Macroeconomic review, December 2021
Monthly comment for November

Sparinvest

HIGHER RISK AVERSION IN NOVEMBER

Financial markets were dominated by higher risk aversion in November. The coronavirus infection rate was on the rise, taking its toll on Europe, the U.S. and parts of Asia. The new variant, Omicron, caused concern as to whether existing vaccines are effective. The oil price dropped 16% amidst the U.S. decision to release oil from its strategic reserves. Finally, investors started to factor in monetary policy tightening in the U.S.

According to MSCI ACWI, stated in local currencies, global equities were down by 1.7%, or by 0.1% in DKK, in November. Japan and Europe posted the largest decline, and the U.S. the smallest. At sector level, Semiconductors and Hardware stood out positively, whereas Energy and Banks stood out negatively. Credit spreads (i.e. the yield pick-up on investment in a corporate bond relative to a government bond) of European investment grade and high-yield bonds widened by 23bp and 49bp, respectively. As a result, the two asset classes yielded excess returns of -110bp and -140bp, respectively, relative to comparable government bonds. The Danish 10Y government bond yield dropped from 0.15% to -0.05% in November.

Signs of economic stabilisation in the OECD area

Leading indicators have signalled tentative economic stabilisation in the OECD area in November. Thus, the modified ratio between order inflows and inventories in manufacturing in recent months suggests certain signs of stabilisation in November. However, this trend remains subject to negative observations; for example, the component of "expectations 6m", included in a report published by the German ifo Institute, has dropped to the lowest level since February 2021. Conversely, according to the NBS business confidence survey, China saw a minor decline in the ratio between order inflows and inventories in November. According to the confidence survey, the output component rose from 48.4 in October to 52 in November in the wake of the easing of power supply problems. Signs of economic stabilisation are also starting to show in movements in the so-called CESI indices (Citigroup Economic Surprise Indices), which track how economic data are faring compared with expectations. Overall, these indices have lost momentum since mid-June, but rose to zero levels in November, meaning that, today, economic indicators are neither deviating to the positive nor to the negative side of market expectations.

The coronavirus is again spreading across Europe, the U.S. and parts of Asia – now in the form of the mutation strain described above. The authorities' response is well-known, and the current development forebodes more restrictions in the near future. Viewed in isolation, this will put economic momentum under pressure into the new year.

Investment conclusions and asset allocation

This autumn, leading growth indicators have mainly given off signals of peaking global economic growth after this summer's high levels. In terms of growth, levels are not critical in the OECD area, but trends are characterised by a certain slowdown in recent quarters. November's development does not change that radically.

The corona crisis has left a deep mark on economies and the political landscape. Therefore, the current slowdown is characterised by dynamics and expectations untypical of phases like that:

- Supply chains are unbalanced
- Inflation expectations are significantly higher
- Acceleration of monetary tightening

This makes for a larger outcome in terms of economic momentum in the coming quarters. However, generally, recent indicators do not seem to indicate a substantial improvement of supply chains and deliveries in manufacturing. Indicators for response times and prices remain at a high level. Selectively, this will continue the industrial production curb in the time ahead. Also, the notably higher input prices pressure companies to pass on these increases to end prices.

The Fed is seriously starting to question the conclusions drawn in its own economic research published under the common denominator of "transitory". After only a few weeks, the Fed is now withdrawing from its plan to taper the quantitative easing announced at the FOMC (Federal Open Market Committee) meeting on 3 November. The ECB is now free to take the same step. Changes in the economic policy are deemed to be important signals that will affect economic momentum and ultimately the financial market. In the OECD area, the future environment will be less favourable and less predictable in terms of risky and risk-free financial assets. That leaves us with China as the only key economy where a more lenient fiscal and monetary environment may potentially kickstart a period with higher economic momentum.

In aggregate, the above considerations do not speak in favour of any major economic momentum changes – something which in combination with the current corona-induced activity restrictions is deemed to prolong the period with some slowdown. Neither the economic growth factor nor the higher inflation expectations seem to suggest lower risk premiums. The neutral tactical allocation between equities and fixed income is maintained.

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