Valvest

Investment View – 2nd Quarter 2019

When will the market crash?

As an asset manager you are often confronted with this question. In almost all cases the concern is whether the price of equities is set to fall. However, various elements can experience a crash - the economy, the price of assets or the currency used for valuing an asset. If asset prices fall, the purchasing power of uninvested money increases. In the medium to long term, however, the reverse case is much more likely and deserves greater attention from investors.

Currencies – Race to the bottom

Since the financial crisis of 2009, we have experienced a crash in the value of currencies in relation to assets such as equities, bonds and real estate. Record-low interest rates and balance sheet expansion of central banks have been aimed at increasing the global money supply, absorbing public debt and stimulating the economy. If the yield expressed in interest rates is low or even negative, as we are experiencing right now, investors look for alternatives to increase the return on their capital. This causes the prices of income-generating assets such as equities and real estate to rise until the returns on these assets have adapted to the new level of interest rates. The risk for an investor is thus not only the ever-dreaded fall in the value of assets, but also the fall in the value of the money itself. This is especially true when central banks tirelessly emphasize their readiness for further easing measures.

In the last six months, the US Federal Reserve first refrained from a previously planned rate hike and has now even signaled its willingness to lower interest rates again. The European Central Bank has not even begun to normalize interest rates, yet President Mario Draghi still feels compelled to underline that he will do everything in his power to achieve inflation targets.

Only paying attention to what central banks are saying, one could get the impression that we are in the midst of a serious crisis. The trade conflict certainly brings some headwind and after the cyclical highs, a slowdown in economic growth rates is apparent. Nevertheless, the global economy continues to grow, unemployment is low and most economic participants are positive. In addition, real interest rates are already record-long record-low and continue to stimulate economic growth.

It is becoming apparent that central banks cannot have their own currency weak enough to give their economy a competitive advantage. In addition, government spending is growing steadily while debt is already high. There is thus no room for any potential economic weakening. In order to reduce the burden of government debt, higher inflation rates are longed for and required. Studies have already been done on how to best enforce negative interest rates and how inflation rates may be evaluated over an average period of time to temporarily allow inflation to run above target rates.

It has once again become evident what governments and central banks are focusing on. The market also seems to have understood this message. Commodities, especially gold, and stock markets have risen following the US Federal Reserve's 180 degrees policy shift. The trade conflict, tensions with Iran and political conflicts in Europe are currently holding back the markets from further increasing. These risk factors can tilt to both sides. The only thing that looks fairly evident is that central banks are ready to intervene swiftly, should the economic growth show signs of weakening.

As an investor, you are well advised to hedge against all types of risks. Diversifying across different asset classes is one of the best ways to do so. We continue to focus on high-quality stocks, gold, cash and medium-term bonds. A well-positioned investor can patiently observe the further development and make use of newly emerging investment opportunities.

Zurich, June 2019