

HOLLYHEDGE REPORT - 12 / 2018 - 01 / 2019

BACK TO THE PAST

Since the beginning of the quarter, the capital markets have continued to cloud over, mainly due to losses on the stock markets. The unresolved political problems in all zones and now also the more cautious assessment of the global economy for the New Year are responsible for this. The unresolved Chinese trade conflict with the USA, the economic slowdown in Europe and now also in Germany, the trend towards rising interest rates due to rising inflation expectations and the dramatic fall in crude oil prices in recent weeks are, in my view, the most important influencing factors. Moreover, tensions between Saudi Arabia, the United States and Persia have increased further following the death of Mr Khashoggi and the Saudis' nuclear ambitions. In Europe, the Brexit and Italy remain on the agenda with the budget proposal of the new government and its unresolved banking and debt crisis. In addition, President Macron has suddenly received domestic political headwinds from the street. Against this sobering backdrop, it is astonishing that so far no more porcelain has been smashed on the capital markets. In addition, the chances of an expected year-end rally on the stock markets seem to be dwindling with a further recovery at the beginning of the year, despite the now more attractive valuations.

OUTLOOK

But there are also numerous economic and political approaches that, in my opinion, give the capital markets a more positive light after the partial bear markets that have existed since 2015. There is hardly a country in the industrialised world that has not had to struggle with political, social and economic distortions and grievances at both national and international level since the financial crisis of 2008 was overcome. Their pending solutions can actually no longer be put off if the global community of states wants to risk slipping into processes that are difficult to control. Political reason is the order of the day, and the signs are increasing.

In the USA, after the elections, the American president is now dependent on cooperation with the House of Representatives, which is controlled by the Democrats. This applies nationally to the development and reorientation of infrastructure, including the economic damage caused by climate change, which can no longer be denied, and the solution of the stalled immigration policy. Internationally, the trade war with China and Europe, the conflict with Russia and the delimitation of the various sources of tension in the Middle East remain open flanks that must be delimited or closed.

Following the renewed stimulus provided by the tax cut and the flattening of global growth, the US economy must also expect a slowdown in the new year - the fall in oil prices is a first sign. This makes the already tight financing of the budget for the next two years more difficult. On the other hand, the Fed should end its contractive central bank policy and switch to neutral when the first signs of a cooling and easing of inflation appear. This could already be the case by the end of the year. This would be a positive development for the American capital markets.

In Europe, the focus is currently on England, Germany and Italy. Meanwhile, even the last one has realized that the conservatives have scored a huge own goal with the Brexit. The consequences will in many ways take years for politicians and the English people to deal with if the compromise negotiated with the EU is waved through in Parliament at the end of the year.

After the state elections, not only has the big chair begun to move, but politics in Germany is finally beginning to take up the omissions of the past few years. The amendment of Article 104c of the Basic Law from a standing start with the help of the Greens and Liberals is a good sign. The federal government will thus be able to intervene financially directly in social housing construction, the financing of municipal transport routes and the education sector. This will initially clear the way for the Digital Pact for Schools with 5 billion euros. This is a very important step towards renewing and increasing the efficiency of the antiquated German school system. It is to be hoped that with the personnel reorientation in the CDU due in December, projects such as the modernisation of the electricity supply, the expansion of the Internet, the reorientation of the outdated federal railway structure, the development of electromobility, company law and the pension and tax reform, to name but a few, will now be quickly launched.

In Italy, however, things are not looking very encouraging after the elections. In fact, the modernisation of infrastructure and industry, the inevitable rescue of the ailing banking system and the labour market and education policies that were not implemented years ago and are so necessary for Italy's future should have been at the top of the agenda of the new government. Instead, the populists are putting Italy's economic future at risk with an unproductive flood of spending and a rising budget deficit. The stagnating labour productivity for years, the youth unemployment rate of 20% and the inadequate school system are already casting their dark shadows today. By maintaining this policy, Italy threatens to become an economic victim of globalisation in a few years' time. A fundamental rethink would be desirable, but is probably not conceivable in this political constellation at present.

CAPITAL MARKET OUTLOOK

This means that the black Peter remains with the ECB, which is already preparing a rescheduling of the European bank loans expiring in 2020 and 2021. This also means that instead of a fundamental bank reorganization - that would be the responsibility of the respective countries - the economically questionable ECB policy will probably continue beyond 2019. EU interest rates would therefore continue to be kept low. If my assessment of the future course of the global economy is correct, then the interest rate cycle in the USA, with yields on long-term US government bonds of around 3.3%, has already reached the upper end. This should help the partly shaken stock markets from the USA to regain stability at the levels now reached. The stock market corrections would then be largely over. This also applies to the Japanese stock market, which has long occupied a special position in the concert of industrialized countries due to the special position of the Japanese economy. Investors should also keep an eye on this market in 2019.

A comparison of international stock markets since summer 2015 shows that the cyclical, non-cyclical and technology sectors have developed very differently. Many categories, especially

in Europe such as banks, utilities, chemicals, automobiles and also many capital goods manufacturers, have since gone through rolling bear markets with partly considerable price losses since reaching their highs. Only at the end of this development did the technology shares of industry 4.0 also experience considerable value adjustments globally. This also includes the shares of the so-called FAANG Group. While many first class stocks, also known as value stocks, have regained investor interest over the last month due to their attractive valuations and returns, the technical correction in the latter category does not seem to have been over yet. Fundamentally, however, there has been no change in the long-term growth potential of the societies leading the digital revolution. In contrast to the dotcom bubble of the year 2000, this global IT revolution is irreversible and penetrates all areas of life faster and faster from year to year. These market leaders should therefore continue to be the cornerstones of a long-term equity portfolio.

30.11.2018

Serious problems that have not been solved for years are already coming to the Italian people and the EU, who have been struggling for years anyway.