Quarterly Letter

Stephan Vollert, Head Research & Analysis, Belvalor AG

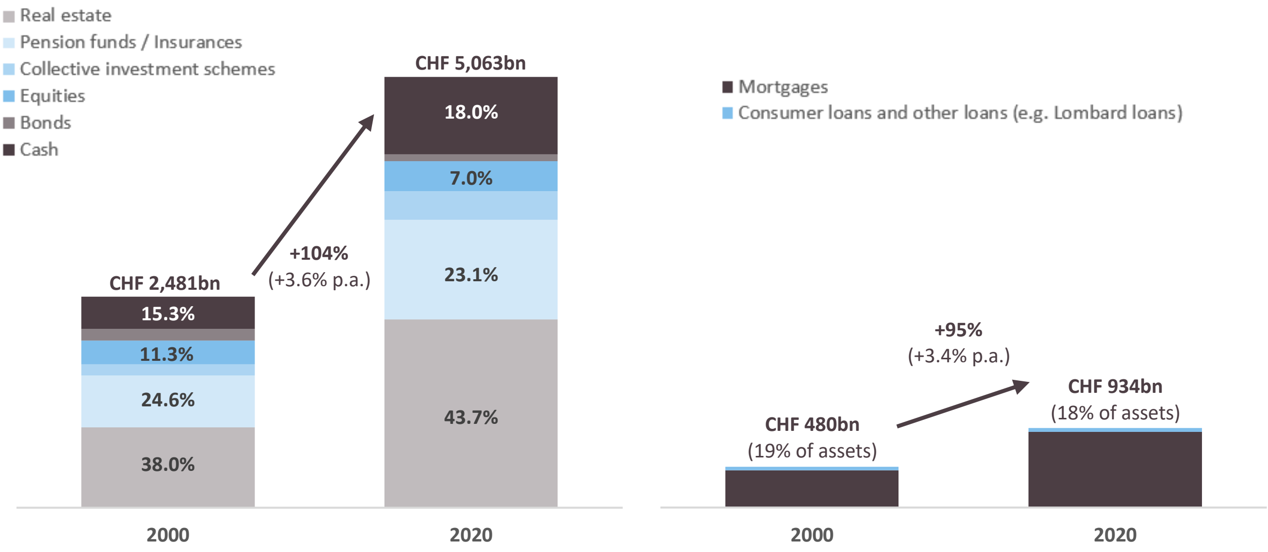
The developments observed in the first half year – such as rising commodity and energy prices – are continuing and have tended to intensify. Concerns about China have not decreased. Covid-19 is omnipresent; an end to the pandemic, and therefore a return to a new normality is however becoming apparent. Even the USA is opening its borders. Supply chain bottlenecks and product shortages are on everyone's lips. Not only have manufacturing wares and consumer goods recently become scarce commodities, but skilled workers are desperately needed in many places. This has led to sharp wage increases in some industries. Furthermore, state economic stimulus programs are – still – waiting in the starting blocks.

The slowdown in economic growth, which we had been expecting towards the end of the year, did not fail to leave its mark on the stock markets in the third quarter. With more headwind, monetary policy – which continues to have a considerable impact on the equity markets – and the asset allocation, are gaining special significance. That's why we are focusing on these two topics in this letter.

The central banks could actually pat themselves contentedly on the back. Thanks to their monetary policy, not only has the economy started rolling, but inflation has been rekindled. We believe, however, that the joy about this will not last. Although we can assume that the wage price spiral will continue to turn at a base level, digitization, technologization and globalization as well as the high levels of national debt will again have a deflationary effect. We expect that the money glut will soon be restricted but not be turned off for a long time – and certainly not reversed. We will have to wait a while for the initial interest rate hikes. The US Federal Reserve may begin to twist the interest rate screw in an upward direction in 2022/2023; in Europe, and therefore in Switzerland, we first expect this to happen in 2024 at the earliest. The zero and negative interest rate policy will be accompanying us for a long time yet.

The effects will therefore remain the same – it's only a matter of the scale. The frequently quoted asset inflation, i.e. the value appreciation of financial assets, is taking ever more significant characteristics and is accelerating. The flip side of the coin is the financial repression, i.e. the gradual loss of savings. Rising costs are offset by zero-to-negative interest rates on savings. Despite this, the majority of the Swiss population do not own any equities. The equity quota has even declined, despite the gratifying stock market. More cash is now held, than is invested in shares, bonds and collective investment schemes combined. Our conclusion is that, thanks to the relative attractiveness to all other asset classes, more money will be allocated to equities. Fortunately, most of the working population are invested thanks to pension funds and other insurance institutions, albeit indirectly. Value appreciations have also be obtained with real estate. The following graphic shows that the debt ratio in the previous 20 years has sunk. In Switzerland, liabilities increased less strongly than assets, which have more than doubled. The distribution of household assets and liabilities varies from country to country. While the share of equities is higher in the USA and in UK, it is even lower in Germany.

Private households in Switzerland: asset distribution (left side) and liabilities (right side)



Source: Swiss National Bank (data.snb.ch), Belvalor AG

In the current environment with little visibility in the short term and assuming an upturn during the next two years, we see no reason to make changes to our investment policy. We recommend resisting the temptation to unnecessarily increase risk. Quality takes priority in all investment classes. Our preferred instruments continue to be equities of quality companies and real assets. Even if, contrary to our expectation, inflation remains elevated, this strategy is the best way to retain purchasing power – it won't succeed with cash alone. We keep larger equity holdings partially hedged with put options. Selectively, we have purchased additional precious metals, which mostly suffered losses in 2021.