COMMENTARY ON FINANCIAL MARKETS 03/2023

Prague, 1 March 2023

Equity Markets Corrected January Growths in February

While the most closely watched S&P 500 Index strengthened by a significant 6.2 percent in January 2023, a 2.5 percent correction occurred in February. Weakening of the equity markets was also contributed to by higher-then- expected inflation in the United States, accompanied by speculations about the FED raising the benchmark interest rate above 5 percent p.a. and then leaving it unchanged for a longer period of time. In practice, the corporate earnings season for the 4th quarter of the past year has been completed in the United States. The S&P 500 Index companies published an overall profit decline of -4.8 percent, y/y, and a sales growth of 5.4 percent, y/y, over that period.

Among the sectors, the best performing was the Industrial Sector (-0.2 percent), the Technology Sector (-0.1 percent), and the Short-Term Consumption Sector (-1.1 percent). On the other hand, the worst performing were the Energy Sector (-8.3 percent), the Utilities Sector (-5.7 percent), and the Real Estate Sector (-5.3 percent).

Following higher inflation data in the United States reported in January this year, expectations have it that the FED will continue to increase the benchmark interest rate from the current 4.75 percent up to approximately 5.5 percent. Fighting inflation remains the FED's priority; it increased by 6.4 percent, y/y, in January.

It is also expected that the ECB will raise its repo rate from 3.0 percent p.a. up to 3.50 percent p.a. at its session on 16 March 2023. The markets anticipate that the ECB benchmark interest rate can grow up to 4 percent p.a. in the course of the year (*Source: Bloomberg*).

The yield of the ten-year U.S. sovereign bond has climbed up to 3.95 percent from 3.50 percent over the last month, after some less favourable inflation data. The yield of the ten-year German sovereign bond fluctuates around 2.80 percent p.a. The Czech National Bank still keeps its benchmark interest rate at 7 percent p.a. The Czech CPI increased in January up to 17.5 percent, from the December value of 15.8 percent.

The yields of Czech sovereign bonds with longer maturities have been volatile. At the end of February, the yield of the Czech sovereign bond reached the limits of approximately 5 percent p.a., from 4.6 percent p.a. recorded in January.

The anticipated P/E of 18.0 (*Source: Bloomberg*) for the coming 12 months has been somewhat lower for the S&P 500 Index than its five-year average of 18.5 (*Source: FactSet*), nevertheless, it is higher than its ten-year average of 17.2 (*Source: FactSet*). The current low risk premium in the FED model indicates relative attractiveness of bonds compared to the equity S&P 500 Index.

Mr Michal Ondruška
Manager, Asset Management

Viewed by performances, the very successful January was followed by a significantly more volatile February, when it was not easy to keep our separate investment strategies in positive values, similarly as regards the majority of monitored indices. Performances of the investment strategies were mostly affected by prices paid for Czech sovereign bonds, which have begun to decline quite significantly since the middle of the month, but at the same time have revealed new investment opportunities. Such opportunities subsequently led to purchases of longer-maturity bonds and thus to the prolongation of duration, both in individual portfolios and in RIS funds.

For example, we realised purchases for RIS funds in February 2023 of bonds with maturities of 2030 and 2033 for higher hundreds of millions of crowns. In the event of further possible decreases, the fund managers are prepared to buy longer-maturity bonds again in order to "lock" the currently high yield for the coming years. The average term to maturity of the bonds held was extended also in the case of the US Dollar; here some attractive investment-level corporate bonds with duration of over 8 years were purchased.

As far as the RIS funds are concerned, faster several-day equity trading took place, e.g., involving shares of Total, the French energy giant, or ČEZ, which was very volatile in February.
The decisive factors for the further development of financial markets, in addition to the growth of profits and sales of individual companies, include global inflation trends and an end of the interest rate raising cycle by central banks. Further risks remain in the form of the war conflict in Ukraine and global recession.

As far as our investment strategies are concerned, we keep neutral positions in equities as against bonds. We have reduced overweighting of equities in the North American region, while increasing our stakes in Emerging Markets. We make advantage of growing bond yields for additional extending of duration, now to the range of moderate overweighting as against the benchmark. In the event of drops in the equity markets, we are prepared to boost the equity portion and its gradual over-weighting as against bonds.

We wish you much success in the coming period!

For the Asset Management team,

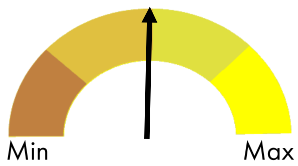
Mr Michal Ondruška

Summary of Investment Strategies:

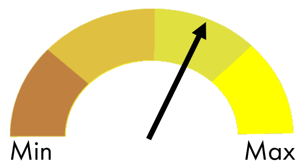
Tactical Allocation

Equity overweighted in portfolios

Current



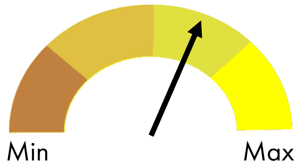
3M outlook



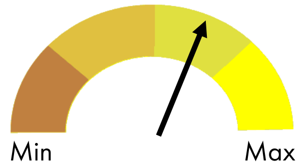
Interest Rate Risk

Average bond maturities (Duration)

Current



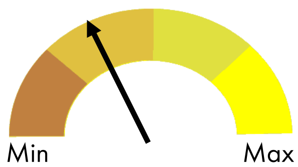
3M outlook



Credit Risk

Portions of, e.g., corporate bonds

Current



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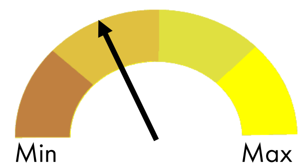
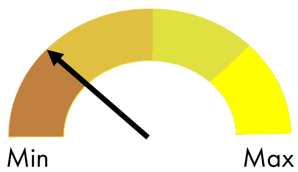


Currency Risk

Unsecured positions in foreign currencies

Current



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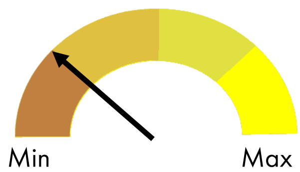

Source: Raiffeisenbank, a.s., Asset Management, data valid as of 1 March 2023.

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