RENEWED PRESSURE ON RISKY AND RISK-FREE ASSETS IN APRIL

April saw a mix of events and key figures that the financial market was required to take into account. This was particularly true in relation to Russia/Ukraine, covid-19/China and growth/inflation, which, together, put risky as well as risk-free assets under pressure in April.

Global equities lost 6.5% according to MSCI ACWI stated in local currencies, or 3.4% in DKK. Prices dropped the most in the U.S., followed by Japan and Europe. Higher risk aversion (i.e. investor's aversion to take risk without receiving compensation) also fed through to return patterns viewed by sector. Defensive sectors, such as Consumer Staples and Utilities, were outperformers, while cyclical sectors, such as Consumer Discretionaries, Tech and Banks, were underperformers. MSCI World Minimum Volatility yielded an excess return in April of 3.6% relative to MSCI World.

Credit spreads (ie the yield pick-up on investment in a credit bond relative to a government bond) of European corporate bonds widened in April. As a result, the OAS spread (i.e. the yield spread between a government bond and a callable covered bond) of Investment Grade bonds and High Yield bonds rose by 22bp and 51bp, respectively. As a result, the two asset classes yielded excess returns of -102bp and -164bp, respectively, relative to comparable government bonds. The Danish 10Y government bond yield rose from 0.8% to 1.2% in April despite higher risk aversion.

Growth indicators are losing momentum

Confidence indicators generally lost additional momentum in April. This was true for both business and consumer confidence indicators. Recently, this trend has been most pronounced in Europe and China, while the U.S. has proved stronger in relative terms. Naturally, this bears evidence to the fact that the Russia/Ukraine conflict and the covid-19 crisis in particular hit the hardest among the economies most involved.

Signs of loss of economic momentum have been visible since mid-2021. However, overall this has only resulted in a mere drop in the global business confidence in manufacturing from 56 in May 2021 to 53 in March 2022 according to the JPM PMI. The signs of growth have thus changed from extremely strong to moderate, which should be interpreted as neither optimistic nor pessimistic and is typical of a slowdown phase. In recent months, these signs have, however, brought in their trail a fairly large decline in the orders component/inventories component ratio, also in the U.S., leaving the impression that a more broad-based slowdown in demand is feeding through to the build-up of inventories. The impaired ratio is likely to have an adverse effect on industrial production over the summer.

Investment conclusions and asset allocation

There are still many uncertainties linked to the conflict between Russia and Ukraine, which does not seem to be approaching its end, and which therefore continues to affect parts of the commodities market. In the energy area, gas supplies from Russia to Europe have been excluded from sanctions. The tail scenario for the European economy and parts of the energy market has not materialised, but Russia hass gradually escalated sanctions – most recently by decreeing settlement of gas trade in RUB going forward, and not in EUR or USD as agreed under the original contractual terms. The Russian gas company Gazprom has recently announced that it will suspend its gas deliveries to Poland and Bulgaria, citing the two counties' refusal to pay in RUB. If sanctions are implemented, Poland and Bulgaria will be compelled to use own gas reserves or find new sources of supply. The measures described are yet another step towards including Russian gas in the geopolitical conflict, which will bring the development in the energy area closer to a destructive tail scenario.

The conflict has also left its mark on the global food market, and countries in Asia and Latin America have introduced export restrictions on certain agricultural products to protect security of supply. More countries are likely to follow suit. Generally, this leaves a larger bill to be footed. This development will feed through to end-customers' purchasing power or the corporate sector's ability to pay.

With a military stalemate in Ukraine, it could take some time before the conflict reaches its conclusion, which may be an indication that we are looking into yet another period of a prolonged and more pronounced economic slowdown – a slowdown that began in mid-2021. This development is currently spilling over into market expectations for earnings. In recent weeks, the number of downward revisions of ESP have exceeded the number of upward revisions of ESP. This is an early sign that the ESP growth rate is also trending downwards. We cannot rule out an annual growth rate in the 0-5% range if the downward/upward revision ratio does not show a more positive trend.

This points towards favouring continued neutral allocation between equities and bonds. In mid-March, a tactical overweight of Minimum Volatility was established relative to the market at the MSCI World level. Minimum Volatility tends to yield a positive excess return in periods of falling confidence indicators, lower economic momentum and a generally tighter financial environment, see the publication "Overvægt Minimum Volatility".

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