Stocks Suppressed by Higher Rates

Observing developments of the stock indices shows, the stock market year 2023 has so far taken a fairly positive course overall. September has the reputation of being a difficult stock market month. September has lived up to its reputation this year, since stock markets declined across the board over the past four weeks.

The broad U.S. S&P 500 Index fell by more than 3%, while its European counterpart, the Euro Stoxx, was down 1.5%. The DAX saw the biggest drop of around 3.5%. In contrast, the Japanese Topix Index fell by almost 4% in September. It rose by almost 4% in September, further consolidating Japan's leading position among the major stock indices in 2023.

Overall, the stock markets were dominated by significantly rising long-term interest rates in September. This continued the normalization on the bond markets after more than a decade of ultra-low rates. While short-term interest rates in the USA, the UK and Switzerland were not raised further, there were marked price losses at the long end of the yield curve. At the end of the month, the United States had to pay around 4.6% for newly issued ten-year government bonds. Yields on ten-year Italian government bonds are at roughly the same level. However, long-term interest rates are also rising in Germany. They are now just under 3% for ten-year German government bonds. By contrast, comparable yields on Swiss ten-year bonds are only 1.1% and on Japanese bonds only 0.75%.

The level of interest rates on the financial market is important for the economy and consumers. The stock markets cannot ignore the historic turnaround in interest rates either. The days when investing in equities was considered to have no alternative are over.

Interest rates affect the stock markets in at least three ways. First, it should be noted that credit investments are the classic investment alternative to equity investments. The higher the interest rates, the less attractive equity investments become. Another important factor is the influence of interest rates on the valuation multiples for equities. In order to assess equity investments in terms of their value for money, estimated future corporate earnings are discounted to the present day. The higher the discount rate, the lower the present value of future earnings. Therefore, increased interest rates cause companies to depreciate in value. Finally, most companies are financed by a mixture of equity and debt. Companies have to pay interest for their debt. The increased interest rates lead to weaker financial results in companies.

In contrast to debt financed companies, there are also companies that have no debts and instead show a cash balance. Japanese companies in particular offer many examples. For the LOYS fund management, the turnaround in interest rates makes it more necessary to take a closer look at the quality of companies' balance sheets. On balance, it can be said that the public companies in the portfolios of the LOYS funds have robust balance sheets.

Sincerely yours,

Fund managers and co-investors

Dr. Christoph Bruns Ufuk Boydak

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