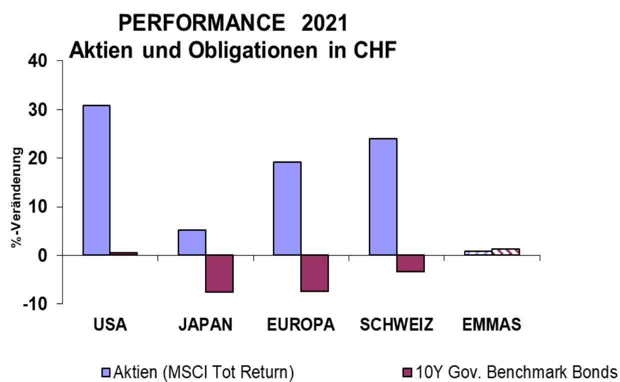
Danger in view?

Prof. Dr. Josef Marbacher
Chief Economist

The past year has brought shareholder returns of a kind not seen except every four or five years. This applies above all in Western states, as the below graph shows. Things were comparatively worse off in the emerging markets, which practically achieved no yields when calculated in CHF. Pivotal to this performance was the Chinese market, which lost around 25% in the past year. If we carry out an equal weighting of the five regions listed below, the annual result seems a little more modest, at around 16%. The markets for government bonds lost an average of 2% in the past year, something that can be attributed to the clear rise in inflation and worrisome interest rates. A balanced portfolio of 50% bonds and 50% stocks thus brought in a total yield of 6.8%.



Equal-weighted performance:
Stocks: +16% / Bonds: -2.4% / Balanced PF: +6.8%

The large-scale losses in China seem to indicate a change of policy. Over the last 30 years, the Chinese Government accorded the private sector ever greater freedoms, contributing to a growth in speculation. At the same time, however, the unequal distribution of assets and incomes reached levels comparable to those in certain Western states. The increasing monopolisation of the economy also drove the Government to announce a change of policy aimed at ensuring greater attention was paid to equality of opportunity, social mobility and orderly competition. The implementation of the new focus was set out in a strategy paper of July 2020 and then carried out at once. Thus, profit-oriented private schools previously only open to the well-off were forced to adopt a non-profit constitution. And in many other sectors, changes to the underlying conditions of the market were set out, making it harder for individual companies to profit excessively from dominant competitive positions and stemming increasing levels of indebtedness. Alongside this, caps were placed on debt-to-assets ratios and just two years assigned for compliance to be assured. This entailed great hardship for the financing model of Chinese property developers (e.g. Evergrande). Nevertheless, we assume that some of the economically damaging measures were deliberately brought about in good time to curtail certain excesses and will be loosened again this year – not least because at the 20th Party Congress in November, Xi Jinping is set to be elected for a third five-year period in office.

Overall, however, it is incredible how powerfully Western stock markets have manoeuvred past such a large number of obstacles in their path. The pandemic has been producing new surprises and mutations continuously: first the Delta variant and then the highly infectious Omicron. But another shock was provided by the inflation figures in the USA (over 6%) and Europe (over 5%), with the rise in production costs for industry partially even higher, leading to a potential erosion of profit margins. The defining aspect here was, in the final account, that the uniquely expansive global monetary and fiscal policy succeeded in bringing the real economy out of the sharp recession of 2020. Thus, global GDP rose from its -3% dip in 2020 to a positive 6% increase last year. And the forecasts remain very promising: approx. 5% for the current year and 3.5% in 2023. It must be added that the prognosis for overcoming the pandemic is looking up, as the Omicron variant has turned out less harmful than was originally thought. Furthermore, the high transmissibility of this variant of the virus has led to the more rapid immunisation of the populace, as many of the unvaccinated gained protection through infection. One risk remains, however: the arising of new virus mutations that could outrun the current rates of inoculation and immunity. But even in this case there is great confidence that suitable vaccines could be prepared with relative celerity.

There is greater uncertainty about how inflation may develop. Even until last November, central banks and forecasters were agreed that what they were looking at was probably a transitory phenomenon. However, the US Federal Reserve retracted this position in its last session. It now considers the risk of inflation expectations surpassing their accepted and ordinary bounds as real, and cannot exclude the possibility of a wage-price spiral. The security repurchasing programme will thus be terminated already at the end of March, with three interest rate raises for 2022 and 3 more hikes in 2023.

Not a few voices have warned of higher inflation over recent years. They are oriented above all by the monetary policy models of the 'sixties and 'seventies, stating that any monetary expansion above and beyond real GDP will lead over the short or long term to a corresponding level of inflation. It stands to reason that nobody still working to these traditional concepts could still sleep easy, faced by the fact that the money supply from most central banks has increased since the Great Financial Crisis by several hundred percent. However, the world of today cannot be compared to those post-war decades. Globalisation and technological progress have led to extensive differentiation of professional profiles and the marked heterogenisation of the labour market. Collective wage agreements have declined in significance. In addition, with the conversion of earlier planned economies to market economies, the potential workforce has approximately doubled. This intense competition in labour markets makes it thus seem unlikely that an endemic wage-price spiral will develop. And even if inflation sticks for several years at a level higher than the long-term goal of 2%, the Federal Reserve is hardly likely to set restrictions leading to a recession. Rather the contrary, it will put everything it can into play to ensure the great losses of wealth caused by the Financial Crisis (2008) and Coronavirus Pandemic can be compensated for. For this, it needs a long, stable path of growth. Only in this way can the high debts built up over the course of these crises be worked off. It must also be added that both in academia and at the central banks, the cost-benefit ratio of monetary braking manoeuvres is considered more critical today, as many determining inflation-driving factors can be traced back not to collective decisions but to sectoral origins, e.g. in the oil and raw materials markets, in global supply chains, in nature (pandemics, natural catastrophes) or politics (control measures).

We interpret the relatively determined stance by the FED, the intent to rein in developments rather more swiftly than planned, rather more as an attempt to curtail any expectations of inflation early on by sending the message: inflation remains of importance to us, and we will combat it with all disposable means. As sectoral drivers of inflation are transitory in nature, we still assume that such a reaction from the FED remains far in the future. In first place, the pandemic must be defeated and the economic recovery kept up at full steam. The conditions in place are favourable for such a course.

We will thus enter the first quarter of the year with a neutral ratio of shares and take advantage of market corrections to re-establish the overweighting here that is considered strategically desirable over the long term in this environment. Bonds, however, are unpromising: they will hardly reach zero in nominal terms, let alone retain their real value.

This is as much as can be said regarding general trends. And they, after all, are decisive for the end result.

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

Strategic and tactical Asset Allocation for the 1st Quarter 2022

	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**	**11**	**-7**	**5**	**11**	**-7**	**5**	**11**	**-7**
Bonds	**40**	**28**	**-4**	**40**	**28**	**-4**	**40**	**28**	**-4**
Home Country	24	16	-5	23	17	-3	3	4	-1
Rest of Europe	8	6	+1	5	2		5	2	
USA	4	3		8	6	-1	28	19	-3
Rest of World	4	3		4	3		4	3	
Stocks and shares	**45**	**50**	**+10**	**45**	**50**	**+10**	**45**	**50**	**+10**
Home Country	9	9	+1	15	17	+4	7	12	+4
Rest of Europe	11	12	+3	6	6	+1	7	8	
USA	12	14	+4	15	14	+4	23	21	+4
Rest of World	13	15	+2	9	13	+1	8	9	+2
Alternative investments	**10**	**11**	**+1**	**10**	**11**	**+1**	**10**	**11**	**+1**
Commodities	4	5		4	5		4	5	
Various	6	6	+1	6	6	+1	6	6	+1
Total	**100**	**100**		**100**	**100**				

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

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