COMMENTARY ON THE CURRENT SITUATION FACING FINANCIAL MARKETS 11/2021

Prague, 1 Nov. 2021

Equity Markets Went Up Again in October, Inflation Remains in Investors' Focus

The most closely watched S&P 500 Index strengthened again in October following its weakening in September, namely by 5.7 percent, thus reaching its new historic high. This development in the equity markets results mainly from good economic achievements scored by companies in the third quarter of this year. More than 56 percent of the firms belonging to the S&P 500 Index have already published their economic results; out of them, 82 percent generated better than expected profits per share, and 75 percent of them pocketed better revenues than anticipated. So far, the aggregate profit of the S&P 500 Index has grown by 36.6 percent, y/y, while the figure stands at 15.8 percent, y/y, as regards revenues (*Source: FactSet*).

Among the sectors, the best performing last month were the Consumer Durables Sector (+11.3 percent), the Energy Sector (+6.7 percent), and the Technology Sector (+6.6 percent). On the contrary, the Communications Sector (-1.4 percent), the Short-term Consumption Sector (+3.2 percent), and the Utilities & Infrastructure Sector (+4.7 percent) were less successful. It was Tesla's shares, which have a large weight there, that had helped the Consumer Durables Sector to perform well on a monthly basis. Tesla both generated better quarter results than market expectations, and Hertz made a major order for the Tesla-made vehicles. The VIX Volatility Index slipped in the course of October below its long-term average value, which indicates greater calms in equity markets.

Inflation remains in the focus of attention of investors because it has ranged in the majority cases above both analysts' and central banks' expectations. 'Preliminary' October inflation exceeded 4.5 percent, y/y, in Germany; one month earlier it was 4.1 percent. Such higher inflation also affected the yield of the ten-year German bond which moved from -0.19 percent at the end of September to the present-day -0.11 percent. Similarly, the yield of the ten-year U.S. sovereign bond increased from 1.5 percent to approximately 1.6 percent. Expectations have it that the Czech National Bank will respond to such higher inflation by taking another hike in the base interest rate as soon as this coming Thursday, this time from 1.50 percent maybe up to 2.25 percent. Some analysts even speculate that the rates may go up by as much as one percent. In the Czech Republic, the yield of the ten-year-maturity sovereign bond increased from 2.1 percent in September to 2.65 percent at the end of October. The FED for the time being does not plan to boost its interest rates any time in 2021 or next year; nevertheless, this position may still be reviewed in the course of the coming months. The market, on the contrary, expects the FED to boost the base interest rate at least once in 2022. The FED is meeting at a session this week, at which attenuation of 'quantitative easing' is expected. The FED kept purchasing bonds monthly to the tune of USD 120 billion, until October this year, and this volume is envisaged to be reduced gradually down to a zero in the summer of 2022.

Mr Michal Ondruška
Manager, Asset Management

The envisaged P/E of 21.1 in respect of the next 12 months is higher for the S&P 500 Index than its five-year average of 18.3 (*Source: FactSet*). Nevertheless, the yield of the ten-year U.S. sovereign bond remains relatively low, while the aggregated growth of the S&P 500 Index corporate profits stays high at 21.6 percent, y/y, also in the fourth quarter of 2021.

As regards our managed funds, we have take advantage of existing market volatility and we have continued to optimize their bond structure, similarly as we did in the previous months. In particular, we were selling longer-maturity sovereign and corporate bonds denominated in EUR and USD, which had not yet responded to high inflation. We have placed the proceeds in shorter securities, and possibly in bonds whose yields have on the contrary been linked to the growing inflation. In this manner, for example, we have repeatedly purchased the floating-yield Czech sovereign bond with maturity in 2027. Another important part of our investment strategy, which limits the negative effects on bonds of higher inflation, has required overweighting of shares and other high-risk assets. Such overweighting starts approximately at 3 percent in respect of the more conservative funds, and reaches up to 10 percent in respect of higher-risk ones.

The portfolios of some selected RIS funds also include alternative instruments that correlate less to typical stock exchange assets. Therefore, we have also included a new ETF fund in some investment funds, which copies the development of the 'Bitcoin' crypto-currency. We keep Bitcoin futures contrast (rather than Bitcoin itself) in this ETF; such futures contracts have been traded on regulated stock exchanges in the United States. Therefore, the system risk related to such positions (bankruptcy, peculation, etc.) has been relatively low as a result. Of course, the risk of high volatility remains in place, which – on the other hand – represents an opportunity and a potential for interesting yields.

We do not intend to alter our investment strategy in the coming period. We remain over-weighted in equities, growth sectors, as well as in alternative instruments. We watch very closely the course of inflation and fluctuation of interest rates. **In our opinion, the current rapid to hasty growth in interest rates in the Czech market significantly brings closer the moment of their stabilisation. We see this moment as an important milestone in setting up a successful investment strategy for the future period. It will be the correct timing of <u>extending</u> bond maturities that will prove of key importance especially in view of bond strategies as it may bring about additional precious points to performances of our managed portfolios.**

We wish you much success.

For the Asset Management team.

Mr Michal Ondruška

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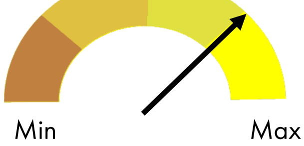
Summary of Investment Strategies:

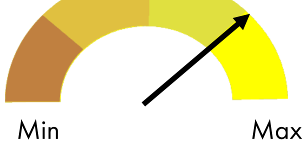
Tactical Allocation

Equity overweighed in portfolios

Current



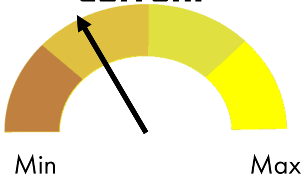
3M outlook



Interest Rate Risk

Average bond maturities (Duration)

Current



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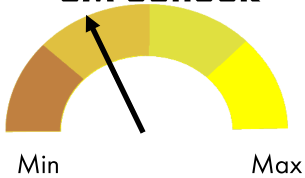
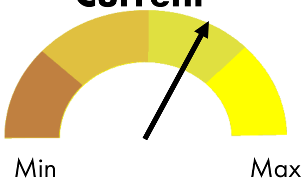


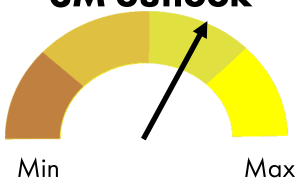
Credit Risk

Portions of, e.g., corporate bonds

Current



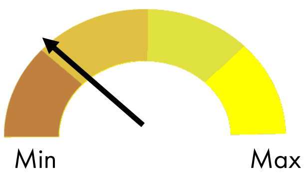
3M outlook



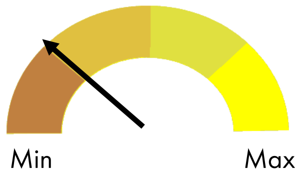
Currency Risk

Unsecured positions in foreign currencies

Current



3M outlook



Source: Raiffeisenbank, a.s., Asset Management, data valid as of 1 November 2021.

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