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RISK APPETITE RETURNED IN JUNE

Optimism among investors was evident in June, when global equity markets saw broad-based increases. All 11 Global Industry Classification Standard sectors (such as Information Technology, Health Care, Real Estate and Communication Services) saw progress with Consumer Discretionary at the top of the return hierarchy, up 9.9%, and Utilities at the bottom, up 2.3%. In June, Information Technology generated a return of 5.7%. Investors were attracted to the sector because of the focus on AI. Overall, MSCI ACWI increased by 5.8% measured in local currencies, while the index increased by 3.1% measured in DKK.

At index level, the European corporate bond market was characterised by major changes in June. Credit spreads, ie the yield pick-up on investment in a credit bond relative to a government bond, decreased. The spread of investment grade bonds fell by 9bp to 166bp, while the spread of high-yield bonds was down by 36bp to 458bp. This meant that investment grade bonds yielded an excess return of 59bp relative to comparable government bonds. The excess return on high-yield bonds amounted to 147bp in June. The Danish 10Y government bond yield increased by 11bp to 2.7% at end-June.

Continued downturn in manufacturing momentum

Recent business confidence indicators in manufacturing once again signal a loss of momentum. Declines are broad-based, as PMIs according to S&P Global show a downturn in Europe, the U.S., the UK and Japan. For all data series, PMIs have again dropped below index 50, which signals a decline in manufacturing output. Recent data from China are mixed. The confidence indicators from NBS and Caixin, respectively, fluctuate around index 50, which can be interpreted as a broadly flat development in manufacturing output now.

The latest business confidence indicators in the services industry indicate that economic momentum has started to peak at relatively solid growth levels. The gap in current economic momentum between the services and the manufacturing sector in the leading economies has not been bigger since 2009, measured by the confidence indicators mentioned above.

Recent inflation data have generally confirmed the tendency for inflation to decline - mainly because of developments in cyclical components, including food and energy prices. Core inflation, on the other hand, appears to remain sticky. Core inflation in the U.S. and Europe is at 5-5.5%, while it has risen to just under 7% in the UK. These inflation levels are still extremely far from central bank targets.

Investment conclusions and asset allocation

Market expectations have shifted again. Major central banks will not be lowering key policy rates in H2/2023 after all. On the contrary, announcements from the Federal Reserve, the ECB and BoE now clearly show that monetary tightening will continue after the summer. This happens at a time when investor optimism has once again moved to the peak of its zigzag path since early 2022.

Since 2021, the OECD economies have been in a late-cycle position, which is in many ways classic. Job markets have reached capacity. The idle capacity in the labour market is so modest that it is unable to meet labour demand. This imbalance has caused wage inflation in many countries to increase to the highest levels in several decades. As long as the above-mentioned capacity issues in the job markets remain unsolved, it will be difficult to transition to a new "mini-cycle" with a related economic upswing.

With the prospects of key policy rates characterised by "higher for longer", banks are most likely to maintain tight credit conditions. During such conditions, households and businesses will hold back on borrowing. Key indicators suggest that the economic momentum is likely to moderate further in the coming quarters. Against this backdrop, a transition to a new long-term upswing and thus a new "mini-cycle" is not very likely in the near future.

The tactical asset allocation stems from expectations of short-term economic momentum – but the prospect of an imminent turning point in the job market means that for the first time in around 15 years, the strategic environment provides a strategically negative backdrop for risky assets. The U.S. job market has reached its maximum. Job openings have decreased by 16% since their peak in June 2022. Since then, earnings among U.S. companies have been in recession. The negative earnings trend is expected to continue as the job market eases. Current risk premiums are low. Short-term U.S. yields have risen to 5.25%, which is in line with the earnings yield of S&P500 and the yield of U.S. IG bonds, see the publication "Low unemployment = low premiums".

The scenario outlined and current premiums result in a risk/reward ratio with an allocation preference for risk-free assets. Equities and corporate bonds are underweighted relative to government bonds/mortgage bonds. In the equity universe, we overweight the Minimum Volatility segment.

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