COMMENTARY ON THE CURRENT SITUATION FACING FINANCIAL MARKETS

Prague, 1 Sept. 2020

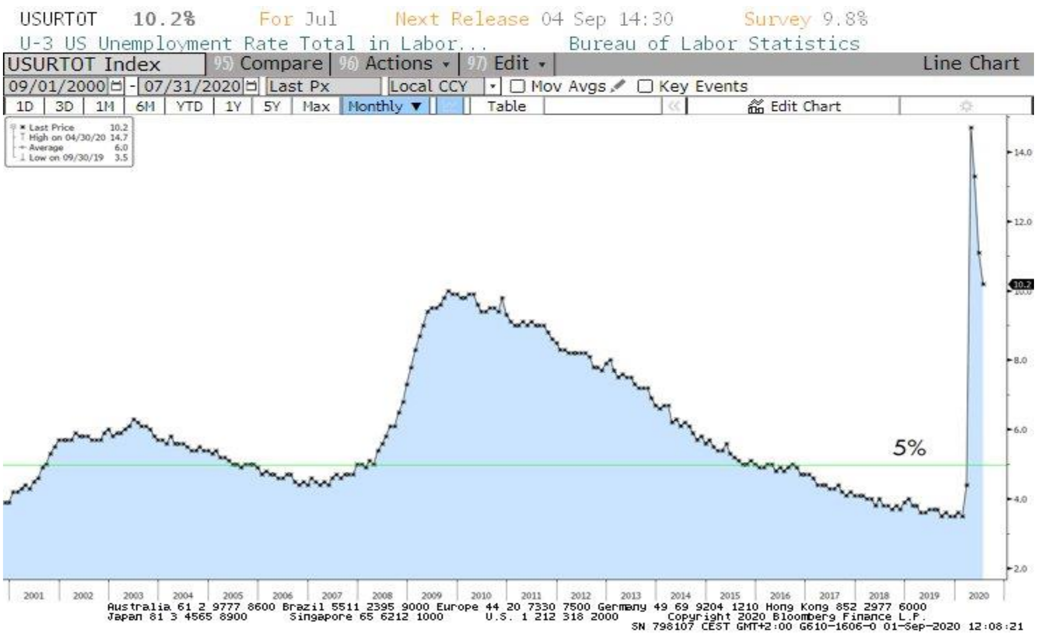
U.S. Equities Reach New Historical Highs

The equity markets were overwhelmed by a very positive mood last month. The S&P 500 Index has added 7 percent, while the Nasdaq technological index even increased by more than 9 percent; both indices thus reached new historical highs.

Practically all companies belonging to the S&P 500 Index have published their economic results achieved in the second quarter of this year. In 84 percent of cases, their profits exceeded those forecast by analysts. On the other hand, the aggregate profit of the companies belonging to the S&P 500 Index dropped by 31.8 percent. Equities have received substantial assistance in the form of the support measures adopted by the FED, including the government packages aimed at helping economic growths in the U.S.A.; at the same time, it is obvious that investors into equities have reflected positive expectations regarding growths in corporate profits next year.

Leading macroeconomic indicators remain favourable. For example, the U.S. Manufacturing and Services Purchasing Managers' Index has settled high above the 50 mark, something which indicates that the U.S. economy has been growing, thus having achieved better results than envisaged by analysts. The FED head, Jerome Powell, signalled a new strategy at the latest session at Jackson Hole; the FED will be newly aiming at average inflation which – as a result – may even exceed 2 percent as long as full employment in all labour market segments is achieved. No exact number has been specified but probability has it that it will require an unemployment rate below 5 percent.

Chart: Unemployment in the U.S.A.



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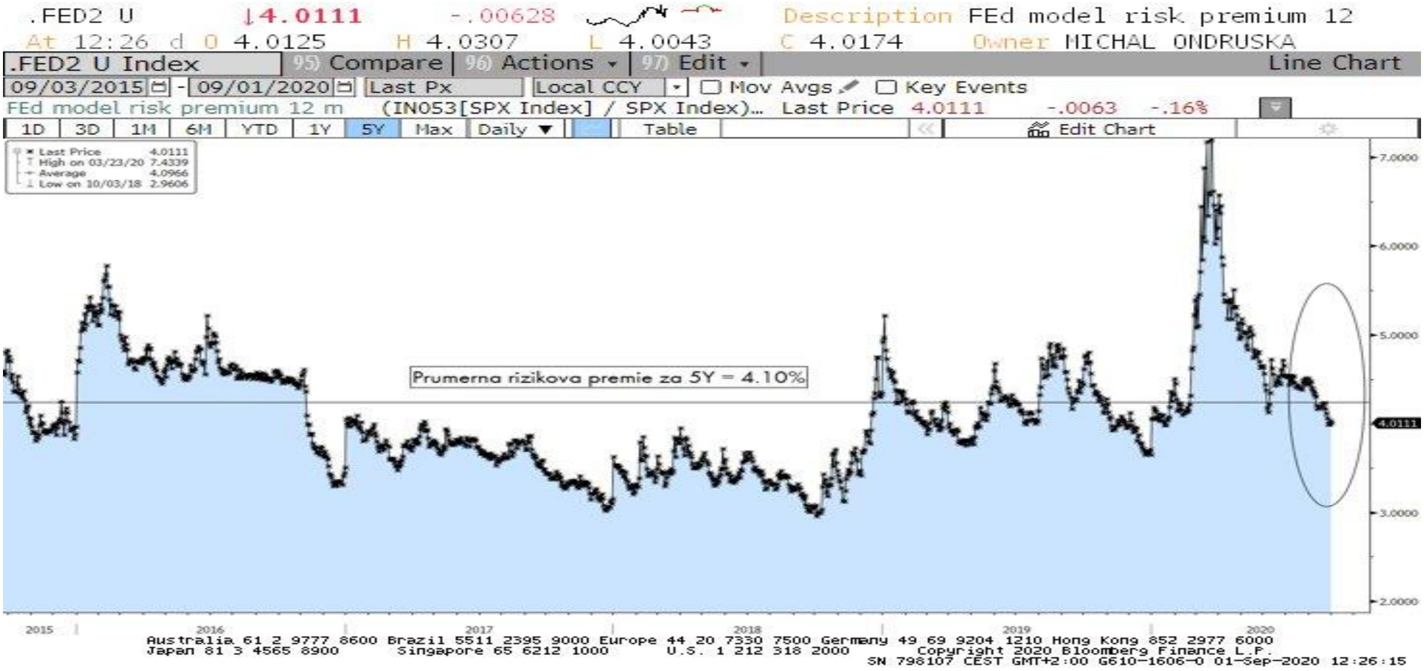
The expected P/E of 22.8 over the course of the next 12 months is for the S&P 500 Index higher than its five-year average of 17.1 (*Source: Factset*). On the other hand, the returns on the ten-year U.S. sovereign bond equal a mere 0.70 percent, which fact continues to prioritise the equity markets. The risk premium, i.e., the difference between the expected return on an investment in equities and the return on a ten-year U.S. sovereign bond, is slightly lower than its long-term average, as assumed in respect of next year – see: the chart. This indicates that the equity markets have no longer been so cheap. Nevertheless, we still keep our portfolios slightly overweighed in equities; returns on bonds have been low and not very attractive as viewed by ourselves, while inflation risk has been increasing, which may result in a drop in bond prices.

Chart: Risk premium, Equities vs. Bonds (so-called FED model)



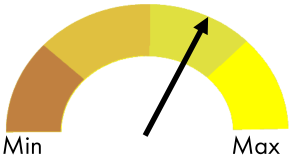
We have not altered the share of equities and similar instruments in our portfolios in the past month; ever since March, we have stuck to the strategy of their slight overweighing as against neutral levels. As far as territorial distribution is concerned, we still trust American equities the most which, compared to the structure of the global MSCI AC World Index, we have overweighed to the detriment of, in particular, shares from the Pacific region. As far as the sector distribution is concerned, we give priority to equities of corporations active in the cyclical branches (e.g., technology) or corporations manufacturing pharmaceuticals. As regards our implemented investment transactions regarding the RIS funds, we would also like to mention, e.g., purchases of stocks in Microsoft in the second decade of August, and sales of a half of this position at the end of the same month, for a price by almost 12 percent higher, or collection of profit as regards the instrument of ProShares Short VIX Short-Term Futures ETF, which we had purchased in June for a price by 20 percent lower than the selling price. As far as the bond component of the portfolios is concerned, we have overweighed corporate bonds as against sovereign bonds in several past months; in view of signals indicating speeding up of inflation and generally lower yields to maturity, we have preferred short-term and medium-term bonds to long-term bonds. In response to the statement of the boss of the U.S. FED who confirmed in the last week of August a change in the approach of the local central bank in relation to inflation, we have included in our portfolios, after quite a long pause, also so-called TIPS (TIPS – Treasury Inflation-Protected Securities, U.S. sovereign bonds whose face value as well as interest yields fluctuate in keeping with inflation).

Summary of Investment Strategies:

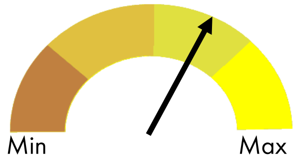
Tactical Allocation

Equity overweighed in portfolios

Current



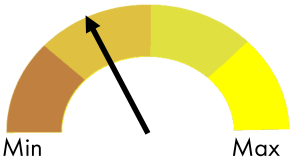
3M outlook



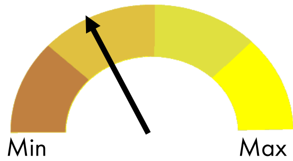
Interest Rate Risk

Average bond maturities (Duration)

Current



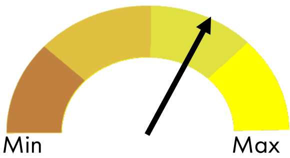
3M outlook



Credit Risk

Portions of, e.g., corporate bonds

Current



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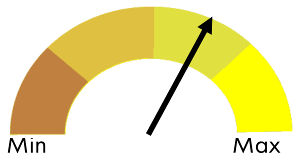
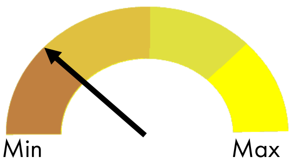


Currency Risk

Unsecured positions in foreign currencies

Current



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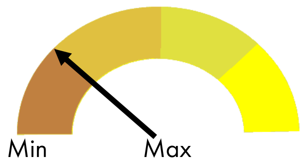

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