October 2021 | Issue no. 123

Investor Info
Investment Commentary

Briefing from the ARVEST Investment Committee

In the last investment commentary we already asked the question where in the business cycle we are. A few days after going to press, the NBER[1] committee officially set the end of the last US recession for April 2020. So the recession lasted only two months. A sharp downturn in March 2020 was followed by a rapid consolidation in April. Already in May, the US economy grew again, albeit from a lower level. In its commentary, the NBER emphasised the distorting influence of the pandemic on economic data as well as the unusually short recession duration. The shortest recession in US history since 1854 lasted 6 months. This forced the NBER to question its own definition of a recession, according to which a recession must last longer than a few months for the subsequent recovery not to be considered a continuation of the previous expansion. The NBER eventually classified the period as a full-fledged recession precisely because of the unprecedented scale of the decline in employment and output and the broad impact on the economy as a whole.

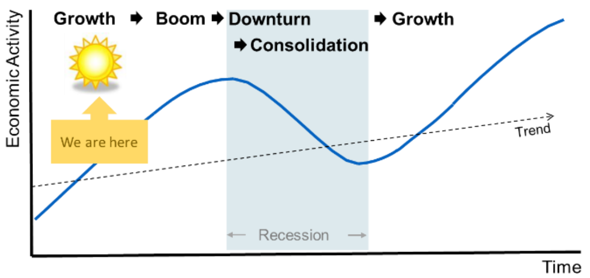
The recession thus had different dynamics and characteristics than previous recessions. The same applies to the subsequent growth phase that began in May 2020. The US government had launched the basic stimulus packages already during the recession, and the Fed had lowered interest rates and decided to inject massive liquidity into the economy in the form of quantitative easing. These rigorous steps led to consumption recovering much faster than after previous downturns. However, demand was concentrated only in certain sectors or products due to the measures introduced to combat the pandemic. For example, many American city dwellers needed a new vehicle for their move to the countryside and their mobile home office. However, car manufacturers had learned in previous economic downturns that new cars sell poorly in times of crisis and cut back on production. Since new cars were scarce, buyers switched to second-hand cars, which in turn quickly also became scarce and more expensive. There are many similar examples of specific price increases. Central banks and most financial market participants regard such events as transitory. However, if such consumer experiences of supply shortages and rising prices become more frequent and increasingly affect important

[1] National Bureau Of Economic Research, nber.org

household items such as rents, higher inflation expectations could well lead to rising wages and more persistent inflation.

Future Prospects

The ARVEST Investment Committee sees the global economy as a whole being in a growth phase, with the US in particular already having entered the second half of its growth phase. Although we take into account that the current economic cycle could be shorter than the previous ones, we do not yet see the economy in the final, overheated boom phase.



Uncertainty about the foreseeable bankruptcy of the Chinese construction company Evergrande with over USD 300 billion in liabilities and its impact on the global economy as well as the possible decision by the US Federal Reserve to tapering its quantitative easing (QE) are currently preoccupying the financial markets. As far as Evergrande is concerned, we, like most financial market participants, do not expect a "Lehman moment" that could plunge the world economy into the abyss, as was the case with the financial crisis, despite the enormous amounts involved. At its core, Evergrande's problems stem from its aggressive business model and last year's decision by the Chinese government that property developers must adhere to stricter debt limits. This policy decision for less debt-financed growth in China, on the other hand, is likely to have a noticeable impact on the global economy in the medium term. Nevertheless, there are attractive investment opportunities in Hong Kong and China whose valuations do not price in high credit growth or government guarantees. Tapering in the US, on the other hand, is likely to become more relevant for the financial markets than for the real economy. The mere announcement of a possible Fed decision has caused prices to fall in recent weeks. An end to the expansion of the Fed's balance sheet, a winding down of earlier QE programmes and an increase in prime rates in the near future are not yet priced in by any means. The financial markets seem to be disconnected from the typical development of the real economy in the business cycle. In this recovery it was simply easier to use the liquidity to buy securities than to build a factory with it. The realignment of stock market and economic cycles may thus lead to increased volatility soon.

Despite the high stock market prices, which imply below-average returns in the long term, there are still no convincing alternatives to equities and real assets on the financial markets. We counter the high valuation risks with a targeted selection of individual stocks and a portfolio structure that can deviate significantly from the sector and country composition of the broad equity indices. We expect that the current optimism could be put to the test in the coming quarters. Therefore, we continue to set the maximum equity exposure in our cyclical investment strategies somewhat lower than we have done in previous economic cycles. We may also selectively use derivative hedging strategies, particularly for investments that appear to us to be very liquidity-driven.

7 October 2021
On behalf of the Investment Committee
Stefan Kimmel
Chief Investment Officer ARVEST Funds AG