COMMENTARY ON FINANCIAL MARKETS 03/2022

Prague, 1 March 2022

Capital Markets Affected by Russian Troops' Invasion of Ukraine

The invasion of the Russian armies of Ukraine has made financial markets very nervous. Movements have been reported of the prices of almost all investment instruments, commencing with equities, over bonds, currencies, as well as commodities and crypto-currencies. The worst drop was recorded as regards the equity markets in Russia: by more than 30 percent (the state as of Friday 25 February; ever since, the Russian stock exchange has been closed). The U.S. equities suffered a not so bad impact: the S&P 500 Index declined by a moderate -3.5 percent. Nevertheless, the U.S. markets continue to monitor and respond to high inflation and the subsequent expected response from the FED. The invasion of the Russian troops of Ukraine means that the FED may be more cautious when increasing the interest rates.

We expect the European shares to suffer from the current crisis more than their U.S. and Asian counterparts. This has been due to closer interconnection between Europe and Russia than the case has been in respect of the U.S. and Asian markets (with the exception of China). The DAX equity index of Germany dropped in February by almost 7.5 percent, thus having exceeded more than twice the declines reported from the U.S. market. In Europe, almost all sectors have been hit: energy, industry, banks, etc. The banking sector reports very strong sales-off, namely, in the order of tens of percent. The reason behind this has been higher exposition of European banks in Russia. Nevertheless, the European banks have now been stronger as regards their capital positions, as compared to the previous year; at the same time, they have a relatively easier access to liquidity provided by the central banks, if the need be. The current declines in the prices reported by the European banks still remain much softer than, for example, at the time of the Pandemic.

The chief topic of discussion before the invasion, that is higher inflation, has stepped back; nevertheless, inflation remains here and it will probably further speed up – namely, as a result of the conflict. The current pressure for higher prices results in particular from the supply side; fears of a geo-political crisis have driven up mainly the prices of energy commodities, which – in turn – will slow down the demand side. Higher rates would further restrain significantly such demand, and the central bankers are well aware of it. Thus, any speeding up of inflation needs not necessarily result in interest rates hikes over and above the framework of the original expectations from before the invasion.

Mr Michal Ondruška
Manager, Asset Management

As regards further economic information, corporate economic results remain of some interest: a total of 95 percent of the S&P 500 Index companies have already published their economic data for the fourth quarter, and 76 percent of them generated better than expected profit and 78 percent collected better than expected revenues. This year, it is believed that the aggregated growth of the S&P 500 Index companies profits will reach 8.5 percent, y/y, and revenues will increase by 8.1 percent, y/y (*Source: FactSet*).

Direct positions held by the Raiffeisen managed funds and individual portfolios in the Russian markets have been close to zero. Indirect positions, then, have been represented by stakes in instruments focused on the segment of so-called emerging markets; even in those instruments, though, the share of Russia has been minimal, namely, in the order of lower percentage units. Viewed from this angle, drops in Russian equities will not have any direct material impact on our managed portfolios.

We expect the most sever impacts of the current crisis to hit European equities and shares from so-called emerging markets, in particular those located in the European region. U.S. shares should be affected to a lesser extent. **Our investment strategy currently aims at overweighting in particular such U.S. equities where we have allocated approximately 60 percent of the overall equity positions. We currently hold European equities in a neutral position of approx. 16 percent, while our share in the emerging markets of approx. 15 percent has been concentrated in particular in the Asian region as regards our managed portfolios. The rest belongs to developed Asian markets, such as Japan.**

The financial markets will probably remain unstable in the immediate days to come. **We wish to make use of the current higher volatility prevailing in the financial markets for performing some short-term trading. Initial shocks suffered by financial markets are usually followed by similarly strong short-term countermeasures.**

In future, when the situation calms down, we cannot exclude adjustments in our tactical allocations, namely, towards underweighting equities as against bonds. We already made the first step in January this year by reducing – after some long time – overweighting of equities and increasing the share of bonds. **However, such expected adjustments are primarily based on a medium-term scenario of a gradual reduction of risk in portfolios due to higher interest rates.** History shows us that geo-political or other out-of-markets shocks usually have rather short-term and limited in absolute figures impacts on financial markets.

In the just past month, we gradually invested in our managed RIS funds proceeds from sales of bonds denominated in foreign currencies and performed at the beginning of the year (i.e., prior to the significant price drops that we witnessed in the just past weeks – before the invasion – and which can be attributed to the expected tightening of the monetary policies of both the U.S. FED and the central bank). In several steps, we bought sovereign bonds of the Czech Republic in February, but some newly issued corporate bonds were not left out either. The above-indicated transfer of bond investments to the domestic market has been motivated by the fact that the cycle of rising interest rates in the Czech Republic (which, under otherwise identical conditions, is pushing bond prices down) is irresistibly approaching its end, while it is still in its infancy in the case of economies on both sides of the Atlantic.

However, in view of the traditionally higher interconnection of the development of prices of long-term sovereign bonds of the Czech Republic with their counterparts in developed markets (where we expect yield growth in the future, i.e., a fall in prices), we are cautious in purchases of this segment of maturities. We continue to maintain slight over-weighting of the equity portion as against neutral positions, typically in the order of 3-4 percent points. We made use of the higher volatility (fluctuation) of equity prices as a result of the Russian invasion of Ukraine for performing some short-term trading.

On the day of the invasion of the Russian troops in the territory of Ukraine, we slightly increased the stake of American shares at attractive prices (which are not directly affected by the conflict) and the following day we sold part of these positions with more than a 3-percent profit. The rest remains in the portfolios and their closing prices at the end of the month, as compared to the achieved purchase prices, stood (depending on the purchased instrument) by 4-5 percent higher.

Therefore, our portfolios are slightly over-weighted in equities as against bonds, the majority of investments have been directed to the United States whose economy is not supposed to be hit so severally by the impacts of the invasion of the Russian troops of Ukraine. In view of possible further rates hikes, and not only in the Czech Republic but also in the United States and in Europe, we hold for the time being shorter average maturity of bonds (so-called 'duration') as a whole in the portfolios, against 'benchmarks', although we extended such 'duration' in the portfolios in the course of February in view of the envisaged declines of the rates at the end of this year.

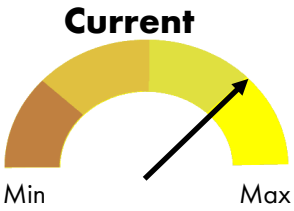
Wishing you peaceful days,

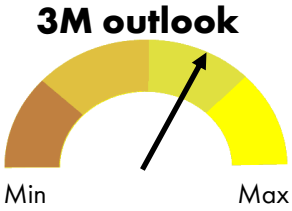
Mr Michal Ondruška
For the Asset Management team

Summary of Investment Strategies:

Tactical Allocation

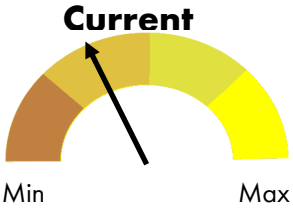
Equity overweighted in portfolios

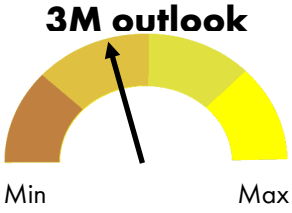




Interest Rate Risk

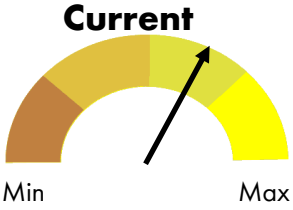
Average bond maturities (Duration)

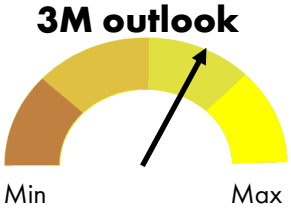




Credit Risk

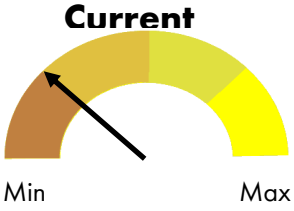
Portions of, e.g., corporate bonds

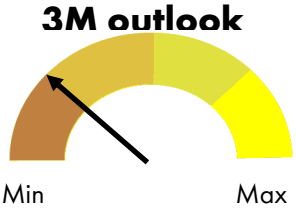




Currency Risk

Unsecured positions in foreign currencies





Source: Raiffeisenbank, a.s., Asset Management, data valid as of 1 March 2022.

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