Investing in Value & Values.

To:	CIIM Co-Investors only	**Memo**
From:	Stefan Riesen, CFA	
Date:	01 June 2023	
Subject:	**The big picture: Feather Strokes**	

In times of crisis, people's need for protection increases, especially as the intervals between crises become ever shorter and more intense. The bursting of the Internet Bubble, the Great Financial Crisis, the Euro Crisis, Corona, the Russia-Ukraine War, inflation, energy shortages and now the slowdown of the economy. And each time the state is asked for help. The flip side of the coin: "…Spirits that I have called, I can't get rid of at all…"

In the Sorcerer's Apprentice of 1797, Johann Wolfgang Goethe already recorded:

"… Off they run, till wet and wetter
hall and steps immersed are lying.
What a flood that naught can fetter!
Lord and master, hear me crying! -
Ah, here comes the master!.
Sir, my need is sore.
Spirits that I have called
I can't get rid of at all…"

What has happened?

People are becoming more thin-hearted and the recurring calls for the state may be understandable. But this comes at the price of a dependent rather than free market economy and the redistribution of power, in the sense of a dependence of citizens, within a state. Once this has shifted in favour of politics, it is reluctant to let the power it has gained be taken away again.

When push comes to shove, shareholders, bondholders, central banks and even competition commissions have little or nothing to say. Whether they were Silicon Valley Bank, Repbulic National Bank, Signature Bank or Credit Suisse, they were all "persuaded" by politicians to take over or be taken over.

When UBS ran into trouble in 2008 because of bad speculations in low-quality mortgages in the USA, it was still a matter of course that the largest Swiss bank was supported with loans amounting to 60bln dollars. In 2023, Credit Suisse will not be granted the same right. The risks are too great, according to Bern.

Interesting. 259bln francs in guarantees from the Swiss National Bank and the federal government are supposed to represent only a marginal risk for the Swiss taxpayer. Do the math! Switzerland booked government revenues in the order of 157bln francs in 2021. Thus, the politicians in Bern created a giant with the new UBS.

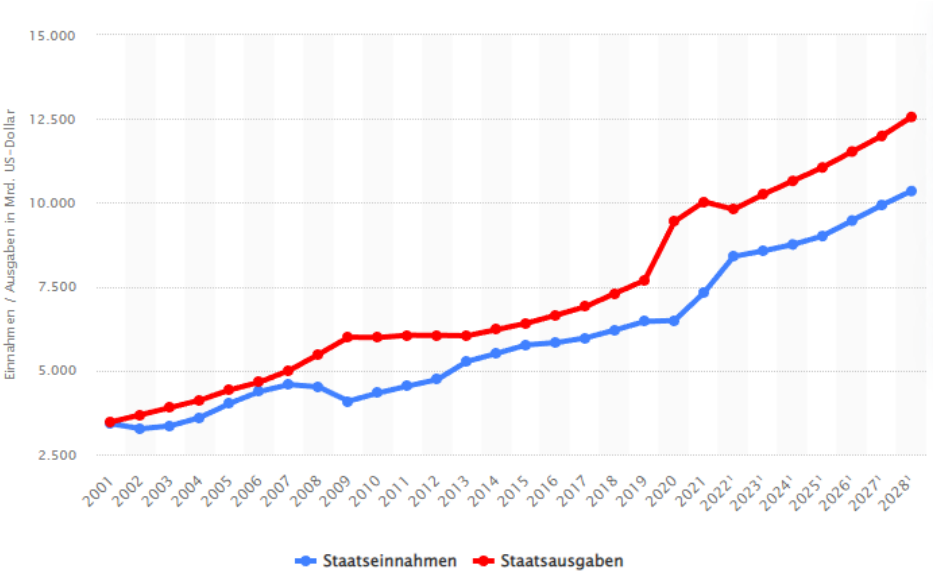
Politics has decided. Politics has spoken. Politics has taken sovereignty over the capital markets.

More feather strokes to follow

The escalating global sovereign debt is pushing the global financial system to its limits. The more this debt is covered by government guarantees or government debt, the more vehemently the influence on monetary policy, i.e. on the money supply, interest rates, inflation and the growth of gross domestic product, is shifted from the central bank to the government.

Conceivable pen strokes are, for example, to steer targeted investment decisions by the state, i.e. to oblige institutional investors such as banks to make certain investments (see Credit Suisse/UBS). It is also conceivable, irrespective of the real return, that insurance companies and pension funds will one day be forced to invest in mandatory bonds.

Graph 1: USA: Government revenues and expenditures from 2001 - 2022 and forecasts to 2028

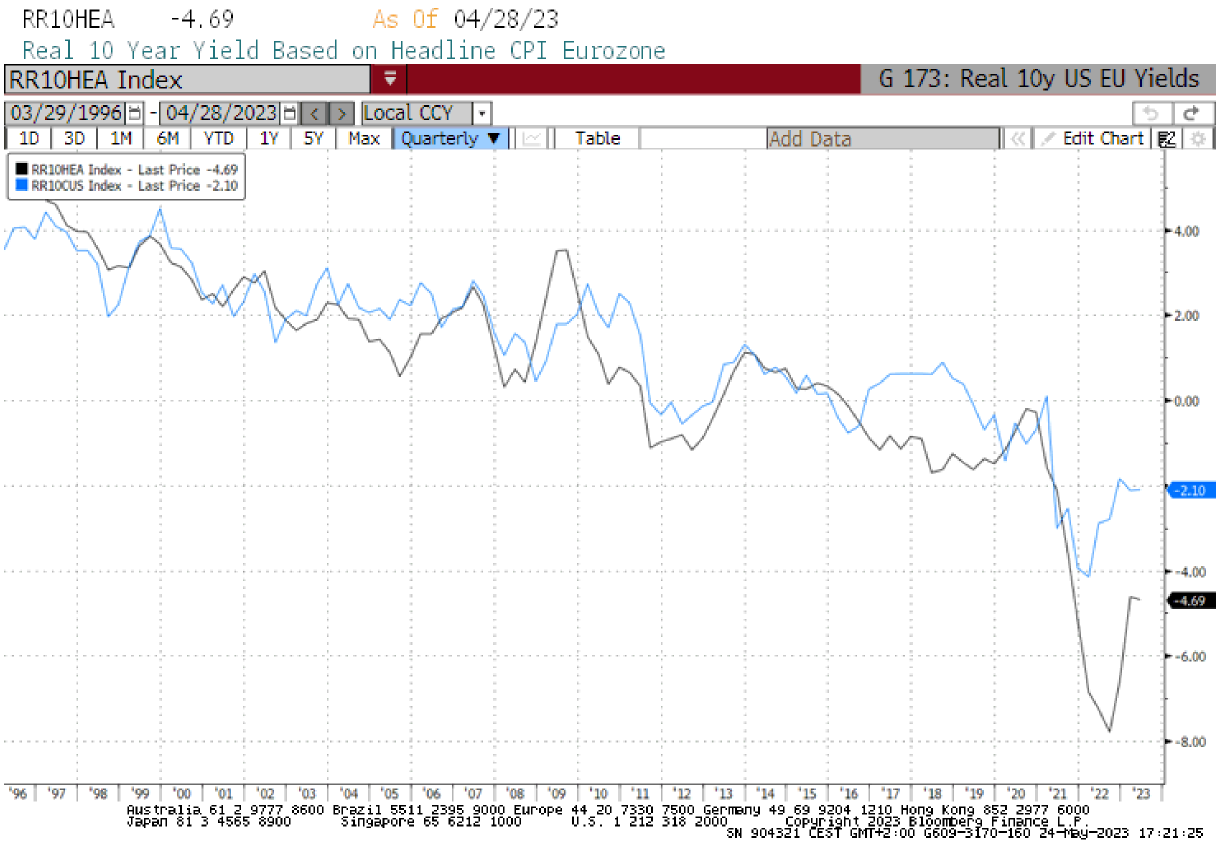


The only thing that will help, is a negative real interest rate to limit the debt burden. For this to be reduced, we need a minimum level of inflation that constantly gnaws away at the mountain of debt.

Over the last 12 months alone, the US has had to pay 853bln dollars in interest on its 31tln dollars debt. With estimated government revenues of 8.6tln dollars, this is a good 10% trend ascending.

It is also in full swing (see **Graph 2** USA blue line, Eurozone black line) and is not entirely inconvenient for policymakers, as it brings some calm to the game in addition to debt reduction, so that the debt bubble will not burst immediately. However, should real interest rates turn positive at some point, the debt burden and its interest payments will sooner or later drift into the unbearable and a monetary reform is imminent.

Graph 2



Debt ceiling discussion

Negotiations in the US on the debt ceiling were particularly tough this time. The U.S. Parliament was playing with fire, because a prolonged default would have resulted in a downgrade of the credit rating and thus higher interest costs. In the run-up, the Fitch Rating agency put the AAA for long-term government bonds in foreign currencies on the "watch list". The costs of default insurance, so-called CDS, rose accordingly for the USA. After Italy and Greece, the U.S. had to pay the third-highest premiums.

If the default had occurred, the White House in particular would have suffered the consequences. After all, the president will be elected or re-elected in the United States in just under 18 months. Therefore, Joe Biden cannot be blamed for doing everything he could to avoid a default.

Inflation & interest

2/3 of GDP in the western industrialized countries is determined by consumers. If they are able to consume less next fall due to higher inflation, higher interest rates and rising unemployment, the elections in the states will become a complete failure for the incumbent president. Since the state is also heavily involved in monetary policy in America, it can be assumed that interest rates will not be raised to infinity before the presidential elections.

The ECB's focus is primarily on the debt policies of European countries. Inflation seems to play a less central role. On the contrary, a negative real interest rate will help highly indebted countries such as France, Italy, Spain, Portugal, and Greece to keep their debt mountain in check. Therefore, an aggressive interest rate policy in Europe would be surprising.

Macro

Economic indicators such as the PMI composite (USA: 54.5; euro zone: 53.3) point to an expansion. The PMIs for manufacturers, on the other hand, are clearly depressed, having been below the growth threshold in the US since November and in the Eurozone since July of last year.

Another very reliable indicator for determining economic momentum, the yield curve, has inverted in both the United States and the Euro area.

These are all strong signs that the global economy is in a downturn.

Conclusion

The inflation target of 2%, as recently targeted by the central banks, is out of reach; the inflationary forces are too high. These are the

- Demographics of the Western industrial world
- Decarbonization
- Deglobalization
- Deleveraging

With the old conventional acquired character trait to repay debts cannot win an election today, nor is it capable of raising poll ratings. That's why debt relief, provided the citizen acceptance, will only be realisable through inflation. In other words, **inflation is here to stay.**

Accordingly, high nominal but low real interest rates are to be expected. Assets will lose purchas-ing power. This must be protected by investing in tangible assets such as equities.

However, should the capital markets one day resist the negative real interest rates and demand higher real interest rates, **currency reform will inevitably occur.** In such a scenario, diversification into investments in Swiss francs as well as gold should be considered as a preparation. **We will therefore offer the CIIM European Stock Portfolio Fund additionally currency-hedged in Swiss francs as of July this year.**

Schaan, 1 June 2023/sr