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# »FischView

## Monthly Update – August 2020

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### Summary


- The balance between positive and negative forces in financial markets and the global economy remains in place for the time being.
- Monetary policy continues to provide strong stimulus for equity and credit markets, offsetting the dangers of a slow global economic recovery. In addition, large government aid packages for the economy and the labour market remain in place worldwide.
- The Covid-19 pandemic continues to spread unchecked. However, the mortality rate is under control in many countries and potential second waves can be better tackled based on previous experience.
- Overall, the situation in stock markets and in the economy remains manageable and justifies a slight increase in risk exposure in certain sectors and countries.
- However, the first major changes in the system are beginning to emerge. For the first time since the outbreak of Covid-19, the US dollar is falling sharply in response to the extremely expansive monetary policy provided by the US Federal Reserve. The price of gold and various industrial metals reflect this as prices soar.
- Subsequently, there is the possibility of a chain-reaction being triggered by the weakness of the US dollar: rising commodity prices could lead to higher inflation expectations, thus reducing the room central banks have to manoeuvre, which will have consequences for financial markets.
- However, the falling dollar and liquid monetary policy should over the short term have a positive impact on markets: the effects of an inflation chain-reaction would only occur over the medium term. Central banks are likely to tolerate a possible inflation overshoot, while the lower exchange rate reduces stresses across emerging markets, enabling them to implement their own monetary policy. This includes, for example, reducing interest rates without devaluing their own currency.

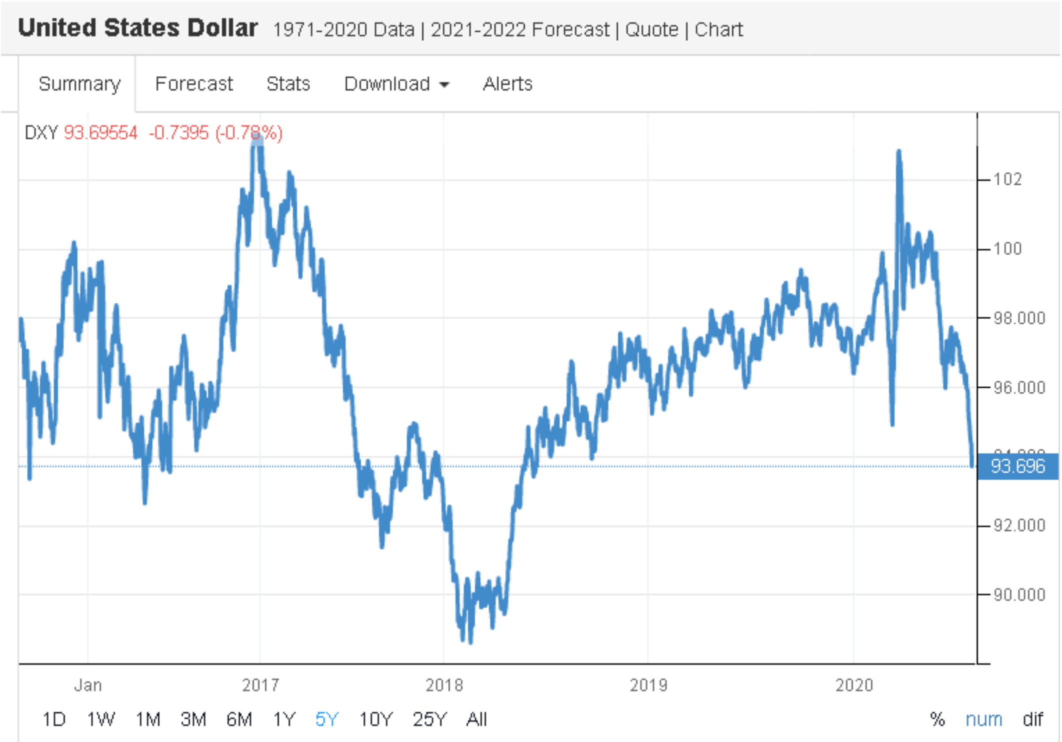
## Highlights and key changes

- The prevailing Goldilocks environment (liquid monetary policy, low inflation and an – albeit relatively weak – economic recovery after the shock) remains in place. In addition, there is a "wall of worry" in the form of a realistic assessment of the situation by many market participants and consumers. Historically, this combination has always provided solid support for equity and credit markets.
- The rather weak economy is also being supported by ongoing large government aid packages. Consequently, many of those unemployed in the US currently have a higher income than in their previous jobs.
- However, a potential change in the current favourable conditions has recently become apparent. The increasingly weak US dollar is the first warning signal that the extremely expansive monetary policy implemented by the US Federal Reserve could – apart from stabilising the economy and raising asset prices – have negative side effects over the medium term. Historically, a weak US dollar has often correlated with rising commodity prices, increasing inflation and rising interest rates. These would restrict central banks' room to manoeuvre.
- However, an immediate negative reaction from financial markets is unlikely at present. Central banks around the world want to see inflation rise to around 2%. Therefore, no change in monetary policy is expected before then. This means that a possible rise in interest rates due to inflationary fears can be prevented through the purchase of government bonds. For the time being, a rise in interest rates on the back of ballooning government debt can also be kept in check.
- Nevertheless, we are following developments closely. The current weakness of the US dollar represents a fundamental change in the reaction of the financial system to monetary policy. Various other risks also continue to persist: the economy is beginning to weaken again after an interim spurt (due to pent-up demand). Meanwhile, financial market valuations have reached very high levels and are detached from fundamentals, plus are heavily dependent on loose monetary policy.
- However, the vaccines that may be made available in the foreseeable future would have a positive impact. Various projects around the world are in the third test phase. Up to 100,000 people are being tested for antibodies. Some of these vaccines have shown promising results in previous tests and are already in mass production.

## Topics on the radar

The US dollar is starting to weaken significantly. Consequently, the US central bank's very expansive monetary policy is beginning to have an impact on the foreign exchange markets for the first time. This is the first sign of a fundamental change in behaviour and indicates the continuing "reflation" of the financial system. No immediate negative consequences are to be expected. In the medium term, however, there is likely to be upward pressure on inflation expectations and interest rates. It is also conceivable that markets will increasingly not only question the extremely loose monetary policy in the US, but also worldwide.

### Chart: US dollar reacts to monetary policy and weakens




Source: Reuters, Eikon

**Please note with regards to the table of asset class preferences:**
In the current fast-changing environment, we have decided not to present the usual table of country and sector preferences. Relatively static information is of limited use as positioning can change quickly. Our current preference has been on debtors whose credit quality is high enough to survive a prolonged recession. We also prefer securities with good market liquidity. However, due to improvements in the indicators we look at, we are increasingly seeking opportunities in challenging sectors with a high recovery potential.

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