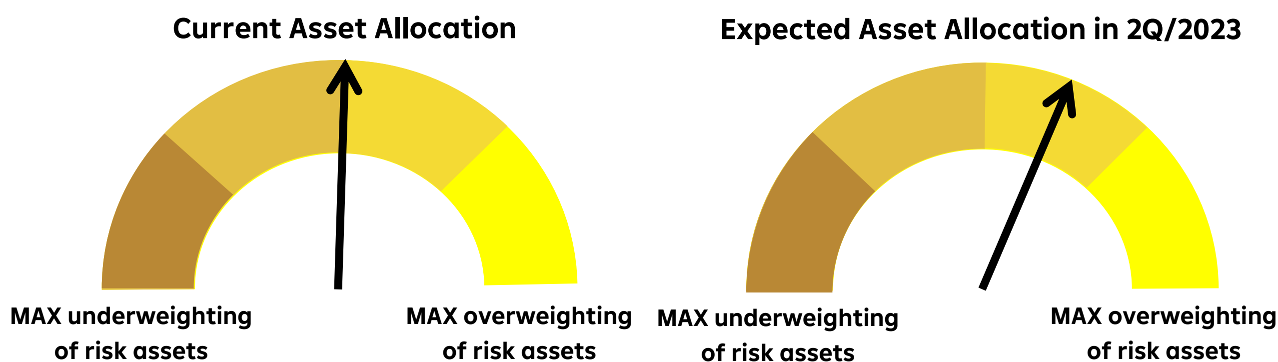
ASSET ALLOCATION

RB Asset Management 2Q/2023

Raiffeisen BANK



Source: Raiffeisenbank a.s., Management, data valid as of 12 April 2023.

Dear Clients,

The just past quarter brought about higher fluctuations in the financial markets, mainly due to economic and geo-political uncertainties. We witnessed some significant events: two U.S. banks collapsed, subsequently a major Swiss bank got into trouble. Despite those and other developments, however, both equities and bonds were doing well and both of those asset classes ended up the first quarter 2023 increasing.

We are still facing high inflation and soaring interest rates, economies begin to slow down, thereby fulfilling the understanding of central bankers of their fight against inflation. The slowing down of economic growths and the recent bankruptcies of the U.S. banks, however, have affected expectations of market players about further trends in the movements of interest rates in a significant manner. The market now awaits first reductions of the rates to occur as soon as in the second half of this year, although the original assumptions only mentioned the year 2024 (*Source: Bloomberg*).

Lower interest rates may result not only in an economic revival but also represent a positive signal for both the equity and the bond markets. We have extended the average terms to maturity (duration) as part of our investment strategies as early as in the past weeks and months, with the goal of profiting from growing bond prices. Yet another probable step required as part of our strategies will represent increasing the portion of equities and growth sectors, which may better profit from such economic revival.

We expect the financial markets to remain fluctuating and no further short-term market declines can be excluded, either. Again, more than ever, the importance of spreading investments over time is imminent, while the true tipping point cannot be determined as yet. Recurring and regular investments represent a very effective form of asset management. The basic pillars of asset management strategies include spreading risks, both in time and in view of the specific portfolio distribution between different types of instruments.

Thank you and we wish you much success in the coming period!
Mr Michal Ondruška
Manager, Asset Management

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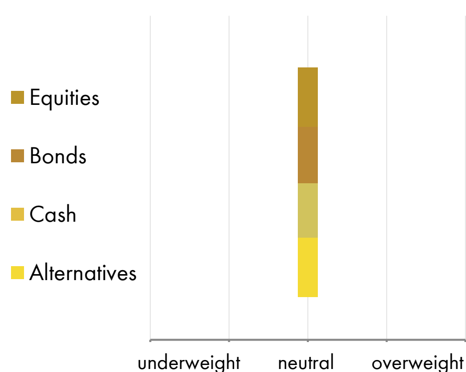
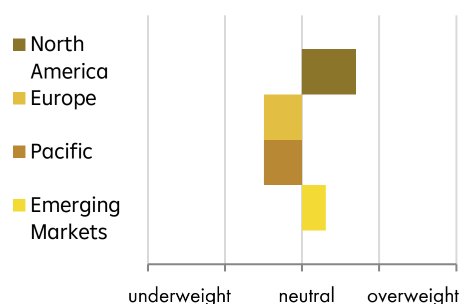
TACTICAL ASSET ALLOCATION – ASSET CLASSES



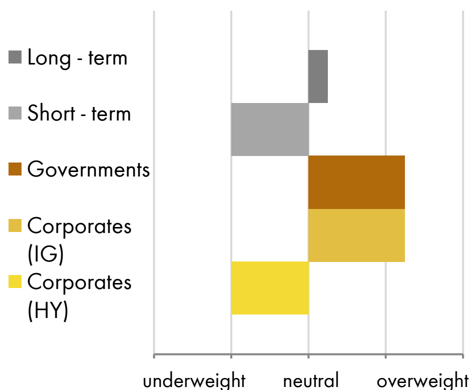
Market trends in the first quarter of 2023 were relatively volatile because the struggle waged by the central banks against global inflation was accompanies by difficulties regarding banking sector liquidity. Bond markets have commenced considering recession as a possible chief scenario and – as against central banks' representatives – they count on lowering the rates to occur already this year. The markets and the central banks as a matter of fact work continually with several scenarios of the future development, from a soft landing, mild or deeper recession to stagflation, and they carefully weigh between inflation targets, labour market trends, economic growths, and functional and liquid financial market. The risk-weighted return is currently higher for bond markets than for stocks. Equity markets, for instance, ignore scenarios based on recession, and/or stagflation, which would threaten with higher declines in corporate profits; central banks, however, may give priority to struggle against inflation and fail to reduce the rates, in spite of resulting recession or stagflation. The just opening earnings season will allow markets to respond to new data about the outlook for corporate profits, sales and margins. Due to increased uncertainty of further developments, we keep our tactical allocation at neutral level, however, we are prepared to increase the share of stocks in the event of a technical correction, a better than expected earnings season or rapidly receding inflation.

TACTICAL ASSET ALLOCATION – EQUITY REGIONS



As regards our investment strategies, we have reduced our overweighting in the region of the United States (nevertheless, we still continue to remain overweighed in that region) and – as a new step – we have overweighed the emerging markets, in view of the opening of the Chinese economy following the termination of the Covid pandemic. We still keep underweighted allocations in Europe and the Pacific. Exposition in the U.S. equity markets now represents approximately 65 percent of the risk portions of our portfolios. Of that, about 10 percent are held in the Nasdaq technological index. Also, we have been overweighed in the Financial Sector, the Industrial Sector, and the Health Services Sector. Our representation in European equity markets amounts to 13 percent. We hold 6 percent in the Pacific region, including Japan, and approximately 16 percent in the emerging markets.

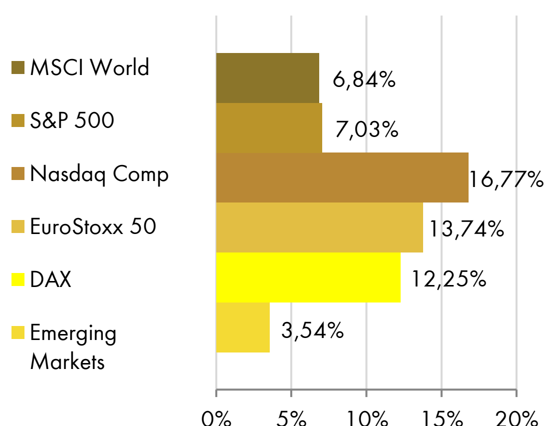
TACTICAL ASSET ALLOCATION – BONDS



Bond prices were fairly volatile in the first quarter of 2023, when the MOVE volatility index of the U.S. sovereign bonds had reached its highest values since March 2020 (Covid-19). The Czech-crown-denominated sovereign bonds with maturities of 3 to 5 years offer yields just under 5 percent, that is, similarly as at the start of this year. At the beginning of March, though, they yielded 5.5 percent. Investment grade U.S.-dollar-denominated corporate bonds are currently traded with a yield of 5.3 percent (previous data: 5.2 percent) and of 9.0 percent (8.4 percent) in the high yield segment. Investment rating EUR-denominated corporate bonds are traded with a yield of 4.2 percent (4.1 percent) and 8.3 percent (8.1 percent) per year in the HY segment. Uncertainty in the bond market, in particular, will continue as the market is assessing central banks' struggles against inflation, possible recession, wage increases, and potential 'black swans', similar to the recent collapses of the regional banks in the United States. The attractiveness of Crown-denominated bonds is gradually decreasing, however, the Czech National Bank ("CNB") does not rule out the possibility of raising rates in the event of wage pressures. In view of the increasing market risks, we prefer sovereign bonds, and also investment rating corporate bonds due to their attractive yields and low credit risks. In the event of the 'soft landing' scenario, we will probably increase the portion of HY bonds.

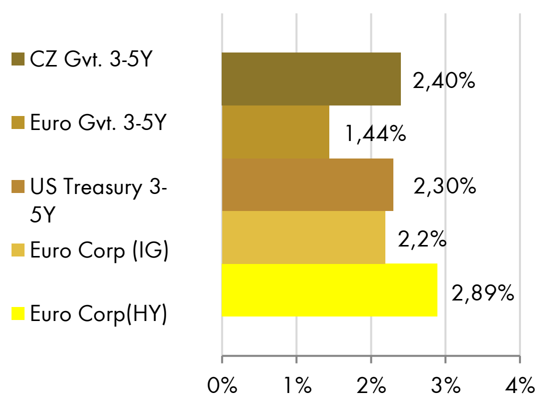
Source of the data in the charts: Raiffeisenbank a.s., Asset Management, data valid as of 12 April2023.

ECONOMIC SITUATION AND MARKET TRENDS IN 1Q/2023



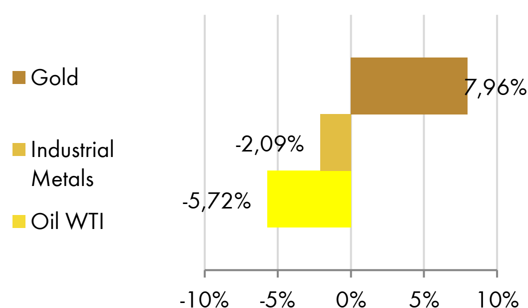
SHARES

The first quarter of 2023 was positive for equity markets. Particularly technological equities were doing well. The Nasdaq Index added 16.77 percent, followed by European stocks. The Euro Stoxx 50 Index jumped up by 13.74 percent. The S&P 500 Index strengthened by 7.03 percent. The MSCI Global Stock Index added 6.84 percent. The relatively worst performance was reported by the MSCI Emerging Markets Index: it added 3.54percent.



BONDS

Signs of culminating inflation and expectations of a milder pace of interest rate hikes by central banks influenced bond markets positively. The index of the Czech sovereign bonds with maturities of 3 to 5 let went up by 2.40 percent. European sovereign bonds strengthened by 1.44 percent. U.S. sovereign bonds with maturities of 3 to 5 years jumped up by 2.30 percent. Also corporate bonds did well. The index of European corporate bonds went up by 2.20 percent. European High-yield bonds added 2.89 percent.



COMMODITIES

Industrial commodities showed disinflationary pressures. The Industrial Metals Index weakened by 2.09 percent. The WTI-oil Index lost 5.72 percent. This fluctuation has not yet reflected the oil extraction reduction by OPEC (the decision was taken in the second quarter). Gold, as an imaginary 'safe haven', appreciated by 7.96 percent.

	30/12/22	**31/3/23**
EUR/CZK	24,16	23,47
USD/CZK	22,56	21,65
EUR/USD	1,0705	1,0839

CURRENCIES

Euro slightly strengthened against the dollar by 1.3 percent. The Czech crown continued in its 'winning campaign'. It strengthened against the dollar by 4.0 percent. And it added 2.9 percent against the Euro. This strengthening of the Czech crown may be the result of several factors. They include, in particular, exploitation of loans in EUR by exporters, as well as the rhetoric of the central banks with regard to potential initiation of interventions in the event of unfavourable movements of the Czech crown.

Source of the data in the charts: Bloomberg. Performances of individual assets are measured in the primary currency of the given instrument in the period from 30 December 2022 to 31 March 2023.

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

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FUTURE OUTLOOK

The development characteristic for the capital markets in the first quarter of this year was fairly wild since the struggle waged by the central banks against global inflation was accompanied by difficulties in the banking sector. Still, this year's first quarter was successful as to its results, in view of the trends in the movements of both equities and bonds. Bonds profited from higher demand on the part of investors for more security and from changed expectations of future movements of interest rates in the direction of their potential decline. Equities, beside the factor of possible earlier reduction of interest rates, were also supported by the quick reassurance from the FED regarding the banks in trouble, and also the speedy resolution of the long-lasting difficulties facing the Swiss financial giant, Credit Suisse. The most closely watched S&P 500 equities index strengthened in the first quarter of this year by 7 percent, in Dollar terms, and the benchmark of the Czech sovereign bonds with maturities of 3 to 5 years increased by 2.4 percent.

Saudi Arabia surprisingly announced at the beginning of April that the OPEC countries would cut down on their crude oil extractions approximately by 1.15 million barrels per day commencing in May 2023. This piece of news has already been responded to by the prices of both the Brent oil and the WTI oil, which were going up. Increasing crude oil prices heighten pressure on inflation and, on the other hand, they may result in a slowdown of the growth of the global economy.

In March, the FED increased its benchmark interest rate by 0.25 percent up to 5.0 percent. It cannot be excluded that the FED would hike its interest rates again in May 2023; however, market expectations have it that first reductions of the rates may take place as soon as next autumn.

Also the ECB increased its interest rates by 0.50 percent at its session in March. The deposit rate reached 3.0 percent p.a. and the refinance rate 3.50 percent p.a. As regards the ECB, further hikes of the interest rates are expected.

The CNB continues to stick its benchmark interest rate to 7 percent p.a., although Czech inflation increased by 16.7 percent, y/y, in February. The market expects the CNB to reduce its benchmark interest rate as soon as in the second half of this year (*Source: Bloomberg*).

Any future trends regarding the equity markets will also be affected by the economic results season for the first quarter of this year. Expectations have it that the aggregated decline of the S&P 500 Index companies profit will reach -6.8 percent, y/y, while their revenues are expected to grow by 1.8 percent, y/y (*Source: FactSet*). Analysts anticipate that the total profits will again start to grow, commencing in the third quarter of this year.

The projected P/E of 18 (*Source: FactSet*) in respect of the next 12 months has been somewhat lower for the S&P 500 Index than its five-year average of 18.5 (*Source: FactSet*), but at the same time higher than its ten-year average of 17.3 (*Source: FactSet*). As far as this year is concerned, analysts anticipate a moderate growth of aggregated profits in the S&P 500 Index by 1.2 percent and of revenues by 2.1 percent (*Source: FactSet*). The anticipated higher growth of corporate profits next year and projected declines of interest rates, including lower global inflation, can support equity markets in the second half of this year.

Despite the neutral outlook regarding the equity markets, we assume a gradual increase in the stake of shares in our management strategies in the next quarter of the year, as we believe that equity markets can record a more favourable development compared to bonds in the longer run. The preferred regions include the U.S. market and the emerging markets; among the sectors, we wish to focus on the growth segments, such as technology, industry or consumer durables.

As far as bond strategies are concerned, we are at the moment happy about the current extension of 'duration' up to the level of moderate overweighting against the benchmark. As for the coming period, we consider increasing the share of corporate issues which offer higher yields as against sovereign bonds; at the same time, though, we contemplate possible credit risks very cautiously.

Higher core inflation and a possible global recession remain risks for the future development of capital markets.

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Outlook by: Raiffeisenbank a.s., Asset Management, regarding the individual asset classes in 2Q/2023:

SHARES	BONDS	CASH	ALTERNATIVES
USA	Bonds< 3Y	Cash, Term Deposits, Savings Accounts	Energy, crude oil
Technology, Healthcare, Finance, Industrials, Materials, Dividend-paying shares segment	Bonds > 3Y		Real Property
	Credit		Gold

LEGENDA: POSITIVE EXPECT. NEUTRAL EXPECT. NEGATIVE EXPECT.

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