Commentary on the Financial Markets

12/23

The stock and bond markets strengthened in anticipation of a drop in inflation

In November, both the stock and bond markets were dominated by a positive sentiment, supported by investors' expectations of a decline in inflation, especially in the USA. The pace of inflation growth (CPI) in the USA decreased from 3.7% YoY in September to 3.2% YoY in October, while the year-on-year inflation growth in the Eurozone also decreased from 2.9% in October to 2.4% in November. The yield on the 10-year US Treasury bond decreased from approximately 5% p.a. to the current 4.3% p.a. The significant decline in bond yields also supported the stock markets, with the widely followed S&P 500 index gaining 8.9% in USD during November.

In terms of sectors, the best performers last month were technology (+12.9%), real estate (+12.5%), the financial sector (+10.9%), and the long-term consumption sector (+11%). The energy sector recorded the worst performance (-0.7%).

In the USA, the earnings season for the third quarter of this year has practically already taken place. Overall, corporate profits were better than market expectations, with approximately 81% of companies in the S&P 500 index reporting better-than-expected results.

After better-than-expected inflation in the USA and an expected slight deterioration in the labor market, investors no longer anticipate further increases in the FED's benchmark interest rate, which is currently set at 5.5% p.a. However, the FED has not ruled out the possibility of raising the benchmark interest rate. Therefore, the future movement of the interest rate will still depend on incoming macroeconomic data. The median of analysts surveyed by Bloomberg expects the first interest rate cut in the second quarter of 2024.

In November, the ECB kept the deposit rate at 4.0%, and it is likely that there will be no further increase in this rate. The next meeting is scheduled for December 14, 2023, one day later than the FED's meeting. The Czech National Bank (CNB), in line with expectations, maintains the repo rate at 7% p.a., but analysts predict that the CNB will still cut rates to 6.75% p.a. before the end of this year. The CNB will meet in the second half of December.

The yield on the 10-year German government bond is around 2.4% p.a. The yield on the 10-year US Treasury bond has fallen to approximately 4.3% p.a. At the end of November, the yield on the Czech government's 10-year bond was around 4.2% p.a.

Raiffeisen
Investiční společnost

Michal Ondruška
CIO, Member of the Board

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The expected P/E ratio of 18.6 for the S&P 500 index over the next 12 months, as reported by FactSet, is lower than its five-year average of 18.8 and higher than its ten-year average of 17.6. This suggests that the markets are not overvalued, assuming that year-on-year inflation continues to slow down towards 2% per annum and individual economies do not fall into recession.

Analysts are still forecasting double-digit earnings growth for the S&P 500 index next year, according to FactSet, although their optimistic expectations have been lowered in recent days. November and December statistically tend to have better performance, so it is possible that despite the high market gains in November, the sentiment in the stock markets during December will remain positive. The highest current risk is likely the fear of a return of higher inflation and a possible recession if central banks continue to raise interest rates and the "soft landing" of individual economies does not materialize.

RIS funds in November benefited from the ongoing strategy of overweighting equities at the expense of bonds and longer average bond durations. Given the increasing conviction that the interest rates of the Federal Reserve and the European Central Bank will not rise further in this cycle due to slowing inflation, long-term bonds were further added to portfolios. However, profit-taking from ongoing trading also occurred, as in previous months. In terms of equities, this includes purchases and sales of an ETF fund tracking the performance of the Japanese stock index TOPIX, and in the case of bonds, trades with an instrument benefiting from the rise in yields of ten-year German government bonds (Amundi German Bund Daily -1x Inverse). Temporary available funds are being invested in short-term deposits with interest rates close to the Czech National Bank's policy rate, i.e., 7% per annum.

Within our investment strategies, we maintain an overweight position in equities compared to bonds. Regionally, we favor North America, slightly underweight Europe and the Pacific, while the emerging markets region is in a neutral position. In terms of sectors, we favor technology, industry, and dividend stocks. In our bond strategies, we maintain a longer average bond duration compared to bond benchmarks. We prefer government bonds over corporate issuances.

We wish you success in the upcoming period!

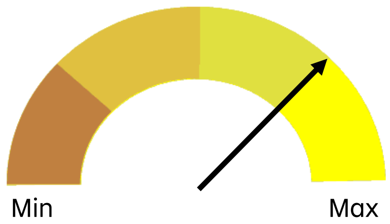
Michal Ondruška

Investment Strategy Summary:

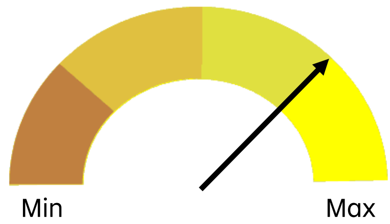
Tactical Allocation

Overweighting of stocks in portfolios

Current



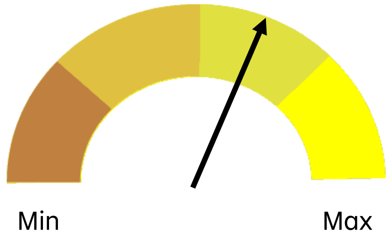
3-month outlook



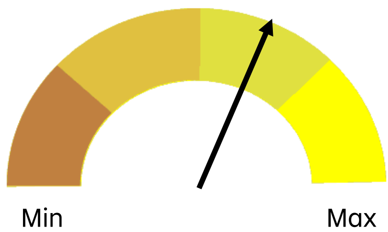
Interest Rate Risk

Average duration of bonds

Current



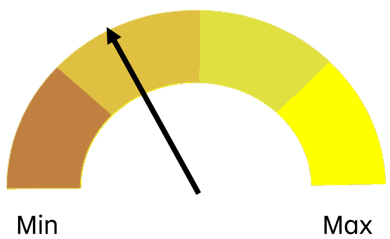
3-month outlook



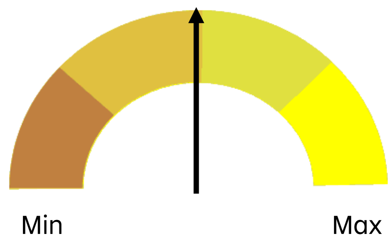
Credit Risk

Share of corporate bonds

Current



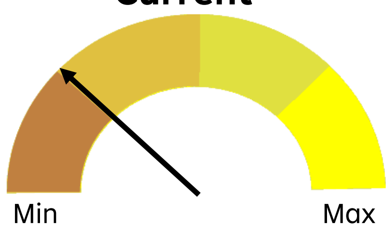
3-month outlook



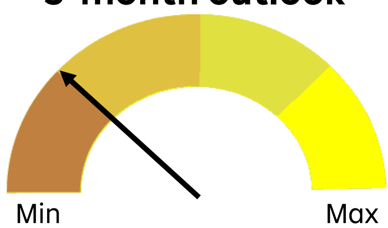
Currency Risk

Unhedged positions in foreign currency

Current



3-month outlook



source: Raiffeisen investiční společnost, a.s., as of December 1, 2023.

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