Prague, 1 Oct. 2020

U.S. Equity Markets Corrections and Presidential Elections

The equity markets experienced higher anxiety last month. The S&P 500 Index weakened by approximately 4 percent. Among the sectors, best performed the utilities sector (+0.5 percent), the materials sector (-0.5 percent) and the industrial sector (-2.3 percent) in the previous month. On the contrary, the following sectors failed to perform: the energy sector (-17.8 percent), the communications sector (-6.5 percent), and the technological sector (-5.25 percent). Market corrections were also caused by actions of retail investors who had driven the prices of Apple and Tesla shares to dizzying heights after their split, which later caused a decline in the technology sector.

Chart: Tesla shares price curve from 31.12.2019 to 01.10.2020

Source: Bloomberg

Yet another reason for the entire equity markets correction was caused by reports by AstraZeneca to the effect that one of the volunteers tested on their vaccine had shown side effects in the third phase of tests; as a result, the company decided to postpone manufacturing of the vaccine. The last straw that failed to support the markets came from the FED that plans to keep the benchmark interest rate at technical zero (0-0.25 percent) also in the course of 2023. What is not clear though is whether the FED will also affect bond buyouts as well as the longer end of the yield curve, which has also introduced uncertainty among investors .

Leading macroeconomic indicators remain favourable. For example, the American Manufacturing and Services Purchasing Managers' Index (the ISM Index) has firmly settled above the 50 mark, an indicator of economic growth in the U.S.A .

Mr Michal Ondruška
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Yet another factor, which is going to influence the equity markets, will be the upcoming season of publication of corporate results for the third quarter of 2020 in the U.S.A. Here, an aggregated drop in profits by approximately -22 percent, y/y, is expected in the third quarter. However, the year 2021 should already see increased profits.

Chart: Manufacturing Purchasing Managers' Index (the ISM Index), period 10/2015 – 09/2020
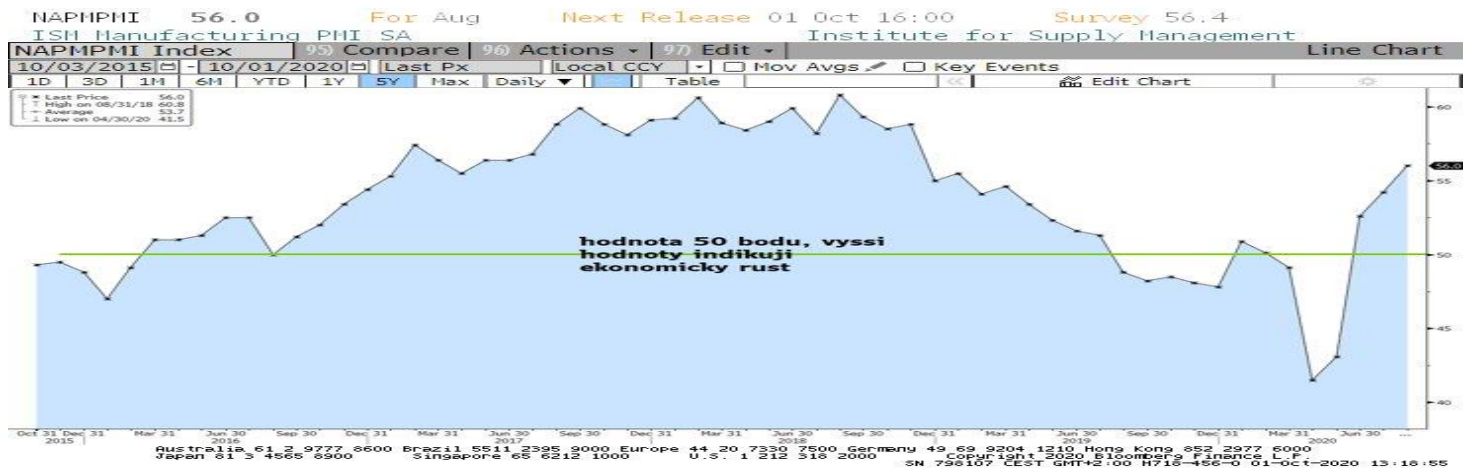
Source: Bloomberg

The envisaged S&P 500 Index P/E of 21.7 for the coming 12 months exceeds its five-year average of 17.1 (*Source: FactSet*). On the other hand, returns on the ten-year U.S. sovereign bond continue to fluctuate around 0.70 percent, which also supports the equity markets. The risk premium based on earnings expectations for the next year is only slightly higher than its average over the past 5 years, which indicates that equities are not expensive at current levels.

However, markets face the risk that the Democratic candidate may win the U.S. presidential election, with the resulting possible increase in corporate taxes. The U.S. elections will be taking place at the beginning of November 2020.

Yet another risk for the equity markets and corporate bonds markets is represented by the second wave of the Corona virus pandemic and the continuing commercial disruption between the U.S.A. and China. Therefore, we tend to expect higher financial markets volatility in the coming period.

We keep the portfolios slightly overweighed in equities. As regards regional priorities, we have continued to trust American shares, while trying to identify in a selective manner opportunities also among European equities and equities from emerging markets. As far as investment funds are concerned, we were taking advantage of higher market volatility throughout the month and entered certain positions at better prices. Thus, investments have been made, for example, into equities in Microsoft and Netflix; as regards Microsoft, we have repurchased its equities following their sales for profit at the end of August 2020. We have also purchased certain specific sectors: let us mention, for example, American technologies and European health sector. Regarding regional transfers, we have realised, for example, sales of Asian shares accompanied by concurrent purchases of shares in European technology companies. We have repeatedly traded in both directions in gold or in other instruments, partially copying the volatility of the U.S. stock market. Looking at the bond components, we have rather purchased short-term and medium-term bonds, prevailingly denominated in U.S. dollars, with complementary trading also in EUR. We have also invested in U.S. sovereign bonds, whose nominal values and interest payments change along with inflation .

For the Asset Management Team
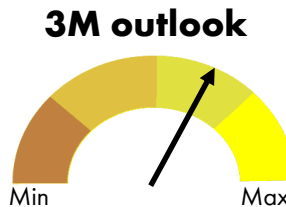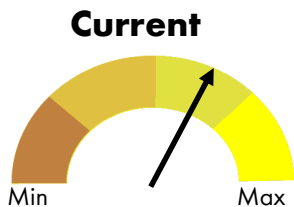Mr Michal Ondruška

Summary of Investment Strategies:

Tactical Allocation
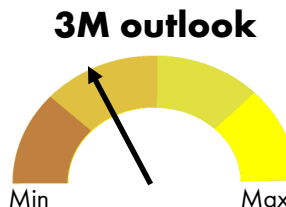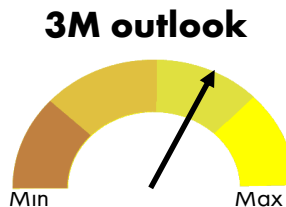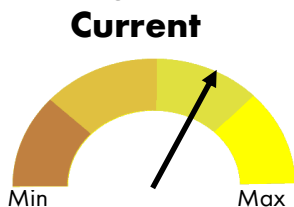Equity overweighed in portfolios

Current

3M outlook

Min — Max

Interest Rate Risk
Average bond maturities (Duration)

Current

3M outlook

Min — Max
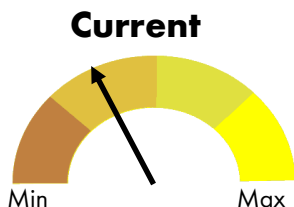
Credit Risk
Portions of, e.g., corporate bonds

Current

3M outlook

Min — Max

Currency Risk
Unsecured positions in foreign currencies

Current

3M outlook

Min — Max
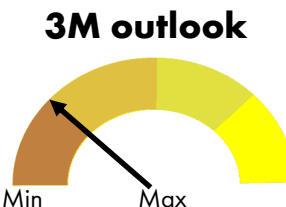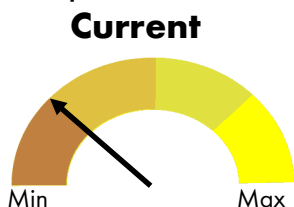
Source: Raiffeisenbank, a.s., Asset Management, data valid as of 1 Oct. 2020

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