Multiple Crises Dampen Markets

Markets had to bow down to a multitude of problems in October. A significant rise in interest rates is certainly the main concern. Rates have now reached a level of positive real yields.

Investors who want to commit themselves for longer and prefer government bonds are getting a yield of almost 5% on ten-year Italian bonds, for example, which puts the country at roughly the same interest rate level as the USA. In contrast, yields on ten-year German government bonds are just under 3%. In view of an inflation rate of 4.5% reported for September in Germany, this is still too meagre a yield, which does not guarantee a real preservation of the money invested, even though the inflation rate has been falling recently.

However, the trigger for the recent stock market weakness is primarily to be found in the outbreak of war in the Middle East. Stock market participants are extremely imaginative when it comes to dreaming up negative macroeconomic scenarios. An additional war in the Middle East would mean a further strain on budgets in Europe and the United States, adding to the woes of already out-of-control national debt. A further increase in national debt means higher financing requirements and this leads to further increases in interest rates. The vast majority of countries in the western world have been pursuing a Keynesian economic policy for decades. The state plays an active role when economic downturns trigger a decline in private demand. The state then steps in and compensates for the lack of private demand by increasing government spending. The only problem is that in good economic times, states are not in a position to build up reserves, as John Maynard Keynes - the British economist - had envisaged. The simple truth remains that politicians are not elected for austerity and humility, but rather for rosy promises and patriotic statements.

The crises of the last 25 years have shown that, from the perspective of the political elite, the solution is to use the central banks as a deus ex machina to stimulate the economy. In fact, more and more voices are calling for an end to interest rate hikes and for the central banks to provide relief, especially as tax revenues are no longer flowing so abundantly and interest budgets are rising rapidly. Once again, what happens in the United States of America will play a key role. The times when interest rate trends were based on the German Bundesbank have been over for almost a quarter of a century.

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As a reminder, German politicians recklessly and prematurely gave up sovereignty over their own currency in favour of the euro. And the euro has not become a second Deutschmark, as once promised by the political elite. Today, we need to look across the Atlantic to understand where interest rates in Europe are heading.

Perhaps it is fortunate that an end to interest rate rises is in sight in the USA. After two years of interest rate hikes and a bond crash, the dampening effects on the economy and subsequently inflation is unmistakable. The end of rate hikes would benefit the stock markets, where one can find many unusually cheap stocks at the moment. This observation applies especially to European and German dividend stocks.

Sincerely yours,

Fund managers and co-investors

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