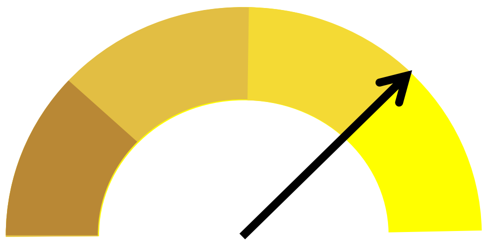
ASSET ALLOCATION

RB Asset Management 4Q/2021

PĚTIHVĚZDIČKOVÁ BANKA
K VAŠIM SLUŽBÁM

KLIENTSKY
NEJPŘÍVĚTIVĚJŠÍ BANKA
2015–2019

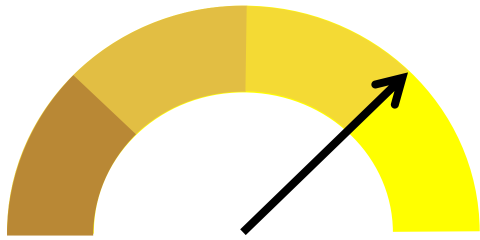
Current Asset Allocation



MAX underweighting of risk assets

MAX overweighting of risk assets

Expected Asset Allocation in 4Q/2021



MAX underweighting of risk assets

MAX overweighting of risk assets

Source: Raiffeisenbank a.s., Asset Management, data valid as of 8 October 2021

Dear Clients,

The past quarter meant a slight cooling-off to financial markets. Global equities dropped by 1.2 percent, while crown-denominated bonds with maturities of 3 to 5 years wrote off 1.1 percent. We see the reasons for such declines mainly in increasing inflation and in efforts exerted by central banks to slow down price increases. For example, the Czech National Bank increased its reference rate three times in succession, and that in the course of a mere three months. The latest hike boosted the rate by unexpected 0.75 percent, up to the value of 1.5 percent. Also the world central banks have responded; the U.S. FED as well as the European ECB have talked quite loudly about subduing their so-called 'quantitative easing' programmes. It is the question of just a few months, in particular in the United States, that the local central bank should either cut down on or terminate its repurchases of bonds in the open market, that is, pumping more and more cash into the economy.

The topic of 'inflation' resonates in practically all spheres of the economy and, at the same time, it significantly affects our everyday lives. Price increases have been projected into almost all fields, the prices of goods and services are rising at a pace that we have not been used to for a long time. Prices of energy and energy commodities have grown significantly in the past weeks. This trend will probably find its reflection in increases of the prices of goods and services in the coming months; thus another wave of inflationary growth cannot be ruled out.

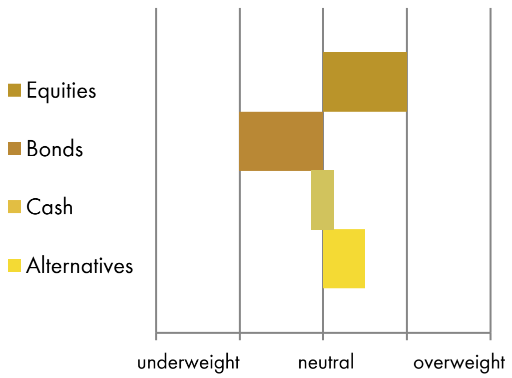
Viewed from the angle of our investment strategy, we consider inflation to represent a significant factor also in the months to come. Under higher inflation, stocks and alternative instruments usually perform better. Shares represent one of the few asset classes that have currently been generating some positive real appreciation. We have been watching closely yield premiums on equities over bonds; this trend still indicates a relative attractiveness of stocks. At the same time, this represents one of the reasons why we have continued to overweight equities as against debt instruments. As regards bonds, we have held shorter maturities, with the intention of eliminating any negative impacts of further potential yield growths; simultaneously, we prefer corporate bonds to sovereign debt.

We expect higher market volatility to occur in the coming period, probably also accompanied by lower return on equities. Other factors, too, will be playing an important role, such as increasing numbers of people infected with the Corona virus or the nearing advent of the winter season characterised by growing difficulties regarding gas and other precious energy supplies. On the other hand, some new and interesting investment opportunities may be emerging.

We wish you much success in the coming period.

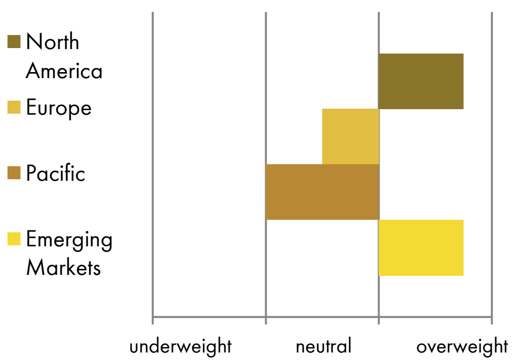
Mr Michal Ondruška
Manager, Asset Management

TACTICAL ASSET ALLOCATION – ASSET CLASSES



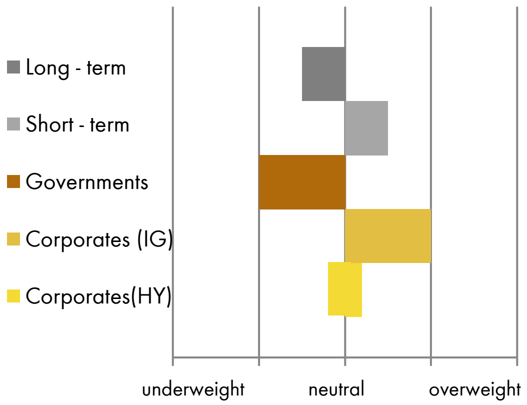
In the third quarter, stock indices in developed markets reached new highs with growths of 5 to 6 percent, in order to end at the end of September at about the values characteristic of the beginning of the quarter. Yields of 10-year U.S. and German bonds shifted from 1.2 percent to 1.5 percent, and from -0.5 percent to -0.2 percent, respectively. Equities were supported by the record-high growth of profits and revenues assisted by central banks and governments. Rising bond yields have been driven by expected drops in central bank support, economic growth, and higher inflation. As a result, valuation of equities as against bonds still remains attractive. The risk return premium on U.S. shares currently stands at 3.5 percent, while the 30-year average is 2.1 percent, that is 1.4 percent above the long-term average (thus, stocks are historically cheap). This difference indicates to us the potential increasing yields of the 10-year Treasury (to 2.7 percent), which trend would give equities some average attractiveness in the long run. For Czech investors, where the yield of a 10-year sovereign bond climbs to 2.2 percent, its attraction declines, however, still remaining justifiable. Moreover, equities overcome bond yields under increasing controlled inflation; therefore, they have been capable to achieving real yields. In the coming period, we continue to overweight shares and alternatives as against debt instruments.

TACTICAL ASSET ALLOCATION – EQUITY REGIONS



We have left tactical allocation unchanged as against the previous quarter. In our models, we remain overweighted in the United States and in the emerging markets. On the contrary, we are underweighted in the Pacific Area and – slightly less – in Europe. Exposition in the U.S. equity markets represents approximately 62 percent of the risk portion of our portfolios. Out of that, some 10 percent has been invested in the Nasdaq Technology Index. At the same time, we have been overweighted in the Financial, Industrial, Health Services, and the Consumer Durables Sectors. We hold a stake to the tune of 14 percent in the European equity markets. We hold 5 percent in the Pacific Area, including Japan, and approximately 19 percent in the emerging markets.

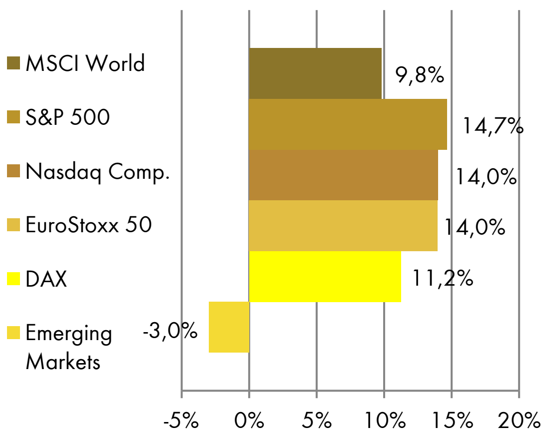
TACTICAL ASSET ALLOCATION – BONDS



The central banks in the developed countries, particularly the European ECB and the U.S. FED, continue to extend major assistance to liquidity of the financial markets, keeping yields of sovereign bonds low. Although the FED is expected to announce reduction of purchases soon, it would not raise its rates until the end of 2022. According to Bloomberg, the ECB even plans a new programme aimed at purchases of assets designed to replace the so-called PEPP (Pandemic Emergency Purchase Program, sized EUR 1.85 thousand billion) terminating in March 2022, in order to prevent the sell out of bonds issued by indebted countries. This, obviously, will not change anything regarding the low to negative yields on EUR bonds. The Czech National Bank still carries on its aggressive rate hikes. The Czech rates may exceed 3 percent at the end of 2022, which is 1 percent point more than predicted by the market three months ago. Therefore, we are evidently not going to see an end to drops in prices of fixed-coupon and longer maturity bonds. On the other hand, yields around 2 percent generated also by shorter maturities represent an interesting improvement. Compared to the benchmark, we keep shorter average terms to maturity (so-called 'duration') and we tactically overweight the portion of premium corporate bonds.

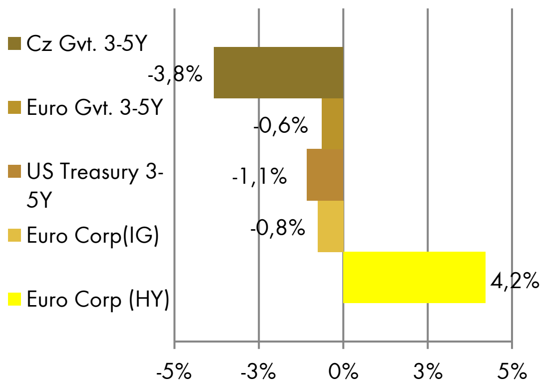
Source of the data in the charts: Raiffeisenbank a.s., Asset Management, valid as of 8 October 2021.

ECONOMIC SITUATION AND MARKET TRENDS



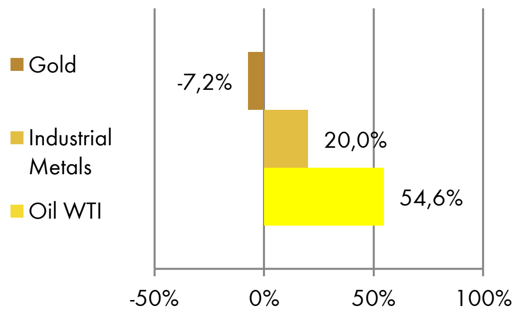
SHARES

The developed equity markets stagnated in the third quarter, while the major emerging markets weakened. The equity markets became somewhat nervous towards the end of the quarter. The end of the quarter itself was particularly affected by the situations resulting from the default suffered by the Chinese developer Evergrande, as well as from fears of inflation, rocketing energy prices, and the reaching of the U.S. debt ceiling. The U.S. S&P 500 Equity Index has strengthened by 14.7 percent since the beginning of the year, with the Nasdaq Technology Index with +14 percent at its heels. Both the European and German equities have been doing very well (the DAX Index: +11 percent, Eurostoxx: +13.9 percent). Emerging markets stocks performed relatively worse, having written off almost 3 percent since the beginning of the year.



BONDS

The index of the Czech sovereign bonds weakened fairly significantly during the monitored period, in response to the ongoing interest rates hikes. The index of the Czech sovereign bonds with maturities of 3-5 years has declined by 3.8 percent since the year start. Also other important bond indices dropped, however, their declines were not so significant and their reflected the slower expected speed of increases of rates denominated in EUR and USD. This is true with the exception of the index of European high-risk bonds, which strengthened by 4.2 percent since the beginning of the year.



COMMODITIES

Commodities in general recorded a steep growth in the third quarter. Especially energies reported a major growth. Crude oil (WTI) has increased more than 54 percent this year. The prices of electricity have reached historical highs. Also industrial metals have continued to grow (+20 percent this year). Gold, though, was an exception, having written off 7.2 percent this year.

	30/06/21	**30/09/21**
EUR/CZK	25,51	25,34
USD/CZK	21,51	21,89
EUR/USD	1,1858	1,158

CURRENCIES

The Czech crown weakened by 1.75 percent against the U.S. Dollar in the course of the third quarter and by a total of 1.9 percent over the entire year. As against the EURO, the crown strengthened by 3.4 percent this year, and – on a quarterly basis – the exchange rate was almost unchanged. The Dollar strengthened against the EURO by 2.34 percent in the third quarter and by 5.2 percent overall this year.

Source of the data in the charts: Bloomberg. Performance of individual assets is measured in the primary currency of the given instrument since the beginning of the year until 30 September 2021.

The currencies table shows the rates as of the date as indicated.

FUTURE OUTLOOK

The most popular S&P 500 Index strengthened by 14.7 percent since the beginning of the year and by 0.23 percent over the past three months. Nevertheless, a correction occurred in the equity markets during September 2021, when the S&P Index wrote off 3.6 percent over that one single month. Among the sectors, the best performing throughout the past quarter were the Financial Sector (+2.3 percent), the Technology Sector (+1.1 percent), and the Real Estate Sector (+0.3 percent). On the contrary, the list of the worst performing sectors includes the Industry Sector (-4.5 percent) and the Materials Sector (-3.9 percent).

The recent weakening of the equity markets has been caused by deteriorating investor sentiments and gradually growing global risks, resulting especially from high inflation driven mainly by the input side (expensive energy and commodities in general, lack of chips, insufficient transport capacity, and interrupted supply chains). The speed of corporate profits growths in the United States probably reached its peak in the second quarter of this year, which represents another reason for the temporary decline of the markets. Still another cause for corrections lies in expected attenuations of quantitative easing (the monthly purchases of bonds by the FED to the tune of USD 120 billion) and its subsequent termination sometime in the summer of 2022, and the resulting boosting of yields of not only sovereign bonds. Last but not least, the worsening investor sentiments have had their roots in the difficulties faced by the Chinese real estate sector (e.g., the Evergrande company has been in difficulties regarding repayment of bonds, and it is not the only firm facing such situation). Also, increasing the limit on the debt ceiling in the United States has not yet been resolved. The Volatility Index VIX again reached the value of 20, which confirms higher nervousness on the part of investors and the equity markets.
Inflation has continued to remain in the focus of attention of investors. Inflation has increased high above 4.1 percent, y/y, both in Germany and in the Czech Republic in August, while the figure has even risen to 5.3 percent, y/y, in the United States. Such higher inflation affected the yield of the ten-year German bond, which moved from approximately -0.38 percent at the end of August to -0.19 percent towards the end of September. The yield of the ten-year U.S. sovereign bond similarly increased from 1.3 percent to approximately 1.5 percent. In the Czech Republic, the sovereign 10-year bond yield reached as much as 2.1 percent, which is 0.3 percent more than one month ago. Probably, the Czech National Bank will increase the rates up to approximately 2 percent by the end of the year. The FED so far plans no interest rate hikes either in 2021 or next year; however, it still may rethink this position in the course of the coming months.

The envisaged P/E of 20.1 over the next 12 months represents for the S&P 500 Index a higher figure than its five-year average of 18.3 (*Source: FactSet*). Nevertheless, the yield of the ten-year U.S. sovereign bond still remains relatively low and the awaited aggregate growth of the S&P 500 Index corporate profits still remains high at 27.6 percent, y/y, also in respect of the third quarter of 2021. As regards the entire year 2021, expectations have it that the aggregate growth of the S&P 500 Index corporate profits will reach 42.6 percent, y/y, and of revenues 15 percent, y/y (*Source: FactSet*). Actually, it is such positive corporate results generated in the third quarter that may support the equity markets again.

In view of the still awaited increases in profits this and next year, we leave our portfolios overweighted. We expect further rate hikes to take place in the Czech Republic, as well as higher bond yield, so we hold in our portfolios shorter average maturity bonds as a whole as against 'benchmarks'. Given the growing risks, we cannot exclude higher volatility in the capital markets in the weeks to come. Risks to growth in equity markets are represented by higher inflation and sharp rises in bond yields, lower corporate profit margins, policy speculations about raising the U.S. debt ceiling, and a possible increase in corporate taxes.

Outlook by: Raiffeisenbank a.s., Asset Management, regarding the individual asset classes in 4Q/2021:

EQUITIES	BONDS	CASH	ALTERNATIVES
USA, EMM Asia	Bonds < 3Y	Cash, Term Deposits, Savings Accounts	Energy, crude oil
Technology, Healthcare, Finance, Industrials, Consumer Discretionary, Dividend-paying shares segment	Bonds > 3Y		Real Property
	Credit		Gold

KEY:			
	POSITIVE EXPECT.	NEUTRAL EXPECT.	NEGATIVE EXPECT.

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Information about Raiffeisenbank a.s.

The document has been drafted by Raiffeisenbank a.s., with registered office at Hvězdova 1716/2b, Praha 4, Registration number (IČO): 49240901, incorporated in the Companies Register administered by the Municipal Court in Prague, Section B, File no. 2051. Raiffeisenbank a.s. has been supervised by the Czech National Bank. The information has been valid as of 11 October 2021. This information may be modified in future and RB shall not be required to inform any recipients of the present document about such modifications.

Officer in charge: Mr Michal Ondruška, Manager, Asset Management.