Temporary and permanent

Milton Friedman, the renowned American economist, once famously remarked that nothing seems as permanent as a temporary government program. If you think of the sparkling wine tax to finance the German navy before the First World War or the tiresome solidarity surcharge, initially slated for just a year but ending up persisting for more than three decades, then you immediately realize that Milton Friedman was on the trail of a seemingly universal pattern.

In this context, a publication by the European Central Bank warrants attention. It deals with the gigantic bond portfolio that the central bank has bought up on the capital market over the past ten years. In doing so, the ECB has followed its American role model – the Federal Reserve – which itself has accumulated bonds worth a good 8 trillion US dollars. Until now, the financial market had assumed that the gigantic bond purchases were a temporary measure. According to the ECB's statement, it has now revised its approach and will continue to hold a "structural securities portfolio" on a permanent basis.

Well, that's how it works. The central bank's crisis measures, which were dubbed and praised as temporary, are quietly and silently mutating into a permanent government financing program. Despite the public crocodile tears, the European capitals will be happy to hear this. Above all, those countries with particularly high debt levels are likely to be relieved to have a dependable financing ally in the central bank. It's worth recalling the initial promises made during the inception of the euro in 1999, emphasizing that government financing by the ECB would be precluded within the new single currency framework. At the time, it was widely proclaimed that no country in the newly created eurozone would have to guarantee the debts of another country. The EU now has its own bonds and the member states are liable for the ECB's losses in proportion to their shares, without their parliaments being consulted. Let's cover the Maastricht Treaty with a cloak of silence: not a single signatory country is willing to abide by the agreement.

For the bond market, this development carries positive implications, affirming central banks as ultimate rescuers in times of im-

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pending bank and state insolvencies, thereby mitigating exposure risk. The risk of exposure is thus significantly reduced. Yet, this also implies sustained suppression of bond yields for investors, courtesy of the central bank's predominant market presence. Consequently, the allure of government bonds as a means of preserving real assets has dwindled over the years. This in turn benefits the stock markets, which manage without artificial government support and are currently heading for new highs. Despite facing disparities such as in tax treatment and equity backing, equities consistently outperform government bonds. This underscores the prescience of LOYS AG's decision nearly two decades ago to transition into a purely equity-focused fund management entity, much to the benefit of investors.

Sincerely yours,

Fund managers and co-investors

Dr. Christoph Bruns Ufuk Boydak

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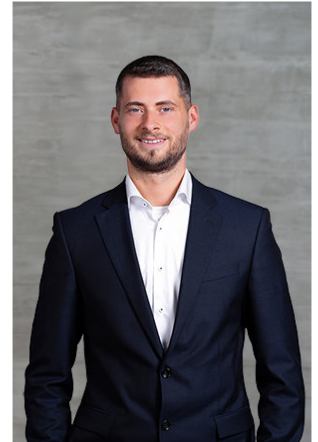

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