Valvest

Investment View – 2nd Quarter 2021

Inflation is a current and controversial topic, which is based on different definitions and targets. Austrian Economics defines inflation as an increase in the amount of money or credit, as the effects can manifest themselves in different ways. The Keynesian approach, which the majority of economists advocate, focuses on the rise in consumer prices. Whether the shopping basket, represented by the consumer price index, covers the inflation of personal consumption or consumption needs is up to one's individual perspective.

From an Austrian Economics point of view, inflation has long since taken place as the money supply has sharply increased. Prices of assets such as real estate or stocks have also risen significantly. Only the consumer price index has up to this year only shown a moderate increase. Globalization in the form of global competition at product and labor level have kept prices low. Digitization and technological progress have increased efficiency and thus reduced production costs. In addition, the aging of the population has led to a decline in consumption among the wealthiest age group. All of this has led to deflationary tendencies in consumer prices. More so, commodity prices fell sharply after too much was invested in their production up to 2014, while demand was declining.

The corona crisis has now simultaneously set various processes in motion. On the one hand, the central banks' balance sheets have expanded massively and fiscal spending has greatly increased. On the other hand, the temporary standstill of the economy has severely affected the global supply chain. If consumption increases due to the economic recovery and the pent-up demand, while supply is still constrained, there is further potential for rising prices.

While it was still possible to justify the low interest rates at the beginning with stable consumer price developments, the situation has changed in the meantime. In the last few months, the consumer price indices have risen sharply around the world. The low - sometimes negative - nominal interest rates, together with inflation, lead to negative real interest rates. Central banks now argue that current inflation is a temporary phenomenon and thus the level of interest rates is still appropriate.

But what happens if the economy actually recovers more strongly than expected and continued demand continues to put pressure on prices? The central banks will be forced to put on the interest rate brake or at least announce a tightening of monetary policy. Higher interest rates are problematic for assets because their valuation is strongly related to interest rates. If higher interest rates cannot be compensated for with stronger earnings growth, this consequently leads to a correction in asset prices.

As of today, rising interest rates, especially after deducting inflation, are a long way off. The various uncertainties weigh too heavily, the dependence on cheap financing is too great for central banks to put on the brakes just yet. But even the remark by the American central bank that interest rates could be raised in 2023 did lead to a negative market reaction.

Various indicators suggest that the economic recovery will continue. It remains to be seen whether the increased inflation will stabilize again after the temporary distortions in the supply chains have been resolved. If interest rate increases were necessary at a later point in time, this would be negative for asset prices in the short term. However, since this could be attributed to a positive economic trend, corporate profits would still be higher in the long run.

It is therefore advisable to continue to take a long-term perspective and counter short-term uncertainties with a robustly invested portfolio. Our focus on well-positioned companies with high-quality products and services ensures that any persistent cost pressure does not have a negative impact on their profitability. We currently see no reason for major adjustments to our asset allocation and remain overweighted in carefully selected stocks at the expense of bonds.

Zurich, end of June 2021