

BROAD-BASED LOSSES IN SEPTEMBER – THE FIRST SIGNS OF SYSTEMIC STRESS

Financial assets were dragged by broad-based losses in September, and both risk-free and risk assets were under fire. In September, financial markets also saw the first signs of stress of a more systemic nature. At end-September, Bank of England (BoE) intervened in the financial market, in response to strong market reactions to the publication of the so-called Mini-Budget ahead of the full Budget. A few days later, UK 30Y government bond yields rose by 1.5pp, and the GBP was down by just over 10% vs the USD. In a buyback operation, BoE will repurchase an unlimited number of long-dated government bonds until 14 October to stabilise pricing of financial assets in the UK.

According to MSCI ACWI, global equities were down 8.4% in September, stated in local currencies. Translated into DKK, this was a decrease of 7.2%. MSCI EM lost by just over 1pp more than MSCI World in September. At sector-level, the more defensive sectors of Health Care and Consumer Staples suffered the lowest return losses, while the highest return losses came from the more interest rate sensitive sectors of Real Estate and Info Tech. Risk premiums on European corporate bonds were on an upward trend in September. Credit spreads (ie 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 25bp and 73bp, respectively, resulting in excess returns of -90bp and -220bp, respectively, for the two asset classes relative to the returns on comparable government bonds. The Danish 10Y government bond yield rose from 1.9% to 2.5% in September.

Economic indicators are negative in Europe and China, but more mixed in the US

Growth-related economic indicators continue on a negative trajectory in Europe. In the region, Germany's exceptionally weak performance should be emphasised. The IFO Expectations Index fell again in September from 80.3 to 75.2, and is now below the lowest level of the financial crisis when it bottomed out at 79.2 in December 2008. Euro area consumer confidence also dropped in September from -26.4 to -29.9. During the financial crisis, European consumer confidence bottomed out at index -20.7 in March 2009.

In China, there are still signs of a certain loss of demand momentum. Domestic and foreign order indicators are not showing clear signs of acceleration. Broadly speaking, the indices are below index 50, indicating a decline in underlying industrial output.

US indicators are more mixed, with business confidence continuing on a downward trend, while consumer confidence indicators are increasing slightly, thanks, among other things, to the drop in US petrol prices.

Investment conclusions and asset allocation

In recent months, the financial market has continued its zigzag path in terms of returns of risk vs risk-free assets. Thus far, this return pattern most resembles the mini cycles of 2011/12 and 2015/16 when periods of moderate loss of economic growth momentum led to periods of converging returns across the risk spectrum. However, the economic and political environment is very different from the aforementioned mini cycles, which has mainly to do with the current synchronised monetary tightening cycle in the OECD area

and parts of Asia, which basically aims to dampen growth and with that the price development. A few weeks ago, Federal Reserves' Jerome Powell stressed the gravity of the situation: "Restoring price stability will require a sustained period of below-trend growth and a weaker labor market". The monetary tightening cycle has a significant, two-pronged impact on the macroeconomic environment expected to play out in coming quarters:

- The short-term tactical momentum will remain weak, and tightening is likely to rule out a significant, sustained increase in the Composite Leading Indicator (the OECD's growth indicator).
- This time around, low growth momentum will last for so long that it may potentially trigger turnarounds in strategic areas, such as job markets and housing markets.

These negative signals on inflation expectations given by leading central banks have once again sent real rates up – after a sharp drop in July. Viewed in isolation, this development is expected to curb the possibility of premiums on risk assets again returning to the low levels seen at the onset of 2022. In this environment, positive returns of equities will be even more dependent on the development in EPS continuing its upward trend. Here, it is worth emphasising that, in recent months, earnings expectations for 2022 and 2023 of S&P500 companies have changed from a positive to a negative trend. This trend is expected to continue because of the economic environment. A defensive asset allocation is generally preferred. Both equities and corporate bonds are underweighted relative to government bonds and covered bonds, see the publication (in Danish): "[Taktisk risikoniveau sænkes](#)". The Minimum Volatility segment within the equity spectrum is overweighted, see [publication](#). The risk of the strategies derives from several factors, relating in part to the economic area, if growth momentum is restored and accelerates in the near future, and in part to the political area, if the current tightening cycle is suddenly replaced by an expansion cycle. However, the likeliness of such an outcome is deemed to be fairly small, especially in the light of recent monetary policy signals that reach into the next couple of months.

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