sound capital

A touch too much?

February 2021

- Excellent performance of all risk assets
- High risk appetite, especially in the US
- Danger of an overheating economy
- Rising inflation expectations in the US

Rampant financial markets

Everyone knows that the stock market mirrors future expectations of investors. A look into the future becomes ever longer the lower and more predictable interest rates are. This is due to the fact that the present value of any investment depends not only on future earnings, but even more on the interest rate at which these future cash flows are discounted. Given this simplified explanation, it is easy to understand why stock markets are performing excellent despite the current economic trouble. The combination of reliable vaccinations against Covid-19, the promise of central banks to freeze interest rates and massive fiscal packages to stimulate the economy lead to rosy prospects for financial markets. But at what point is it too much of a good thing? There are already visible bubbles in today's markets, especially an extremely high volume of new and unprofitable equity listings. In the real economy, sharply rising commodity prices and freight rates give pause for thought. They are probably largely responsible for the spike in inflation expectations and long-term interest rates in the US. What will happen to producer prices when the economy returns to full speed? Stagflation (rising prices in a stagnant economy) could be the result of economic overheating. This scenario poses a major challenge for financial markets and central banks alike.

The indicators of our Navigator confirm this rather critical situation. In sum, they lead to our continued negative assessment and underweighting of equities and fixed income securities, a positive assessment and overweighting of liquidity and a neutral assessment and weighting of alternative investments.

Assessment Bonds: -

	low		Yields		high
	- -	-	0	+	+ +
New	●				
Old	●				

	low		Spreads		high
	- -	-	0	+	+ +
New		●			
Old		●			

Assessment Equities: -

	expensive		Shiller PE		cheap
	- -	-	0	+	+ +
New	●				
Old	●				

	low		Risk Premium		high
	- -	-	0	+	+ +
New		●			
Old		●			

	Contraction		Leading Indicators		Expansion
	- -	-	0	+	+ +
New				●	
Old				●	

	Euphoria		Risk-Index		Panic
	- -	-	0	+	+ +
New		●			
Old		●			

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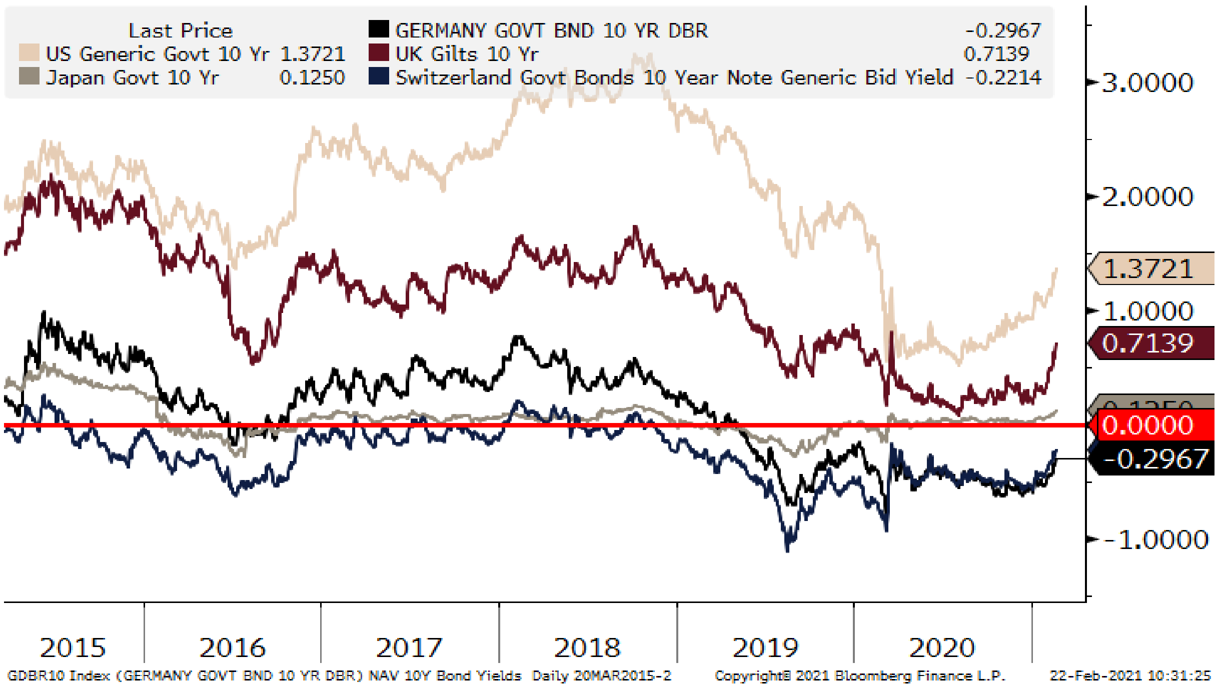
Since our last publication, we have not made any changes to either asset classes or investment categories.

Underweighting equities in a positive stock market environment comes with an unpleasant feeling "to say the least". In the current situation, we see clear benefits of active risk management in our portfolios. Instead of reducing the equity quotas through selling existing positions, we decided to hedge equity risk using derivatives. Although this approach comes with the cost of a premium, it does not limit the upside potential of our equity investments. “Putting on the hand break while driving” is probably a good comparison.

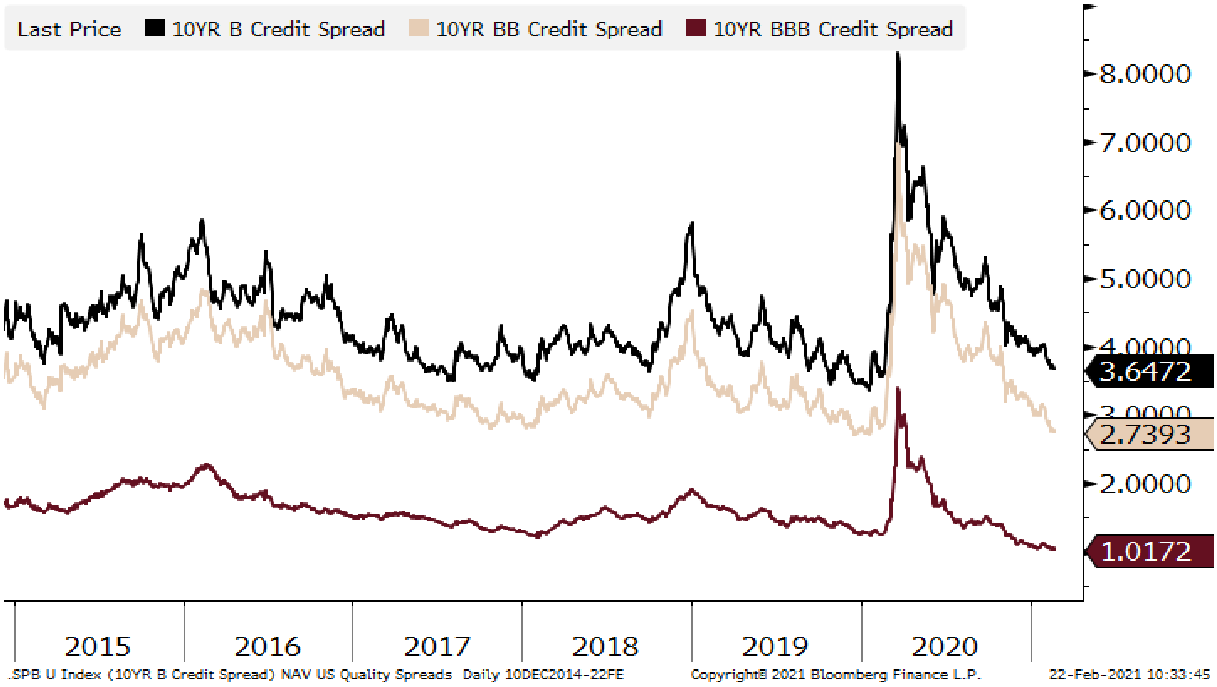
Interest rate level (indicator --) / Spreads (indicator -)

Assessment unchanged / Assessment unchanged

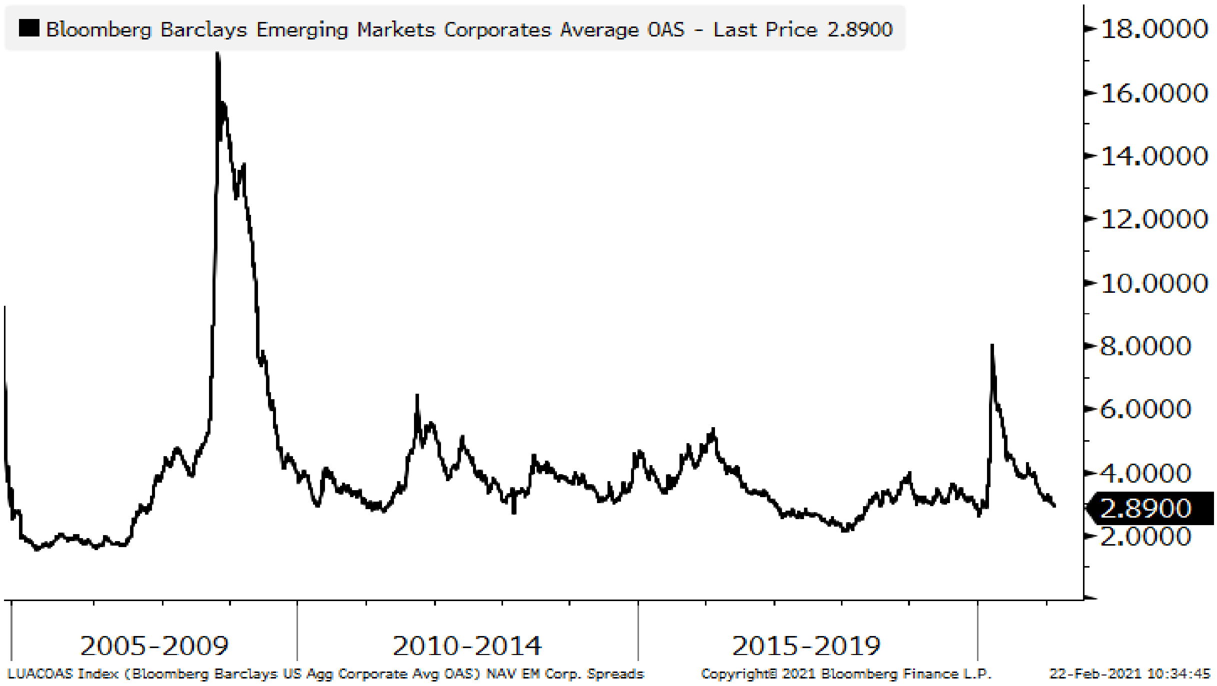
Although interest rates have increased quite significantly, they are still at unattractive levels. While yield spreads have already fallen back to pre-pandemic levels, nominal yields still have further upside potential, which is why we continue to avoid long maturities.



Credit spreads below the level of December 2019, when the market was not yet hit by the COVID crisis, make corporate bond markets look unfavorable.



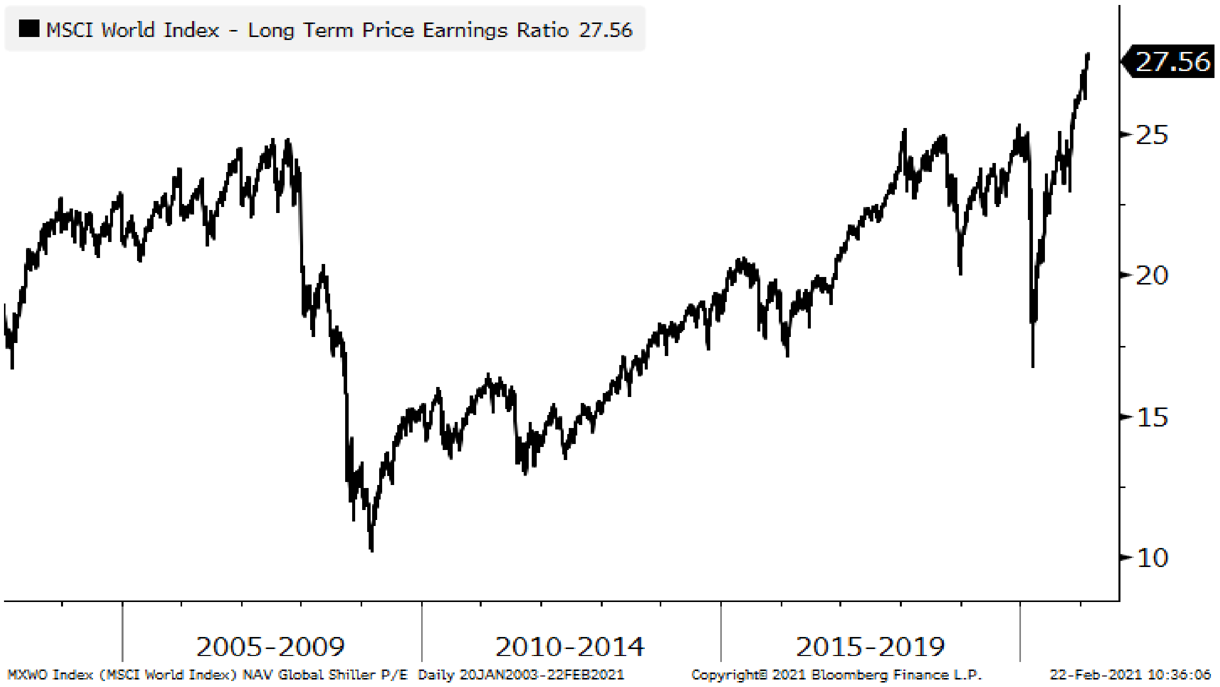
Credit spreads on emerging market corporate bonds continue to look relatively attractive due to being less distorted by central banks.

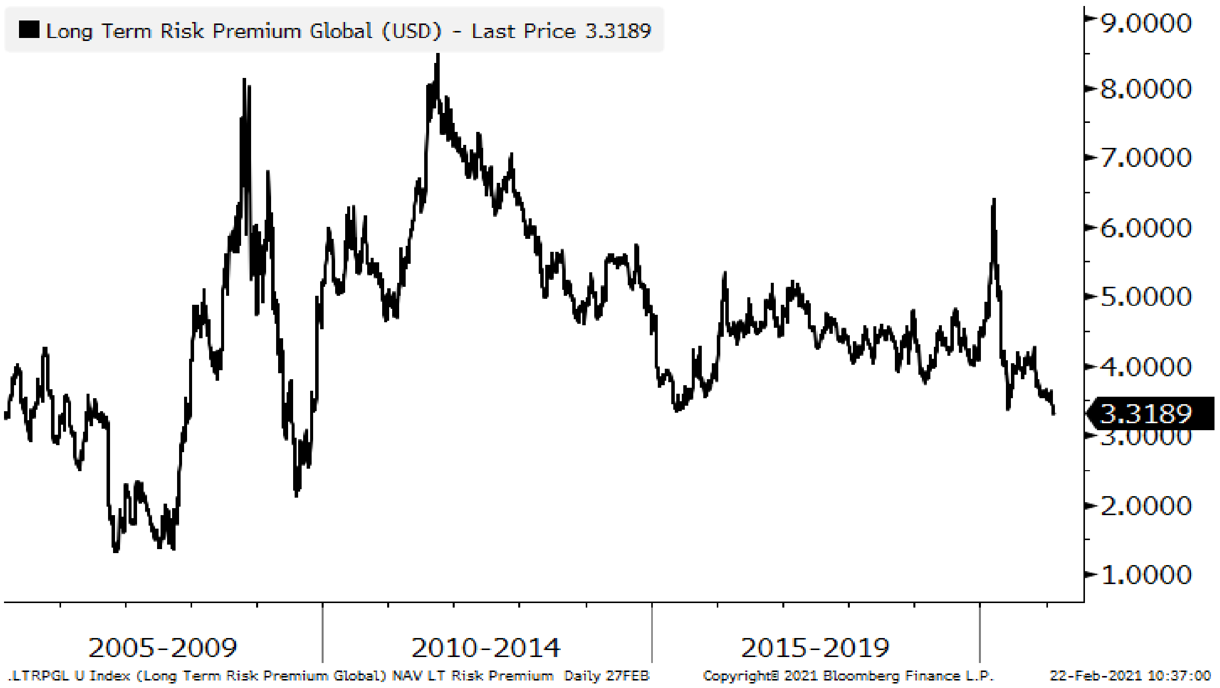


Shiller P/E ratio (indicator --) / Risk premium (indicator -)

Assessment unchanged / Assessment unchanged

The absolute valuation of equity markets has continued to rise sharply, while equity risk premiums have fallen slightly.

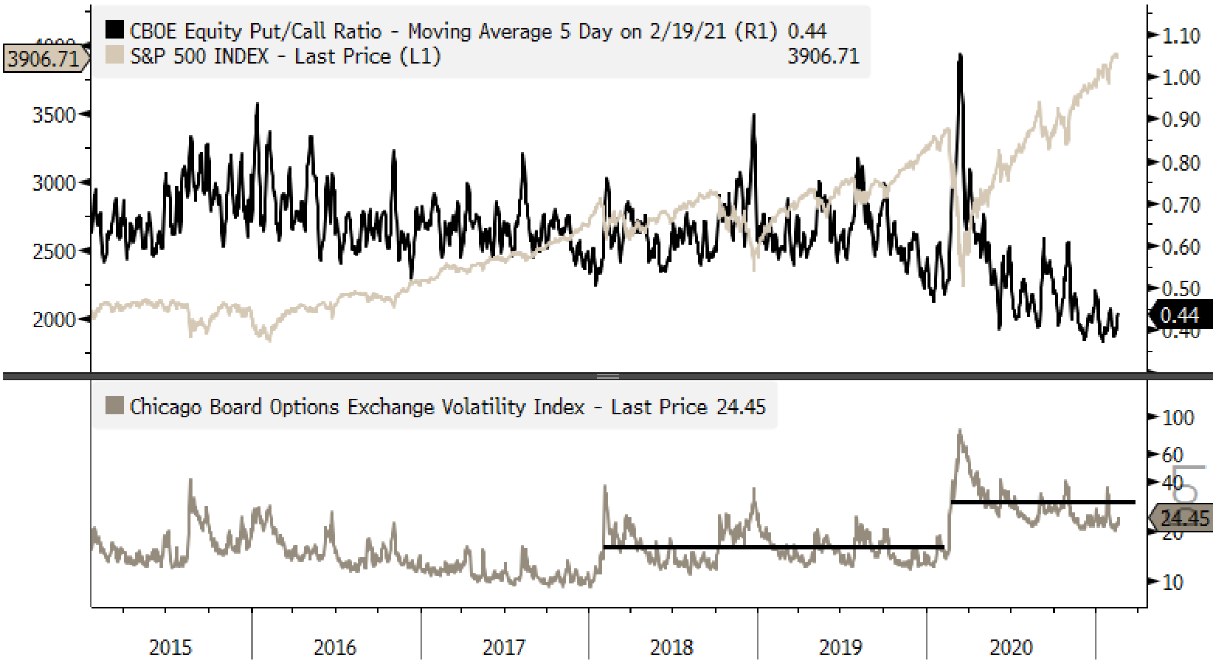




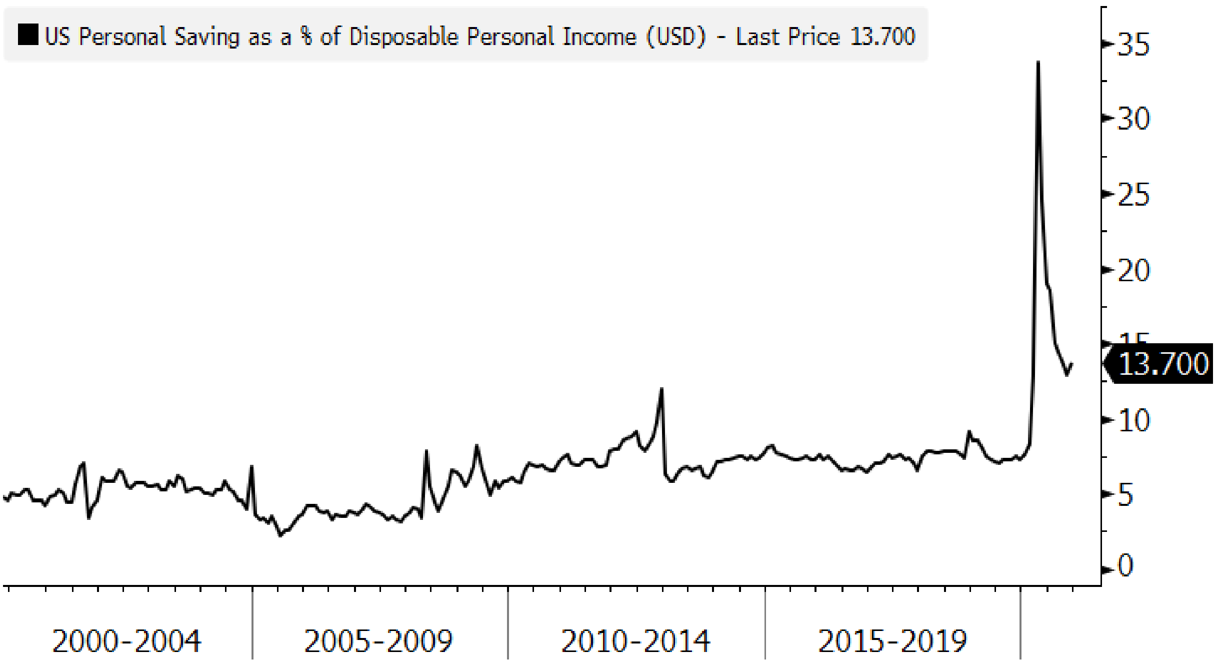
Macro leading indicators (indicator +)

Assessment unchanged

Despite record high global equity markets and very low credit spreads, general stock market volatility has not abated since the beginning of the pandemic. In addition, within the consumption-driven US society, available savings in % of disposable income have shot up to record high levels due to the "lockdown situation". Thus, an opening economy will most likely lead to a very large increase in consumer spending. Both indicators make a positive contribution to our macro leading indicators.



PCUSEQTR Index (CBOE Equity Put/Call Ratio) NAV Put Call Ratio Daily 23JAN2015- Copyright© 2021 Bloomberg Finance L.P. 22-Feb-2021 10:48:44



PIDSDPS Index (US Personal Saving as a % of Disposable Personal Income) NAV Savi Copyright© 2021 Bloomberg Finance L.P. 22-Feb-2021 11:34:01

Risk index (indicator -)

Assessment unchanged

According to the latest fund manager survey, cash held by funds has fallen to the lowest level in eight years, while equity ratios have reached their highest level since 2011. A total of 25% of fund managers surveyed are currently holding above-average risk in their portfolios - an absolute record high. Thus, our risk index continues to give a negative signal for the overall assessment.

Appendix:

The Navigator is the central tool for our investment allocation. We use it to systematically and consistently assess the aspects that are relevant to the development of the financial markets. As a result, our clients can rely on a rational and anti-cyclical implementation of our investment decisions.

- Focusing on the essentials: Interest rate level, risk premium, valuation, economic development, investor sentiment and positioning. These are the decisive factors for success on the financial markets, especially in turbulent times when the temptation to react irrationally to the headlines is particularly strong.
- Comparability over time and place: The factors mentioned above are equally relevant for all markets and at all times. This is the result of a strict «backtesting» process that continues into the future.
- Cumulating our investment experience: Our strength lies in the many years of experience of our partners and principals. It is precisely this experience that we summarize and make applicable with our Navigator.
- Transparency: Thanks to our monthly publication, our clients always know where we stand in the investment cycle and where the financial markets are headed.

Datasource: Bloomberg