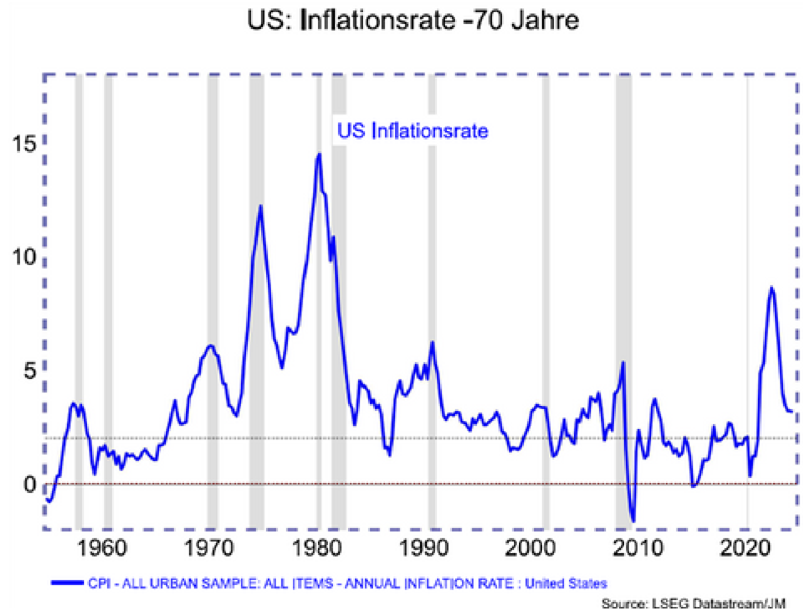
CORUM Comment on the investment policy in Q4 2024

The inflation fighters laid down their weapons in the 3rd quarter

Expectations about the central banks' further interest rate policy really collapsed in the 3rd quarter. For the USA, the money market interest rate expected for the end of 2025 fell from 4.2% at the beginning of July to 2.8% at the beginning of September. This indicates that the inflation cycle is over. It has two special features: first, it is one of the shortest of the post-war period, and second, it has not been ended by a recession triggered by the central bank. This amicable course has a lot to do with the causes of the price increases.



They are primarily due to the major real shocks of the last five years, namely the pandemic, the Ukraine war and the collapse of supply chains. They have led to a slump in global production. Deficiency symptoms were the result. Due to the massive disruptions in the supply and transport systems, practically all industries have been affected by the shortages. Most states have resisted the temptation to distribute the scarce goods to the population according to socio-political criteria. No, the market has largely been allowed to play.

This even applies to essential goods such as energy and food. The consequence was that prices shot up across the board. Companies have adjusted prices to scarcity conditions and expected wage increases. However, wage increases came with a delay and only partially, so that workers were confronted with a loss of purchasing power globally. The great fear of many opinion leaders and economists of a wage and price spiral, as we had experienced in the seventies, has also not been realized.

This has had an extremely positive impact on companies and shareholders. They were able to record a significant increase in margins, which they used for the further expansion of services (shortage of skilled workers). This has contributed significantly to the rapid decline in prices. This has very little to do with monetary policy. This is because interest rate hikes take an average of around 18 months to contribute to a slowdown in economic activity and put pressure on prices. However, since in the current case it is mainly a matter of supply and not demand inflation, the market itself is responsible for the additional supply and the loss of purchasing power of consumers for falling prices.

The central bank political activism or even alarmism, as practiced above all by Powell, could probably have been dispensed with. In view of the special starting position, a neutral monetary policy has been called for by well-known economists.

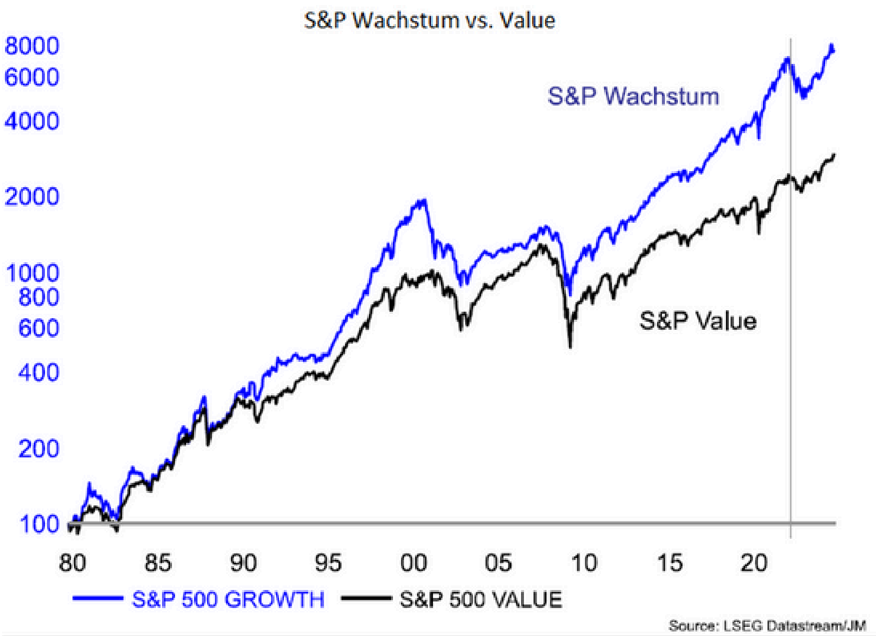
The panic reaction of individual central bank politicians and opinion leaders, who conjured up a wage and price spiral that would require a sharp reaction in Volcker's sense, has caused considerable damage. World assets lost over 10% of their value in 2022 and banks had to fear for their equity or even went under.

It is unthinkable if alternative strategies could have been pursued at best. One person who was aware of this problem is certainly Thomas Jordan. It is therefore not surprising that he heralded the interest rate turnaround before all other central bankers. Now, however, the way is clear for better monetary conditions. But the real sector has also weathered the shocks of recent years well. The extreme price movements have eliminated the supply shortages in a short time. In addition, new opportunities are opening up with the application of artificial intelligence (AI).

It is now likely to diffuse more and more into other industries. Output and production processes are likely to receive significant impetus. The markets are taking these opportunities into account. For example, the market value of tech stocks on the S&P index has risen from 20% to 50% within eight years. It is thus higher than the peak value in the tech bubble crisis of 2000.

Many therefore fear that a similar crash could be imminent. However, analyses show that the two forms of future expectations are not comparable. Today's tech companies are undoubtedly highly valued, but they are much better backed by current profits than was the case in the dot-com bubble. This means that there is a significantly higher probability that the new technologies can be successfully implemented in the wider economy.

Of course, the high increases in the value of the tech sector are likely to be a thing of the past. This means that value stocks are likely to experience a gradual renaissance, as was the case after the dot-com bubble. But this transition is likely to be smoother.



Nevertheless, there is no shortage of risks. The flare-up of the question of hegemony between the USA and China, the weakening of international organizations, such as the UN, the Climate Change Conference, the World Trade Organization and the EU. The failure of the Schengen Agreement and the fear of further migration flows have triggered a strong movement towards the protection of one's own borders: right-wing parties with nationalist and autocratic traits have a strong following.

Environmental issues are given less weight. For companies that have to make long-term decisions, these are not ideal conditions. The example of the European car industry shows how a flourishing industry can get into difficulties in a short time when decisions made long ago, such as the ban on new fossil cars, are suddenly put up for discussion. However, fighting instead of cooperation also means that more power is being used instead of law. The means of struggle for this are subsidies, tariffs and quotas. They distort trade flows, they make entrepreneurial action more difficult.

The high level of international debt remains a risk. It remains unchanged at around 100% of GDP, 60% would be desirable. In addition, the military spending of Western states must be permanently increased in the coming years. Distribution battles are foreseeable.

Despite all the risks, there are still one constant: the fight for the best framework conditions for one's own and potential companies. This largely secures the room for manoeuvre of company management.

Overall, monetary and real conditions have improved significantly over the past three months. This makes it sensible to maintain the overweight in equities. Since we assume that long interest rates still have room to fall, bonds can also be left at overweight. In the longer term, however, bonds are likely to fall to an unattractive level. At least in Europe.

We take account of the greater political risks by partially hedging foreign investments and broadening geographical diversification compared to market capitalisation.

So much for the big lines.

With warm greetings,

Prof. Dr. Josef Marbacher & CORUM Investment Office