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Markets in the wake of debt policy

Investors should stay in cover

A guest contribution from Uwe Günther

Austria swinging right, Spain and Portugal swinging left and a possible EU withdrawal by Great Britain, while the USA is gripped by Trump fever. Political crises and growing debts are the biggest dangers for share prices.

Many investors nourish the illusion that the increasing political tensions in Europe and across the world will have hardly any or only short-term effects on personal capital investments. This may be a serious and above all expensive mistake.

The numerous and violent global conflicts and the rising appeal of politically extreme parties are not the cause but the result of the worldwide economic slowdown, inadequate growth and an orgy of debts, stemming from consumer and transfer spending and non-productive investments. This is reinforced by the increasing gap in income and assets between large population segments. The overall economic data do not look promising.

Sobering figures

In the USA, company profits have slumped by eight to ten per cent year on year. China remains well behind the official growth target of 6.5% per year and its economy risks a hard landing. Oil-producing countries like Saudi Arabia are wrestling with exploding state budget deficits and are needing to start selling the family silver. And in worldwide trade, freight rates and transport volumes have been collapsing. Despite massive central bank interventions, none of this is passing unmarked on the capital markets.

The originally wildly popular FANG shares have fallen far below there peaks, with the exception of Facebook: Apple -33%, Netflix -37% and Alphabet (formerly Google) -17%. Other major companies are massaging their profits with cheap central bank money and thereby simultaneously financing their dividends. There is no element of stability in this: it resembles a house of cards.

The financial markets have been operating for years in an increasingly politicised environment. The big central banks are increasingly subject to direction from their governments. The welcome share price gains of recent years are not so much the result of strong economic development. Rather, they are based on the cheap, sometimes free, money with which the central banks are flooding and artificially distorting the financial markets.

Markets at the crossroads

Venturesome investors who continue to trust the supreme power of central banks and the sustainable political control of economic processes are continuing to bet on investments whose current price has been based primarily on political influence. This relates primarily to property and old-timers as well as shares and bonds of medium to weak creditworthiness. Perhaps the events in the style of 1923 are repeating themselves and a catastrophic bull market is under way. This could lead to a further explosion of the nominal price of risky investments, before debts and the asset values, capital investments and receivables with which they were supposedly financed then fall apart - which would lead to a painful recuperation process for the capitalist financial system.

Investors who by contrast are convinced that political markets have short staying power and that market forces always force their way through in the end are better advised to take cover - or stay in cover. The logical consequence is the strict and consistent reduction or securing of risk-laden investments inflated by loans. This applies above all to shares with a high proportion of external capital and to large parts of the bond market. It is recommended, by contrast, to over-weight investments which are not inflated by debt. This includes undertakings with a high proportion of genuine substance and limited indebtedness, gold as a currency of last resort and nominally invulnerable gilt-edged bonds from First-quality national governments with their own currency. Investments that should also be considered are those with only limited correlation of profits to relative market changes, which are thereby able to make targeted profits from increasing divergences in interest rates, currencies and share markets. Market-neutral strategies like this are not per se dependent on increasing share prices in order to grow.

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