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Anxiety Continues, Stocks Are Falling, Opportunities Rising

The financial markets have been through a period of high uncertainty and they have alternately experienced days of panic euphoria and scepticism; nevertheless, the bloc of sceptics seems to prevail at the moment, pushing stock markets to new lows this year. We have witnessed a similar development in the bond markets a few days ago: bond prices kept going down while yields shoot up to several-year's highs. There was, *de facto*, no place to hide as the 'safe harbours' remained closed. Talk goes here of 'stagflation', recession, and continued sales off of the financial markets. However, have those threats really been genuine? It is possible to trace down several unique investment opportunities under the current developments that could not be seen here for the past twenty and more years!

<u>Opportunity No. 1: Investments in crown bonds/bond funds.</u>

Currently, Czech Republic's crown-denominated sovereign bonds offer yields in excess of **5 percent p.a.** We have not seen similar yields until back in 2001. Investors in those bonds will enjoy the following advantages: (i) today, a relatively high yield of 5 percent+ will have been fixed for a protracted period of time, e.g., 3, 5 or 10 years; (ii) purchase of a sovereign bond, i.e., high creditworthiness; (iii) daily liquidity as the bonds can be sold at any time; (iv) at the same time, if the interest rates start falling, bond prices will go up which can add up further interesting yields to the above-mentioned 5 percent p.a., even in the range of several percent p.a.; (v) if inflation declines, let's say, to 3 percent in the coming years, crown-denominated bonds will offer safe and at the same time real appreciation as against inflation. **As regards our investment strategy, we have altered our outlook in respect of crown-denominated bonds from NEUTRAL to POSITIVE.** A risk factor facing the bond strategy would be in a further rise in inflation above market expectations. Such expectations have it that inflation is supposed to culminate in the Czech Republic some time in this year's summer, and its growth rate should gradually decline towards the Czech National Bank's inflation target of around 2 percent. Should the inflation growth rate not decrease or should it remain at higher values (up to a double-digit value) for a longer period of time even during the next year, the prices of fixed coupon bonds could fall further. We are prepared to combine our strategy aimed at purchases of fixed coupon sovereign bonds with purchases of sovereign bonds with floating coupons; e.g., the current coupon yield of the CZGB float 2027 bond has been set (commencing yesterday) at 6.12 percent p.a., with a half-year preset revenue of the return according to the then current market situation, i.e., free of any interest risk.

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Opportunity No. 2: Investments into equities/equity or mixed funds.

Share prices dropped by tens of percent since the beginning of the year 2022, while some indices, such as the Nasdaq U.S. technological index, have lost more than 27 percent since the year start, thus moving to the so-called 'bear market'. Yes, risks have growing significantly, along with their accumulation into a short period of time: inflation, higher rates, the Russian invasion of Ukraine, COVID, new lockdowns in China. From a purely statistical point of view, such accumulation of so-called 'black swans' will start to fade off gradually. Sooner or later, also the inflationary pressures will weaken, possibly as soon as in the second half of 2022.

At the same time, the highest interest rate hikes adopted by the central banks will have probably taken place this year; markets will then subsequently flip into the mode of stagnation expectations or a decrease in rates, which can bring about positive impulses to stock markets.

Equity markets, too, enjoy a major support from the current labour markets: we have witnessed historically very low unemployment rates both in the United States and in the Czech Republic. The growing slope of the U.S. yield curve then further indicates a low probability of recession. It is next to impossible to time or guess correctly the moment of reaching the equity bottom, however, the current values of certain stock titles or stock indices, including their valuations, encourage either reflection or a straightforward business deal. We definitely recommend caution since the decreases can continue. Currently, we consider gradual accumulation of long-term positions, i.e., purchases distributed over time, even in the horizon of several upcoming months, as a suitable strategy in respect of equities. As regards, for instance, existing regular investments, a temporary increase in such regularly invested amounts can be a solution; similarly, in respect of currently managed portfolios, we would suggest an increase in their managed volumes and gradual investments thereof, again distributed over time.

Declines represent natural features in the development of financial markets. Panics overwhelming markets help create unique investment opportunities; is it better to purchase things for their regular prices or with a discount? Equities represent one of the few instruments that can defeat inflation in the long run; nowadays, bonds have joined equities in an absolutely rarely seen manner. Such high drops in the prices of the two classes of assets at the same time do not occur often, so – in our point of view – this offers long-term and interesting investment opportunities.

We wish you much success in the coming days!

Mr Michal Ondruška

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