KATHREIN
PRIVATBANK

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A ghost is hunting

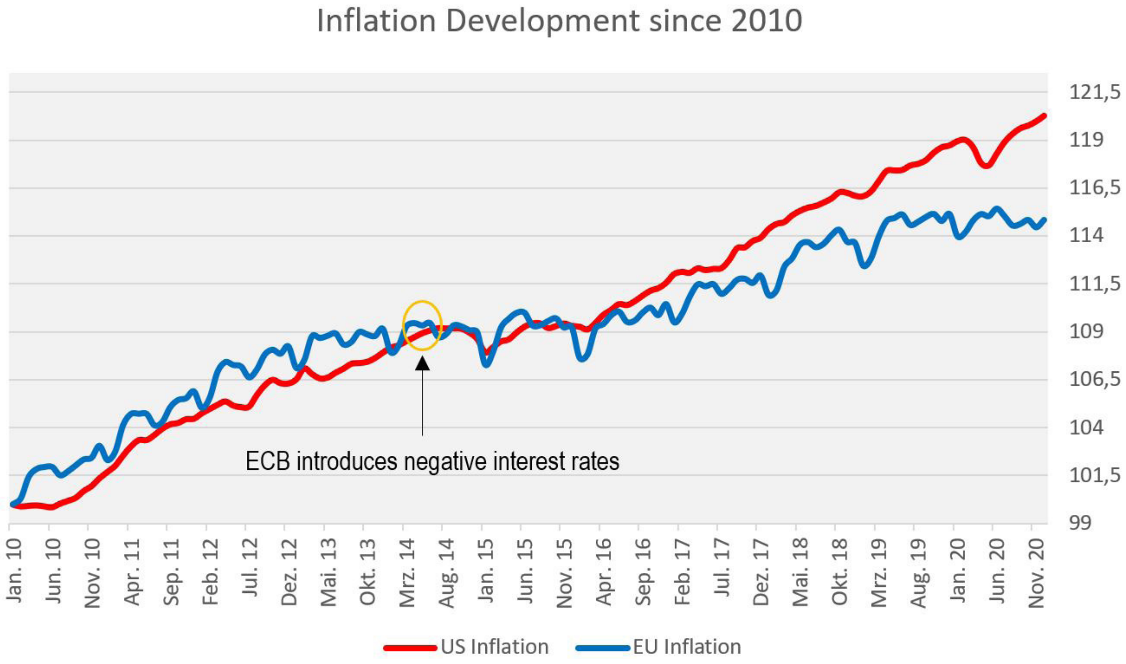
We humans are getting stronger and stronger. Twenty years ago, it took two adults to carry a ten-dollar purchase. Today, a five-year-old child can do it.

A modified quote from Henny Youngman- taken from:
„The Intelligent Investor" by Benjamin Graham (2006).

The specter of inflation is once again haunting the markets. Although the financial markets continued the rally of the previous quarter at the beginning of the year, there have been some setbacks on the stock markets in recent days. Higher volatility and nervous investors are fueling shifts into supposedly „inflation-proof" asset classes, sometimes ignoring general trends and fundamental valuations.

What does inflation actually mean?

Basically, it means nothing more than an increase in the average price level, which is often expressed as the annual rate of increase (inflation rate) of commodity prices. The most common ways of measuring inflation are the Consumer Price Index (CPI) and the Purchasing Price



Source: Kathrein Privatbank and Thomson Reuters
The data were calculated back to the starting point of January 15, 2010 and begin at a starting value of 100. The development extends to January 15, 2021, resulting in an overall performance of 20.26% for the USA and 14.83% for the EU.

Index (PPI). The indices are nothing more than baskets of goods that are modified and updated over time to reflect changes in technology and consumption and production patterns.

Should I be worried about high inflation?

In Europe and the U.S., the ECB and Fed central banks have committed to an annual price increase of 2%. The annual rate of increase measured since 2010 would be about 1.85% for the US and 1.40% for the Eurozone. This means that the target was missed by around 60 basis points in the euro zone. Currently, one can generally speak of a very low inflation level.

From an economic theory point of view, the current low interest rate environment would further fuel inflation, as low interest rates lead to higher consumer demand and thus the general price level would rise as expected. So far, however, the low or negative interest rate environment that has prevailed for more than six years in the U.S.A. and the euro area has not led to any notable change in the inflation rate. Indeed, it is not only low interest rates that are important, but also that money enters the economic cycle via lending. However, due to a number of factors (including tighter regulatory requirements), this is not happening to a sufficient extent to drive inflation up on a sustained basis.

But why are concerns about a sudden rise in inflation mounting?

Government support programs include measures that directly supply liquidity to the economic cycle (e.g. aid checks directly to the population), which, coupled with an economic recovery in the medium term once lockdowns are finally a thing of the past and the economic engine is running at

pre-crisis levels again, could lead to a rise in inflation. However, the generally low level of output does not suggest that inflation will pick up rapidly at the moment.
A study by our partner Ned Davis Research shows that energy stocks in particular, but also producers in the automotive industry or media companies, have repeatedly been among the winners in times of high inflation over the past five decades. In seven of nine instances of high inflation since 1972, the energy sector outperformed the S&P 500 by a median of 14 percentage points, the study found.
In addition, value stocks companies that typically trade at relatively cheap valuations - tend to do better when inflation is high.

Our Kathrein Ad-Hoc message later this week will tell you how to invest successfully despite heightened inflation expectations.

Why rising inflation rates lead to price losses of stocks and bonds

From a financial mathematics perspective, investments are usually valued using the discounted cash flow (DCF) method. In this way, the value of an investment is calculated on the basis of expected future cash flows (cash flows such as interest or dividend payments), whereby these cash flows are discounted. Thus, one tries to determine the present value of an investment (present value).

A payment of 101 Euro in one year has a present value today of 100 Euro, if the annual interest rate is 1%. In other words, if I invest 100 euros today, I will get 101 euros out in one year. If the annual interest rate rises to 10% (e.g. because the central banks raise interest rates due to inflation fears), the payment of 101 euros in one year today is still worth about 90.9 euros. In other words, future payments (interest or dividend payments) lose value in purely mathematical terms, since capital can be invested at a higher interest rate today.

The result is lower calculated bond and share prices. For fixed-rate bonds, this calculation is accurate in determining the present value of future payments. However, for stocks, lots of other factors enter into it (future cash flows are not fixed). Some companies (e.g. the financial sector) may also benefit from rising interest rates, which is why, as mentioned many times before, a precise analysis of current conditions is necessary.

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The current prospectus as well as the Information for Investors according to § 21 AIFMG and the Key Investor Document (KID) of the funds managed by Kathrein are at your disposal in the valid German version at the web page www.rcm.at and/or www.kathrein.at, or are available free of charge at Kathrein Privatbank Aktiengesellschaft.

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