COMMENTARY ON FINANCIAL MARKETS 09/2022

Prague, 1 Sept. 2022

Jackson Hole Central Bankers' Conference Cooled Capital Markets

The most closely watched S&P 500 Index corrected its previous growth in August 2022, having weakened by 4.1 percent. The equity markets, especially towards the end of the month, responded to the conclusions from a central bankers' symposium at Jackson Hole. The FED head indicated that there was no imminent threat of tightening the bank's monetary policy and increasing its interest rates, accompanied by a reduction in the volume of assets on the FED's balance sheet (quantitative tightening). Nowadays, the FED's priority has unequivocally included efforts to fight inflation. Higher interest rates and tight liquidity in the capital markets bring about a risk of a continuing recession and a further decline in stock markets.

Expectations have it that the FED will again increase its benchmark rate in September, possibly as much as by 0.75 percent, up to 3.25 percent p.a. Any FED rate reductions are almost out of the question next year. Ms Loretta J. Mester (Cleveland FED president) has indicated that the FED rate will exceed 4 percent p.a. next year and that it would sit there for some time. The ECB, at its session next week, will most probably also increase its benchmark rate from 0.50 percent up to as much as 1.25 percent p.a., and the deposit rate from 0 percent up to 0.75 percent p.a.

Among the sectors, the best performing last month were the Energy Sector (+2.6 percent) and the Utilities Sector (0.5 percent). On the contrary, the worst performances were recorded by the Technological Sector (-6.2 percent), the Real Estate Sector (-5.6 percent), and the Health Services Sector (-5.8 percent).

The yield of the ten-year U.S. sovereign bond jumped over 3.1 percent p.a. from 2.6 percent p.a. after the Jackson Hole conference, when FOMC members hinted at tightening their monetary policies. Also, Germany's ten-year sovereign bond yield increased from 0.8 percent p.a. up to the current 1.6 percent p.a. towards the end of July. The CNB board, in its new setup, contrary to both the FED and the ECB, do not want to make any further benchmark rate hikes; it now sits at 7 percent p.a. Nevertheless, the yields of the Czech sovereign bonds increased again at the end of August, in response to similar trends occurring in both the United States and in Germany. The bond yield curve remains to have an inverse shape in the Czech Republic.

Mr Michal Ondruška
Manager, Asset Management

Raiffeisen BANK
Banka inspirovaná klienty

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, www.rb.cz, IČ: 49240901, zapsaná v obchodním rejstříku vedeném Městským soudem v Praze, oddíl B, vložka 2051

The anticipated P/E of 17.1 (*Source: Bloomberg*) for the next 12 months has been lower than its five-year average of 18.6 for the S&P 500 Index (*Source: FactSet*); however, it slightly exceeds its ten-year average of 17.0 (*Source: FactSet*). Nevertheless, the equity markets may find themselves exposed to selling pressures and become more volatile in the short term, as higher interest income usually means pressure on lower margins charged by individual companies.

Moreover, in addition to further increases of interest rates in the United States and the EU, the FED expects faster reductions of the asset volumes on its balance sheet. In conclusion, it is possible to claim that the anticipated inflation in the United States and in Europe will be playing one of the most important roles as regards further trends in the capital markets. The FED strives to push inflation in the direction towards 2 percent, although such move will not be painless for both enterprises and households.

Similarly as in the previous months, based on up-to-date economic data, we continued to extend the average terms to maturity in respect of bonds held in our portfolios in August 2022. We mainly purchased Czech sovereign bonds maturing in the years 2024, 2025, 2028, and 2035. Furthermore, we sold an instrument profiting from drops in the price of the ten-year German sovereign bond, which had also been reflected in a positive manner in the ‘duration’ of our portfolios. The equity markets continued to be very volatile in August. We made use of that phenomenon and – following the almost 13-percent increase in U.S. equities over the holidays, we generated profit in certain selected funds and we reduced the stake of equities by more than 3 percent in mid-August. This turned out to be a clever thing to do when the U.S. equities subsequently took a different course; they began to decline, and wrote off 8 percent of their previous growth by the end of the month. Also, sector allocation has been optimised in respect of our managed funds by selling off some U.S. industrial enterprises and companies producing durable goods; on the contrary, we purchased shares in smaller European technology companies.

Our managed portfolios continue to be weighted in neutral positions as regards equities and bonds. Most of our investment ventures have been directed to the U.S. market. We have gradually extended duration in respect of the bond portions of our portfolios. Geopolitical tensions and out-of-control gas prices and supplies make any further short-term predictions very difficult. Therefore, we expect high-level volatility to prevail in the financial markets in the course of the coming months which – on the other hand – may give rise to some interesting investment opportunities, both in the area of equities and bonds as well in respect of alternative instruments.

We wish you much success in the coming days!

For the Asset Management team,

Mr Michal Ondruška

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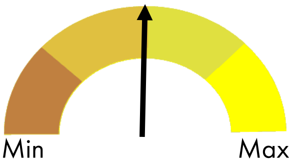
Summary of Investment Strategies:

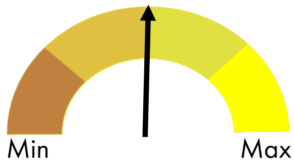
Tactical Allocation

Equity overweighted in portfolios

Current



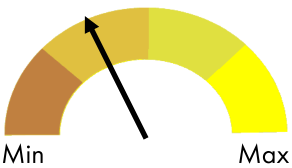
3M outlook



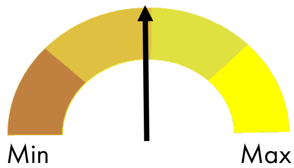
Interest Rate Risk

Average bond maturities (Duration)

Current



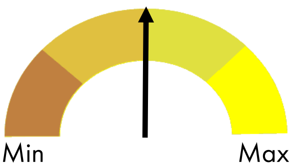
3M outlook



Credit Risk

Portions of, e.g., corporate bonds

Current



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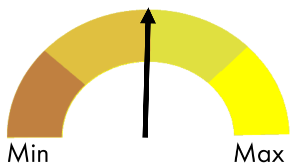
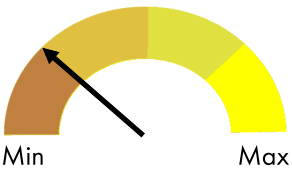


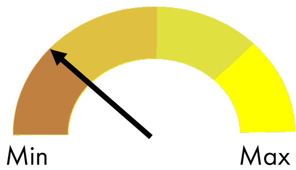
Currency Risk

Unsecured positions in foreign currencies

Current



3M outlook



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

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