COMMENTARY ON THE CURRENT SITUATION FACING FINANCIAL MARKETS 10/2020

Prague, 2 Nov. 2020

U.S. Presidential Election Outcome Affect Markets for Days & Months

Major uneasiness lingered all over the equity markets last month since investors had eagerly awaited the results of the U.S. presidential election. The election results will probably be tight, so the winner may not be known right after the ballots. The outcome of the U.S. elections may have an impact on market developments both in the short and in the medium terms. The VIX Volatility Index reached the value of 38 lately, which represents the highest figure recorded this year ever since mid-April. The global spreading of the 'second wave' of the Covid-19 virus pandemic has not helped the equity markets. The monthly value of the S&P 500 Index dropped by 2.8 percent, despite the so-far better than expected economic results recorded by companies in the third quarter of this year.

Out of the sectors, the utilities sector performed best in the past month (+5 percent), while the technologies sector (-5 percent), the energy sector (-4.1 percent) and the health services sector (-3.6 percent) did the worst. Although both Apple and Amazon reported better than expected results, their shares fell because the structure of their sales (e.g., of iPhones) did not meet the expectations of analysts. Moreover, Apple has failed to publish their outlook for the next quarter. Yet another reason for the decline in the technologies sector resulted from 'profit taking', because it was this very sector that had performed best since the beginning of the year. To this date, some 64 percent of the companies belonging to the S&P 500 Index have disclosed their results, of which 85 percent have generated higher profits than envisaged by the market. At the end of October, the aggregated decline in profits reported by the S&P 500 Index companies amounts to a mere -9.6 percent, y/y, and of sales to 2.1 percent, y/y, while expectations of such aggregated drop in profits mentioned figures in excess of -20 percent, y/y, in the third quarter. Next year's outlook of aggregated increase in profits of S&P 500 Index amounts to 23 percent, y/y, and of sales to 7.9 percent, y/y (*Source: FactSet*). At the same time, analysts anticipate possible rotation of sectors, as higher growth in cyclical sector profits and a slightly steeper yield curve are expected.

Also, data about the gross domestic product in the third quarter were disclosed in the U.S.A. (+33.1 percent, q/q) as well as in the Czech Republic (+6.2 percent, q/q) last week (*Source: Bloomberg*). This information indicates some major economic recovery to take place as against the previous quarter. The currently prevailing second wave of the pandemic will most certainly hamper such revival, however, as soon as the impact of the pandemic is over, we assume that the pace of economic progress may again be relatively strong. It is the robust dynamics of economic growths and better corporate results in the third quarter that have inspired us to adjust our tactical allocation outlook where we have currently been slightly increasing overweighing in equity instruments.

Mr Michal Ondruška
Manager, Asset Management

Nevertheless, we continue to assume higher volatility in financial markets. Victory of the democratic candidate in the U.S. presidential election may represent a risk for the markets as it may result in a possible increase in corporate taxes, stricter business regulation, and the consequent slowdown in economic growth in the U.S.A. The Trump administration introduced lower taxes in order to boost U.S. manufacturing businesses and boost jobs for Americans. On the other hand, the Democrats spend more, so potentially higher fiscal incentives may offset any negative impacts of higher taxes on markets in the short term. According to the latest polls, the Democratic contender is in the lead, but the Republican candidate seems to be catching up on his advantage. Yet another risk for the equity markets as well as the markets of corporate bonds will continue to be posed by the second wave of the Covid-19 pandemic and potential economic lockdown, unless early production of sufficient amounts of vaccine is commenced. Yet another drawback is represented by the rift in the U.S.-China trade area.

Viewed from the angle of business activities regarding our managed funds, the month of October was twice as energetic as the previous month. In the case of the equity component, we took advantage of lower stock market volatility in October and adjusted to a greater extent the sector weight in individual fund portfolios, making use of exchange-traded ETFs. We cut down on the share of the energy, health services and daily consumption sectors. We added up to the sectors of information technologies, industry, consumer durables or finance. As far as regional preferences are concerned, we continue to rely most of all on American shares and we have selectively taken advantage of opportunities discovered among equities issued in emerging market. In respect of the bond component of our portfolios, we purchased broadly diversified bond ETFs issued by companies with lower credit ratings or selected EUR issues, mainly sovereign bonds with medium maturities (for example, Mexico and Romania).

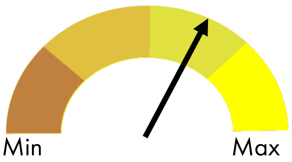
For the Asset Management Team
Mr Michal Ondruška

Summary of Investment Strategies:

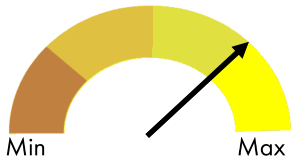
Tactical Allocation

Equity overweighed in portfolios

Current



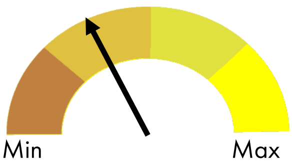
3M outlook



Interest Rate Risk

Average bond maturities (Duration)

Current



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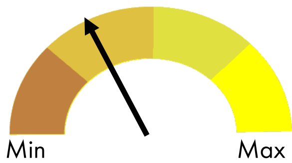
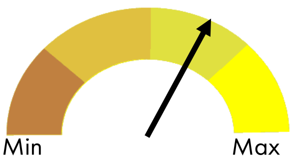


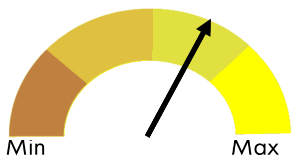
Credit Risk

Portions of, e.g., corporate bonds

Current



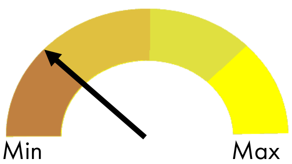
3M outlook



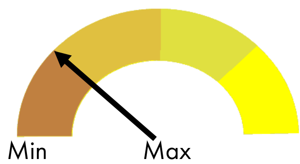
Currency Risk

Unsecured positions in foreign currencies

Current



3M outlook



Source: Raiffeisenbank, a.s., Asset Management, data valid as of 2 Nov. 2020

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