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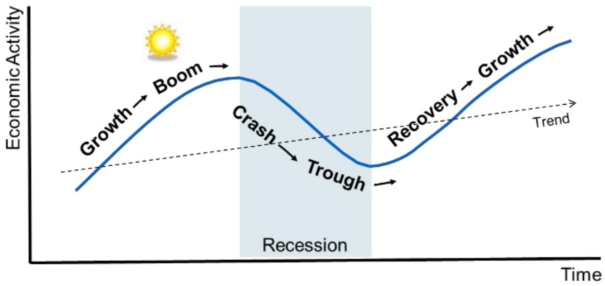
Investor Info
Investment Commentary

Briefing from the ARVEST Investment Committee

Future Prospects

Investors started the 2018 financial year full of optimism and now look back on it with great disillusionment. What went wrong? And what does this mean for the future?

With the exception of short-term bonds or cash in the US dollar, no asset class achieved a positive result last year. The attractiveness of dollar bonds has been correctly pointed out in our January investment commentary. We had also guarded against exuberant hopes back then and rightly warned in October against concentration in a few large-cap technology stocks. Unfortunately, despite good positioning, we were unable to beat the markets clearly. The US stock market correction was accompanied by economic growth concerns since October and thus also affected oil companies, financial stocks and other cyclically sensitive securities worldwide. Since October, these stocks have mostly lost less than the technology and the communications sector, but have not been able to compensate for the weaker development in the first half of the year.



We cannot fully share the widespread economic growth concerns. The economy, especially in the USA, is likely to weaken and to develop asynchronously globally in 2019. The leading indicators already showed this since late summer. In the last few months, sentiment has also deteriorated, as shown by survey data such as the Purchasing Managers Index. A recession, however, is still very unlikely even for the USA on the basis of the latest data, unless a shock-like external event occurs.

Currently many investors seem to expect exactly such a shock coming from political events. For the financial markets, the trade conflict between China and the US is the most significant, alongside the challenging economic restructuring in China and numerous problem areas in the EU. The trade conflict is reminiscent of the chicken game known from game theory, which is known to moviegoers from "Rebel without a cause" or "Footloose". Who blinks first, has lost. And if nobody blinks, they all lose everything. It is irrelevant who objectively has more to lose. It's all about subjective willpower. It is therefore impossible to calculate the probability of victory. In today's political environment where increasingly no one sees themselves as responsible and everyone blames the opponent, this apparent inability to compromise unsettles many political observers and investors. The risk seems intuitively high that something external may intervene and – just as in the movie - the jacket or shoelace will get tangled up in the vehicle, preventing even the smarter protagonist from jumping off.

How does the ARVEST Investment Committee position itself in this situation? On the one hand, we assume that every game has an end. In the trade conflict, both parties are likely to declare themselves winners one day, not least because the concrete effects will only become apparent years later. On the other hand, it does not make sense to protect oneself tactically against unknowable events. Hedging is not for free and usually also comes at the expense of future profit opportunities. It should not be forgotten that much uncertainty has already been priced into the markets. Volatility belongs to stock markets. It is now a matter of keeping calm and aligning oneself with one's long-term goals and discussing these with the advisor.

We therefore continue to feel comfortable with an equity ratio in the middle of the strategic range, as we have been doing since the fourth quarter of 2017. This provides the most flexible starting point for possible developments. It is neither the time for tactical bargain hunting nor for panic reactions. In today's market environment, we attach great importance to true diversification, and continue to favour high-quality, international value stocks over high-flying US growth stocks, which also dominate many stock market indices and passive ETFs. We have increased the ratio for US bonds at the expense of equities only for investors who calculate in US dollars. The USD currency risk is likely to become more significant for other investors. Price losses could erode the excess return. We maintain our fundamentally positive attitude towards equities. In fact, some important notes are lost in the spectacle that the media report to us daily - very much for their own benefit - from the power centres of the world. At the end of September 2018, for example, the renowned Brookings Institute stated that for the first time since agriculture-based civilization began 10,000 years ago, the majority of humankind lives in households with enough discretionary expenditure to be considered “middle class” or “rich” (www.worlddatalab.io). For humanitarian reasons, it is of course very gratifying that there are fewer households that are poor or vulnerable to poverty. For long-term equity investors, however, the profit opportunities offered to companies by a strong middle class are significant. Middle class households consume about a third of the world's economic output. The fact, that the middle class is also the fastest growing segment in the world, growing from 3.8 billion today to 5.3 billion in 2030, makes us confident as long-term investors.

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On behalf of the Investment Committee
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