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RISK APPETITE RETURNED IN DECEMBER

Investors' appetite for risky assets returned in December. Once again, the news flow was dominated by coronavirus. On the negative side, a rising reproduction rate led to the familiar restrictions in society, especially in Europe and Asia. On the positive side, there were some signs that the rising reproduction rate did not put the same strain on the health care sector as it did early in the pandemic. Overall, this gave rise to hopes that the impact on economic momentum would be limited and more short-lived.

According to MSCI ACWI, global equities gained 3.7% in December (stated in local currencies). Converted into DKK the rise was 3.3%. However, the overall rise in the index was driven by developments in returns at sector level that were headed by the defensive segments. The largest increases in December were seen within Health Care, Utilities and Consumer Staples – the smallest within Consumer Discretionary, Energy and Communication Services.

The higher risk appetite was also reflected in returns on interest-bearing assets. In December, 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 narrowed by 12bp and 39bp, respectively, resulting in excess returns of 76bp and 138bp, respectively, for the two asset classes relative to the returns on comparable government bonds. Danish 10Y government bond yields rose marginally from -0.08% to 0.07% in December.

Loss of economic growth momentum in December

Most of the growth-related indicators continued to fall in December. The order components of the Flash PMIs (Purchasing Managers' Index) published recently showed falls in the U.S., Europe and Japan. This extends the period of loss of momentum in order intakes that began in the early summer of 2021. Levels are not critical in terms of growth in the OECD area, but a certain slowdown can be seen in recent quarters.

Corresponding indicators from China point to some degree of stabilisation. Business confidence from NBS showed a marginal increase from 50.1 in November to 50.3 in December. The manufacturing sector is still operating close to its critical level, reflecting stagnation and idle capacity. By Chinese standards, the general economic momentum has fallen to uncomfortable levels. The debt problems in the Chinese real estate sector have persisted for some time now. Data from November show lower activity in the housing market in China, as well as a negative knock-on effect on price developments. For the first time in many years, the housing sector is challenging economic policy in China, and the authorities want to dampen speculative tendencies and also
to halt the accumulation of debt within the sector. Consequently, intervention has so far been on the defensive side, presumably mainly aimed at stabilising developments.

Investment conclusions and asset allocation

The external shock that the corona crisis can be said to constitute has had a strong impact in several areas:

- Supply chains are unbalanced
- Delivery times are record-long
- Prices for commodities, freight rates, intermediate goods, etc have skyrocketed.

It is widely believed that these effects are temporary. Balances will be restored when the virus is eliminated. Naturally, it is acknowledged that the global pandemic has played a major role. However, the last 40

years have also shown that longer delivery times generally tend to go hand in hand with high demand.

Therefore, at the start of 2022, there are extensive imbalances in the global economy because of limitations on the supply side combined with high activity on the demand side. The imbalances are currently so great that in the coming period marginal changes in growth will determine price developments – from commodities to intermediate goods to end-products. In 2022, precisely this circumstance is expected to keep the financial market in the dilemma-filled intersection between growth and inflation that has developed into a complex issue at the levels seen right now. The current slowdown is expected to dampen returns on risky assets – and at the same time, it is expected to cap inflation, inflation expectations and signals of tighter monetary policy. Periods of renewed acceleration in growth are expected to have the opposite effect.

The coming period is not assessed to bring major changes in the economic momentum. But the current corona-related restrictions on activity are deemed to contribute to prolonging the slowdown. Furthermore, the Federal Reserve has just brought forward its monetary tightening. The current growth environment does not generally indicate lower risk premiums. The substantial narrowing of spreads for high-yield bonds seen since Q2/2020 has also had the consequence that this area no longer has the same potential to drive down risk premiums on other risky assets – including equities. The neutral tactical allocation between equities and fixed income is maintained.

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