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BODMER CETTIER

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We have never boxed before but we do understand a few simple ground rules: if possible, do not box against stronger opponents. Pace yourself. Keep your guard up in difficult phases. Keep moving and don't let yourself be pushed into a corner.

Don’t fight the FED

One Wall Street pearl of wisdom is not to position yourself against the world’s most powerful central bank. Since the 2008 financial crisis, central banks have been on the side of investors with their ultra-relaxed monetary policies. Every market tremor has been smoothed out by cheap money and lower interest rates. To continue our boxing match analogy, the judges were sitting in the corner of the market participants. Now, driven by inflation, the judges have changed corners and the boxer is reeling. Recent market events will go down in the history books as an epic wrestling match between market forces. Rarely has the search for the right price been more painful: it has been the worst half-year for bonds since 1788 and the worst six months for equities in over half a century.

Insights

Looking back at the past six months, one thing in particular stands out: the market participants’ delayed reaction to slowly emerging realities. For example, the issue of inflation had been known about since last year, but its momentum was generally underestimated. It was also the consensus that central banks would raise interest rates. Of course, the war in Ukraine has changed a great deal. However, the impression remains that the extent of the developments was underestimated. Looking back is only helpful if it yields useful insights for the future. For us, one such insight is the realisation that, although the market does perceive developments during a phase of upheaval, it reacts to them far too sluggishly. Psychologically, this phenomenon can be explained, because people tend to assume that developments will continue in a linear fashion. A 180-degree turnaround is cognitively difficult to process and implement.

Learning for the future

The dominant market topic at the moment is an impending recession. We believe that here, too, people are underestimating how challenging the current situation is for companies. In particular, we believe that the sharp rise in producer prices (driven mainly by exploding energy and raw material prices, but also by increased labour is having a strong negative effect on companies’ profitability and this has not yet been fully priced in. In addition, the outlook for growth is deteriorating sharply and consumer sentiment is at rock bottom. One current example illustrates our observation:

Zalando, announcement of 24 June 2022

Zalando fears a prolonged slump in demand due to the recent economic downturn. As a result, the company, which was one of the big winners during the coronavirus pandemic, has now cut its annual targets and expects at best only slight sales growth in 2022.[1] The share price fell by up to 11.5% on the day of the announcement – after having already lost 70% from its annual highs.

We expect to see more news of this kind. A turnaround is not yet in sight. To stick with our boxing analogy: we don’t believe we are in round 11 of 12. We are in the middle of the fight – perhaps round five. Skilful perseverance is the name of the game.

Pace yourself and prepare to fight back

We continue to view high liquidity reserves as sensible, prefer defensive industries and companies (e.g. in the pharmaceutical sector) and maintain gold positions. If we are indeed facing a recession, it could be interesting to utilise increased interest rates to add bonds with positive yields to portfolios. Companies with constant dividend policies are also becoming more attractive. When share prices fall, the dividend yield increases if the dividend remains constant. This is well worth considering for cash-flow-oriented investors. In addition, investors should prepare to buy up good companies at fair prices. Particularly after heavy share price losses, opportunities arise at the appropriate time and should be seized. To this end, we have devised a strategy that we are activating for the fightback. Throwing in the towel is not an option.

Dr Patrick Cettier

[1] https://www.tagesschau.de/wirtschaft/unternehmen/zalando-gewinnwarnung-aktie-101.html