



COMMENTARY ON THE CURRENT SITUATION FACING FINANCIAL MARKETS

Prague, 3 August 2020

S&P 500 Index Firms Still More Profitable Than Expected

The equity markets have strengthened in the course of the past month; the S&P 500 Index exceeded the 3,270 points mark and added 5.5 percent in July. The American S&P 500 Equity Index has already made up for its losses generated over the previous months and it has strengthened by 1.3 percent since the beginning of the year (measured in USD), while the MSCI All Country World broader global index has lost approximately 2 percent. Over the past month, the utilities sector and the communications sector beefed up the most of all (e.g., Facebook, Netflix, and AT&T).

Picture: The S&P 500 Index close to its maximum values again



The FED confirmed at its latest session its outlook estimates that the GDP will drop by 6.5 percent in the U.S.A. this year and that it will grow by up to 5 percent next year. Unemployment is expected to drop to 9 percent at the end of 2020 and further to 6.5 percent in 2021. The FED session has also left rates unchanged at technical zeros (0 - 0.25 percent) and it anticipates to maintain the basic interest rate at the same level also in the course of the next two years.



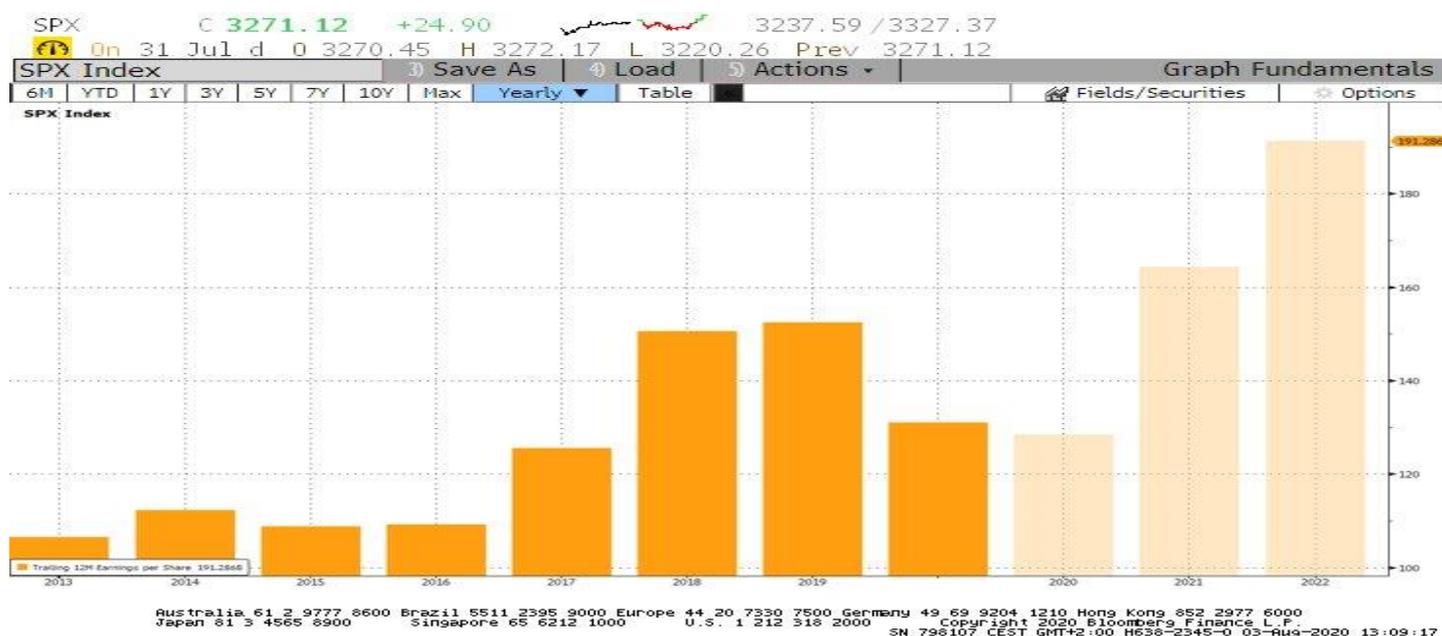
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The trends in the financial markets continue to be affected to a significant extent by the corona virus pandemic. Tension has been growing again over the past several weeks due to boosted numbers of newly infected, *de facto*, the world over. On the other hand, the markets have been positively impressed by information about the development of a new vaccine. Such vaccine is expected to be ready as soon as in the course of this coming autumn. The most progress has been reported by such firms as AstraZeneca, Pfizer, Moderna, and J&J. The vaccine now seems to be the key to a more lasting calming down of the situation, and not only in the financial markets.

In the U.S.A. and in Europe, the season of disclosing corporate economic results for the second quarter of the year has been under way. Analysts estimated that the aggregate profit of the S&P 500 Index would fall by more than 43 percent and sales by more than 11 percent in the second quarter (Source: FactSet). So far, 63 percent of the S&P 500 Index corporations published their results. For now, corporate profits are 84 percent and sales are 69 percent better than analysts estimate (FactSet). Aggregated profits have so far dropped by about 36 percent and sales by 9.6 percent. Aggregate profit and sales growths of the S&P 500 Index firms are not envisaged until next year, by 19.4 percent for profits and 3.2 percent for sales (Source: FactSet) .

Picture: Past, present, and anticipated profitability of U.S. corporations (S&P 500, in USD per share). Analysts expect that profitability of U.S. companies will grow again as early as next year .



The S&P 500 Index has been traded with the envisaged P/E 22 over the coming 12 months, which is more than the anticipated average value of P/E 17 recorded over the past five years (Source: FactSet). Nevertheless, the yield of the 10-year American sovereign bond has been below 0.60 percent, and that supports higher valuation of equities .



As regards future risks, we see them in the U.S. presidential election to be held in the autumn, since a winning Democratic candidate may seek higher corporate taxing; in yet another corona virus wave, if a sufficient amount of vaccine and effective medicine cannot be produced in time; and in the tense relations with China.

In spite of those risks, we do not intend to alter our tactical strategy and we remain moderately overweighted in equity instruments. At the moment, we cannot see any feasible alternative to, in particular, equity markets. Yields, especially of government bonds, have been at their long-term lows, which significantly reduces their attractiveness. While such sovereign bond yields are likely to remain low for some time to come, stock profitability may surprise with growths. However, such growths are unlikely to be widespread; the choice of the 'right' sectors will play an important role. While, e.g., the technologies and health services sectors have been performing relatively well, on the contrary, e.g., energies or air transport continue to face strong pressure and have been losing significantly since the beginning of the year .

Picture: Differences in trends marked by some selected sectors since the beginning of 2020 (technologies, health services, energies, air transport)



Source: Bloomberg

As regards funds, we have continued to purchase shares in some specific corporations (Walt Disney, Mastercard, Bayer); at the same time, we have also used widely diversified equity ETFs (for example, the American stock index S&P500 ETFs or consumer goods sector ETFs). On the bonds side, we have replaced the ending Polish government bond by purchasing a new issue of the multinational company Black Sea Trade & Development, which matures in 2023. We have also continued to sell the 10-year Czech sovereign bond, which has been approaching its historical highs in terms of price. Furthermore, we have also participated in the subscription of a new bond fund from BNP Paribas. This is a 'buy-and-hold' mutual fund aimed at issuers from developing countries, with maturity in December 2024 and an average investment rating of BBB- (investment grade). In the dividend model, we have replaced shares in the financial corporations Axa, Allianz, Komerční banka, and RBI, with shares in the IT and consumer companies Alphabet, Comcast, Amazon, and Procter & Gamble .

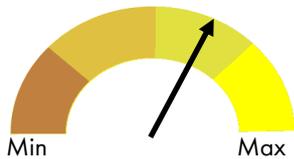


Summary of Investment Strategies:

Tactical Allocation

Equity overweighed in portfolios

Current



3M outlook



Interest Rate Risk

Average bond maturities (Duration)

Current



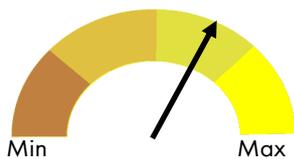
3M outlook



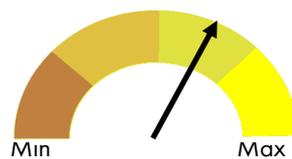
Credit Risk

Portions of, e.g., corporate bonds

Current



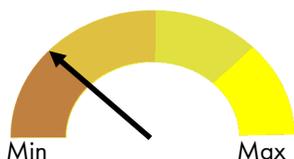
3M outlook



Currency Risk

Unsecured positions in foreign currencies

Current



3M outlook



Sincerely,

Michal Ondruška



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