

# UPSIDE FORCES

Investment policy

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## Equities are in favour

Let's cut to the chase for once: we are maintaining an overweight position in equities. Why? Because we don't see any fundamental disruptions or crises ahead that for us would cast doubt on the long-term earnings prospects of healthy companies.

It is true that the investment community is currently facing a host of questions and uncertainties. Not all of these are relevant for long-term investment success, but they do need answering.

## When will the upturn finally come?

When the economy is weak, pent-up demand builds, forming the basis for a subsequent upturn. That simple mechanism still holds true. However, we should not lose sight of the fact that the dip in European manufacturing has been deep and, above all, prolonged. The industry has been lacking any growth stimulus for a couple of years now. Many Swiss industrial firms are under pressure, and this has fed through to share prices. This is because the cyclical downturn is compounded by structural changes that will persist into the upturn ahead and pose challenges for long-established business models:

- Europe's energy sector is in a state of upheaval, as the energy transition meets new political realities. Europe has clearly lost some of its appeal as a location for energy-intensive activities.
- Governments are increasingly driving industrial policy and consciously impeding market forces. A prime example is the car industry, where entire value chains have reached an existential crisis point.
- China's structural challenges are large and becoming increasingly obvious. In view of its size alone, China will remain relevant as an export market. However, its contribution to global growth looks set to shrink going forward.

Nevertheless, we are confident that the conditions for an upturn are in place, with subdued inflation, normalised interest rates and a healthy, innovative corporate world. There is much to suggest that the next long-term economic trend will be an upward

one. A measure of patience is required, however, along with a rigorous approach to stock selection, reflecting the new realities.

## What is happening with inflation and interest rates?

Inflation is under control. While many market watchers are fixated by the speed and scale with which monetary policymakers will implement rate cuts, these decisions are not particularly relevant. Long-term interest rates are what matters most for long-term investment performance, and they are largely determined by a currency area's inflation level. This in turn reflects the quality of its political institutions.

Fiscal policy remains the biggest headache. Public finances are out of control in many places. The mountains of debt are so vast that they can no longer be surmounted through savings programmes alone. A feat on this scale would also require very stable political majorities, which is not the case in much of Europe.

Haircuts and currency reforms could offer a way out of this plight, but the short-term political and economic fallout would be huge. A scenario in which debt is gradually eroded through relatively high inflation looks more probable. A policy of this kind would automatically result in currency weakening.

For nominal investments (cash and bonds), it makes sense to focus on the Swiss franc. There are solid fundamentals behind its strength relative to other currencies, and that is not about to change. Domestic inflation and interest rates are therefore set to stay low.

## Will US elections set the tone?

2024 is a remarkable year for democracy, with around half the world's population in over 60 countries heading for the polls. These culminate in November's US elections. The candidates' platforms have one thing in common: there seems to be little trust in orderly, self-regulating market forces. Government intervention is seen as the answer. This is regrettable from a business perspective, but we should not be defeatist. A government wishing to actually implement its manifesto is reliant on

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a functioning economy. Policy that ignores this reality will not last long in a functioning democracy. As Bill Clinton's campaign team memorably put it back in 1992: "It's the economy, stupid."

Gearing one's portfolio around a particular electoral outcome is therefore short-termist, speculative thinking. Business success is built on much deeper foundations: legal certainty, market forces and access to knowledge and capital that is as open as possible. Anyone sharing this view would be well-advised to devote a large slice of their equity allocation to North American and Swiss stocks.

## **See the potential**

The investment environment is not as gloomy as many people fear. The investment community always places too much emphasis on current turbulence and underestimates the latent, long-term upside forces. Many companies are in excellent shape, continuing to offer great potential for profitable growth and rising corporate earnings. These earnings are what will form the long-term basis for higher share prices.