ASSET ALLOCATION

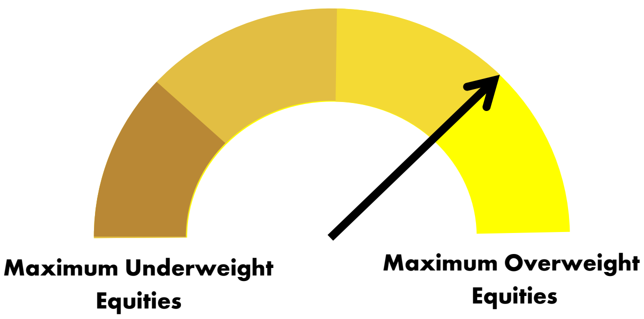
RB Asset Management 3Q/2020

PĚTIHVĚZDIČKOVÁ BANKA
K VAŠIM SLUŽBÁM

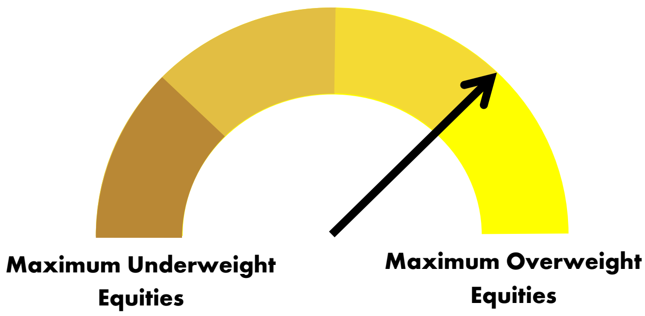
KLIENTSKY
NEJPŘÍVĚTIVĚJŠÍ BANKA
2015 - 2019

CURRENT STATE OF FINANCIAL MARKETS AND PORTFOLIOS ALLOCATION

Asset allocation in previous period



Asset allocation in next period



Dear Clients,

The financial markets have been gradually recovering from the shock imposed upon them by the corona virus pandemic. The values of some economic indicators, such as, for example, the gross domestic product or industrial production, have recorded historic declines. The equity markets, too, suffered considerable losses, having written of more than 30 percent in March (the American S&P 500 Index). On the other hand, the atmosphere of a high uncertainty has suited bonds, whose prices increased as a result of drops in interest rates. For example, Czech sovereign bonds with maturity of 3 to 5 years have earned their holders not negligible 4.5 percent from the beginning of the year. As regards the values of mixed portfolios (investing in both equities and bonds), their declines have been significantly made up for by rises in bond prices.

Although uncertainty continues regarding future developments of the pandemic in the form, e.g., its second wave, the economy and the financial markets have been gradually consolidating. Investors again re-focus their attention to fundamental indicators. Estimates of future economic development of the individual countries have been particularised, as well as projections of corporate profitability and revenues. For example, Bloomberg estimates American corporate profits to reach the pre-crisis levels as soon as next year. This is a good piece of news from the point of view of the equity markets, and it has also been reflected in equity prices, which have increased by almost 40 percent as against their minimum values in March (the American S&P 500 Index).

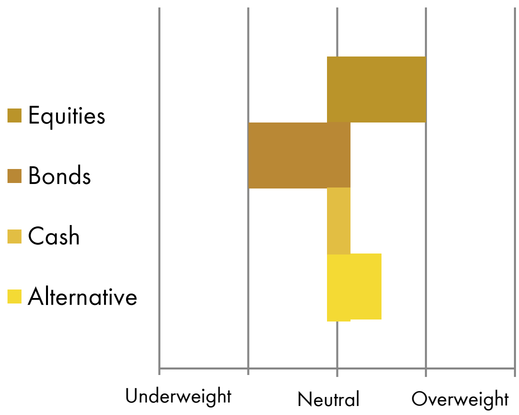
We remain moderately optimistic as regards the future period. The economy will continue to revive gradually; however, intensity of such revivals will differ in individual regions as well as sectors. We do not alter our investment strategy, we remain slightly overweighed in equities, giving priority to the regions of the U.S.A. and Europe; as regards sectors, we promote technologies, health services, and the segment of dividend-paying shares. As concerns bonds, we keep shorted average term to maturity, while actively working with premium corporate bonds that offer interesting yield potentials, but with acceptable risk.

I wish you a pleasant and peaceful summer.

Sincerely,

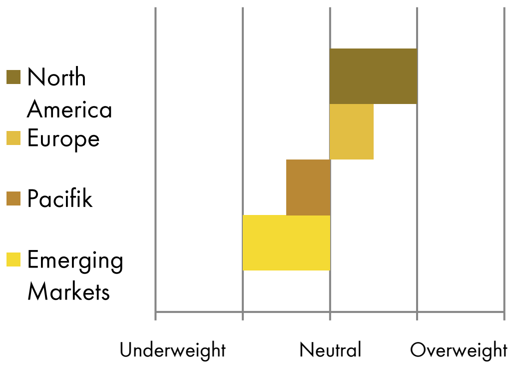
Michal Ondruška, Manager, Asset Management

ASSET DISTRIBUTION AS RULED BY THE INVESTMENT BOARD



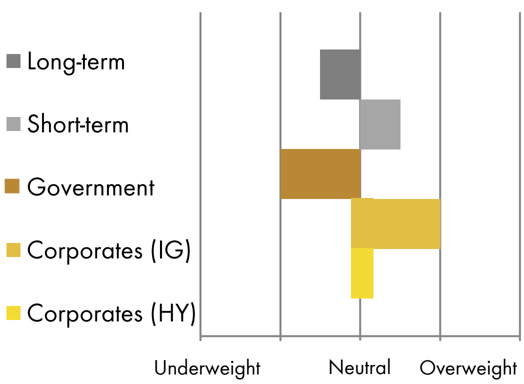
The unprecedented support from central banks and governments, combined with hectic efforts exerted by experts in pharmaceutical laboratories and medical doctors, offer the markets hopes for an early management of the economic recession and the effects of the corona virus infection. Our basic scenario counts with a gradual revival to come about in the second half of 2020. We shall learn how to live with the virus and we shall be making use of the incentives provided for by governments and central banks, and excess liquidity. Our evaluation of the fundamental indicators and market dynamics indicate a medium-term selective growth potential of high-risk assets. As part of our tactical allocations, we have been moderately over-weighing equities and other high-risk assets over sovereign bonds, whose yields have been approaching record lows. Any potential corrections, in particular in equity markets, should aim at further potential purchases of growth investments. Alternative investments, such as, for example, rental income from real estate or gold as an anti-inflationary insurance will serve as a diversification tool for the strategic portfolio.

TACTICAL ASSET ALLOCATION – EQUITY REGIONS



We have slightly adjusted assets allocations regarding the regions because we have increased the weight in our models of the U.S.A., while under-weighing the emerging markets. We have applied no adjustments to the sector allocations. Our exposure in American equity markets represents approximately 60 percent of the high-risk portions of our portfolios. Out of that, about 10 percent has been invested in the Nasdaq technological index and 8 percent in the financial sector. Our exposure in European equity markets extends to 18 percent. Also, we hold 9 percent in the Pacific area, including Japan, and approximately 13 percent in emerging markets.

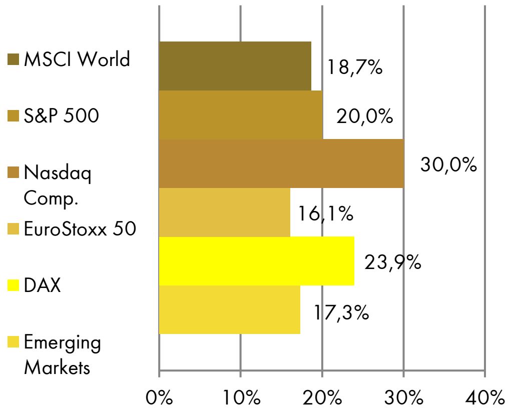
TACTICAL ASSET ALLOCATION – BONDS



The significant easing of monetary policies applied by central banks, with rates close to 'zero' on both sides of the Atlantic and also in the Czech Republic, has been fully reflected in the bond markets, whose earnings have touched historical lows. We are of the opinion that the risk of gradual growth, especially longer-maturity sovereign bond rates, now rather prevail in developed bond markets due to fiscal incentives and requirements for financing. As compared to the benchmark, we have therefore been maintaining shorter average terms to maturity (so-called 'duration'). We perceive opportunities for further reduction of credit margins especially in respect of corporate bonds, and a similar impulse may further help Czech sovereign bonds against German bonds. As compared to the benchmark, we tactically prefer the share of premium corporate bonds.

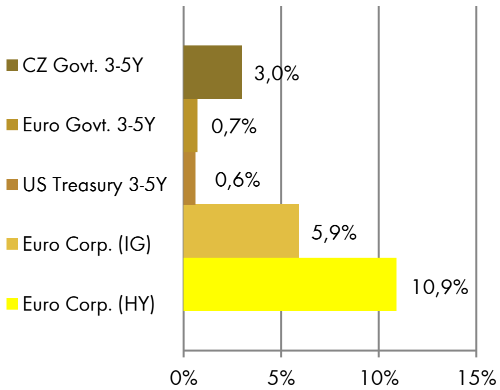
ECONOMIC SITUATION AND MARKET TRENDS

- **EQUITIES**



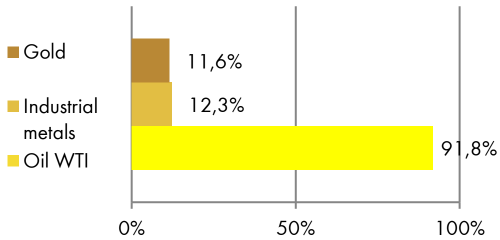
Following corrections applied in the first quarter of the year, the equity markets – in particularly in the U.S.A. – showed an extremely quick and strong 'comeback'. In the second quarter, American technologies performed best among the significant indices. Nasdaq increased by exactly 30 percent and S&P 500 by 20 percent. The European equities have not remained lagging behind, either, when DAX of Germany added 23.9 percent and Eurostoxx increased by 16.1 percent. The emerging markets, too, have begun to recover gradually from corona virus wounds and low oil prices. The emerging markets index has increased by 17.3 percent.

- **BONDS**



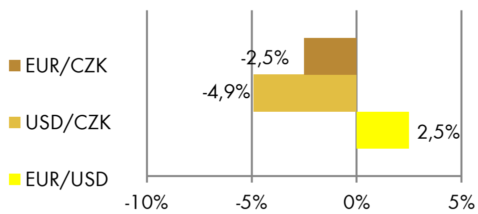
Easing of monetary policies – low interest rates combined with the long-term outlook and the rhetoric applied by central banks – have created further possibilities for a rise in the prices of sovereign bonds. American sovereign bonds have added 0.6 percent in the monitored period. European sovereign bonds increased by 0.7 percent. Czech sovereign bonds have performed well, too, having added 3.0 percent. The calming down of the market situation and purchases of corporate bonds by central banks have led to narrowing credit spreads and it has offered further support to growing prices of corporate bonds (+5.9 percent) and high-risk bonds (+10.9 percent).

- **COMMODITIES**



Gold has continued in its 'chevauchée', having added almost 12 percent in the second quarter. Tranquillization of the situation on the markets and expectations of a faster economic recovery have led to a significant rise in commodity prices. Oil (measured in respect of the American WTI) increased by 91.8 percent! Industrial metals increased by 12.3 percent.

- **CURRENCIES**



The Czech crown strengthened by 2.5 percent against the EUR and by 4.9 percent against the USD in the second quarter, and it has thus corrected its loss from the first quarter. The U.S. dollar weakened against the Euro by 2.5 percent, as a result of the US Federal Reserve having supplied dollar liquidity to other central banks.

Source of the data in the charts: Bloomberg. Performance of individual assets is measured in the primary currencies of the instruments in the second quarter of 2020.

OUTLOOK

The equity markets have almost managed to eliminate their losses generated in the first quarter of this year. The U.S. equity S&P 500 Index has been lagging behind by a mere 3 percent as against the beginning of the year. The S&P 500 Index strengthened by exactly 20 percent in the second quarter, which represents the best average performance generated by the index per year-quarter ever since the fourth quarter of 1998. It appears so far that the technology sector may aspire to stand out as the winner of the corona virus crisis; it has strengthened by 14 percent since the beginning of the year. On the contrary, the energy sector has performed the worst, with a drop in excess of 34 percent. The FED published its cautious forecast on Wednesday 10 June which – combined with increased numbers of Covid-19 cases in some states of the U.S.A. (e.g., Arizona, Florida, Texas, and California) – resulted in the strongest drop in stock markets since March 2020 on the very next day. The FED estimated in its forecast a 6.5 percent decline in the GDP in the U.S.A. this year, and its subsequent major increase by 5 percent in the year to come. Unemployment is expected to be reduced from the current level of approximately 14 percent down to 9 percent at the end of 2020, and further down to 6.5 percent in 2021. In order to support the economy, the FED plans to keep the key interest rate at 0-0.25 percent also during 2022, and it does not even consider any rising of rates. Moreover, the FED continues to purchase sovereign bonds to the tune of USD 80 billion per month, and it has also begun to buy corporate bonds and mortgage bonds. The U.S. Government is about to propose another fiscal incentive in the amount of USD 1 trillion, which aims at investments into infrastructures, including 5G networks. July sees the beginning of the season of publication of corporate results for the second quarter of the year. Analysts estimate that the aggregate profit of the S&P 500 Index will fall by more than 43 percent and sales by more than 11 percent in the second quarter of this year (*Source*: Factset). It will be interesting to see the outlook of corporate managers regarding the end of this year, since company results are likely to improve. It is not expected that the S&P 500 index firms will start generating an aggregate growth of profit and sales until next year, by 28.7 percent for profits and 8.5 percent for sales (*Source*: Factset).

The S&P 500 Index has been trading with the envisaged P/E of 21.9 over the coming 12 months, which is more than the average expected P/E of 16.9 over the past five years (*Source*: Factset). Nevertheless, the yield of a 10-year American government bond has been low, about 0.70 percent, and that encourages higher stock valuations, as companies have cheap financing and investors do not find bonds attractive. The anticipated risk premium according to the FED model is around its five-year average of 3.4. According to RBI analysts, the S&P 500 index will reach the value of 3300 points at the end of the year, which would represent its strengthening by approximately 6.4 percent as against the current figure (*Source*: RBI).

As regards future risks, we would like to mention the U.S. presidential election to be held in the autumn, since a winning Democratic candidate may seek higher corporate taxing; yet another corona virus wave, if a sufficient amount of vaccine and effective medicine cannot be produced in time; and tense relations between the U.S.A. and China. On the other hand, recent reports from the companies like Pfizer, AstraZeneca, Moderna or Gilead regarding future production of a corona virus vaccine or medicine have been quite encouraging.

The following table indicates our outlook regarding the separate asset classes in the horizon of three months:

EQUITIES	BONDS	CASH	ALTERNATIVE
USA, Europe	Bonds < 3Y	Cash, Term Deposits, Savings Accounts	Energy, oil
Technologies, Healthcare, Finance, Dividend equities	Bonds> 3Y		Real estate property
	Credit		Gold

KEY:			
	POSITIVE EXPECTATION	NEUTRAL EXPECTATION	NEGATIVE EXPECTATION

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