Albin Kistler
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Wir halten Wort.

QUALITY INSTEAD OF EMOTIONS

Our **View** on Financial Markets
February 16th, 2016

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The periodically appearing views on financial markets are also available on Albin Kistler's website as downloadable PDF.

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Current Turbulences

Despite volatile financial markets our economic scenario is storm-resistant: stagnation and zero inflation. It is, however, often the case that developments not related to the real economy determine the course of equity markets over long periods of time. This is particularly the case when fears or losses in confidence take centre stage.

A weakening China, falling commodity prices, deflationary price trends, negative interest rates, European banks being tested to their limits, fears of credit defaults, contagion risks and recessionary fears. The central banks incapacity to act has become obvious. Their negative interest rate policy further undermines investor confidence.

Since its peak in summer 2015 the SPI has lost around 20 %. Will the Swiss equity market find support from its current level of around 8,000 points? As long as equity markets are driven by people's emotions, this remains difficult to say. Hence, we are maintaining our liquidity reserve.

NB: stock exchange prices always reflect real corporate developments over the long term! It is obvious that the lower indices fall, the greater stocks are undervalued and the greater the ensuing upswing. Therefore, further drastic price falls would provide a possibility to make use of our liquidity reserve. This way our client deposits would benefit from the equities' attractive prices.

What is going to happen next?

Instead of repaying debts, tackling reforms and letting weak banks and companies go bankrupt, the problems have been covered up by unprecedented money flows in Europe, Japan and the USA. This has given rise to stagnation and falling prices.

Politicians will neither be willing nor able to carry out fundamental reforms and build new trust. The current turmoil on the financial markets will not make a difference. The political muddling through and adoption of a wait-and-see policy will continue. Ultimately, the required measures will be forced in place by the markets themselves.

Although for the commodities the worst is over, interest rates are set to remain very low. Whereas a deep global recession is less likely, persistent stagnation is foreseeable with the exception of selective growth regions. However, this is not a bad environment for agile and internationally leading companies.

The arithmetic of stock markets is not complex: the earnings yield of first-class corporations is currently at around 6.5 %. If our selected companies succeed in maintaining or expanding their past earnings power over the next few years, their current valuation levels are attractive. Although there will be years with negative returns, subsequent ones will more than make up for them. This view is not based on speculation but on the search for quality and undervaluation that have gone unrecognised.

Conclusion

The global economy has become uncertain. Massive inflation awaits at some point in distant future. Government debt and money supply flows have never been at such high levels, interest rates have never been as low as they are today and the upswing was never as weak as it currently is. It is obvious that these records speak against holding currencies in the form of cash, nominal values and bonds. The solution: material instead of nominal values.

Favouring the corporate rather than the government world. The world's best companies have healthy balance sheets, solid earnings and real earnings yields of 6.5 % and more. These investments are highly attractive in relative terms. There are no other forms of investment that come close to the long-term security and quality offered by a solid equity investment.