ADJUSTMENT

Investment policy

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Economy

We have seen a constant stream of forecasts and indicators for some while now suggesting that a significant economic downturn lies ahead. There is already talk in some quarters about the widely forecast recession facing many economies. At the same time, there are still labour shortages in many places, and inflation rates remain persistently high despite large-scale counter-measures by central banks. The picture on the equity markets remains broadly constructive, with all the major markets recording healthy gains in the first half of the year.

The current state of affairs highlights once again the futility of changing investment tactics based on general economic forecasts. Long-term investors need the humility to accept that periods of economic weakness will always differ in the form they take, which makes accurately predicting them a matter of chance. Other than in severe systemic crises, there have always been some sectors and industries which have been able to shrug off a downturn or at least navigate it fairly successfully. It is also important to always keep in mind that every crisis paves the way for the next upturn.

When pessimism about the economy builds, there is a danger that short-termism motivated by fear will lead investors to be underinvested for the next upturn, with serious implications for their long-term investment returns.

In the long term, it is not economic growth, but corporate earnings which dictate share prices. It is a rarity for the environment to be so weak as to cast doubt on the long-term growth and earnings power of first-class companies.

Outlook

Some key long-term trends have reversed of late, specifically inflation, interest rates and the money supply. We are digesting this altered state of affairs right now, as the business world adjusts to this new monetary environment. After years of cheap money and negative interest rates, the discipline of market forces is increasingly taking hold again. This is primarily taking the form of more restrictive bank lending policies, causing suffering for heavily indebted borrowers in particular. The significantly increased interest rate burden is impacting above all on the real estate markets.

The outcome of this new reality is consumer caution, stagnating company profits and rising numbers of insolvencies and loan defaults. This is all squeezing the global economy – and it will remain with us for some quarters to come. In this low-growth environment, inflation rates are expected to edge downwards to a higher but bearable level for the economy.

Conclusion

We see no reason to change our portfolio's tactical approach. After all, despite the sizeable interest rate reversal, yields on many bonds are still close to zero after inflation. By contrast, investors are compensated for the fluctuation risks inherent in equity investments by significant, positive real returns.

This means there is no way around an overweight position in equities for disciplined, security-minded investors. An uncompromising focus on top quality and targeted diversification are key.

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