TARENO
INTERNATIONAL
ASSET MANAGERS

TARENO VIEW Q4 2021

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MARKET COMMENTARY

Review

Taking a look back at the past quarter, it can be stated that, all in all, the financial markets developed positively. Even the summer months, which are usually characterised by volatility and low trading volumes, did not significantly slow down the momentum. The S&P500, for example, registered its 7th positive monthly close in a row at the end of August. During this phase, shares were driven primarily by very good company figures in the second quarter. These often even exceeded the comparative values from the pre-crisis year 2019.

The central banks, which continued to provide the markets with liquidity, also had a supporting effect. In September, the US Federal Reserve announced its intention to gradually reduce its monthly bond purchases. This did not come as a surprise to the markets, however, as the Fed has repeatedly emphasised in recent months that the „tapering“ measures should not be linked to an end of the low interest rate policy in the near future. Apart from a few weak trading days in September the markets showed the usual positive picture. This is a remarkable fact, because beyond the capital markets the tone became increasingly harsh.

The economy lost momentum at the beginning of the summer. Slowly, awareness is growing that the pandemic will accompany us for a while. The vaccination rates in many growth regions are low. This repeatedly leads to problems in the supply chains of globally active companies. Further cracks are appearing on the political stage. China is not afraid to enforce its goal of „shared prosperity“ by intervening in the market economy. In doing so, they distance themselves from the „whatever it takes“ mentality of the West, especially the US. The US, on the other hand, is upsetting many experts by continuing President Trump‘s foreign policy path under the new administration of President Biden. The effects of „America first“ were demonstrated exemplarily by the chaotic withdrawal of Western military forces from Afghanistan. The numerous environmental disasters that hit many regions of the world hard in summer are also still present in the form of images, videos or direct impressions. For example, the droughts in the USA, forest fires in southern Europe, Hurricane Ida or the flood disaster in Germany.

Bonds

Slightly gloomy economic data and the expansive central bank policies were enough to initiate a turnaround after the slight interest rate increases in spring. The government bond segment remains unattractive from a risk-return perspective. Negative yields are still not uncommon. The risk premiums for corporate bonds and high-yield bonds remain at a stable low level. Issuing activity has recently increased significantly again, which speaks for strong demand despite the low interest rates.

Equities

At the end of the third quarter, volatility on the markets increased and, contrary to the course of the summer months, led to some weak trading days. The imminent bankruptcy of the real estate developer Evergrande brought back memories of the similar Lehman case in 2008. However, the markdowns on the markets remained within reasonable bounds and were perceived more as a buying opportunity. The third quarter showed that the large US technology stocks are still highly in favour among investors. Value stocks continued to attract investors only occasionally.

Alternative Investments

The gold price moved sideways in the 3rd quarter in a range between USD 1,830 and USD 1,720. The recent rise in inflation expectations has not had the expected effect on the gold price. The central banks keep repeating that inflation is only of transitory nature. This is how they counteract a rise in the gold price. In contrast to gold, bitcoin has been much more volatile. While the price was still below USD 30,000 in July, it rose to over USD 50,000 by mid-September.

ECONOMY

However, initial leading indicators, such as the Purchasing Managers' Indices (PMI), point to a flattening of the momentum. They exceeded their highs in Q2, but still point to expansion. At the same time, inflationary pressure is increasing. Currently, the inflation rate in the US is 4% and in the Eurozone 2.2%. This is above the long-term average of recent years. It remains to be seen whether this is a temporary phenomenon or whether inflation will develop above the central banks' stated target in the long run.
The handling of the pandemic and the respective vaccination rates continue to have a noticeable influence on the economic development in the affected regions.

OUTLOOK

The recent increase in volatility is likely to continue into the fourth quarter, especially as October is a seasonally weak stock market month. However, most observers agree that investors‘ risk appetite remains intact. Setbacks are likely to be perceived as buying opportunities and consequently not to take on significant proportions. Liquidity in the markets remains high and central banks will continue to tolerate only limited volatility in the markets.

The upcoming corporate results in November are likely to influence the markets in the short term. The impact of increased costs, supply chain distortions and labour market tightness will impact results depending on the sector. Due to high valuations, „truffles“ will become scarcer. It can be assumed that the wheat will increasingly be separated from the chaff. Careful selection of both equities and bonds is indispensable.

It is also important to keep an eye on political developments. Above all, the steadily deteriorating relationship between the US and China is difficult to predict. We remain cautious about geopolitical influences. However, we also know that political stock markets usually have short legs.

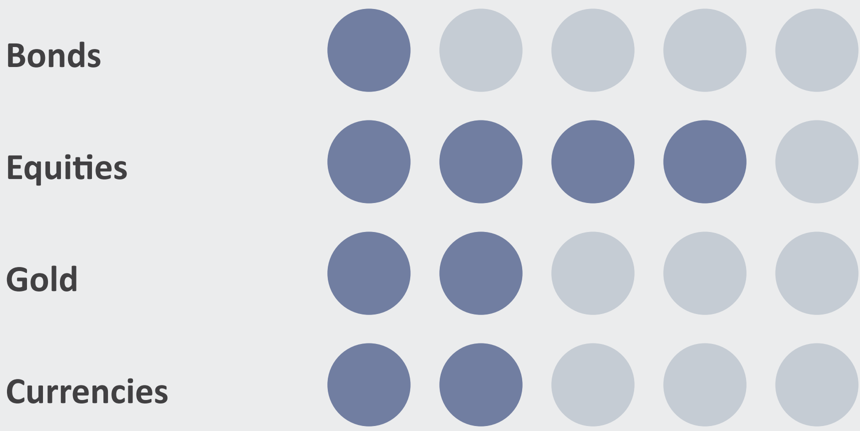
INVESTMENT POLICY

In general

The current increase in inflation, regardless of whether it is temporary or not, will continue to make life difficult for bond investors. In the vast majority of industrialised countries, the inflation rate exceeds the bond yield, which means that bond investors are gradually expropriated unless they actively manage their bonds.

Conversely, for equities this means that over time more and more capital will probably be allocated to this form of investment and stronger corrections on the equity markets will only be temporary. In terms of a higher inflation environment in the future, equities are an extremely attractive investment as long as interest rates do not rise significantly. Nevertheless, a rise in interest rates is not to be expected in the short term due to fragile global government financing, as many countries simply cannot afford a higher interest burden. Central banks will act accordingly to take this into account.

Positioning



The chart shows the Tareno PM's current assessment of its relative attractiveness compared to other asset classes. The more blue dots, the more attractive.

Bonds

With the relatively strong rise in interest rates towards the end of the third quarter, we expect increased volatility in the final quarter. While inflation is likely to remain high for longer than expected before settling around 2% in the Eurozone and 2.5% in the US next year, we also see growth risks on the horizon in China and with the pandemic development in autumn and winter months.

Since we do not substantially expect higher interest rates, we currently see opportunities in stable A/BBB borrowers in the middle range of the yield curves. In the sub-investment area, we continue to prefer investments with a short duration. Government bonds, covered bonds and first-class corporate bonds continue to be underweighted.

Equities

The upcoming 4th quarter has historically seen periods of significantly increased volatility, but has also always seen impressive upward movements towards the end of the year. Since 1945, the period from October to December has delivered the best quarterly returns on average.

The equity market is also expected to enjoy structural support from the steady inflow from former bond investments and corrections should continue to be used as entry opportunities. Themes such as cyber security, in which we have recently increased our exposure, will continue to be of interest in future and, in our opinion, will enjoy brisk demand. In addition to the technology sector, we also hold an overweight in cyclical consumer stocks and the healthcare sector.

Alternative investments

In the area of alternative investments, we are still invested in gold and bitcoin.
As is well known, the gold price benefits from falling real interest rates, i.e. 10-year US government bond yields minus the inflation rate. We do not expect 10-year US government bond yields to rise significantly in the medium term. With regard to the inflation rate, however, we believe it is very likely that it could turn out to be higher than expected. All in all, we believe that the gold price is fundamentally well supported and are sticking to our weighting of 5%.
Bitcoin is and will probably continue to be exposed to higher volatility than most other traditional asset classes. However, the potential is also significantly higher. We remain convinced that a 1% defensive weighting in Bitcoin improves the risk-return profile of a portfolio.

Currencies

We maintain an active currency management, in which we keep the weightings in foreign currencies very moderate. The performance volatility that can be triggered by foreign currencies should not be disregarded.

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