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Current fiscal policy positive for value stocks

The government pushes inflation with its extensive public spending programs.
Hans Peter Schupp is a portfolio manager at Fidecum and says this is a buying opportunity for value stocks.

Nowadays, one can easily get the impression of living in a world upside-down. The critics hit out on the ECB from various directions all saying that the central bank should increase interest rates quicker and more aggressively to fight inflation. In fact, the U.S. Fed and the Bank of England have started much earlier to tighten their monetary policies.

In contrast, the ECB has started only in early June to stop their bond buying programs. A first interest rate hike should follow at the next central bank meeting on 21 July. Apparently, a hike of a maximum of 25 basis points is considered. A far cry from the measures taken by the Fed: the U.S. central bank has increased their rates by 75 basis points, up to a range of between 1.5% and 1.75%, the single biggest move since 1994, and the third move this year!

Government support programs undermine monetary policy

Obviously, inflation is (far) too high in Europe and in Germany. Hence, it seems like the first logical step to call for a more restrictive monetary policy. But, with its public spending programs, the government absurdly fights back the ECB's tentative attempts to limit inflation via a slightly more restrictive policy. Be it the 9-Euro-ticket, subsidized petrol prices or subsidies for heating costs – all these measures aim at increasing public demand.

But in fact, demand is not the problem. Indeed, high inflation hits low income households a lot harder than those with a high income as they have to spend most of their money for consumption. However, instead of offering general spending programs which support all consumers equally this would rather call for the idea of a resource re-allocation. But the current government with a minister of finance from the liberal democrats will hardly subscribe to this idea.

The main reason for the high inflation rates is the low level of supply which in turn is a consequence of the interrupted supply chains from Asia and particularly from China. While, for instance, there is still a robust demand for automobiles, supply of vehicles is low. Hence, car producers have cancelled their rebate programs and have effectively increased selling prices with this measure.

Lots of cash in the bank account

During the Covid-pandemic consumers have put a lot of money into their savings accounts as there was little opportunity to spend it like in the old days. Travelling was impossible for some time, restaurants and shops were closed. Today, any extraordinary increase in demand is most likely rather a catch-up effect.

A fine example are flights to the Balearic Islands. Many airlines had simply cancelled flights to the Spanish islands in the Mediterranean as well as to other destinations, particularly as ground service workers had been laid off during the pandemic. As a consequence the more or less normalized regular demand for flights today meets a far too small supply and it becomes quite obvious that many countries, in particular the U.S.A. had provided their citizens with immense support programs which have inflated private savings during the pandemic on top.

Comfortably filled savings accounts in combination with a continuation of governmental spending programs plus a robust demand meet a fairly short supply. One can easily predict that inflation will remain on the elevated level for quite some time. Hence, the discount factor (for future profits) will remain high which is potentially positive for value stocks and less favorable for growth stocks.

Extreme investment bargains

As investors fear that corporate profits will come under pressure value stocks are currently available at absurdly low prices. Salzgitter, for example: The steel manufacturing and trading company expects “lower on average margins in the second half of 2022”. However, the company only lately upped its EBT outlook for FY 2022 from 750-900 m. € to now 1.0-1.2 bn. €.

This should lead to a net profit between 800 m € to 1 bn. € . At a market cap of 1.4 bn € investors could amortize their investment in less than 1.5 years! Against this background it should not be of importance whether future profits are going to be stable or will decrease as those profits are coming on top of the current valuation anyway!

Salzgitter may be an extremely drastic example for a substantially discounted value stock. But it is certainly not the only investment opportunity around. There is a good chance that investors fairly soon will recognize the extreme value bargains in the stock markets due to higher inflation rates.

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