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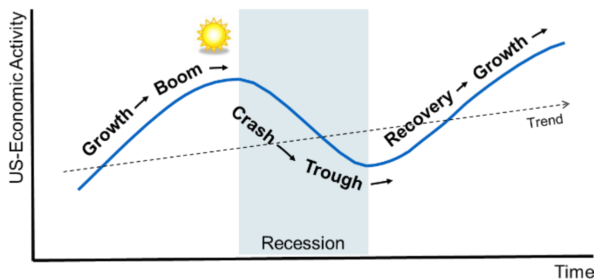
# Briefing from the ARVEST Investment Committee

Geopolitical uncertainties and key interest rate cuts by the major central banks shaped the financial markets in the past summer quarter. Defensive investments such as bonds, gold and safe-haven currencies, such as the US dollar, the Swiss franc and the Japanese yen, gained further against other currencies. In equities, non-cyclical sectors with regular dividends were particularly in demand.

We notice a bizarre reversal of established investor behavior. In today's low interest environment, many investors buy equities to generate income. By contrast, they buy long-term government bonds with the aim of speculative capital gains or because they are required by law to hold "safe" investments. There is no other convincing explanation for the successful partial placement in August of a 30-year German government bond offering an average annual yield of only minus 0.11% in euros. In order for this low yield to remain attractive until redemption, inflation would have to stay significantly negative for the next 30 years. Perhaps we lack imagination, but we cannot envision that health insurance premiums, rents and tuition fees, for example, will be halved by 2050. The dangerous effects of a negative interest rate policy, which encourages investors to take excessive risks in the equity market, are often and rightly pointed out. Too rarely, however, is there talk of the price risks that investors take on long-term government bonds. Many investors are likely to lull themselves into a false sense of security and underestimate the volatility of bonds. In the short period from April 2019 to August 2019, for example, the yield on the aforementioned government bond fell by a full 1%. If the interest rate environment were only to normalize again to the April level, an investor would experience a 30% loss in market value with this investment, regardless of any changes in the credit quality of Germany.

If we look around for market bubbles with unrealistic valuations and euphoric investors, then we find them rather in certain bond classes than in equities. Equity investors who closely follow the business outlook of companies are anything but euphoric. During the presentations of the business results, management's uncertainty about the further development and effects of the US trade dispute with China is palpable. As a result, companies are often reluctant to invest in operational growth and focus on maximizing profits from their current business. For example, they employ financial engineering to benefit from low interest rates, which may lead to higher debts and greater dependence on

future interest rate developments. This is most offen the case for defensive securities.




**Future Prospects**

Global economic growth has continued to weaken. With the exception that key interest rates have already been lowered and that investor sentiment on the stock markets is cautious, the typical signs of a boom phase in the US economy have continued to solidify. The long leading indicators warn of a possible beginning of a US recession next summer. However, this is not yet confirmed by short leading and more reliable indicators. Overall, it is therefore still too early to warn of an imminent slide of the US economy into recession.

Many American and Swiss stocks have become expensive. The very low inflation expectations enable unusually low, often negative nominal interest rates. This also led to very high valuations for other asset classes such as bonds and real estate.

We assume that the financial markets will be strongly influenced by political news until the US elections in the fall 2020. The decisive factor here is how confidence in future developments will guide every investor's activities. It is difficult to measure confidence reliably in economic terms, and even more difficult to forecast it. On the one hand, confidence arises from personal experience in constant interaction with the environment. But especially with today's means of communication, true and false stories can spread quickly. Good leadership can also build confidence. But how many of the following institutions currently inspire your confidence: President Trump, a divided US Congress, the FED, the ECB, Boris Johnson and the British Parliament, the EU institutions, global business leaders ...

How does the ARVEST Investment Committee position itself in this situation? We keep the equity allocation at the lowest strategic range, as our ARVEST CYCLE investment strategy recommends for a boom phase. In view of the risks associated with other asset classes, we tactically leave the equity quota at the upper end of this range. However, we are prepared to adjust the equity exposure at any time, depending on the development of the trading dispute or on new economic data. In equities, we attach great importance to diversification and prefer high-quality, international value stocks. Only in exceptional cases will we extend fixed-income maturities to the same extend as we did in earlier boom phases since even long-dated bonds often have negative yields to maturity. We are also sticking to gold investments. Inevitably, this leads to a higher liquidity in the portfolios. In the short term, disciplined action is still called for, but in the long term we remain convinced equity investors.

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On behalf of the Investment Committee
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