

NEGATIVE RETURNS ACROSS THE RISK SPECTRUM IN FEBRUARY

All-loss in February as opposed to all-gain in January, driven by the interest rate development in both months. In recent weeks, the financial markets have had renewed doubts about the ability of the major central banks to steer the synchronised monetary tightening cycle into a soft economic landing.

Global equities lost 1.9% in February according to MSCI ACWI stated in local currencies, or 0.4% in DKK. There were wide disparities within the returns for Developed Markets relative to EM. DM equities dropped by 1.6%, while EM equities were down by 4.7% last month, both stated in local currencies. The return patterns at sector level were mixed and showed no clear trend in the returns for cyclical and defensive sectors. Tech/Industrials/Consumer Staples generated the highest returns, and Real Estate/Utilities the lowest.

Credit spreads (ie the yield pick-up on investment in a credit bond relative to a government bond) of European corporate bonds decreased. The changes were -5bp and -24bp of Investment Grade bonds and High Yield bonds, respectively. The two asset classes reached excess returns of 38bp and 123bp, respectively, relative to the returns on comparable government bonds. The Danish 10Y government bond yield rose from 2.5% to 2.9% in February.

Still mixed tendencies in key indicators

According to data from S&P, business confidence indicators for the manufacturing sector declined in Europe and Japan, but rose in the US in February. Overall, this still paints the picture of a weak manufacturing sector in the OECD area, which is characterised by low order components and high inventory components. In China, business confidence rose considerably within the manufacturing sector. This should be seen in light of China's full lifting of corona-related restrictions. In February the services sector showed a

more unambiguously positive trend. It was particularly noteworthy that the US ISM Services index regained the large decline in January. Overall, the key indicators confirm that the demand in the services sectors within OECD continues to generate solid job creation and high inflation.

The business confidence tendencies mentioned above are reflected in consumer confidence within certain areas. Business confidence in Europe has risen in recent months, which should be seen in light of the plunging energy prices in the region. US consumer confidence determined by the Conference Board declined again. Consumers were somewhat more pessimistic about the future purchase of consumer durables, cars and homes. On a positive note, it should be emphasised that household confidence in the US and in Europe was high in terms of a continued favourable job market.

Investment conclusions and asset allocation

As mentioned above, the financial markets have had renewed doubts. Uncertainty lingers over the major central banks' ability to steer the synchronised monetary tightening cycle into a soft economic landing.

This has feed through to the financial market's expectations for the Fed funds terminal rate, which once again have been revised up in the US and in Europe. This follows in the wake of the recent economic indicators, showing a US services sector for which neither job creation nor inflation shows any indications of a soft landing. This is completely in tune with the conclusions from Jerome Powell, who stated after the FOMC meeting in early February:

"... you will not have a sustainable return to 2% inflation in that (core services ex-shelter) sector without a better balance in the labour market".

This message conveyed by the Fed updates its programme for the economic process in the coming quarters. This determines the central banks own criteria for a successful outcome of the tightening cycle. And this includes a reversal in the job market. With higher terminal rates, we anticipate that a possible monetary policy pivot has been further postponed. Overall, the financial conditions have been tightened again. For this reason, it will be difficult to establish a sustainable cyclical upswing as long as the purpose of the economic policy is to curb growth.

Periods of monetary changes are often challenging to investment environments. The financial market is adjusting its expectations. Expectations for S&P500 EPS (+12M) peaked at 238 USD in July 2022 and has been revised down to 224 USD in the course of six months. This should be seen in the light that a cycle in which S&P500 EPS is declining lasts for 15-16 months on average. The downward revisions of EPS (earnings per share) now imply an annual negative growth rate, which is a rare phenomenon. Since 2000, negative annual growth has only occurred three times (excluding corona). In connection with these episodes, the ultimate lowest return for equities relative to bonds has occurred after the negative EPS growth.

Given the prospect of a weak tactical environment, a turning point in the strategic environment and generally reduced liquidity due to quantitative tightening, a defensive allocation of assets is preferred. Both equities and corporate bonds are underweight relative to government bonds/mortgage bonds. In the equity universe, the Minimum Volatility segment is overweight.

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