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Federal banks are leveraging the financial markets

The dawn of traditional fund strategies?

A guest article by Uwe Günther

Investment strategies that were once successful are now barely working. The new super-powers "central banks" are smashing the classic valuation models. Given the manipulations performed by the Fed, ECB and others, the main aim now is to avoid losses.

Many analysis and forecast models, and the investment strategies which institutional investors - and above all traditional fund managers - deduce from them, are increasingly losing their effectiveness and as such also their justification, at least for the time being. This is because the interventions or manipulations by the major federal banks have put portfolio managers of public investment funds under pressure threefold.

By now, the gigantic federal bank interventions on the capital markets are the main factors determining prices. Only the European Central Bank (ECB) will be buying more than one trillion Euros worth of government and corporate bonds this year and next. That's almost precisely the total value of the 30 Dax companies. In other words, the ECB is swallowing anything that it can get its hands on. Only the Bank of Japan is taking an even more aggressive course than the ECB, based on the GDP.

The federal banks' vast purchases are pushing bond rates while returns are falling. And it's getting worse and worse: By now, not only government but also corporate bonds (Henkel and Sanofi) with negative returns are issued on the market. The price of investments is no longer influenced by the attractiveness of the company valuation or the quality of the debtor, but instead by undifferentiated, blanket interventions on the part of the federal bank – and that's fatal.

More and more investors are moving from actively managed investment funds to passive exchange-traded funds (ETFs) in order to at least reduce costs while income

is falling. But if market pressure suddenly goes up, there is no longer an active manager to bravely take action. ETFs work well in rising markets. But where volatilities and pressure on prices is going up, exchange-traded funds are entirely at their mercy.

To be fair, one must add: When markets are really crashing, active fund managers are also largely powerless. And also: The fees for fund management charged by some asset managers are so large and have in fact reached such a motivating effect that sensible disinvesting is unlikely to occur. In other words - the song and dance continues until the music ends.

Conclusion: If the financial markets become distorted in spite of the massive interventions on the part of the federal banks, which can probably not be avoided, investors are likely to suffer noticeable losses no matter whether they are using active or passive funds.

Fin-Techs are no alternative (yet)

Unfortunately, even the recently hyped robo-advisers, which work primarily based on largely sweeping customer analyses and historic market fluctuations, are no real alternative. That even applies where the software programs are able to learn. That's because there can be significant losses between the sudden occurrence of a new event (in the worst event a stock market crash) and the subsequent realignment of the software model - which cannot be deduced based on history. Technology and largely unsuitable risk models (such as VaR) simply can support but not replace independent thinking.

So what to do?

No doubt, intelligent and active passive management for ETF investors is a significant future trend. But the broadest possible diversification in the traditional sense is still necessary. This currently includes substantial bank balances, even if these earn no interest these days. This lack of interest should be bearable given the near-absence of cash devaluation at the moment. An owner-occupied property and

physical precious metals round off such a private safety package. And private debt reduction is also becoming more and more important - contrary to the current trend!

There is no reason why the types of investments in which the federal banks are currently dropping the most cash can be ignored for once. Specifically, this means European government and corporate bonds and large parts of the stock market. The federal banks' interventions have created a dangerous bubble in this area which threatens to burst at any time. Avoiding losses is definitely the key topic now and in the coming quarters.

Best regards,

Uwe Günther

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