

TACTICAL ASSET ALLOCATION – ASSET CLASSES



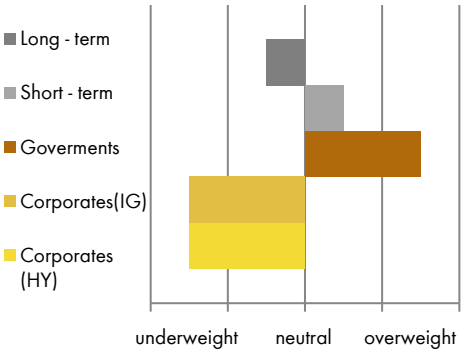
The geo-political situation in Europe has affected developments in the financial markets. The war in Ukraine will bring about a reduction of the global economy growth, in particular in Europe; it will impact on commodities prices and long lasting inflation. The world's central banks will thus be forced to accelerate the pace of tightening their monetary policies, with a subsequent negative impact on fixed-yield bond prices. The Czech central bank is expected to reduce its rates as early as at the end of this year. Despite these negative effects, the growth in the profitability of U.S. stocks should be close to a double-digit rate. Profits generated by, in particular, European shares, will take a slower advance. Unless the geo-political situation further worsens and commodity prices rocket further, investments into equities should outdo bond investments and even generate real positive yields. In the tactical allocation, we are therefore positively set towards shares, and the yields on Czech-Crown-denominated sovereign bonds have already been relatively interesting.

TACTICAL ASSET ALLOCATION – EQUITY REGIONS



We have significantly adjusted our tactical allocation as against the previous quarter. Given the war in Ukraine and the expected slowdown in the economic growth, especially in Europe, we strongly over-weighted the region of America as regards our investment strategies. On the contrary, we have underweighted Europe and we keep the Pacific region underweighted as well. We have also newly underweighted the emerging markets as against the benchmark. Expositions into U.S. equity markets represent approximately 70 percent of the risk portions of the portfolios. Out of that, some 10 percent has been invested in the NASDAQ technological index. We have been over-weighted in the Finance Sector, the Industrial Sector, and the Health Services Sector and in the Consumer Durables Sector. We hold 13 percent in European equity markets. Also, we have expositions equal to 6 percent in the Pacific region, including Japan, and approximately 11 percent in the emerging markets.

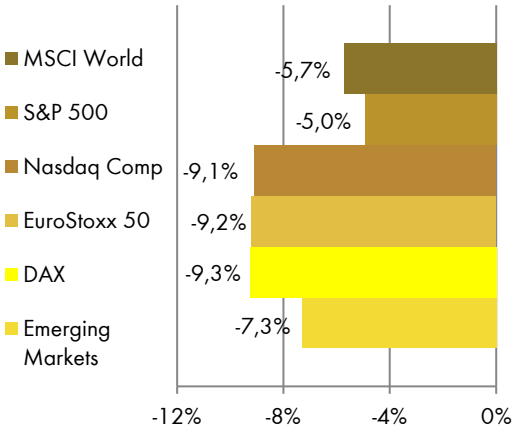
TACTICAL ASSET ALLOCATION – BONDS



The first quarter of this year brought about one of the fastest paces of growth of yields to maturity in respect of both USD and EUR-denominated sovereign bonds over the sever past years. Also Czech rates grew further significantly. Current financial market estimates suggest increases in central bank rates in the U.S. by 2 percent points this year, an increase in ECB rates by 1 percent point over the one-year horizon, and the CNB repo-rate of 6 percent points in several months. Attractiveness of, in particular, Czech-crown-denominated bonds, money market instruments, and the local currency will thus continue. The inverse shape of the Czech yield curve with yields above 5 per cent at the short end and close to 4 per cent in respect of 10-year maturities indicates a potential reduction in CNB rates following the easing of price pressures. Longer-term inflationary pressures and rising global bond yields continue to pose a risk to longer-dated bond prices. In view of higher risks inherent in the markets, we prefer sovereign bonds to corporate bonds and we are prepared to extend mildly their average terms to maturity, so-called 'duration'.

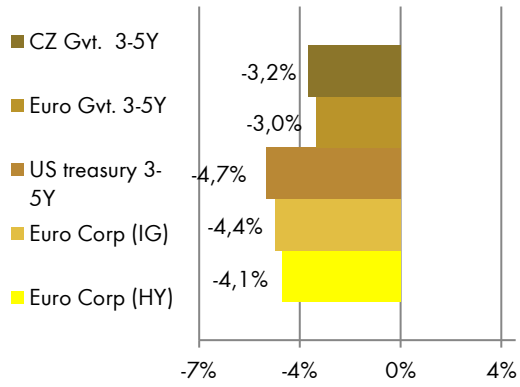
Source of data in charts: Raiffeisenbank a.s., Asset Management, data valid as of 12 April 2022.

ECONOMIC SITUATION AND MARKET TRENDS



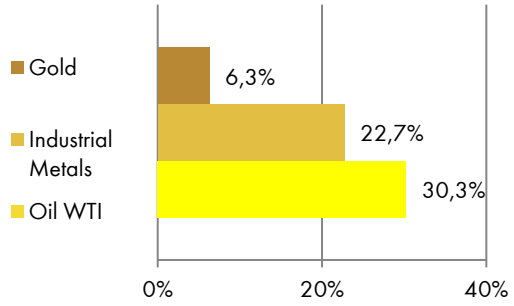
SHARES

The first quarter of the year 2022 was marked by 'corrections'. At the quarter start, equity markets were slowing down for fears of fast rate hiking by central banks, to which the conflict in Ukraine was added. It was in particular U.S. equities that recovered from the worst declines at the end of the quarter. Due to the above-described reasons, in particular European and technological equities did not do well. The German DAX Index wrote off 9.25 percent, the EuroStoxx 50 Index lost 9.21 percent. The U.S. SP500 Index did relatively better, having lost 4.95 percent.



BONDS

Also the bond markets were characterised by sales in the monitored period. In the second quarter, the U.S. FED increased its rates by 25 points, which indicated as new cycle to tightening of its monetary policy. The U.S. sovereign bonds with maturities of 3-5 years corrected by 4.67 percent. Czech sovereign bonds lost 3.23 percent while European sovereign bonds declined by 2.95 percent. Corrections also hit the European high-risk bonds. Then High-yield Bonds Index wrote off 4.13 percent.



COMMODITIES

Commodities, on the contrary, were doing well. In particular crude oil profited from the energy crisis, having increased by 30.25 percent. Also industrial metals were doing well. Their index increased by 22.73 percent. Gold strengthened by 6.3 percent. It shows that, at least in the second quarter, a significant statistical correlation existed between prices of commodities and inflation.

	31/12/21	31/3/22
EUR/CZK	24.89	24.40
USD/CZK	21.88	22.06
EUR/USD	1.137	1.107

CURRENCIES

The Euro weakened against the Dollar by 2.66 percent. The Czech Crown strengthened against the Euro by 1.94 percent. The Czech Crown weakened against the Dollar by 0.81 percent. Obviously, the Dollar was hit by the negative sentiments prevailing in Europe and by outlooks for further rates hiking in the United States.

Source of data in charts: Bloomberg. Performance of individual assets is measured in the primary currency of the given instrument since the beginning of the year until 31 March 2022.

The currencies table shows the rates as of the date as indicated.

FUTURE OUTLOOK

The most closely watched S&P 500 Index dropped in the first quarter of this year, without the impact of dividends, by 5 percent, thus having responded to the initial reports about the war in Ukraine and also to increased inflation and the envisaged interest rates hikes in the United States. The FED raised its benchmark interest rate by 0.25 percent to the range of 0.25-0.50 percent, in mid-March, a milder move than expected by some market participants, but a further increase to two percent or even higher is likely to occur in the coming months, until the end of this year.

Among the sectors, the best performing were the Energy Sector (+ 38.9 percent) and the Utilities Sector (5.5 percent). On the contrary, the worst performance was recorded by the Communications Sector (- 10.8 percent), the Consumer Durables Sector (- 9.4 percent) and the Technological Sector (-9.9 percent). In the stock markets, investors' uneasiness has been slowly calming down; the VIX Index fell to 20, which is close to the long-term average.

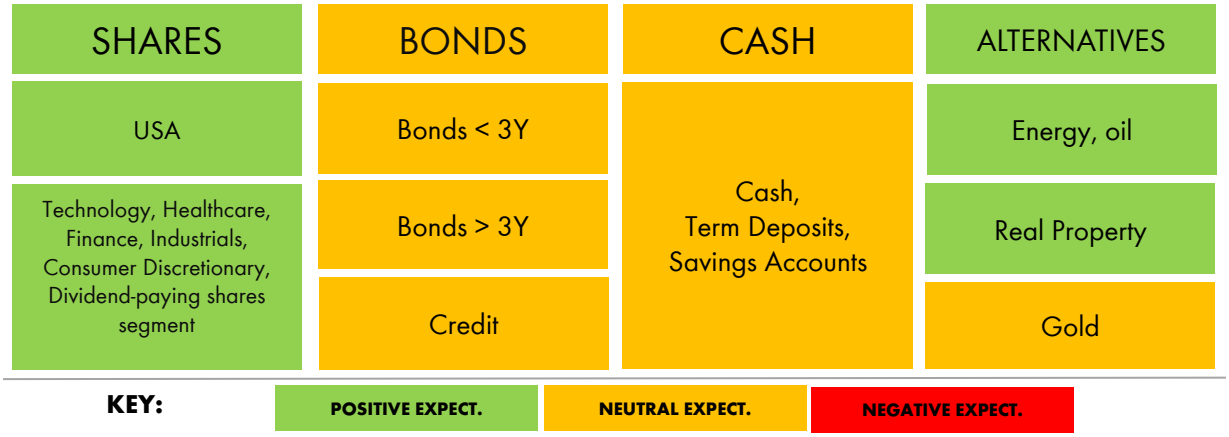
Investors will again be watching out for the 2022 first quarter corporate results; they will start appearing in the United States in April. Analysts envisage aggregated increase of the S&P 500 Index corporate profits by 4.5 percent, y/y, and of revenues by 10.7 percent, y/y. As concerns the entire year, a very decent growth of S&P 500 Index corporate profits is expected, namely by 9.8 percent, y/y, and of revenues by 9.5 percent, y/y. (*Source: FactSet*).

Higher inflation has already caused movements of yields of the ten-year sovereign bonds not only in the United States but also in Europe. The yield of the ten-year U.S. sovereign bond has increased from 1.5 percent to the current approx. 2.7 percent since the beginning of the year. Also, the yield of the ten-year German sovereign bond shifted from approx. - 0.1 percent as much as up to 0.8 percent. In the Czech Republic, the yield of the sovereign bond with maturity of ten years increased from 2.9 percent to 4.0 percent during the first quarter. The Czech National Bank responded to the threat of higher inflation by increasing its benchmark interest rates up to 5 percent at the end of March, something that was to the tune to investors' expectations. The market further presumes that interest rates will still grow in the Czech Republic until the year-half when they should reach their peak. The bond yield curve has had an inverse nature in the Czech Republic, which represents one of the indicators of future possible cooling down of the economy.

Bond yields still remain relatively low in the United States, which indicates moderate attraction of shares which – too – protect as a rule investors better from inflation than bonds do. Moreover, we still presume that corporate profits of U.S. companies will grow at a decent pace.

We maintain equities slightly over-weighted against bonds as part of our overall investment strategy. We direct the majority of equity investments to the United States because its economy is not supposed to be so badly hit by the consequences of the invasion of the Russian troops as, say, we in Europe. Among the sectors, we overweight the Technologies Sector, the Industrial Sector, the Finance Sector or the Consumer Durables Sector, as well as the defensive Health Services Sector. In view of potential rates increases, we provisionally keep shorter average maturity of bonds (so-called 'duration') as against 'benchmarks'. Attractiveness of Czech-Crown-denominated bonds, in particular the sovereign ones, continues to grow so the moment of the next extension of 'duration' has been nearing. We still expect higher volatility in the financial markets. In the long perspective, we still remain positively oriented in the direction of high-risk assets, although the threat of 'stagflation' (high inflation combined with an economic decline) increase with the continued war in Ukraine.

Outlook by: Raiffeisenbank a.s., Asset Management, regarding the individual asset classes in 2Q/2022:



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Information about Raiffeisenbank a.s.

The document has been drafted by Raiffeisenbank a.s., with registered office at Hvězdova 1716/2b, Praha 4, Registration number (IČO): 49240901, incorporated in the Companies Register administered by the Municipal Court in Prague, Section B, File no. 2051. Raiffeisenbank a.s. has been supervised by the Czech National Bank.

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Officer in charge: Mr Michal Ondruška, Manager, Asset Management.