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ZINNECKER BIMONTHLY – JUNE / JULY 2021

REVIEW

My assumptions about capital market developments were confirmed during the reporting period. This was equally true for bond rates as well as equities. Despite the disproportionate rise in prices in the month of April, U.S. bond yields with longer maturities became cheaper again after the March peak, while longer yields in Europe continued to rise in price, led by Germany. Interest rate developments then had the euro regaining the ground it had lost against the dollar since the end of the year. During this period, Western stock markets, with the exception of Japan, continued the second upward movement they had begun in November, recording new highs for the year as measured by their indices. However, this development has recently been accompanied by rising price volatility and erratic price movements in a wide range of sectors. Many hopelessly overvalued stocks in the high-tech and internet sectors lost up to 60% of their value in a short period of time. The collapse of Bitcoin speculation did the rest to drive the weak hands out of the market. At the same time, the gold price resumed its long-term uptrend after the correction ended in late March.

OUTLOOK

Capital markets are at a crossroads and are facing a realignment in early summer. Following the end of the Bear Market in March 2020, the first phase of the equity market recovery is largely complete. This phase, which was based on hope and the expectation of the start of a new economic cycle, is now being replaced by the longer-term growth phase. Following re-opening, this will be characterized by sustained profit increases in cyclical and consumer goods-oriented industries, in the course of which rising inflation expectations will again play a role for the financial markets for the first time in years. The course of events will differ from country to country and thus give the respective capital markets back their specific character. This applies equally to the USA and Japan as to the European countries and especially to Germany.

Germany is embedded in the middle of the EU with all its political obstacles and, as an export-oriented country of cyclical capital goods, continues to be globally oriented and dependent on it. The outcome of the Bundestag elections to be held in September is therefore of crucial importance for the future of the German economy as never before. A government then under the possible leadership of the Green Party may entail a socio-economic paradigm shift, the consequences of which are, from today's perspective, fraught with great uncertainty and difficult to fathom. The new political orientation that is then possible will involve even more state instead of less and even more socialism and bureaucracy instead of a return to a more self-reliant social market economy with a future-oriented safeguarding of global competitiveness and employment in the direction of 2030. The election outcome will no longer be decided by the post-war generation but by the voters of the third generation. It stands for different values and goals than those of many of the old generation. In my opinion, it stands for a contradictory model of the future, because it is precisely this new generation that should politically advocate a model of life shaped by freedom. The coming months may therefore generate political irritations that could put additional pressure on the German capital market.

The economic growth phase that follows the hope phase will influence and realign the future risk-opportunity profiles of the interest rate and stock markets. The important drivers will be inflation and interest rate developments on the one hand and corporate earnings growth and free cash flow generation on the other. This includes specialty companies across all vital service and manufacturing sectors that can positively incorporate the technological disruptions unleashed by the technology revolution into their business models. Completely new national and global business areas will open up in the next few years, as the global startup scene has been exemplifying for years. On the other hand, many old unprofitable and structurally disadvantaged companies will fail.

The wheat will be separated from the chaff when the inflation trend forces central banks to rethink their previous interest rate and monetary policies and borrowing costs rise again. Even though the U.S. central bank currently attributes the emerging price trend to supply chains and distribution bottlenecks torn down by Corona as being technical in nature and temporary, it is merely a matter of time before that happens. When global economic activity returns to normal later this year and employment, consumption, and environmental and infrastructure investment pick up steam, then we will see whether this process can proceed without inflation. The answer to this will be provided by 10-year US yields, virtually as a harbinger of a change in US central bank policy, should they sustainably exceed 1.8% from a technical perspective. This is something to watch out for today, even if the Fed says the time is not before 2023 and thus still a long way off. At the very least, it is a new additional uncertainty factor for the stock markets in the coming months.

CAPITAL MARKET OUTLOOK

The interest rate corridor between 1.5% and 1.8% is therefore quite narrow. Exceeding it should then set the other interest rate markets in motion and continue to trigger price corrections on the stock exchanges, especially in speculatively overextended sub-sectors. It is often the case in times of transition from hope to growth phases that the stock markets take a break. At the current relatively high valuations, the stock markets could therefore correct over the summer months and then strategically realign themselves. Having discounted expectations for economic recovery in the markets, fundamental economic data and real corporate earnings growth during the 4-year business cycle now beginning will play the decisive role in investors' future investment decisions from now on. This is also the period when, unlike in the past, real annual stock index gains diminish due to the permanent decline in price-earnings ratios. It is the time of the stock pickers.

During the expected consolidation of the stock markets, the new bandwagons for the further course of the stock bull market should emerge in the coming months through relative strength against their stock indices. I believe the following sectors and their market-leading companies should emerge as new favorites and receive increased consideration in future portfolio compositions: in addition to traditional FAAMG stocks, health care, e-mobility and renewable energy, banks, financials and commodities, and those in low-cycle consumer discretionary.

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