Valvest

Investment View – 3rd Quarter 2021

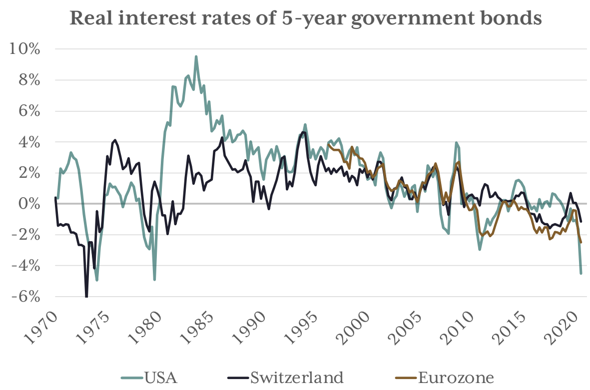
No sooner has the economy recovered from Covid than the next adversity is looming. Not only are viruses spreading faster than before as a result of globalization, but the financial system is also heavily interconnected on a global scale. Similar as in 2009, the current uncertainties originate in the real estate market. Since a lot of debt capital is used to finance real estate, falling real estate prices bring considerable risks for the entire financial system. This is because loan defaults by real estate companies affect banks that structurally also have low equity.

In this case, China deliberately took measures to cool down the real estate market. As a result, the Chinese company Evergrande has run into financial difficulties. We assume that this problem will not go unsolved. What is questionable, however, is the impact on the entire real estate sector in China, which is estimated to influence 20% of the Chinese economy and accounts for around 60% of the private wealth of the Chinese people. A significant downturn in the real estate market would hit Chinese consumers hard and would have a global impact. Due to the state-directed economy, this major player in the world economy remains difficult to predict.

Global supply chains are currently facing a perfect storm. The production is exposed to supply bottlenecks of raw materials and confronted with manufacturing backlogs and transport difficulties. In addition, the demand side is running at full speed due to pent-up consumer spending. This has led to significant price increases. While globalization has mainly been taken advantage of over the years, the downside of globally interconnected economies is increasingly becoming apparent. Companies will increasingly have to focus on carefully weighing up opportunities and risks in relation to the supply chain and dependencies on individual countries.

The same considerations can be applied to an investor's portfolio. In good times, the focus and the overweight of a portfolio can be skewed in favor of a currently successful factor, for example in favor of those profiting from falling interest rates or high-valued companies with strong growth components. In the long term, however, it is advisable to be resiliently positioned for different scenarios. In globally intertwined markets, risks are omnipresent. It is therefore important to position oneself for the dominant medium to long-term influencing factors.

One of the most important factors for asset values is interest or real interest (interests after deducting inflation). Due to the current rise in inflation, real estate rates are nearly at a historic low point.



Fixed income investors will not put up with negative real returns on the current level for long. Either inflation rates will fall, or interest rates will have to rise from the current levels.

If the economy does not weaken unexpectedly, we consider higher inflation rates to be very likely. The current quarterly reports of the companies paint a uniform picture of increased input costs, which well-positioned companies can pass on to customers by means of price increases.

The extent to which interest rates can rise without slowing the economy down remains to be seen. In any case, this process will not be straightforward. Due to the high dependency on low interest rates, economic development swings like a pendulum between deflationary and inflationary forces. After deducting inflation, however, we expect real interest rates to remain negative.

The resiliency of the portfolios we manage has the highest priority. Every change in the macro-economic environment also provides opportunities to find attractive investment possibilities.

Zurich, end of September 2021