The decade ends at a lofty height – reason for caution?

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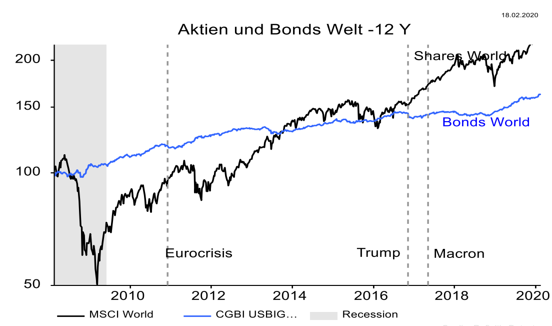
The world's overall capital stock achieved a historic high in 2019. The value of companies has more than quadrupled over the past decade. Even bonds have experienced an increase in value of more than 60%. Real estate has roughly doubled in value over the past decade. In addition, the decade did not see a single global period of recession. Worldwide assets therefore grew at an unprecedented rate, with relatively low fluctuations in value. The current economic cycle has turned out to be the longest in post-war history. Unsurprisingly, books warning of the next crash have made it onto the bestseller lists. Over the medium term, they will surely not be proven wrong. However, this is of little help to those managing the allocation of assets in the near future. Analysing the determining factors of this unique development is therefore of central importance. This will be illustrated using developments in the performance of assets over the past year.



A year ago, the prospects for assets were anything but rosy: the past year, 2018, had brought shareholders a 20% loss. In addition, the USA decided to confront internal organisations, both on an economic (WTO, China), military (NATO) and social (environment) level. This did not bode well for the international division of labour and the development of prosperity. In addition, the leading economic indicators, especially the Purchasing Managers' Index (PMI), indicated an industrial recession. Britain's protracted contractual negotiations with the EU also had a depressing effect. For these reasons, most banks urged caution and reduced share-price risks. But as it soon turned out, they were wrong to do so.

The decisive change was brought about by capital market participants. They let the long-term bond interest rate of over 3% fall below the FED funds rate, stimulating vehement discussion of the negative consequences of yield curve inversion. The Federal Reserve's response was clear. It interrupted the rate increase cycle that had run over nine stages since the end of 2015, even announcing further rate decreases. This was the starting signal for an appreciation in asset values. On top of this, the fears of a potential industrial recession were put to rest.

This example shows what importance interest rates have for value development in all assets. Although the USA's economy is working at full capacity, with historically low unemployment and a monthly job creation rate of around 200,000 new placements, no inflationary expectations have arisen. This is a strong indicator for the thesis of those theorists who say that the so-called "natural rate of interest" has shown a falling tendency for decades, and currently lies at around zero. Responsibility for this does not lie with the Federal Reserve, however, but with economic agents, who are simply saving more than they invest. What lies behind this imbalanced phenomenon are factors such as lower growth in the highly developed states due to demographic shifts (fertility rates, life expectancy) and concomitant lower productivity rates. These are accompanied by individual uncertainty regarding lifetime incomes (job losses, losers to globalisation), reaction to the dismantling of social systems (pension cuts, life expectancy), automation of the job market (lower organisational level of employees), the increasing number of companies with monopolistic scope (networks, economies of scale and brands). The latter gain monopoly rents, leading to higher saving rates and lower investment. In addition, in most of these states, an increase in asset concentration has been noted since the eighties, where the savings rate among the wealthy is much higher than in the rest of society. In addition, technical progress evinces an increasing tendency towards dematerialisation, i.e. output can be increased with less physical investment.

Researchers first addressed the question of the natural rate of interest at the end of the 19th century. Then, the question was once again forgotten. Now, several teams are engaged on empirical research into the theories. The results to date are very promising. If they are confirmed, their effects on investment policies would be significant, above all because the trends are of a stable and long-term nature. They have played an important role in our strategic considerations for some time. In particular, we assume that they will be valid for a long time to come, giving the asset portfolio a solid foundation. Of course, this does not change the fact that shares in particular are, and will always be, characterised by high volatility.

They are affected by political, economic and social "breaking news" or even "fake news", as we experience constantly in our daily lives. But it must be noted: these are volatilities. They are transitory in nature. Overall, the lowering of the natural rate of interest means that economic agents rate the benefit of future consumption higher than in the past. Future promises, such as pension obligations, result in much larger debts today. In the same way, damages caused today but which come to bear only on future generations are of higher value now.

This theoretical and empirical situation analysis also shapes the investment policy for the current year.

We consider lower interest rates well founded. They are the most important guarantor that stock market crashes are not permanent. In addition, the long-standing trend of shifting from wage to profit income in a majority of countries, still suggests that shares, while historically high, are not overvalued in comparison to fixed-income investments. We therefore consider it worthwhile to fully exploit the share quota, or to continue the neutral position. In addition, we consider a possible correction in shares of over 10% as a chance to interpret and set the share quota to "overweighted". However, the situation is different where the correction is based on a change in inflation expectations, especially in the USA.

"The decade ends at a lofty height", as we stated at the start. However, this is not a reason for us to dispense with highly valued investments. It is simply too early for that.

You can take the details of the asset allocation for the first quarter of the year from the following table.

Strategic and tactical Asset Allocation for the 1st Quarter 2020

	Reference Currency CHF			Reference Currency EUR		
	Investment strategy Balanced			Investment strategy Balanced		
	SA	IC	C	SA	IC	C
Investment categories						
Money market	**5**	**6**	**+2**	**5**	**6**	**+2**
Bonds	**40**	**38**	**-2**	**40**	**38**	**-2**
Home Country	24	23	-1	23	22	-1
Rest of Europe	8	7	-1	5	4	-1
USA	4	4		8	8	
Rest of World	4	4		4	4	
Stocks and shares	**45**	**45**		**45**	**45**	
Home Country	9	8		15	13	
Rest of Europe	11	9		6	5	
USA	12	13	-1	15	13	-1
Rest of World	13	15	+1	9	14	+1
Alternative investments	**10**	**11**		**10**	**11**	
Commodities	4	4		4	4	
Various	6	7		6	7	
Total	**100**	**100**		**100**	**100**	

SA = Strategic Asset Allocation IC= Investment Committee C = Change

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