# ZINNECKER BIMONTHLY – OCTOBER / NOVEMBER 2021

## REVIEW

**The upswing in the Western equity markets that has been in place since November was still intact until recently. The consolidation that had been expected earlier has only now occurred. The pressure on investors to invest the liquidity they had accumulated since the start of Corona in equities and to reallocate other assets had grown too great so far, in order to participate in the historic recovery of the global economy and corporate profits.** The picture has been mixed. U.S. stocks have rallied again since June led by tech stocks, the NASDAQ100 +8%, the S+P500 +3.6%, followed by Japan at 2.5% and Europe at 1%. In contrast, the gold ounce lost 9%, while the dollar index increased by 4.3% in value. German equities, on the other hand, closed down -1.3% as measured by the DAX Index, partly due to uncertainty about the election outcome and the unpredictability of future policy, and brought up the rear.

Yields on government bonds of all maturities have remained very stable over this period, owing to the central bank policies pursued to date. They only started to gradually react to the changed interest rate policy and, economic landscape, which had already been in place for some time, in mid-August. Interest rates then rose sharply at the end of the quarter.

## OUTLOOK

**Rising inflation, the cautious departure of central banks from their previous monetary and interest rate policies, faltering supply, delivery and employment chains, China and Russia and, not least, the changes in political structures in Germany and the EU that are already becoming apparent following the German parliamentary elections are already casting their shadows in the assessment of economic developments for 2022/2023.** I refer you to my comments on the first three blocks in the last report so as not to have to repeat myself. However, I would like to add a few comments. The debate as to whether these changes will be merely temporary or permanent will be a key topic of discussion among financial analysts in the coming months.

Global chains of any kind have grown over decades and are logistical masterpieces. Disruptions or interruptions, as now caused by Covid, are therefore not as easy to fix as a bicycle inner tube. It takes time, as the past has shown, for example, after the world wars, the oil crisis in the 1970s, or most recently after Germany's completely precipitous exit from nuclear energy. The electricity supply chain is still disrupted today and the energy turnaround is still a castle in the air, despite green energy. The result is rising prices in all sectors of the economy.

If my analysis is correct, then the Western economies are at the beginning of a permanent annual estimated 2.5 to 3% inflation trend. Western central banks are therefore already facing a dilemma. On the one hand, they could expose themselves to the danger of "too little, too late" by hesitantly reversing their policies, and on the other hand, they will drive up the costs of future government financing considerably with their interest rate hikes. Western government budgets in the EU but also in the U.S., which

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are already quite stressed, will then be confronted after ten years of relief with the question of how their financing principles will have to be shaped or changed in order to be able to shoulder the future higher interest debt and the additional funds for structural investments in the modernization of their economies.

In addition, China as a technology giant and increasingly serious competitor to America and Russia as a supplier of energy and raw materials come into play. They are becoming even more strategically important to the EU as bilateral trading partners despite the political rifts. The EU and each individual member of the Union will therefore have to find ways and means to permanently improve political relations with these states. This will not be an easy path. However, despite all the differences and reservations on ethical and humane issues, the new German government should courageously embark on this path.
The outcome of this election is a profound turning point after the agonizing end of the Merkel era. It has finally brought to light many underlying changes, failures and incrustations that have existed for years in all areas of our polity and economy. It took almost 20 years for German society to grasp the consequences of climate change and the industrial revolution that had been underway for almost 30 years. It was again the first-time and young voters who now gave the Greens and Liberals, and not the two mainstream parties, the mandate with their votes to tackle the “Future Germany” project without delay. Taking their cue from German history, they have elevated the two parties to the status of 'princes' who, if they agree, will ultimately determine their king.

Who will be brave enough from the CDU/CSU or SPD to then be king in this three-way relationship, because this part could be painful and in the end also dangerous for the political future of the king party. Both parties have used themselves up in the years of coalition, in the end only managing themselves, and they are deeply divided and at odds internally and must therefore fundamentally reposition and rejuvenate themselves in terms of personnel in the next few years if they want to remain fit for the future. This will be a painful process for the CDU in particular, whose committees did not or could not determine the end of the Merkel era themselves, totally failed in the election of its chancellor candidate, and now threaten to break apart politically as a result. It should also be emphasized that this election prevented a coalition of RED-GREEN-RED and made it clear that the AfD and the Reds have no future in this orientation and lineup.

Germany and its new government must also use its new policies to exert a decisive influence on the realignment of the EU in Brussels and Strasbourg. It must succeed in convincing all members that the "Future Germany" project is becoming a "Future Europe" project, and that reform of the EU is urgently needed in the interests of all. If the EU continues to be bogged down in small states and does not see itself as a community, it will no longer play a political role in the world and will become the plaything of the old and new great powers. This will not take another eight years. Where the journey will then lead for each individual is currently being demonstrated by Great Britain. The disastrous decision to leave the EU and the naive and unprofessional management of the Corona crisis is now bringing the economy to its knees and many sectors are collapsing - and that after just two years of the Johnson government. Gasoline and gas supply shortages are driving up energy prices and threatening fertilizer and food supplies. Empty shelves in supermarkets, bankruptcies at electricity and gas suppliers due to price fixing are the consequence. Exports to the EU have plummeted by 40% and foreign currencies are becoming scarce. Inflation is rising, in three months it will be winter and the voices for re-entry into the EU are getting louder again. This should be a warning to the dissenters and separatists in the east of the EU but also to all other member states!

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## CAPITAL MARKET OUTLOOK

**Even though politics has taken up a lot of space here for a given reason, it plays only a subordinate role in the assessment of short-term capital market developments. However, international inflation trends, changing central bank policies, interest rate developments and global economic trends will occupy and influence the capital markets in the coming months.** As expected, the technically driven summer rally on the bond markets came to an end in August. Bond markets will now try to price in the changes in central bank policies, meaning that long-dated yields will again rise by up to 50 basis points from this level, starting in the USA. U.S. 10-year bonds should reach a level of 1.8% to 2% over the course of the year, and Bunds will become yield positive again after many years. In the expectation that the U.S. dollar will remain stable against the Euro, U.S. interest rate investments consisting of short and long-dated government bonds offer themselves to investors as part of a "barbell strategy", with the aim of achieving a higher interest rate yield while maintaining the same level of risk.

Developments in interest rates and corporate earnings, with the reporting season resuming in two weeks, and uncertainty about the potential slowdown in global economic growth for 2022 should continue to drive equity market consolidation over the next two months. In addition, faltering supply chains and supply bottlenecks, the crisis at the e-car subsidiary of highly indebted Chinese real estate developer Evergrande, Nord Stream 2, and the extent of the next Corona wave may further weigh on capital market trajectories in the fourth quarter.

In many equity segments, however, the consolidation process has been underway for some time. The extent of future setbacks should therefore be limited in terms of the stock indices, with temporary single-digit markdowns. Nervousness and the growing willingness of investors to lock in share gains will inevitably lead to increased volatility on the stock markets in this phase as well.

The infrastructural and digital transformation and modernization of the Western countries will set immense major projects in motion over a period of years from 2022. Financing the "Future Germany" and "Future EU" projects should not be an obstacle here, as there are other private-sector and more effective forms of financing besides additional government borrowing. It merely depends on the attitude of politicians as to which path they will take: more or less state influence. The issuance of an attractively endowed 50-year or even perpetual, fixed-rate and tax-free federal bond or an EU bond of the same type as part of the NextGenerationEU Funding Strategy is just one way to finance the numerous investment programs over the next 8 years, not to mention tax-advantaged equity participation for private investors.

The agenda "Shaping the Future" on the basis of the social market economy is the only chance to secure prosperity, security and freedom for the democratically organized world. This certainty should bind all societies together and involve them in the historical process of change. There is no alternative to this. This is another reason why the stock markets remain the outstanding long-term investment medium for investors to build up capital and provide for their pensions. The ongoing consolidation should therefore provide an ideal entry point for further building long-term equity portfolios.

30.9.2021

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