KEHRLI & ZEHNDER

INVESTMENT COMMENT September/October 2019

- **TINA, There Is No Alternative (to Equities)**

  Should we fear an inverted yield curve? Most recessions are preceded by an inverted yield curve but an inverted yield curve does not necessarily lead to a recession. Neither short nor long term rates were at high levels, so the risk is relatively low (low cost of capital). In the U.S., corporate bond yields and mortgage rates have also fallen and hiring trends remains positive. We continue to favor equities and would recommend using market dips to increase exposure especially given that credit is expensive, leverage rates are high, bond issuance is breaking new volume records and cash has very low or negative yields. Central banks around the world position themselves to flush markets with liquidity in an effort to fend off a potential recession.

- **What if?**

  If central banks were to lower rates to -2, -3 or -4%, holding cash would become increasingly less attractive. Would it really lead to increased consumer spending, entice companies to invest or borrow even more? To stimulate consumer spending, another alternative could be to hand out money for free (helicopter money) but this creates moral hazard. It will also have a lasting negative effect on the credibility of the global financial system. A better alternative could be to push governments to lower taxes.

- **Real estate and hard assets**

  Negative interest rates are a gift to the wealthy and those with access to borrowing facilities. Money will flow into equities and hard assets such as real estate, gold, art and collectables. But a large percentage of the population does not have access to credit. This segment will only see their pension plans decline in value. Retirees who depend on income from their savings would suffer. Staying on this path for too long could lead to social unrest and political turmoil.

- **Hong Kong**

  The Hong Kong government finally gave in to one of the five demands of the protesters (by formally withdrawing the proposed extradition bill) but it may be too little too late. GDP declined in Q2 (-0.4% compared to Q1) and Hong Kong will most likely enter a recession after Q3 - the first in a decade. Tourist arrivals dropped by 40% in August compared to a year ago as mainland visitors (who account for 80% of tourist arrivals) avoided the city citing safety concerns. Retail, restaurants and hotels are all suffering. Banks have issued unprecedented profit warnings with several listings delayed (e.g. Alibaba has put its USD 15 billion Hong Kong listing on hold). Even the Hong Kong Tennis Open has been postponed as the organizers could not ensure a smooth running of the event. The protests have brought underlying social issues such as housing, education and the lack of opportunity for youth to the forefront. Housing is simply too expensive and completely disconnected with salaries. These issues would take years to resolve. With the additional pressure of the U.S. – China trade war, Hong Kong is facing a financial and existential crisis.

- **Argentina**

  Courageous investors might argue that Argentina offers a great value opportunity. Supposedly the likely new president Alberto Fernandez understands the precarious situation his country is in particular the importance of foreign investment to a recovery for the beaten-up economy of his country. However, talk is cheap and he is not in charge yet. Besides the choice of former Peronist president Cristina de Kirchner as Vice President does not instill confidence. Hence there is no glory in getting involved in Argentina.