

# NOVEMBER SAW HIGH RETURNS ACROSS THE RISK SPECTRUM

Almost all financial asset classes delivered high returns in November. This trend is most likely ascribable in part to consumer prices in the U.S. and Europe starting to show lower annual rates of increase in some areas.

Global equities gained 6.3% according to MSCI ACWI in local currencies. Translated into DKK, this was an increase of 3.2% for November. The increases were driven by the development in MSCI EM, which gained 11.7% in local currencies. By comparison, MSCI World climbed 5.7% in November.

Danish 10Y government bond yields fell from 2.5% to 2.1% in November, while 10Y U.S. Treasury yields fell similarly from 4.1% to 3.6%. Thanks to this development, interest-bearing assets delivered solid returns. For example, Danish 5Y government bonds and 5Y-covered bonds yielded a return of 1.7% in November. The favourable development was also seen for corporate bonds. The credit spread (i.e. the yield pick-up on investment in corporate bonds relative to government bonds) of European investment grade and high-yield bonds tightened by 38bp and 73bp, respectively, in November. This resulted in excess returns of 2.3pp and 3.6pp, respectively, for the two asset classes relative to the returns on comparable government bonds.

## **Confidence indicators stabilised in Europe, but continued down in the U.S.**

The extremely low confidence indicators in Europe were slightly up in November, both in terms of business and consumer confidence. This should be seen in the wake of sharply decreasing energy prices since late summer. At the beginning of November, gas and electricity prices had dropped by more than 90% from the peak at end-August. Things have, however, shifted drastically in recent weeks, and now gas and electricity prices are up by more than 400%.

The U.S. witnessed a relatively sharp decline in business confidence – within both the manufacturing and the service sector. According to S&P Global, the Purchasing Manager's Indices (PMIs) are now at index 47.6 and index 46.1, respectively. As for the household sector, the picture was more mixed in November, with consumer confidence rising according to data published by UMich, but declining according to data from the Conference Board.

Chinese data are still strongly affected by yet another large outbreak of the corona virus. The development in November led to extensive lockdowns in central China, including Beijing and Shanghai. The Purchasing Manager's Index (PMI) ranges between 46.5 and 49.5 across the manufacturing and service sector. The recent development in China should be expected to affect global supply chains for some time.

## **Investment conclusions and asset allocation**

In recent quarters, economies and financial markets have been in the process of shifting to a contractive economic policy in order to curb demand and slow down growth. Growth has so far slowed down at a moderate pace, see the publication "[Slow motion](#)". There are incipient signs of a slowdown in the job markets and housing markets in the OECD area, but impacts remain limited. This has given rise to exceptionally volatile return patterns, both for risk and risk-free assets, reflected in high-frequency fluctuations between risk aversion and risk appetite. This is characteristic of a time of crisis.

Despite the moderate economic slowdown in the U.S., the financial market is desperately looking for signs of a so-called "Fed pivot". In the light of the current focus on a "Fed pivot", the U.S. yield curve has flattened strongly since summer, which is a paradox. Given the current yield spread of -0.8pp, the yield curve is at its

most inverse since 1981. The curve indicates that the U.S. is not facing a recession in the near future. The curve steepening of 2001/2007/2020 gave off signals at the time of the impending recessions. In the light of the current curve flattening, it is fair to say that the return ratio between equities and government bonds has not marked a profound turning point – but has rather moved in a highly volatile zigzag pattern since the beginning of the year.

Federal Reserve chair Jerome Powell has recently stressed: *"So, from a risk management standpoint, we want to be sure that we don't make the mistake of either failing to tighten enough, or loosening policy too soon"*. If the Fed opts to follow this message in its future monetary policy intervention measures, the implications will be two-fold: *Firstly*, the key policy rate will continue up in 2023. *Secondly*, monetary tightening will not immediately be replaced by monetary easing. This is in stark contrast to a financial market that is factoring in the beginning of a new monetary easing cycle in H2/2023. A "Fed pivot" has not previously been a signal that led to impending turning points in risk premiums. Following "Fed pivots" in 2001 and 2007, the credit spreads of global high-yield bonds did not peak until 15-18 months later, see the publication (in Danish); "[Fed pivot og kreditspænd](#)".

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 universe, is overweighted, see [publication](#).

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