

Positive results in the first half of the year

Stephan Vollert, Head Research & Analysis, Belvalor AG

We started the new year on an optimistic note. Looking back at the results for the first six months, we are pleased at how things have gone. However, we have been also surprised by the speed of the economic recovery, and especially by the positive performance of the equity markets.

Following a very satisfying first quarter, the momentum increased over the second quarter. Equity indices have recently climbed to new highs – except in China. Commodity and energy prices have also risen significantly, though precious metals, which seemingly benefit from an inflation-proof aura, have not. Over the last few months, the positive outlook for the post-pandemic period has fed into equity prices. Equity prices offer an early indicator of economic development, and generally preempt the real economy by six to twelve months. Especially equities of companies battered by Covid-19 which are benefiting from the reopening of society, economy and international borders – i.e. from our reacquired freedom – have regained strong buoyancy since April. Thanks to the euphoria, stoked by companies that can largely look back on an excellent first half of the year, expectations for the second half of the year have also improved markedly. Some degree of caution is thus advisable.

The economy is currently operating at full swing and, due to stimulus packages by governments and cheap money, is even at risk of temporary overheating. Since government support schemes look set to continue for a little while longer, their positive effects should be felt more into the next year, and even the following year too. In order to achieve a sustainable recovery, a gradual return to normality over several years would also be preferable to a sharp bounce back. Central banks, including first and foremost the Fed in the USA, will tread carefully when reining in their still loose monetary policies in order to prevent economies from stalling, causing financial markets to crash. Within

this environment, equities will generally speaking remain attractive.

The Fed has suggested that the first interest rate hike may probably come at the start of 2023, a year earlier than previously expected. However, this will only occur if inflation gets out of control and/or the economy continues to run smoothly. The latter scenario appears to be more realistic to us than the former. As mentioned in our Outlook for 2021, we do not think that the uptick in inflation will be sustained. It is expected that digitalisation, globalisation and particularly high debt levels will make their effects felt soon and curb inflation.

Due to the significantly heightened expectations for the second half of the year coupled with the satisfactory performance over the year to date, although bearing in mind also the risk of getting burnt, we have hedged part of our larger equity holdings with put options. We have selectively cashed in some of our profits in order to reduce significant overweighting. Within the current climate, we do not consider it a bad thing not to accelerate at full pelt with our equity portfolio. Despite our tactically prudent stance, equities still represent the strategically most attractive investment class for us in the long run, as mentioned in our Outlook for 2021.

Cash is not a genuine alternative. Cash is being penalised more widely and to an increasing degree. Banks are becoming much less reticent about charging their clients negative interest rates – or expressed in more diplomatic terms tax-deductible “customer deposit charge”. The floodgates appear to have opened. The exemption thresholds above which negative interest rates are charged to CHF and EUR are falling across the board. The relatively low allowance of CHF 100,000 that Post-Finance introduced as of 1 July is not expected to be an outlier. We think it would be illusory to anticipate a relaxation any time soon. This issue is

set to be a perennial one, which will be with us for a long time to come. Caution needs to be exercised in relation to products that are touted as “substitutes for cash”.

The exacerbation of the negative interest rate problem, which has manifested itself in a desperate search for alternatives to cash, is having effects on other asset classes. Bond yields, which were already low, have fallen even further. Essentially bonds now no longer offer any return, especially when compared to the risk taken on. The prices of high-dividend equities and tangible revenue-generating assets – such as real estate – have been driven up even further. However, it is important not to take on excess risk for the wrong motives.