The Big Picture

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No end to the equity boom

Interview with Dr. Martin Jetzer in the Finanz und Wirtschaft dated 26 August 2015

Martin Jetzer, Chief Strategist at Bellecapital, believes it could be months before a new trend sets in. But he does not think the equity boom is over yet, as he explains in an interview with FuW.

Mr. Jetzer, how dangerous is the situation in the stock markets?

We have to make a distinction here: the stock markets are depressed, not the global economy. Apart from the newly industrializing countries, the economic indicators do not suggest a global recession. A sell-off on this scale seems to be exaggerated to me. I think it is unlikely that the equity cycle has changed direction for good. Long periods of low interest rates rarely end in recession but almost always in a financial bubble. We are seeing that in the fixed income markets, and have seen it in the Chinese stock markets.

How much is China's economy really wobbling?

The nose-dive in China followed a euphoric phase that began in the summer of 2014 and ended a year later after a rise of 150%, when the bubble burst. The speculative equity boom, which was also encouraged by the government, has come to a sudden end and millions of first-time investors feel they have been swindled out of their savings. I am not convinced by the widespread interpretation that it was an economic shock that triggered the slump.

What makes you think that?

We have known for a long time that the official statistics from China are not to be trusted. The economy is not growing at 7%, nor even at 6%, maybe only half as fast. But now the government has panicked and ineffective attempts to shore up growth have triggered economic uncertainty. The financial markets are simply factoring in the risk of a „hard landing“ in China.

What will happen next on the markets?

The markets are unlikely to calm down very quickly. It may be months before a new trend becomes established. But I am confident that the economic indicators we will see over the coming weeks and months will confirm that the global economy is not on the brink of a recession. I am expecting a good year for stock markets in 2016.

Will there be a rise in the key interest rate in the US?

It is the interest rate cycle that is important, not whether the actual rate — which is currently at just about zero — will be 25 base points higher. In the USA, the cycle began to change direction in summer 2012, when the return on ten-year Treasuries fell to a historic low of 1.4%. A rise in interest rates is overdue and would be justified by the way the economy is moving. It is always the central banks' job to stabilize the economy, not the stock markets.

So deflation will not be exported from China, bringing with it the risk of a recession?

It is unlikely, especially as deflation is not intrinsically bad; sometimes it is even necessary in order to regain lost competitiveness. The more we can all benefit from the international division of labor, the better. What would be dangerous would be a deflationary spiral, but there is no sign of that.

Three years ago you said in an interview with FuW: „The macro scenario is still not very encouraging, but the micro climate remains favorable.“ What is the situation like now?

It is a bit better, the economy in the Eurozone is growing again, the USA is back on a more stable growth track, and Japan is doing better, too. The macro scenario has become more gloomy in the emerging economies. The story in the BRIC countries has changed from one of growth to one of reform. Structural changes take time, they temporarily depress growth and they can get bogged down. On the micro scale, not much has changed. Companies are still very cost-conscious and react quickly and decisively to any changes in order to defend their market share and margins.

Would you buy shares now, or wait a while?

Even if the downward trend continues, equities are still the number-one choice – combined with cash rather than fixed-interest investments. The global economy is seeing inflation-free, weak to moderate growth, which is encouraging a combination of extremely relaxed monetary policy and unusually restrained fiscal policy that is quite favorable to growth and the stock markets. That ought to prolong the economic cycle. Nevertheless: I would wait a while before buying shares. The downward pressure is still too strong.

Why cash, when interest rates are at zero?

Thanks to nearly five years of slowly falling prices – this year expected to drop by about 1% in Switzerland – people's buying power is increasing, even with interest rates at zero. So that is a real return and one which – and this should not be underestimated – is not taxed. Investors do not attach enough importance to that, but consumers do. Cash serves also as ammunition that can be used opportunistically. This downturn will pass like the others. It is better to wait patiently than to make mistakes by being impatient.

Gold has fallen off the agenda – at Bellecapital, too?

With today's depressed prices, you could add a proportion of 5% gold in your portfolio. Gold bears little correlation to other asset classes, so it helps to diversify your portfolio and therefore stabilize it.

Are emerging markets and commodities also appropriate for the anti-cyclical mood of the times?

The temptation is there but the head says: wait a while. Technical indicators like momentum and relative strength can be helpful now in timing decisions on allocation. These signals do not show any buy signals yet. However, value investors are more relaxed. If you are rewarded for your patience with a generous dividend, then it is worth the risk of swimming against the tide. There are some opportunities emerging in Hong Kong. In general, though, we prefer to share in the growth of emerging economies by investing in multinational companies in the consumer goods, health and insurance sectors.

The general consensus is that Europe is ahead of the USA and Switzerland is somewhere in between. What order would you put them in?

First the Eurozone, then Japan, Switzerland and lastly the USA. We see Japan in a more positive light than the general consensus. The deflationary headwind has turned, the financial system is very healthy, exports are competitive and corporate profits are rising at an above-average rate. Additionally, a Western management culture is gradually developing in Japan, focusing on profit instead of turnover; dividend payout ratios are increasing and share buybacks are being contemplated.

What is your judgement of Switzerland?

It is a special case in monetary terms, because there is no other country with such a strict monetary policy. Now that the Swiss franc is no longer pegged to the euro, the growth in money supply has slowed to less than 1%, compared with nearly 10% in the USA, over 13% in the Eurozone and almost 6% in Japan: it is a monetary shock that will speed up deflation and have a breaking effect on the economy. That does not bode well for the stock markets.

What currency risks are there for investors who think in Swiss francs?

I follow the rule that you should take risks in the stock and bond market, but avoid currency risks. Fluctuations in exchange rates are very hard to predict. We are solely positive on the dollar. We hedge against the yen, and we do not like the euro because we doubt that the Eurozone will survive in its current form.

Zero or negative interest rates on safe Swiss franc investments – how long will this unusual state of affairs continue?

For as long as our currency is regarded as the safest haven in Europe and its value is expected to rise. That is nothing new; on the contrary. Ever since the start of 1973, when Switzerland switched to flexible exchange rates, the franc has increased in value against all other currencies. Every attempt to curtail this proved useless in the end. Eventually, however, the undesirable side effects of negative interest rates will become so great that the National Bank will have no alternative but to hand over rate-setting to the open capital market again. Manipulating interest rates is more dangerous than „controlling" exchange rates. Everything hinges on interest rates.

The very low interest rate policy is fueling an asset-price inflation. Is that the intention? Does the asset-price effect help the economy?

Influencing the distribution of wealth and income is certainly not an objective of monetary policy. However, the stock market boom is tolerated, and even welcomed by central banks as an inevitable consequence of the very low interest rate policy. There is a lot of dispute about the asset-price effect, though, and there is no empirical evidence for it. Why should the transformation of interest income into capital gains stimulate demand in the economy as a whole? Why should the re-distribution of income from savers to debtors support the economy? Despite asset-price inflation, the global economy remains below its growth potential. The good thing about it is that even the current asset-price deflation will not cause any lasting damage.

Which handful of shares do you expect to perform best over the next 12 months?

We expect a solid performance from Swiss shares like Clariant, Georg Fischer, ABB, DKSH, Zurich Insurance and Roche or Novartis. In the Eurozone, we like Bayer, Deutsche Bank, Rexel, STMicroelectronics and Eni, among others. In Japan, we stand by Toyota, Fast Retailing and Nippon Shokubai.

Martin Jetzer