ETHENEA: 10 topics that will still occupy us in 2021

ETHENEA Independent Investors S.A. is celebrating its 10th anniversary this September. During this period, the Portfolio Managers have gained a lot of experience in dealing with crises and difficult market phases. This is reason enough to find out which topics we will still be dealing with on the capital markets in 2021.

1. Liquidity on the capital markets – Volker Schmidt

Despite massive liquidity injections by central banks, liquidity on the markets is decreasing. Commercial banks' trading books have shrunk steadily in the years since the financial crisis. As a result, they increasingly lack a buffer to be able to take orders or sell bonds already on their books. In recent years, central banks have repeatedly purchased bonds through their quantitative easing programmes. However, in between, the central banks have also repeatedly scaled back these programmes. In March 2020, when the ECB only made small-scale purchases and the Fed did not act as a buyer at all, we witnessed dramatic consequences when the spread of the coronavirus led to panic selling. The significant purchases by central banks and the low stock levels of investment banks, on the other hand, have resulted in limited supply. This leads to significant increases in bond prices when institutional investors, such as insurance companies, pension funds or investment funds, have to buy, in particular due to inflows of funds.

This situation will continue in 2021, as the ECB will continue its Pandemic Emergency Purchase Programme (PEPP) until at least June 2021. The funds for the Fed, which makes its purchases rather opportunistically during periods of weakness, have also been approved and the programmes are in place.

2. Multi-asset as a solution for retail clients – Michael Blümke

It is a well-known fact that risk diversification, i.e. spreading the proverbial eggs among several baskets, improves the risk-adjusted performance of a portfolio. However, to remain with the tangible image of fragile eggs, it is important that not all baskets fall at the same time. Successful diversification not only takes place within an asset class, it can also be applied across several of them. For many years, multi-asset solutions have therefore been on the increase in the portfolios of private investors - and rightfully so. This concept is still as relevant and necessary as ever. However, as is often the case, it all depends on the mix. It is therefore important to present solutions for private investors that not only avoid risks but also actively take advantage of opportunities, and that also work in an already changed market environment characterised by very low interest rates.

3. Low and negative interest rate environment – Volker Schmidt

Low interest rates have been around for a very long time and the ECB already introduced negative interest rates on commercial banks' deposits in 2014. Even the bonds of secure issuers were not spared this development and, as a result, in 2016 the yield of 10-year German sovereign bonds fell below zero for the first time. At the time of writing (24 August), more than USD 14 trillion had negative yields. This volume will certainly not disappear anytime soon, so negative-yielding bonds will remain with us in 2021. Low interest rates will probably remain with us for much longer, as this is the only way to finance the escalating national debt. Yet even in this environment, there are opportunities for an active manager to make a lot out of little.

4. Monetary and fiscal policy measures – Volker Schmidt

Governments and central banks are trying to mitigate the economic impact of the coronavirus pandemic with a range of measures. The Pandemic Emergency Purchase Programme (PEPP) for accelerated bond purchases and the EU's "Next Generation Europe" reconstruction programme are the most well-known interventions on this side of the Atlantic. In addition, there are many national support programmes. In the US, too, the Federal Reserve has already bought more than USD 1.7 trillion in government bonds, and the US government is supporting consumers and companies with both scheduled and unscheduled unemployment benefits and tax breaks. Many of these measures will still be with us in 2021. However, it will be interesting to see when and how central banks and governments withdraw. We will certainly see the first steps towards this next year.

5. High levels of indebtedness - Volker Schmidt

Due to fiscal policy measures to contain the economic impact of the coronavirus pandemic, public debt in many countries has soared to record levels - and will continue to rise. In the US, the fiscal deficit for the first 10 months of the fiscal year ending in September is already at USD 2.8 trillion, USD 1.9 trillion higher than in the previous year. In the European Union, part of the high public debt is being shifted to the community level. The EU will become the largest bond issuer in the coming years as part of the "Next Generation Europe" reconstruction programme. However, the coronavirus crisis and the economic downturn are also placing a massive burden on the budgets of individual states. Investors are still willing to overlook this because the central banks are prepared to finance these gaps. Only when the economic recovery continues in 2021 will the differences between economic areas or countries become apparent. At that point, investors will also consider these differences more carefully in their investments.

The Institute of International Finance (IIF) has calculated that global bond issuance reached a record USD 12.5 trillion in the second quarter of 2020, with 60% of issuance sovereign bonds. In comparison, in 2019 the volume was still around USD 5.5 trillion per quarter. Companies have also amassed enormous levels of debt. A mass default is currently being avoided thanks to the fiscal packages. Governments are taking on increasing levels of debt in order to stabilise demand and to keep particularly affected companies afloat through subsidies or loans.

6. Covid-19 - Christian Schmitt

At the beginning of this year, the novel coronavirus was initially still classified as a temporary Chinese phenomenon. However, just a few weeks later, the Covid-19 pandemic dominated all aspects of life worldwide – and still does so today. In the meantime, we have learned a lot about the virus and the pandemic, but the number of open questions has by no means diminished. For example, it is still unclear whether the unprecedented race to invent and produce an effective vaccine will be at all successful and whether the hope that everything will return to normal will be realised.

Currently, only one thing seems to be clear: Covid-19 will by no means be over by the end of 2020. The pandemic will also have a major impact on the coming year (at least).

7. Passive versus active – Michael Blümke

The growing popularity of passive products, which is evidenced by further increases in market share, cannot be denied and is, in our view, justified. Only the active manager, who offers added value for the client after costs, has a long-term raison d'être - and only a very flexible and active manager can meet this requirement. In our view, the majority of relatively benchmark-oriented products will be substituted over time by the offers at the outer edges of the passive-active spectrum. However, we consider it premature to assume that this development will result in a complete ‘passivation’. We believe that the demand for intelligent fund solutions, which firstly have sufficient flexibility and degrees of freedom, and secondly are willing and able to take advantage of them profitably, is definitely there and will even grow with the elimination of the semi-passive offers.

8. Inflation and asset reflation – Christian Schmitt

There was a time when inflation - both positive and negative - posed a serious threat to Western industrialised countries. From the perspective of 2020, it seems that this era ended with the turn of the millennium. This is particularly striking given the expansive central bank policy since the global financial crisis. The rather close correlation between monetary measures and core inflation in the 20th century would have led to expectations of significantly higher inflation from 2008/09 onwards. Yet almost nothing has happened in the price of the basket of goods and services on which inflation measurement is based! In contrast, monetary expansion has had a very inflationary effect on price developments in most asset classes.

It is doubtful, to say the least, whether there will be sustained price rises on the global goods markets in 2021. It seems almost certain, however, that further upward pressure on the prices of the world's major asset classes will continue, given the continued flood of liquidity.

9. Value versus growth – Christian Schmitt

The discussion about the relative performance of the two main investment styles on the equity markets is almost as old as the history of investing itself. For 14 years now, growth stocks have been structurally ahead in this race for the best performance. In recent years, in particular, the financial markets have announced an end to this era repeatedly and loudly. Yet, exactly the opposite has happened: growth stocks have again outperformed value stocks, particularly in 2020. The value trap seems to be bigger than ever.

A look at the long-term drivers of this development - a global economy with sluggish growth in the midst of a technological turnaround and the low/zero/negative interest rate environment - leads even die-hard value investors to doubt that the trend will reverse in 2021. The relative performance of both investment styles will certainly be one of the most interesting questions for the coming year. The answer will depend more on investor psychology than on the development of fundamental figures.

10. Gold - Michael Blümke

After the price of the precious metal had been stagnant for years, gold is back in the spotlight after the last upward movement. From our point of view, there are good reasons to expect a continuation of this rally in the long term. Against the backdrop of a quasi-fixed low nominal interest rate level and with increasing attempts to boost inflation with monetary measures, the real interest rate will remain low for the foreseeable future and possibly fall further. The resulting gradual depreciation of paper money will benefit gold in its value retention function. This process will only be accelerated by the increasingly large and, in all probability, irreversible quantitative easing programmes of the central banks. However, this development is not a one-way street. The recent volatility of the gold price is good proof of this.