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MARKET COMMENTARY

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TILL C. BUDELMANN

As Bergos´ Chief Investment Officer, Till Christian Budelmann regularly comments on events on the international capital markets and examines them in the context of economic and political trends. Since 2004, Budelmann has been responsible for various investment strategies and sits on the bank's Investment Committee. He has been Managing Director since 2013.

CENTRAL BANKS WITH REMARKABLE INFLATION TOLERANCE

In addition to political uncertainty factors, macroeconomic risks can no longer be ignored. In particular, inflation and the reaction of central banks bear watching. Although Till Christian Budelmann, Chief Investment Officer at the Swiss private bank Bergos, is indeed fearful of an overly complacent approach, he does not see excessive stagflation risks. Despite higher bond yields, equities are still the more attractive asset class. Besides US equities, the prospects for Japanese stocks are especially good.

Although the outcome of the German parliamentary elections poses no risk to the global economy, investors are advised to pay close attention to politics in other regions. In China, for example, a paradigm shift appears to be underway. Regulation is moving to the forefront, affecting various sectors. Moreover, investors are increasingly worried about the tumbling property developer Evergrande. “We do not believe that this poses a risk to the financial stability of China or even the world. However, this affair has the potential to slow economic growth in China and Asia”, Till Budelmann said.

In the United States, the Bergos CIO sees a risk in the battle over increasing the debt limit, which bears watching. The downside to the tight balance of power in the House and Senate, which is something markets usually like, is becoming apparent now. “Not only Republicans and Democrats are at odds with each other, but representatives of the different factions within the Democrat party are blocking a resolution. This disunity is compounded by the need to increase the debt ceiling and to finance the planned infrastructure package at the same time. A solution must be found until December, early January latest”, said Budelmann, who is ultimately confident, however, that a solution will be found in time.

US Federal Reserve underestimates inflation

Inflation is presenting additional risks. The Swiss private bank expects that the US inflation rate will reach 4.5 percent in 2021, followed by 3 to 4 percent in 2022. By comparison, the Eurozone forecasts are much lower, by at least 2 percent, in both years. “I think the US Federal Reserve is underestimating the inflation dynamic in its public narrative. It continues to believe that higher inflation is largely transitory and that the inflation rate will quickly fall back in the direction of its 2 percent target”, Budelmann said. Indeed, he shares the view that exceptional factors such as the base effect behind the rise in oil prices and the pent-up demand effect after the corona crisis will eventually subside and supply bottlenecks will be resolved. However, he believes that the US inflation rate will initially settle in at up to 3 percent, instead of 2 percent.

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“In that case, the US central bank really should react to it. Once inflation gets started, it is hard to stop. It takes some time before measures actually work”, Budelmann warned. That being said, he believes that central banks are remarkably tolerant of inflation, so that monetary policy is likely to remain extremely expansive. In the United States, the Fed’s tapering could be followed by an interest rate hike next year, but even then, interest rates would still be extremely low.

The Bergos CIO also stressed the point that the Fed is paying too much attention to financial markets: “In the past, central banks have backtracked quickly whenever their pronouncements triggered volatility in the capital markets. For this reason, it would not be good to abstain from doing what is necessary. Central bankers should be able to tolerate some volatility.”

Only a touch of stagflation

Budelmann does not see a risk of lasting stagflation, meaning inflation paired with stagnant economic output: “We are seeing only faint signs of stagnation right now due to the fact that growth is faltering somewhat.” Fundamentally, however, he anticipates strong growth. The Bergos forecasts for the US economy call for growth of 5.8 percent in 2021, followed by 4.0 percent in 2022. Over the same period, the Eurozone economy is expected to grow by 4.7 and 5.0 percent, respectively.

Bond yields are directly impacted by the behaviour of central banks. For example, the yields of 10-year US Treasuries have risen of late. While this rise has somewhat lessened the relative attractiveness of equities over bonds, the yield gap still remains above its historical average. The value of US blue-chip stocks has doubled since the low in March 2020. But companies have also reported strong profits. Consequently, the price/earnings ratio of the US S&P 500 index has been relatively constant since the beginning of the year.

Short duration, USA and Japan are preferable to Europe and emerging markets

"As we expect bond yields to rise, we prefer short-duration bonds, which are less sensitive to interest rate changes. That goes for Europe and even more for the United States”, Budelmann said.

In the equity sector, Bergos has underweighted emerging markets, including China by now, whereas they had still been overweighted at the start of the year. European equities have been kept neutral and US equities have been overweighted. In a recent development, Bergos is now overweighting Japan. “Japan was a big underperformer in the past years. However, we now observe encouraging developments regarding the coronavirus and corporate profits, as well as growing optimism for better economic policy after the announced retirement of the Prime Minister. In addition, Japan’s cyclically oriented market could benefit from higher interest rates in the United States”, Budelmann said.

On a sector level, Bergos continues to favor structural winners, particularly in the sectors of communication and technology. Cyclicals are being added for diversification. Defensive value stocks in the sectors of consumer staples, utilities, and real estate remain underweighted.

Despite the sharp increase in equity prices, market sentiment is far from euphoric. It can be seen as relatively neutral and more or less at levels seen three months ago. Budelmann: “Based on this circumstance, coupled with attractive relative valuations compared to other asset classes, we are upbeat about equities despite all the risks we see. However, this is not the time to call for an end-of-year rally. We will proceed cautiously in the coming weeks.”

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Bergos AG is an independent Swiss private bank with headquarters in Zurich and offices in Geneva. It emerged from Joh. Berenberg, Gossler & Co. KG, it has been active in the Swiss financial centre for international private clients and entrepreneurs for over thirty years. The Swiss private bank specializes in asset management and advisory services. For its more than 100 employees, the focus is on providing advice in all known liquid and non-liquid asset classes, as well as in alternative investments such as real estate, private equity or art. It provides entrepreneurial clients with access to M&A and other corporate finance services. Bergos AG offers private clients, entrepreneurs and their families a holistic service spanning several generations, which, in addition to investment recommendations, aims at security, neutrality, internationality and cosmopolitanism.

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