



# COMMENTARY ON FINANCIAL MARKETS

## 07/2022

Prague, 1 July 2022

### Both Recession Fears and Czech Crown Bond Prices Go Up

The most closely watched S&P 500 Index dropped by 7.7 percent in June 2022, and it wrote off more than 20 percent from its January highs, which means that the S&P 500 Index has swung into the bear market. Equity indices find themselves under selling pressure, since some investors worry about lower profitability of companies, resulting from higher inflation and higher interest rates, and subsequent recession.

The FED increased its benchmark rate by 0.75 percent to the interval of 1.5 – 1.75 percent in June, as against the anticipated increase by 0.50 percent. This step, too, supported decline in the equity markets in the course of June. Yet another hike of the FED rates is expected to occur at the end of July 2022, namely, by another 0.75 percent. The ECB, too, indicated the possibility of increasing its benchmark rate as early as in July, and then also in September.

Higher global inflation has already caused movements of the yields of ten-year sovereign bonds, not only in the United States, but also in Europe. The yield of the ten-year U.S. sovereign bond, however, currently moves in the range of lower values around 3.0 percent; it reached its high of 3.5 percent in mid-June. In the Czech Republic, the yield of the sovereign bond with maturity of 10 years fluctuates around 4.8 percent; similarly as the U.S. bond, it reached its high of around 5.9 percent in the middle of the previous month. **Czech crown-denominated bonds thus make corrections for previous losses and their prices have risen significantly, in the order of units of percent, in the past few days.**

The Czech National Bank responded to the threat of higher inflation at the end of June by increasing its benchmark interest rate from 5.75 percent up to 7 percent, which was by 0.25 percent more than expected by the market. At the moment, it is not certain whether the new composition of the Bank Board will carry on such rates hiking. The new Governor of the Czech National Bank has indicated in advance that he does not intend to increase the rates. The bond yield curve has so far had an inverse shape in the Czech Republic, which represents one of the indicators of potential future cooling down of the economy in the Czech Republic.

The anticipated P/E of 15.8 (Source: FactSet) for the next 12 months is lower for the S&P 500 Index than its five-year average of 18.6 (Source: FactSet) and it even is lower than its ten-year average of 16.9 (Source: FactSet). **Equities have thus been slightly undervalued, viewed from this angle.** A risk factor will be represented by upcoming publication of companies' financial results for the 2<sup>nd</sup> quarter of this year, which will be released in July and which may slash analysts' and investors' expectations for earnings growths this year.



Mr Michal Ondruška  
Manager, Asset Management



As regards the mutual funds managed by RIS, we have made use of the ongoing volatility in the financial markets and we have introduced certain partial changes to the equity portion of our portfolios. Specifically, we may point out – for example – a reduction of the weight of the shareholding of ČEZ, where the growth of energy prices has contributed considerably to significant stock price increases this year. We would also mention the positional sale of stock exchange traded ETF of companies mining basic industrial raw materials, and its subsequent purchase back at significantly lower prices (approx. by 12 percent). We have also continued to purchase instruments profiting from the decline in the price of the German ten-year sovereign bonds (Lyxor Bund Future Daily -1x Inverse UCITS ETF).

The June increase of the benchmark interest rate by the Czech National Bank to the current 7 percent boosts the yield potentials of Czech-crown issues of both sovereign and corporate bonds. Therefore, we shall continue to give preference in our portfolios to Czech-crown issues over foreign currencies, and we shall benefit from both their yields and price attractiveness. In view of the continuing uncertainty regarding future inflation trends, the 'correct' setting of average term to maturity of bonds remains the biggest challenge on the bond side of our portfolios.

**We are now reducing the slight overweighting of equities, while increasing the share of bonds, in order to achieve an overall neutral position. This is mainly due to the relatively high attractiveness of yields from Czech-crown bonds.** We continue to direct the majority of investments in equities to the United States whose economy should not be hit so hard by the consequences of the invasion of the Russian troops in Europe. Taking into consideration possible further increases of rates and potential weakening of the Czech crown, **we so far keep shorter average maturity of bonds (so-called duration) as a whole in portfolios, as against the benchmarks. However, we envisage gradual extension of their duration.**

We wish you much success in the days to come!

For the Asset Management team,

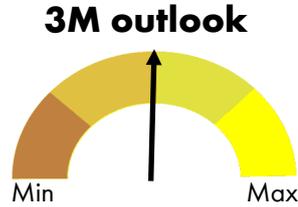
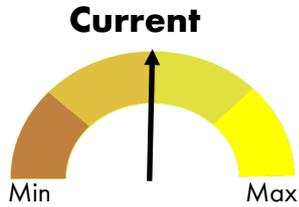
Mr Michal Ondruška



## Summary of Investment Strategies:

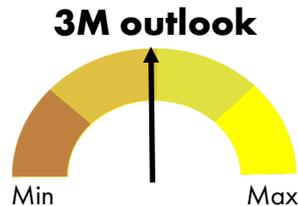
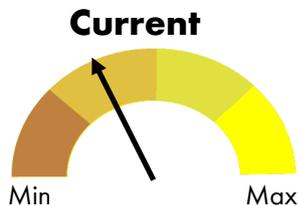
### Tactical Allocation

Equity overweighted in portfolios



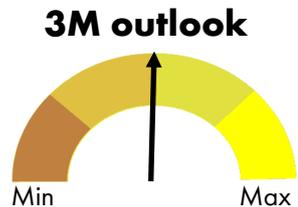
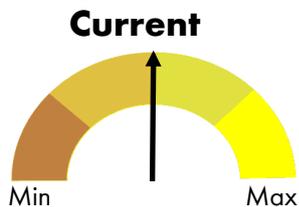
### Interest Rate Risk

Average bond maturities (Duration)



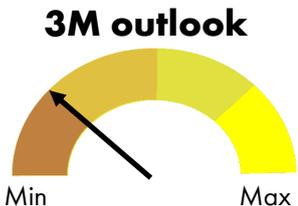
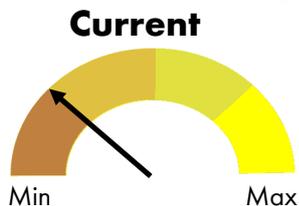
### Credit Risk

Portions of, e.g., corporate bonds



### Currency Risk

Unsecured positions in foreign currencies



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



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