ASSET ALLOCATION

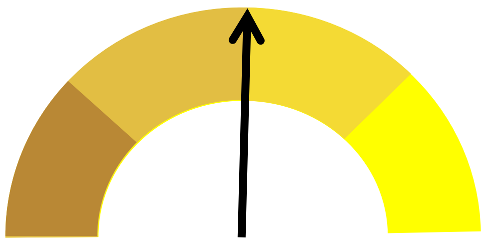
RB Asset Management 1Q/2020

PĚTIHVĚZDIČKOVÁ BANKA
K VAŠIM SLUŽBÁM

KLIENTSKY
NEJPŘÍVĚTIVĚJŠÍ BANKA
2015-2019

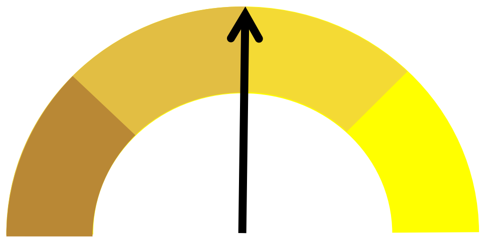
CURRENT STATE OF FINANCIAL MARKETS AND PORTFOLIOS ALLOCATION

Asset allocation in previous period



Maximum Underweight Equities | **Maximum Overweight Equities**

Asset allocation in next period



Maximum Underweight Equities | **Maximum Overweight Equities**

Dear Clients,

The year 2019 was successful for financial markets. Most of the asset classes performed well, while stock markets acted as the 'top-of-the-class' performers; some of them added up to two-digit increases. The S&P 500 American stock index, e.g., grew by almost 30 percent. Also the alternative instruments, such as gold and real property, performed well. And the bond instruments did not lag behind, either, as they ended up in black figures last year, having appreciated by about 2 percent. Positive sentiments projected to performance of managed portfolios that, too, recorded some major increases in their values, exceeding in a significant manner appreciation marked by comparable markets/benchmarks.

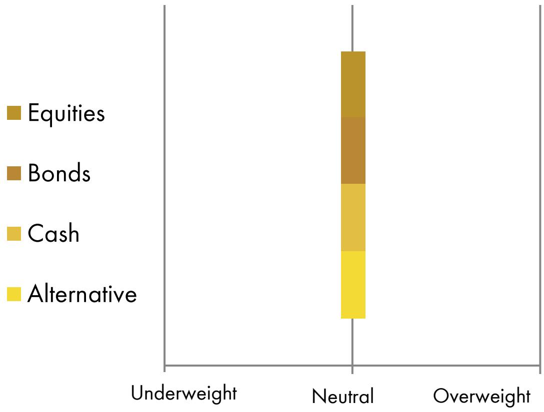
Positive mood on the part of investors has reflected the supportive policies adopted by the central banks in the form of low interest rates, a more lucid 'brexit' climate, and/or promising trends appearing in negotiations regarding mutual trade between the United States and China. In 2020, we expect continuing a global economic growth, at a pace similar to that of the last year (approx. 3 percent). We have the U.S. election year ahead of us which historically links to above-the-average market performances. The monetary policies to be adopted by the U.S. Fed, the European Central Bank, and the Czech National Bank next year will be best described as 'stable interest rates'. Therefore, the currency conditions set by the most important central banks can be seen as stimulating. The expected industrial recovery then creates a suitable environment for the continuation of the current trends prevailing in financial markets. However, we do not expect equities to perform so well as they did in 2019. At the same time, we notice some old-new threats emerging, such as increased tension in the Middle East. Such climate brings about uncertainty and higher fluctuation; however, new investment opportunities can emerge.

We are not going to alter our strategies in the time to come; as regards tactical allocations, we continue to maintain weighed neutral positions as regards both equities and bonds. We stick to our positive outlook concerning both equity and alternative instruments; nevertheless, geo-political tension neutralise such view. We continue to actively exploit advantageous CZK/EUR currency transactions, with a new extension by the Swiss franc and some other currencies in the Central European region. We have been actively searching for investment opportunities in the corporate bonds segment possessing acceptable risk, which offer interesting yield premiums as against sovereign bonds.

In conclusion, let me thank you for your trust and wish you nice and successful New Year 2020.

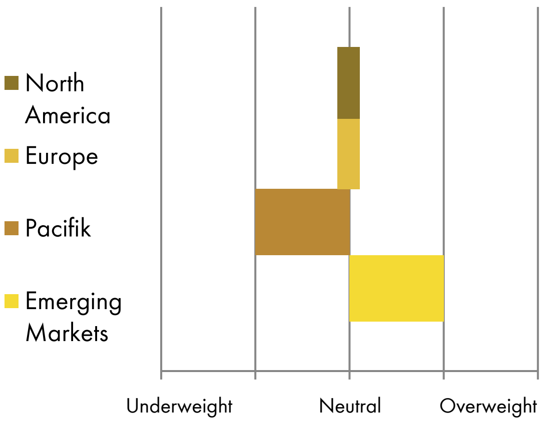
Michal Ondruška, Manager, Asset Management

ASSET DISTRIBUTION AS RULED BY THE INVESTMENT BOARD



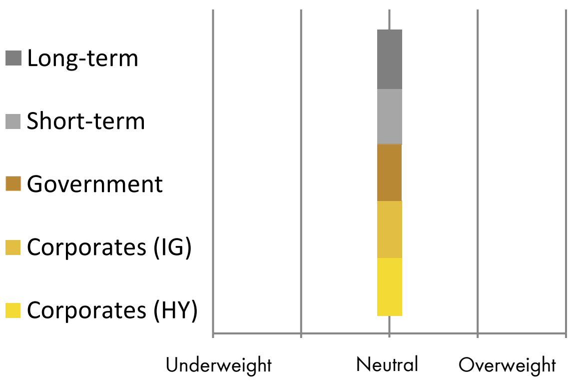
We believe that the global stock exchanges will continue to grow this year, given the macro-economic data confirming the advent of a late stage of the economic cycle. The risk of recession has been significantly reduced. However, it can hardly be expected that the very successful last year can be repeated or even exceeded. The currency policies adopted for the next year by the U.S. Fed, the ECB, as well as the CNB, can be best described using the saying that 'we shall wait and see'. The policies of the central banks rather imply stability of interest rates, while stimulating risk assets. The RBCZ Investment Board's models stick to neutral share of risk instruments. Particularly the following factors will be essential for the setting up of tactical allocations: trends regarding geo-political and commercial risks, performance of the corporate sector, the U.S. elections, 'brexit', and steps taken by central banks.

TACTICAL ASSET ALLOCATION – EQUITY REGIONS



Asset allocations as regards regions and sectors (industries) have remained unchanged. The largest, but at the same time a neutral portfolio exposition, has been maintained as regards the American stock markets where our exposition reaches approximately 56 percent. The Nasdaq technological index occupies about 10 percent while some 8 percent goes to the American financial sector. We hold 18 percent in European stock markets. Our exposition in the Pacific Region, including Japan, extends to 9 percent, while Emerging Markets have been represented by a 17-percent stake. As compared to the benchmark, we have still been slightly overweighed towards Emerging Markets, along with a somewhat lower exposition in the Pacific Region (Japan).

TACTICAL ASSET ALLOCATION – BONDS

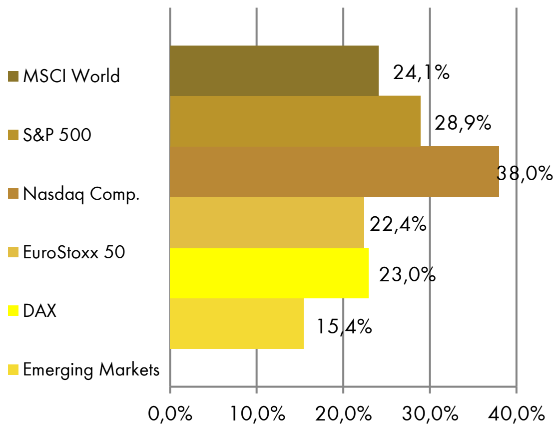


Source: Raiffeisenbank a.s.

The Monetary policies of the major central banks can still be viewed as stimulating. The size of the balance of the U.S. Fed and the volume of funds involved in calming down the U.S. repo loan market should decrease this year, which may make the bond markets nervous. The ECB will maintain or lower its base rate as long as inflation reaches its goal, something that offers relatively higher stimulation than Fed. Thus, EUR-denominated bond yields lag significantly behind dollar-denominated bond yields. A relatively high constant demand for Czech bonds has prevailed, and unless we witness an external shock, yields of Czech sovereign bonds will probably not rise in the foreseeable future. The central bank's relaxed policy continues to have a positive effect on corporate and high-yield bond prices.

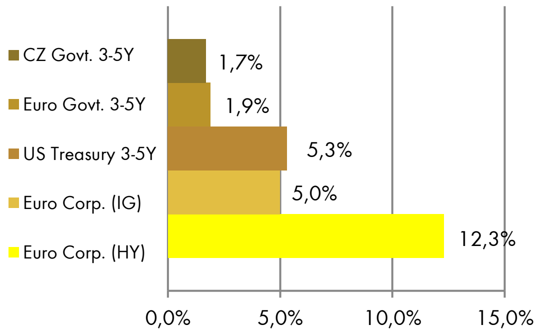
ECONOMIC SITUATION AND MARKET TRENDS

• EQUITIES



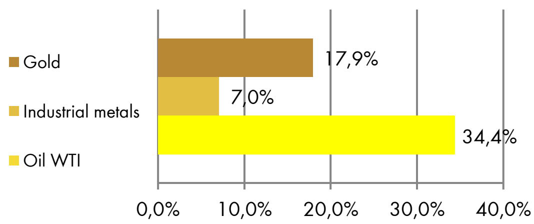
Against the bad performance of the stock markets in 2018, equities demonstrated their ability to recover quickly last year. And the stock indices completed their 'graceful ride' in the last quarter of the year. Out of the major monitored indices, the best performance was recorded in respect of the Nasdaq technology companies index which increased by 38 percent over the year. And the other indices did not remain lagging behind significantly, either. Both the European equities (EuroStoxx 50) and the American S&P 500 indices increased by 22.4 percent and 28.9 percent, respectively. Out of the monitored indices, the 'worst' performance was recorded last year by the Emerging Markets index, which increased by 15.4 percent in the annual horizon.

• BONDS



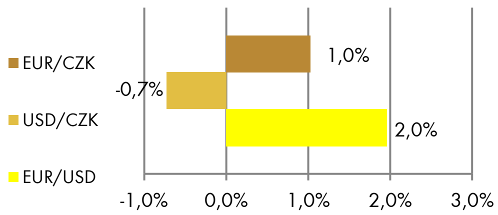
Bonds experienced a dynamic development over the year. The best performance was marked by the HY bonds index, which increased 12.3 percent over the year. As regards sovereign bonds, both European and Czech sovereign bonds showed relatively close correlations. Czech sovereign bonds (with maturities of 3-5 years) increased 1.7 percent, while European sovereign bonds with similar maturities increased 1.9 percent. It is worth to mention 'jump corrections' of prices of Czech sovereign bonds occurring at the end of last year; the index dropped almost 0.7 percent in the course of 4 days. American sovereign bonds increased 5.3 percent over the last year.

• COMMODITIES



Low interest rates and higher demand continued to represent the driving force behind the increased price of gold. Gold traded by 17.9 percent higher at the end of the year than at its beginning. Also oil prices recorded a positive turn in 2019. WTI oil generated profits amounting to 34.4 percent at the end of the year. Industrial metals increased 7 percent.

• CURRENCIES



The Czech koruna (crown) depreciated significantly as against the dollar over the first three quarters of last year. The trend marked a U-turn in favour of the appreciation of the crown in the last quarter. All in all, the Czech currency depreciated against the dollar by less than one percent. Against the euro, the Czech crown appreciated by 1 percent. The dollar appreciated by 1.96 percent against the euro in 2019.

Source of charts: Bloomberg. The performance of the individual assets has been measured in the primary traded currencies of such instruments in 2019.

OUTLOOK

Analysts estimate a slow-down in the speed of the growth of the GNP in the United States of America from 2.3 percent, year-on-year, in 2019, down to 1.8 percent (y-on-y) in 2020. The EuroZone expects a y-on-y slow-down of the growth of the GNP from 2 percent in 2019, to 1 percent. Still, the global GNP is expected to grow moderately from 3 percent (y-on-y) in 2019 to 3.1 percent (y-on-y) thanks to higher GNP rises in Emerging Markets. Moreover, expectations have it that the U.S. President Donald Trump will sign the first part of a mutual trade treaty with China in mid-January, in order to prevent increases in customs duties between the two countries. The leading ISM indicator of the U.S. economic growth did not perform particularly well; it even dropped down to 47.2 in December, which was the lowest value over the past 10 years. We shall see if an up-turn occurs in the months to come. That was one of the reasons why the Fed lowered the range of its base interest rates to 1.5-1.75 percent at the end of October last year, in order to support the growth of the local, and thus also the global, economies. No further decreases of the Fed rates are expected to occur by the end of this coming summer. In mid-January, American companies will publish their economic results (P/L) generated over the fourth quarter of last year, and they will also be presenting their outlooks for the current year. In 2019, stagnation of profit on the part of companies incorporated in the U.S. S&P 500 index (0.3 percent, y-on-y) and a growth in revenues by 3.8 percent, y-on-y (source: Factset). It is expected this year that profits generated by the S&P 500 index companies will rise at an average rate of more than 9 percent, and that the revenues will increase by more than 5 percent (y-on-y). This model seems to us to be rather optimistic, in view of the slowing-down of the U.S. economy, so we expect a downward adjustment of the growth rates. The yield of the 'U.S. Treasury' with a maturity of 10 years fluctuates in the range of 1.7-1.95 percent p.a., while the yield of a similar German sovereign bond would range from -0.20 to -0.35 percent p.a. The S&P 500 index has been traded with the current P/E of 21.6, which is more than the average of 19.8 recorded over the past 5 years. The MXEF emerging markets index (current P/E: 15.6) and the European Euro Stoxx index (current P/E: 20.3) have been traded slightly above their five-year valuation averages of 14.3 and 18.6, respectively (source: Bloomberg). The RBI has issued a positive stock markets outlook, in view of the expected growth of the global economy and the envisaged increase in profits generated by companies this year. Nevertheless, nobody dares to anticipate such strong stock markets growth as that witnessed in 2019. There is a new risk factor in the form of the geo-political conflict resulting from the strained relationship between the U.S.A. and Iran. It may cause certain higher uneasiness on stock markets at the beginning of the year. Moreover, further risks remain primarily in the possibility that representatives of China and the U.S.A. would fail to agree on the second phase of removal of customs duties between the two countries; further worsening of the ISM index in the manufacturing sphere in the U.S.A.; and unfavourable developments in 'brexit' negotiations between the United Kingdom and the European Union.

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

EQUITIES	BONDS	CASH	ALTERNATIVE
Global + Emerging Markets	Bonds < 3Y	Term Deposits, Savings Accounts	Energy, oil
	Bonds> 3Y		Real property
Growth sectors	Credit + HighYield		Gold

KEY:	POSITIVE EXPECTATION	NEUTRAL EXPECTATION	NEGATIVE EXPECTATION

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