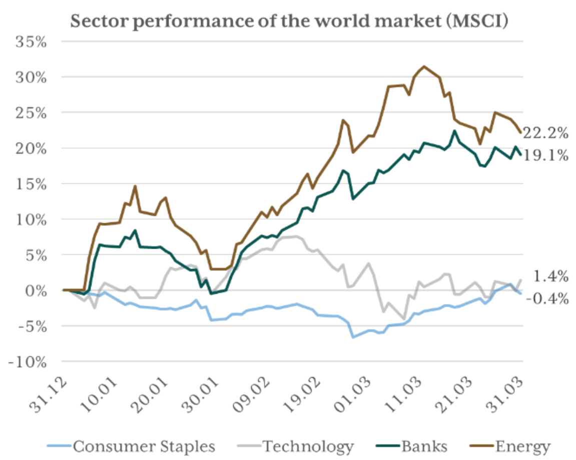
Valvest

Investment View – 1st Quarter 2021

The reliable trends of recent years were turned upside down in the first quarter of 2021. Banks, insurers, cyclical industries and commodity-related companies have shown the best performance so far. The market is anticipating an economic recovery based on considerable government support measures and hopes related to the Covid vaccination. At the same time, increasing consumer demand faces capacity bottlenecks in certain industries, especially after the end of the lockdown. In combination with a broad-based rise in raw material prices, this has led to a noticeable increase in inflation expectations. Consequently, interest rates have gone up, albeit from very low levels.

Market participants' risk tolerance has increased considerably, and cyclical companies are being bought that benefit particularly from an economic recovery. These have been relatively inexpensive compared to the overall market, but benefit disproportionately from strong margin expansion when sales growth increases. The opposite phenomenon can be observed with very defensive stocks, which show steady returns, but often achieve lower growth rates. These firms previously traded at a premium but benefit comparatively little from an economic recovery.



The most important component in this first quarter was valuation. Defensive companies were used to a certain extent as a bond substitute and were valued expensive accordingly. When interest rates rise, the valuation of these stocks must fall in order to maintain relative equilibrium. Due to the defensive nature of these stocks, this cannot be sufficiently compensated for with increases in earnings. Rising interest rates have also hurt the technology sector. Previously unaffected by Covid, this sector was able to show robust growth rates and was thus priced at a premium. If the economy recovers, growth will be better distributed across all sectors, which has reduced the relative attractiveness of IT companies.

The exciting thing about structural market shifts is that they show the robustness of a portfolio. If the portfolio is overly exposed to certain trends, the return may appear attractive in the short term, but long-term risks always come to light. We attach great importance to the robustness of our portfolio. For this reason, we only invest in companies of above-average quality. We also pay attention to the balance of our companies in terms of growth, cyclicality and valuation. This means that we can achieve attractive returns across all economic cycles with comparatively lower risks.

Was this year's market movement a preview of what is to come or just a countermovement in a long-term trend? Should interest rates turn from a tailwind for stocks to a headwind, investors will again have to primarily focus on profit growth and valuation opportunities. For companies with low growth prospects and expensive valuations, we see little potential in such an environment. The technology sector remains a central part of economic development. In view of the cost increases reported due to capacity bottlenecks, weakly positioned companies will be unable to sufficiently pass on rising prices to consumers. Therefore, after this broad-based increase in cyclical companies, the focus will again shift towards high-quality companies.

Overall, nothing has changed in our positioning. We remain optimistic about equities and are sticking to our overweight at the expense of fixed-income investments.

Zurich, end of March 2021