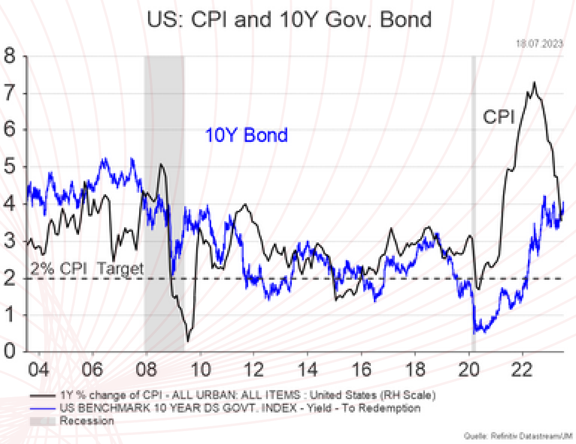
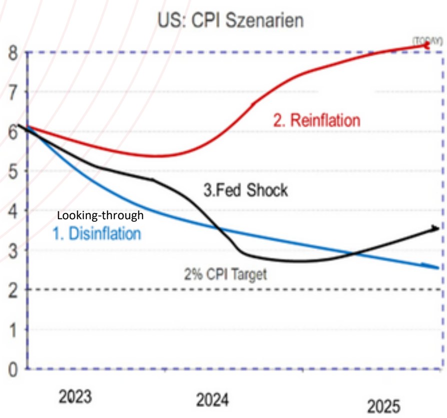
# CORUM investment policy Q3 2023

## The first half of 2023 was gratifying
## Somewhat harder times lie ahead

Central Banks' fears that the high global inflation rates over the past year could be exacerbated yet further by a wage/price spiral have not come to fruition. Rather the reverse: rates have clearly fallen in the USA and in Europe. Credit should be given to those economists who stood fast by the classic doctrine that Central Banks should stay calm in the face of shocks ("looking through"), as their instruments only take effect with a significant time delay (12 to 32 months). *[1](Tenreyro, Juni 2023).*

Central Banks held to this scenario for a relatively long time (disinflation or "looking through" scenario 1) until, in March of last year, Powell made an abrupt volte-face, designating the previous strategy a serious error. According to him, the risk of a wage/price spiral (re-inflation scenario 3) had become more likely. Volcker-style shock therapy would be needed to prevent it (Fed shock scenario 3). This is despite the capital markets never showing any sign of such a danger. On the contrary: long-term interest rates remained astonishingly low. We could hardly speak, here, of "deanchoring" inflationary expectations.



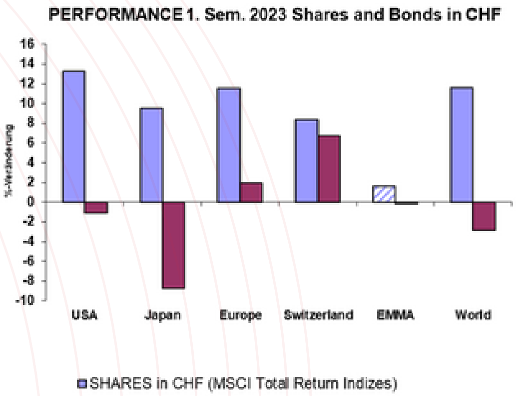




We must assume that this shock tactic caused all companies to increase prices before the Central Banks' braking manoeuvres. The actual inflation over the past year could thus have turned out to be markedly higher than with the "looking through" approach. The strong rise in core inflation in the USA and Europe is an indicator for this thesis. It also means that profit margins have risen. They are now the essential driver of the high demand for workers.

At the annual August meeting of Central Banks in Jackson Hole, Powell convinced his colleagues to follow his example and not place their trust in the assessments of investors. Only the Bank of Japan stuck to the "looking through" approach. Subsequently, key interest rates were raised around four times faster than the historical average. Not surprisingly, this destabilised a number of American banks. The threats to financial stability may have been an essential factor in the Fed having paused its interest rate hikes. In the meantime, both the Fed and the ECB have warned that they may increase the level of restriction yet further.
The necessity of this is an open question, as the rate rises of the past 12 months are only just now being felt in the real economy. The reason usually given is that core inflation is still rising. This is not surprising, however, as practically all companies have been affected by the shocks of the past and are now making efforts to pass on the cost increases. This could take some time. For example, energy companies often buy electricity far in advance on future markets, delivering it today at the conditions prevalent at the time of purchase.

[1] See, in this regard: "Monetary policy in the face of supply shocks: the role of inflation expectations" by Silvana Tenreyro, external member of the Monetary Policy Committee of the Bank of England and professor at the London School of Economics, a paper presented to the ECB Forum 2023 in Sintra, Portugal

For investors too, the rapid clearance of the shock comes as a positive surprise. In the first half of the year, stocks have yielded around 11% and bonds roughly 4%. This boom was concentrated among growth stocks which, for their part, are profiting from the outlook for artificial intelligence.
Around a year has now passed since the start of the Central Banks' restrictive monetary policy. Now, we have to reckon with higher interest rates reaching the interest-sensitive parts of the economy. Investment and consumer durables will weaken gradually and increasingly. This will take some strain off the labour market.




As company profits per employee have markedly increased in the last three years, however, they will endeavour to reap the rewards of high margins for as long as possible. Central Banks have warned that they may further increase interest rates if the labour market figures do not slacken off. In Switzerland, the hope is that the National Bank increasingly uses appreciation of the currency to dampen demand. It has a more than well-stocked armoury for this in the form of foreign currency reserves. This has the great advantage that, on the one hand, debts can be cleared from the balance sheet and inflation reduced by cheapening imports, while rate increases have the side effect of temporarily increasing inflation by way of administered rents.

Despite this: stocks face a much bumpier road. It is very possible that investors will have to be satisfied with appealing dividends. Pessimism is hardly justified, however, as the perspective of falling bond yields and the prospect of the end of the interest rate increase cycle are powerful props for the valuation of stocks. In addition, the high profit margins accrued over the last year because of price increases are strong drivers of economic activity. Companies will increase demand for labour until profits per employee have evened out. In this way, not only are more jobs created, but increased salaries bump up consumer spending power. This is not inflationary, as higher wages will only be paid while profits themselves are on the up. No Central Bank will be able to prevent companies doing this. It is assumed, here, that the Central Banks will not commit any further policy errors after their unnecessary, panicked response to the shock. What is meant by this is any attempt to accelerate the disinflationary trend by way of a full-blown recession. This risk could arise if the yield curve becomes even more inverted.

This is as much as can be said regarding general trends.

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