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INVESTMENT MANAGER UWE GÜNTHER

Sober analysis - how to react to the flood of money from central banks

Whenever there is a crisis, they always tell you: "This time it's different." The current coronavirus crisis is no exception. The asset manager, Uwe Günther, draws a sobering conclusion and uses it to reason what one should buy now.

In the last two global economic recessions, the advocates of the "this time it's different" doctrine were quickly brought back down to the earth of cold hard economic facts. Could it be different this time? Investors should consider a number of current oddities before making future investment decisions. Would you like some examples?

Example 1:
Economic crises, or to be more accurate, debt crises (because that is what they have historically boiled down to) always followed a traditional script. Unproductive capital was - involuntarily - thrown overboard like trash along with the financing side of the balance sheet. These were popularly referred to as "bankruptcies" and "loan write offs". The credit volume shrank and adjusted to the new realities.

As credit is a prerequisite for any real economic growth, this was traditionally the time when central banks began to cut interest rates to boost borrowing. The lower interest expense gradually improved the cash-flow situation of the companies that had survived the economic recovery process or "crisis." The elimination of competition did the rest so that a new cycle could begin.

Upside-down world 1:
Interest rate cuts to boost economic growth in today's climate of "zero and negative interest rates" are no longer a viable option. At the same time, borrowing is exploding during this recession. Since early 2020, commercial and industrial loans have risen to a record level of well over three trillion US dollars. The record debt levels of companies in bad times could thus be a clear indicator of corporate bankruptcies and bond defaults. In the past, one led "the horse to the water"- but it was up to the horse to drink. In the new upside-down world, the water is brought to the horse lying on the ground.

Example 2:
The vast majority of private investors see themselves when asked as long-term investors and not as short-term speculators. In concrete terms, this means that they want to base their investment decisions on fundamental and longer-term valuations rather than short-term market psychology. Many investors are also happy to adopt the talking points of their advisors, who traditionally have value high on their agendas. It also feels "somehow more professional" and manageable. At the same time, value will probably not be the driving force behind the movements ahead.

Upside-down world 2:
The collapse in corporate profits, which began as early as 2018 and accelerated to an extreme in 2020, has resulted in stock markets soaring to their highest valuations for many decades. The direct investment in productive capital, which is extremely important for old-age pensions, and thus the long-term participation in profits of healthy companies, is increasingly taking a back seat to the longing for further price gains.

What is more, investors are increasingly applying different quality standards to the two main asset classes, equities and bonds. While there are still opportunities to pick some quality stocks in the equity segment, there is a sense of ever-increasing, dangerous carelessness when it comes to picking bonds. Even the meteoric fall of the bonds of the car rental company Hertz - from the US treasury-quality rating to junk status - is unlikely to trigger a process of reflection. Countless quality downgrades, expected exponential default rates and trillions of US dollars close to the junk level. Who cares?

Example 3:
Investment advisors and asset managers have known this for a long time: Private investors typically look at performance figures in absolute rather than relative terms. This is both understandable and legitimate. Very few people are interested in whether they lose only 12 percent instead of the minus 15 percent of a benchmark index, thus achieving a 20 percent "better" relative performance.

Upside-down world 3:
It is all the more astounding that the very same investors often fall for the argument of supposed cheap relative valuations of equities because there is currently no interest income on bonds, savings or credit balances as a result of massive market distortions. With every percentage point that the stock markets rise above their long-term upward trend based on these arguments, the future real return expectations for the invested shares and equity funds that are urgently needed for the retirement provision will fall.

A few days ago, even Jamie Dimon, the head of the US investment bank JP Morgan, said that the uncovered flood of money from the Federal Reserve is alone responsible for the rise in the stock markets: "The Fed's liquidity, bringing out the bazooka, is propping up stock prices as well as all other asset classes." Shortly before that, the Fed's chairman, Jerome Powell, laconically acknowledged in a CBS interview that the Federal Reserve simply prints the bailout trillions digitally.

The private asset owner is thus facing risks from at least two sides: The more bailout trillions not covered by economic output are pushed into the market, the more this raises the frequently discussed issue of inflation risk.

In this context, it is important to make a clear distinction between asset and goods price inflation. The former has been traditionally reflected in rising property, equity and bond prices. This is where dreams are in danger of collapsing, if private risk management fails. At the same time, the long-term flood of cheap money and the associated manipulation of interest rates prevented the emergence of additional purchasing power and assets on the consumer side. The same was true for the ability to push through higher prices on the producer side.

Conclusion: Stock prices that have been completely detached from the economic growth figures are de facto lacking economic legitimacy and there are extremely painful adjustments in store if the current deflationary phase ends because the digital liquidity flow has no longer any effect. With exploding unemployment figures - almost 41 million people in the US have newly applied for unemployment benefits since mid-March - and companies "not allowed to go bankrupt," the earnings situation of many favourite stocks is likely to look very bleak.

But as the global central banks cannot reverse anymore their monetary policy, a "crack-up boom" scenario like 1923 can become reality, or is in the process of becoming so. Important preconditions for such a "catastrophic boom" are developing rapidly. In this scenario, which is becoming likelier by the day, stock prices double quickly again even without "value," gold mines increase tenfold, silver mines rise even more.

Hopeful outlook

The current conditions, therefore, not only harbour considerable risks for the well-advised private investor, but also some unprecedented opportunities. Gold and silver mines (funds) are something of a "screaming buy," but also solid commodity companies with excellent valuation figures, low debt, high margins - speculators are out and the mass of private investors are not in yet.

Naturally, gold and silver as traditional means of payment and strategic liquidity position do absolutely belong in the custody account (or the vault). The same currently applies to short-term German and US government bonds despite zero interest rates, but only for shorter periods as an alternative to a bank account. There are interesting prospects in the areas of hydrogen producers, producers of lithium and Co, uranium producers, volatility strategies and other alternative investment concepts.

Acquiring a basket of crypto currencies and e-sports companies can also prove to be a strategically meaningful addition for strategists. And speculators? They are currently looking i.a. at cruise lines and diamond producers. The months to come will be truly challenging.

All the best and good luck in all your present and future endeavours!

Uwe Guenther and the BPM Team

Uwe Guenther is founder and Managing Director of BPM - Berlin Portfolio Management GmbH, Berlin, Germany.