COMMENTARY ON FINANCIAL MARKETS 06/2022

Prague, 1 June 2022

Global Inflation and 'Stagflation' Risks Boost Market Volatility

The most closely watched S&P 500 Index was moving as if on a swing in May 2022; it started by testing the 20-percent drop limit, measured from its peak high in early January, to close finally at 'green zero'. Good news for the equity markets was brought about by certain notes published by the FED at the end of May, indicating that inflation in the United States might have reached its peak, and that the United States would not be hit by recession this year.

The Index also responded in a positive manner at the end of the month to the lower inflation rate (PCE – Personal Consumption Expenditures), which has been observed closely in particular by the FED. The PCE declined in the United States from 6.6 percent in March down to 6.3 percent in April. The FED increased its base interest rate at the beginning of May by 0.50 percent up to 1 percent. Yet another rate hike by the FED is expected to occur in mid-June, namely, by another 0.50 percent.

Among the sectors, the best performing last month were the Energy Sector (+16 percent), the Utilities Sector (4.3 percent), and the Financial Sector (2.8 percent). On the contrary, the worst performances were reported by the Consumer Durables Sector (-5.1 percent), the Real Estate Sector (-5.1 percent) and the Short-term Consumption Sector (-4.1 percent). The anxious investors in equity markets have partly calmed down when the VIX Index dropped from 34 to 26; even so, we still are moving at higher values compared to the long-term average of 19.6.

Investors also focused, in particular, on corporate results reported in the United States in respect of this year's first quarter. So far, 97 percent of the companies belonging to the S&P 500 Index have already disclosed their results, and 77 percent of them recorded better than expected profit. As regards this entire year, aggregate growth of the S&P 500 Index firms' corporate profit is expected to reach 10.1 percent, y/y, and the figure stands at 10,2 percent, y/y, in respect of revenues (*Source: FactSet*).

Mr Michal Ondruška
Manager, Asset Management

Raiffeisen BANK
Banka inspirovaná klienty

Raiffeisenbank a.s. Hvězdova 1716/2b, PO box 64, 140 78 Praha 4, tel.: +420 234 401 111, fax: +420 234 402 111, e-mail: info@rb.cz, www.rb.cz, IČ: 49240901, zapsaná v obchodním rejstříku vedeném Městským soudem v Praze, oddíl B, vložka 2051

Higher global inflation has already caused fluctuations in the yields of ten-year sovereign bonds, not only in the United States but also in Europe. The yield of the 10-year U.S. sovereign bond nowadays circles around 2.8 percent; however, it passed the 3-percent mark at the beginning of May. Also, the yield of the German 10-year sovereign bond was pushed from approximately 0.9 percent at the end of April as far up as to the current 1.1 percent. In then Czech Republic, the yield of the sovereign bond with ten-year maturity increased by 0.4 percent up to 4.7 percent. Faced by threats of higher inflation, the Czech National Bank increased its benchmark interest rate at the beginning of May from 5 percent up to 5.75 percent, which was 0.25 percent more than expected by the market. Moreover, the market further anticipates that the interest rates in the Czech Republic will continue to grow until the middle of the year when they will reach their peak. The currency and the bond markets experienced a major discombobulation following the appointment of a new Czech Nation Bank governor who indicated his intention not to raise interest rates any further.

The Czech crown weakened sharply in response to his comment and the Czech National Bank had to intervene in the foreign exchange market. Also following his comment, the yields of the Czech sovereign bonds went up due to fears of higher inflation. Therefore, it will of importance for the further development of the Czech crown and bond yields whether two more of the serving members of the Czech National Bank Board are going to be replaced or whether their mandate will be extended. The bonds yield curve currently follows an inverse shape in the Czech Republic, which represents one of the indicators of a possible future cooling off of the local economy.

The risk premium (Fed model) of the S&P 500 Index stands at 2.6, which is less than approximately the twenty-year average of 2.8, and which indicates to us that stocks are relatively more expensive. On the other hand, expectations have it that U.S. corporate profits will be growing at a two-digit rate and that the U.S. economy will not slip into recession this year. Further growth or slowing down of the inflation rate in the United States and the resulting responses by the FED will probably represent the alpha and omega for further progression of equity markets in the United States.

As regards the RIS unit funds, we have reduced the positions held by high-risk instruments towards neutral levels in the last decade in May (as part of the equity markets growth wave). There, we were mainly selling, in particular, European equities which – as against other regions – haven been harder hit by the continued war in Ukraine and the associated growth in energy prices, etc. On the contrary, we see Czech sovereign bonds as a suitable investment opportunity due to their fixation of an almost 5-percent annual yield for many years to come, which may represent an interesting alternative or complementation of investing in shares. At the end of the month, we purchased the Czech Republic's ten-year sovereign bonds with yield to maturity of 4.60 percent p.a. for all RIS funds. We have also allocated a portion of the funds in European bonds with yields linked to inflation (iShares EUR Inflation Linked Govt Bond UCITS ETF) or instruments profiting from drops in the price for the ten-year German sovereign bonds (Lyxor Bund Future Daily -1x Inverse UCITS ETF). We also managed to make profits from short-term trading with both of the above-described instruments during the month. We have also sold with profit half of our positions in U.S. corporate bonds with longer maturities, which we included in our portfolios at the end of April, after five months of their steady price decline and in the hope that inflation in the United States could have reached its peak (unlike in Europe and in the Czech Republic).

Overall, we have still moderately over-weighted equities in our investment strategies, while the majority of our investments have been directed to the United States whose economy is likely not to be so hard hit by the aftermath of the invasion by the Russian troops as, for example, Europe. Equity markets' growths still face the risk of higher inflation and possibly also 'stagflation', because of higher energy prices, including potential shortages of natural gas from Russia due to sanctions, lower corporate profit margins and, above all, geo-political risks in Europe.

We wish you much success in the days to come!

For the Asset Management team,

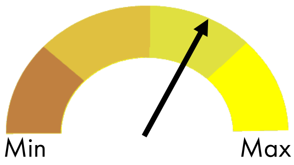
Mr Michal Ondruška

Summary of Investment Strategies:

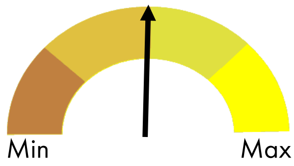
Tactical Allocation

Equity overweighted in portfolios

Current



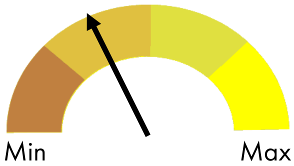
3M outlook



Interest Rate Risk

Average bond maturities (Duration)

Current



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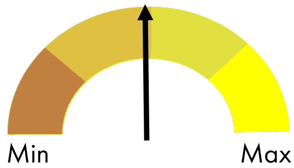
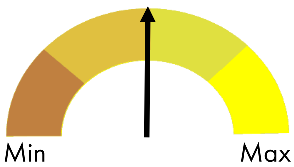


Credit Risk

Portions of, e.g., corporate bonds

Current



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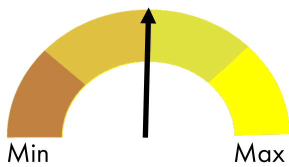
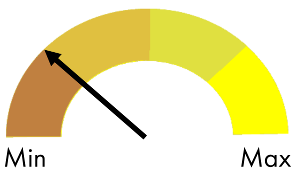


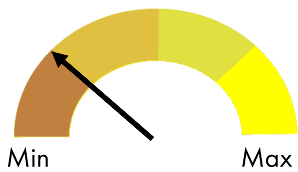
Currency Risk

Unsecured positions in foreign currencies

Current



3M outlook



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

Raiffeisenbank a.s. Hvězdova 1716/2b, PO box 64, 140 78 Praha 4, tel.: +420 234 401 111, fax: +420 234 402 111, e-mail: info@rb.cz, www.rb.cz, IČ: 49240901, zapsaná v obchodním rejstříku vedeném Městským soudem v Praze, oddíl B, vložka 2051

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