Despite voices urging caution: optimism reigns

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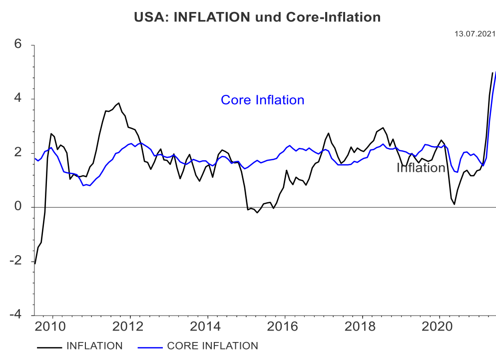
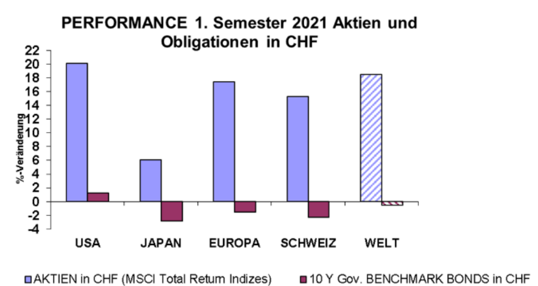
The topic of inflation has become ever more dominant in recent months. Not least because of the surprisingly high rates seen in the USA: in the 2nd quarter, they reached their highest level in a decade, at 4%.



If the historical patterns of central banks were any guide, one would expect restrictive action to take place in the future. This would have a direct, negative effect on financial assets. But not this time. Rather the opposite: the stock markets continued to gain value in the first six months of the year.



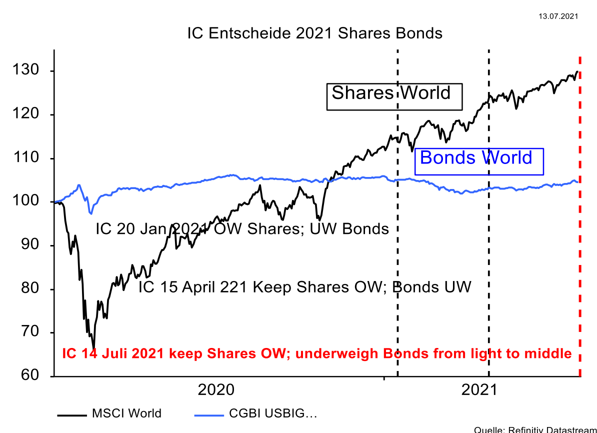
How can we explain this inconsistency?

One common explanation is that we are dealing with a transitory phenomenon. Inflation rates are high because certain prices, particularly the oil price, fell dramatically a year ago. In the months to come, this so-called “base effect” will gradually dissipate. In addition to this, interruptions to supply chains during the pandemic led to bottlenecks and corresponding price increases. With state borders gradually opening up, this effect should slowly fade away.

More important, however, is that the Federal Reserve announced a decisive change to its concept of financial policy in the last year. At its core, this is about moving the focus from combating inflation towards more vigorously supporting the real economy. With this paradigm shift, the knowledge gained from experience in the last four decades is coming into play. Inflation has decreased step by step even though monetary policy has largely been expansive. The monetaristic theory that a monetary growth rate above that of the overall economy would always lead, sooner or later, to inflation, has not been borne out by reality in the last four decades – at least, not in the industrialised world. Rather the reverse: central banks never even managed to get inflation to the desired level of 2%. Today, scientific research has established a predominant consensus that real economic factors have a much greater importance for inflation than the supply of money. The keywords here are globalisation, technological development, demographics and the economic system. In particular, with globalisation, major factors in the economy have realigned. The differentiation of labour markets and the ability to relocate production has shifted power from labour towards capital. This means an important driver of inflationary development no longer exists: the wage/price spiral, or cost-push inflation.

These structural changes have made it possible to reorganise the key focuses of financial policy. This also applies to the European Central Bank, which surprised observers by issuing its new monetary policy last Thursday. This also postulates greater flexibility in setting inflation targets. In the future, a rate of inflation of 2% should be aimed for, but one that makes symmetrical deviations up and down possible.

Concretely, this means that the probability of recessions caused by monetary policy, such as were commonplace in the 90s, has markedly reduced. In the future, recessions will be triggered far more by imbalances between the real and financial sector. For example, consider the dot-com bubble around the turn of the millennium and the financial and banking crisis of 2008. For central banks, these kinds of events mean that they can remain expansive for much longer periods without having to fear rising inflation. With low rates they stimulate investment; with high asset prices, long-term consumption. The new monetary policy will soon have to pass its first test, namely, when consumers start to make up for lost time after the pandemic and, at the same time, worldwide stimulus programmes gather pace. One thing is certain: the Fed knows the risks, but has given a clear signal that the real economy still has free rein for the duration, with inflation above the 2% norm acceptable at present.



The financial markets have confidence in this. We will too. That is why we have maintained our underweighted position in stocks. We are only raising our underweighted bonds position from "slight" to "medium".

You can find the details of asset allocation in the following table.

Strategic and tactical Asset Allocation for the 3rd Quarter 2021

	Reference currency CHF			Reference currency EUR			Reference currency USD		
	Investment strategy Balanced			Investment strategy Balanced			Investment strategy Balanced		
Investment categories	SA	IC	C	SA	IC	C	SA	IC	C
Money market	**5**	**8**	**+2**	**5**	**8**	**+2**	**5**	**8**	**+2**
Bonds	**40**	**32**	**-2**	**40**	**35**	**-2**	**40**	**32**	**-2**
Home Country	24	21	-1	23	21	-1	3	5	
Rest of Europe	8	5	-1	5	2	-1	5	2	
USA	4	3		8	8		28	22	-1
Rest of World	4	3		4	4		4	3	-1
Stocks and shares	**45**	**50**		**45**	**46**		**45**	**50**	
Home Country	9	10		15	13		7	10	
Rest of Europe	11	13		6	6		7	8	
USA	12	12		15	12		23	23	
Rest of World	13	15		9	15		8	9	
Alternative investments	**10**	**10**		**10**	**11**		**10**	**10**	
Commodities	4	5		4	5		4	5	
Various	6	5		6	6		6	5	
Total	**100**	**100**		**100**	**100**				

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

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