COMMENTARY ON CURRENT SITUATION FACING FINANCIAL MARKETS

Prague, 1 June 2020

Equity Markets Get Stronger Again

Last week was one day shorter than usual because Monday was a bank holiday in the U.S.A. and the markets were closed. The equity markets began to strengthen as soon as on Tuesday since yet another firm (NovaVax) announced testing of a corona virus vaccine.

The American S&P 500 index increased by 3 percent during the past week. Among the sectors, the cyclical sectors again performed best last week, such as industries and finances. On the other hand, the communications and energy sectors lagged behind, having increased by less than 1 percent.

In the days to come, investors will mainly watch the American Institute for Supply Management Manufacturing Index (the ISM index), which expects a moderate improvement from 41.5 in April to 43.7 in May; on Friday they will focus on the labour market since the unemployment rate is expected to jump from 14.7 percent in April up in the direction to 20 percent in May (*Source:* Bloomberg). In China, the supply managers' index exceeded 50 in May, which indicated an expansion.

The mutual relations between China and the U.S.A. will remain in the focus of investors also in the course of the following days. The stock exchange seems to has been ignoring so far the unrests in the U.S.A. accompanied by extensive pillaging.

As regards bond markets, yields remain low both in the U.S.A. and in Europe, including the Czech Republic. There is a risk facing bond prices in the form of higher than expected inflation potentially raging in the future months.

Both equity markets and corporate bonds markets still face the risk of the outbreak of a possible second wave of the corona virus pandemic occurring in autumn or in winter this year, as well as the disputes prevailing in the business area between the U.S.A. and China. Yet another risk may be ahead if a Democratic candidate should win the presidential election in the U.S.A., resulting in a possible increase in corporate taxes. The election will take place in the U.S.A. at the beginning of November this year.

We keep our portfolios slightly overweighed in equities, although the days to come may bring about higher uneasiness to the markets, since they have experienced quick increases over a short period of time and valuations have no longer been so favourable as they were one month ago. Nevertheless, equity markets have been supported by negative real interest rates together with profit increases envisaged to occur in the course of next year.

Our funds, too, contained in the past week higher portions of equities than the neutral ratios, and they thus profited from continuing optimisms on the equity markets. Responding to such course of events, we realised collection of profit by selling our

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Total shares purchased several weeks ago for substantially lower prices. A portion of such released funds has been invested into a broader equity index of emerging markets. We responded in a similar manner to increases in the prices of the Czech fixed coupon sovereign bonds; last week we sold bonds maturing in 2027 because they have currently been traded at their historical highs and their current low yields are no longer so interesting for us (yields approx. 0.6 percent p.a.). On the other hand, we purchased variable coupon bonds with maturity in 2027, which have been traded at low prices due to reduced CNB interest rates; however, they may have interesting potentials following economic revival.

Summary

- The American **S&P 500 index broke its 200-day moving average**. The growth trend in the stock markets remains relatively potent.
- As regards tactical regional allocations, we so-called **overweigh the regions of the U.S.A. and Europe**, while slightly under-weighing the Pacific region and the emerging markets.
- As regards tactical sector allocations, **we overweigh technologies, health services, and the dividend-paying shares segment**.
- We consider the bond markets, following a major growth in prices (drop on yields) relatively expensive, especially in the segment of fixed-interest sovereign bonds.
- We continue to **overweigh moderately the equity portions of our portfolios** as against bonds.

Acknowledgement

The financial markets experienced in the past days and weeks a significant calming down of the overall situation resulting from the spread of the corona virus pandemic. Therefore, as a result of such positive development, we shall extend the period of publishing our comments, namely, from weekly to monthly issues. At the same time, we haste to assure you that our weekly comments will return if uncertainties should return to the markets.

In conclusion, I should like to thank you for your kindness and trust. The just passed months have intervened in the lives of each of us. We believe that you have survived this period in good health and that you have had the opportunity of spending more time with your loved ones. As regards financial markets, that period will have its records in history. I believe that we did an excellent job together throughout that phase. This belief of mine is supported not only by the relatively strong revival of performances of our managed funds and portfolios, but also by your trust measured by the volume of managed assets which has again been reaching within the Raiffeisen ČR group the maximum amounts reported prior to the emergence of the pandemic.

Thank you for your kind cooperation.

Sincerely,

Michal Ondruška

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