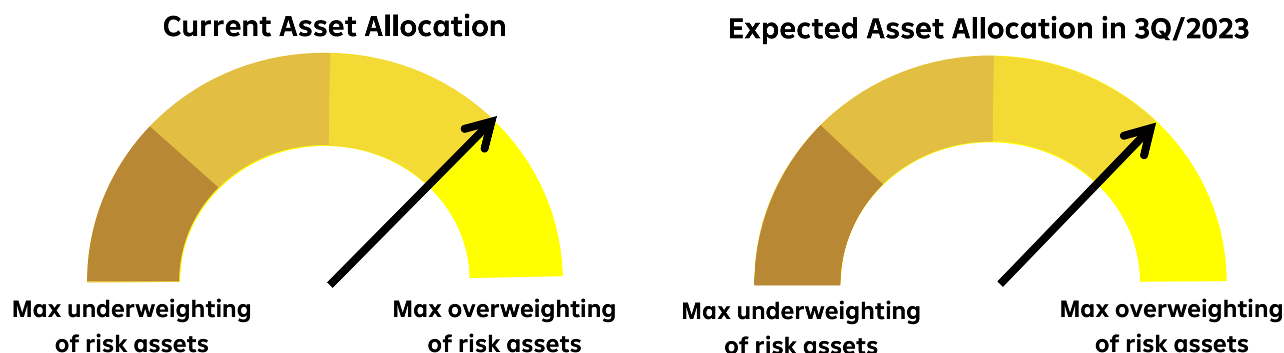
ASSET ALLOCATION

RB Asset Management 3Q/2023



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

Dear Clients,

The first half of this year has brought about some optimism to the financial markets. Despite high inflation, increasing interest rates, as well as the war in Ukraine, the most important equity markets have been growing, often taking a two-digit speed. The Nasdaq technological Index stands out as a prize-winner among other equity indices; it adds in excess of 30 percent this year. Also some bonds have been doing well; for example, the Czech sovereign bonds with maturities from 3 to 5 years have appreciated by more than 4 percent this year. Optimism prevailing in financial markets also finds a positive reflection in the feat of our managed portfolios.

The reasons behind such positive moods are an anticipated decline of inflation and associated potential decrease of interest rates. An expected growth of corporate profits and revenues in the second six months of this year represents yet another positive factor. On the other hand, there are risks of slower fall in inflation or of other steps taken by the central banks and their hawkish outlooks. This phenomenon can also be noticed in the minutes from the latest session of the U.S. FED; in other words, the fight against inflation is by far not over.

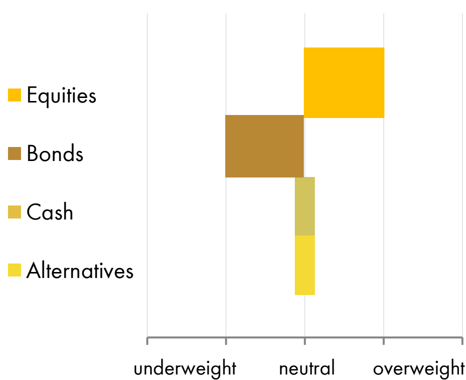
In spite of the above-mentioned risks, the most notable equity indices have taken a new bullish trend. They have currently added more than 20 percent from their minimum values recorded last year, which represents exactly the border for a bull market. Continuing uncertainties will probably result in higher volatility in the financial markets also in the period to come. Nevertheless, any potential declines can at the same time be viewed as investment opportunities.

We envisage a continuation of the growth trend in the future period. As part of our investment strategies, we overweight equities over bonds. In the past six months, we have increased the proportion of equities compared to bonds in several steps, up to the current medium degree of overweighting. As far as regions are concerned, we overweight North America and the Emerging Markets, while slightly underweighting Europe and the Pacific. Among the sectors, we prefer the Technologies Sector, the Industrial Sector, and the segment of dividend-paying equities. As regards bond strategies, we continue to hold longer duration as against bond benchmarks. If new opportunities should emerge from, e.g., higher market volatility, we are ready to make additional purchases for lower prices.

We wish you much success in the future period!
Mr Michal Ondruška
Manager, Asset Management

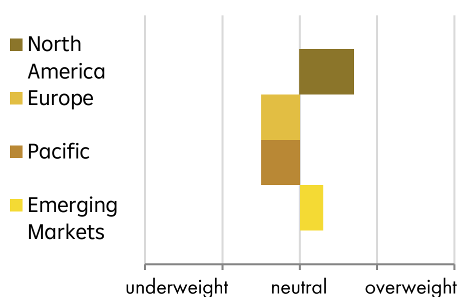
Raiffeisenbank a.s. Hvězdova 1716/2b ▪ PO box 64 ▪ 140 78 Praha 4 ▪ tel.: +420 234 401 111 ▪ fax: +420 234 402 111 ▪ e-mail: info@rb.cz ▪ web: www.rb.cz ▪ IČ: 49240901 ▪ zapsaná v obchodním rejstříku vedeném Městským soudem v Praze, oddíl B, vložka 2051

TACTICAL ASSET ALLOCATION – ASSET CLASSES



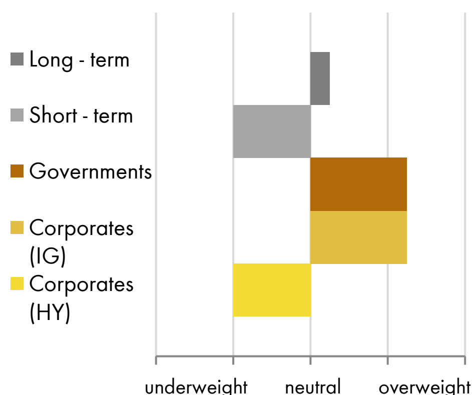
The market trends were calmer in the 2nd quarter of 2023, compared to the first quarter. The difficulties facing the U.S. regional banks did not spread further, the impact on the debt ceiling of the United States was postponed, and the good mood of stock investors in particular improved by the Artificial Intelligence Sector, with the help of excellent results generated by such companies as Nvidia. The S&P 500 Index entered a new bull market as it had added more than 20 percent since October 2022. If history should repeat itself, then - in 92 percent of cases ever since 1950 - the equity market continued to grow after a 20-percent index rise. The average bull market then continued for 65 months and the Index increased on the average by 184 percent (21 percent p.a.). At the same time, an average bear market lasted for 14 month with the average decline by 36 percent. The total average valuation of the S&P 500 Index thus reached 10.6 percent p.a. (*Source: Bloomberg*). Equity markets reflect resilience of economies and, in the long term, outperform inflation by yields more than bond markets. We agree to assurances from central bankers, including those from the Sintra economic forum held at the end of June, that the advanced economies are resilient in an unprecedented manner and can handle higher rates with the help of which central banks have been fighting inflation. Central banks thus assure markets that the scenarios of recession or even stagflation are less probable than a soft landing. The bull market in equities confirms this positive scenario. Therefore, we increase our investments in equities, while underweighting bonds as part of our tactical allocation of assets.

TACTICAL ASSET ALLOCATION – EQUITY REGIONS



In our investment strategies, we remain overweight in the regions of the United States and the emerging markets. In Europe and the Pacific, we still retain underweight allocations. Our exposition in the U.S. equities markets represents approximately 65 percent of the risk portion of our portfolios. Of that, around 10 percent in the Nasdaq Technological Index. We have also been overweight in the Financial Sector, the Industrial Sector, and the Health Services Sector. We hold 13 percent in the European equity markets. And we hold 6 percent in the Pacific, including Japan, and approximately 16 percent in the emerging markets.

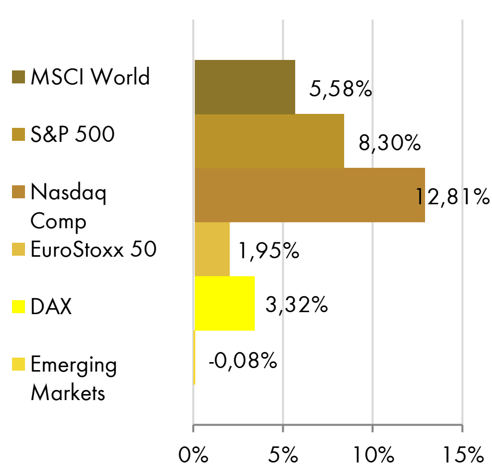
TACTICAL ASSET ALLOCATION – BONDS



The Czech central bank has not changed its relatively high interest rates (repo-rate: 7 percent) for one year, while the FED and the ECB increased their rates up to 5 percent - 5.25 percent, and 3.5 percent, respectively. The Czech-crown-denominated bonds with maturities of 3 to 5 years currently offer yields of 4.9 percent p.a.; at the beginning of this year, the yield oscillated above 5 percent. The corresponding yields of sovereign bonds denominated in USD (4.5 percent) and EUR (3.3 percent) are by 0.5 percent and 0.3 percent, respectively, higher than at the beginning of the year, as a result of the continuing hawkish policies of those central banks. The relative attraction of the Czech-crown-denominated bonds has been gradually diminishing as the market calculates with a quick and early reduction of the rates. Nevertheless, the Czech National Bank repeatedly does not rule out the possibility of raising rates, thus cooling down market conviction of early rate cuts. In view of higher risks, we prefer sovereign bonds in the market, as well as investment rating corporate bonds with their attractive yields and low credit risks.

Source of the data in the charts: Raiffeisenbank a.s., Asset Management, data valid as of 12 July 2023.

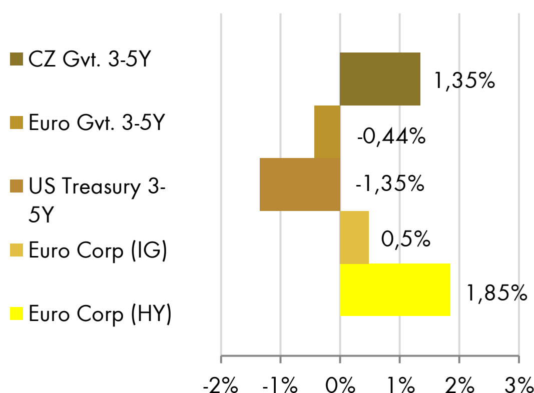
ECONOMIC SITUATION AND MARKET TRENDS IN 2Q/2023



EQUITY

The global equity markets picked up on the successful first quarter of the year. In the course of the second quarter, the indices of all major developed stock markets were rising. And the winner was: technological equities whose Nasdaq Index strengthened by 12.8 percent.

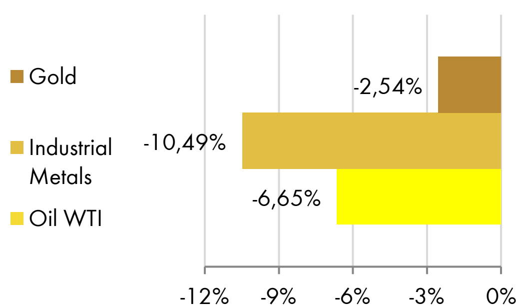
The U.S. equities S&P 500 Index rose by 8.3 percent. The Global Equities Index, supported driven mainly by positive sentiments in U.S. equity indices, strengthened by 5.6 percent. European stock fared relatively worse. The Euro Stoxx 50 Index strengthened by 2 percent, while the German stock exchange DAX Index by 3.3 percent. The worse performing were equities from the Emerging Markets; the MSCI Emerging Markets Index lost 0.1 percent.



BOND

Bond markets recorded various performances. High-risk bonds did the best. The European High-yield Bonds Index rose by 1.85 percent. Venture and corporate bonds benefited from the easing of negative sentiments in this segment of the market and the narrowing of risk premiums. Czech sovereign bonds also performed well, rising by 1.4 percent thanks to significantly falling inflation and a lower probability of further rate hikes.

On the contrary, the indices of U.S. and European sovereign bonds lost 1.4 percent and 0.4 percent, respectively. This was due to the persistently hawkish tone of their central banks.



COMMODITIES

Commodities faced selling pressures in the second quarter of the year. The expected decline in industrial production sent industrial metals to the correction band. They weakened by 10.5 percent in the second quarter fell overall by more than 20 percent from the local highs. Oil correction followed a similar spirit: the WTI Oil Index lost 6.7 percent. Gold lost 2.5 percent over the same period.

	31/3/23	**30/6/23**
EUR/CZK	23,47	23,76
USD/CZK	21,65	21,7789
EUR/USD	1,0839	1,0909

CURRENCIES

Currency markets were relatively calm, quarter-to-quarter. The Czech crown lost 1.2 percent against the EURO. The Czech crown lost 0.6 percent against the Dollar. The Dollar lost 0.7 percent against the EURO.

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 31 March 2023 to 30 June 2023. The currencies table shows the rates as of the date as indicated. Values contained in the text have been rounded to one decimal place.

FUTURE OUTLOOK

Equity markets experienced major strengthening during the second quarter of this year. The closest watched S&P 500 Equity Index rose by 8.3 percent during this period and the MSCI All Country World increased by 5.6 percent, in Dollar terms. Equity markets sped up their growth following their better than envisaged economic results for the first quarter of this year and expectations that Artificial Intelligence would boost the growth of revenues and profits primarily in technological companies (e.g., NVIDIA, Microsoft, AMD). Expectations have it that Artificial Intelligence will then have positive reflections in the economies of companies also in other sectors (increasing efficiency and lower labour costs). It seems that difficulties crushing the banking sector in the previous quarter have been over when the markets have acquired prevailing positive sentiments all over the second quarter.

The index of Czech sovereign bonds with maturity of 3-5 years strengthened during the period under review thanks to falling inflation and also thanks to market expectations that the CNB would reduce the benchmark interest rate towards the end of the year. On the contrary, similar bond indices in the United States and in Germany weakened because expectations had it that both the FED and the ECB would again increase their interest rates slightly, in spite of already falling inflation (*Source: Bloomberg*).

The ECB's discount rate has been set at 3.5 percent p.a. but analysts still envisage that it would be further increased. The next ECB session is planned to take place at the end of July.

The CNB continues to keep its benchmark interest rate at 7 percent p.a. Analysts believe that the CNB would cut down its benchmark interest rate probably towards the end of this year, although the CNB itself indicates that the rate would remain intact for a longer term.

Further trends in the bond markets will be affected by global inflation which has gradually been slowing its growth, as well as by the labour market trends. We believe that fixed-coupon bonds with longer maturities will be more in demand in the months to come.

The reasons behind the current optimistic mood prevailing in equity markets, besides advancements of Artificial Intelligence, are based, in particular, on falling inflation and resulting potential future cuts in interest rates in the course of the next year.

Future trends in the development of equity markets will also be affected by the season of disclosure of economic results for the second quarter of this year. Expectations have it that the aggregated reduction of profits of the S&P 500 Index corporations will reach -6.8 percent, y/y, while sales are supposed to drop by 0.8 percent, y/y, in the second quarter of this year (*Source: FactSet*). However, analysts believe that the total profits and revenues will start to grow again commencing in the third quarter of this year. Next year should see a two-digit growth of aggregated profits in respect of the S&P 500 Index.

The expected P/E 18.9 for the next 12 months will be higher for the S&P 500 Index than its five-year average of 18.6, and at the same time higher than its ten-year average of 17.4 (*Source: FactSet*). This year, analysts envisage a moderate growth of aggregate profits in the S&P 500 Index by 0.9 percent and an increase in sales by 2.4 percent (*Source: FactSet*). The prospective higher growth of corporate profits next year, and a possible drop in global inflation, might strengthen equity markets. Capital markets trends will still face risks due to persistently higher core inflation and possible global recession. For example, the curve of the Index of Purchasing Managers in Manufacturing under 50 points (46 points in June 2023) indicates a cooling down of the U.S. economy.

Outlook by: Raiffeisenbank a.s., Asset Management, regarding the individual asset classes in 3Q/2023:

EQUITIES	BONDS	CASH	ALTERNATIVES
U.S.A.	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

KEY: POSITIVE EXPECT. | NEUTRAL EXPECT. | NEGATIVNÍ OČEKÁVÁNÍ

Positive expectation (green): U.S.A.; Technology, Healthcare, Finance, Industrials, Materials, Dividend-paying shares segment; Bonds < 3Y; Bonds > 3Y; Cash, Term Deposits, Savings Accounts; Energy, Crude oil; Real Property. Neutral expectation (yellow): Credit; GOLD.

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