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ZINNECKER MONTHLY 07 / 2014

Current Situation

The allover performance for bonds and stocks in the first six month of 2014 was controversial, not very conclusive and mostly not in line with fundamentals from the monetary and economic front. The returns for long term government bonds were sensationally high at this stage of the cycle. The still deflationary environment has forced institutional investors to reinvest redemptions again and again at the long end of the government bond markets, as long as interest rates beat the actual rate of inflation. The demand for new issues of long term government bonds not only in the USA could not have been met, causing interest rates to fall temporarily again as low as 2.4%. And this against the allover perception of rising interest rates for this year. Even more dramatic was the swing in the EU periphery with double digit half year returns for long dated paper.

The average equity performance has lagged throughout the entire period with some exceptions in Asia and in the European periphery. Elections in India, Italy and the EU have raised the hope of investors for dreadfully needed structural reforms in these areas of the world. The USA on average has finished somewhat better over this period than classic Europe. It was a market of stocks and the investment success arose from stock picking. The relative high valuation of the equity markets and extreme low price volatilities over the past was another disturbing factor for investors. And portfolio managers of certain hedge fund categories had tough times to cope with.

Economic Outlook

Advancing into the second half of 2014 the financial markets will further be confronted with political inconsistencies and investors will be puzzled with the future direction of the economies, inflation and corporate earnings. Commemorating the Sarajevo shooting hundred years ago it is appeasing that politics in Europe will not let go the Ukraine conflict out of hand and that it will eventually be resolved diplomatically. Europe seems to have learned its lesson from history and the USA should try to learn a lesson in handling the renewed Iraq conflict that definitely will not be settled militarily. The potential financial shock waves from there should therefore be calculable.

That could be different with allover economic growth expectations, where the euphoria of a large and prolonged recovery at the beginning of 2014 has cooled down substantially. It comprises not only the USA and China but also the EU, where the social, structural and economic deficits have dramatically emerged this year. They are waiting to be tackled by a bureaucracy that so far has been unwilling to meet their obligations in this respect. This is the case in Western Germany, in particular, where the allover infrastructure gradually looms to fall apart in the coming years. Also France has not given proper answers on how to start its necessary labor

and economic reforms and after the Alstom debacle doubts have emerged of the all over capability of the French system to tackle these problems.

Financial Markets

The general background does not seem to be overly bullish for the capital markets for the foreseeable future with bond yields being that low and stock market valuations being relatively high. As long as economic projections in terms of the global economic improvement and inflation are not yet clear, market participants could take a "wait and see"-attitude over the summer months, before they set up their new bond and equity investment strategies for 2015 later this year.

The earnings' reporting season will start next week. Corporate profits could be surprising on the upside due to higher operation margins and lower interest rates expenditures, notably in the USA. The stock markets that have stalled again last month could therefore resume their still positive upward trends in the month of July. Conservative investors, however, could then possibly take profits and could consolidate their investment returns so far achieved in 2014. An allover reduction of investment risk could be reasonable advice for the time being under the given market conditions.

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1.7.2014