MAERKI BAUMANN & CO. AG

PRIVATBANK

Volatility, inflation, and other coronavirus trends

Market Comment, February 2022

In March 2021 we identified seven coronavirus trends (see our Market Comment "Consequence of coronavirus: a strengthening of structural trends"). By this we mean trends that were not technically caused by the coronavirus crisis but have clearly been accelerated by it – and are now having an increasing impact on the economic environment. In this Market Comment we highlight a number of other trends influenced by the pandemic that underline the importance of higher-quality investments at times of interest rate and stock market turbulence.

Rising social inequality

Differences in asset and income levels are becoming ever greater in societies all around the world. This can give rise to greater political pressure to support weaker socio-economic groups and combat social inequality generally. However, increasing minimum wages or corporate tax rates could hit company profitability. The affected countries would therefore be risking a reduction in valuations. Due to its buoyant stock market valuation and rising wage pressure this could become an issue in the United States, for example, not least because President Joseph Biden has been losing popularity.

Inflation

As a result of the supply difficulties compounded by coronavirus and the extraordinary flood of liquidity in recent years, particularly in the United States, the rise in US inflation has exceeded the expectations of the American central bank (Fed), leading to interest rate rises in the United States and turbulence in assets with historically high valuations.

Expansion of healthcare

The existing deficits in the provision of healthcare are increasingly likely to be tackled by greater government spending on health systems, although this development will depend on political changes in individual countries. The products and services of the healthcare sector could therefore benefit from stronger demand in the future, as well as higher medium-term growth rates than the overall market. The beneficiaries of this development will include the leading pharma and other healthcare companies, for example, as well as companies specialising in medical technology (medtech) and diagnostics. When viewed in historic terms, equities from the global healthcare sector are not expensively valued and could soon see more growth. This in turn could underpin the Swiss equity market in respect of other markets in the medium term.

> "A focus on quality should pay off in phases of greater market turbulence."
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> Gérard Piasko, Chief Investment Officer

Higher government spending

The coronavirus mutations that we have seen to date have increased the budget deficits of many countries, through the financial support provided to certain sectors, companies and households. Given the amount that needs to be spent in the area of healthcare, government spending is also unlikely to be cut in the future – and could actually rise further. High budget deficits can often prompt interest rate turbulence. Investments in real assets may also experience above-average volatility at such times, but the impact of government indebtedness and budget deficits will have a greater impact on nominal investments such as bonds. The yields on government bonds remain unattractive, and low yields make this asset category vulnerable in an environment of interest rate turbulence. As a result, demand for higher-yielding corporate bonds remains above-average. Given the greater volatility of all asset classes due to the resulting rise in interest rates, focusing on quality has once again become important in the corporate bond segment.

The quest for returns

The hunt for meaningful investment returns goes on – including within the equity market. Due to their higher returns, the equities of companies that have a track record of increasing their dividends could attract greater demand.

Consumers and companies intent on saving

The tendency of households and companies to save is becoming more pronounced against a backdrop of rising uncertainties. The rise in savings rates has been visible since 2020 and can be expected to increase if geopolitical conflicts look to be escalating. If the savings mentality strengthens, cyclical equities would be more affected due to declining economic growth. A logical response here would be to focus on investments that exhibit higher quality and greater earnings stability in times of less dynamic economic growth, too. Historically, high quality has manifested itself in more stable profit margins, less volatile returns on equity and lower indebtedness, which leads to less erratic price performance in a long-term comparison. A relatively low level of debt is particularly important against a backdrop of rising interest rates.

An increase in volatility…

The majority of the trends that – while not caused by the coronavirus crisis – have been accelerated by it are also "socially disruptive". They lead to an increasing imbalance between relative losers and winners within the economies, industries and societies of the various countries. Together with higher inflation and stresses in the area of interest rates, this can be expected to usher in greater market volatility over the next few quarters.

…calls for a focus on quality

We believe the medium- to long-term trends described above support our long-term investment orientation, which has a greater focus on quality. This also makes Swiss equities deserving of a prominent place in an investment portfolio.

Gérard Piasko

Gérard Piasko is Chief Investment Officer and head of the investment committee of private bank Maerki Baumann. Before he was for many years Chief Investment Officer of Julius Baer, Sal. Oppenheim and Deutsche

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