Handelsbanken
Asset Management

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Strategy Review

Key takeaways

Ongoing positivity around vaccine programmes should lead to economic reopening in the second half of the year

Investors have signalled some concerns about the impact of inflation on central bank policy, but near-term inflation rises are likely to be transient

Central banks will maintain their supportive stances in order to support the economic recovery

Alongside continuing government stimulus programmes, this is good news for financial assets

We remain comfortable with the risk levels currently in place across our strategies

Since early 2020, it has been impossible to begin any economic or investment update without a nod to the COVID-19 pandemic. Fortunately, developments in the global vaccine rollout mean that such references are now able to contain a note of optimism.

While vaccine programmes in some areas of the world still look unconvincing, including our mainland European neighbours, for the most part we are now seeing early evidence that the leading vaccines are proving to be both safe and effective. Studies at home and overseas (especially in Israel, which has long led the pack in vaccinating its population) support the notion that vaccines are materially improving the immune defences of recipients. Importantly, these studies point to lower rates of both hospitalisations and COVID-19-linked deaths.

Global growth and economic reopening

As positivity around the vaccine rollout continues, this should lead to ongoing economic reopening. While this is likely to be a story that will emerge more fully in the second half of 2021, a number of economic indicators are already painting a picture of economic recovery.

Thus far, signs of improvement have largely and logically originated in manufacturing, with the US manufacturing sector recently posting one of its strongest readings since February 2018. Air freight and cargo data are now back to pre-pandemic levels too. As production continues to come back online, a restocking story is likely to emerge as inventories are rebuilt, further supporting economic revival. Services sectors, which have been recovering more slowly, should see a boost as economies reopen around the world.

In keeping with an improving outlook, company share prices in sectors benefitting from a ‘stay at home’ world, for example online entertainment, have begun to give up some of their 2020 gains, while interest in businesses in ‘go outside’ sectors has begun to pick up. This includes the energy sector, which has enjoyed a forceful start to 2021.

Meanwhile, President Biden’s $1.9trn stimulus package is moving into law as we write, and will provide a boost to US household incomes. It is worth noting that, in what has been a truly unusual recession, total personal incomes in the US have actually increased during the pandemic rather than falling (see chart overleaf). This is due to the remarkable levels of economic support from policymakers, including employment protection programmes spanning the Trump and Biden administrations.

This is not just a US story: while the impact of COVID-19 has certainly been economically devastating to many, overall saving rates in developed economies exploded at the height of the pandemic. As economies begin to reopen, we expect some of these pent up savings to be further deployed, providing an additional boost to economic growth.

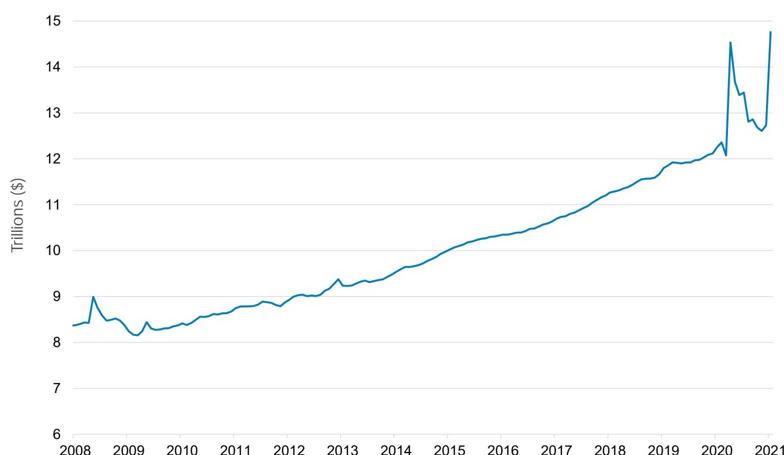
Financial markets have been buffeted by inflation fears

In a classic case of good news spelling bad news, in the opening months of 2021, concerns have grown that the ongoing economic recovery could stoke inflation, which could in turn lead to reduced support from major central banks. This has resulted in some turbulence throughout traditional financial markets.

This is because the risks to financial assets from inflation do not necessarily emerge with the spectre of higher inflation itself, but with the news that central

Total personal incomes in the US have increased during the pandemic

US total personal incomes (including government support)



Source: Macrobond.

Past performance is not a reliable indicator of future results.

banks intend to act in order to halt rising inflation. The latest rhetoric from leading central bankers is clear: they have no plans to imminently taper their support levels. As a result, while not wholly beyond the realms of possibility, in our opinion a full blown 'taper tantrum' (i.e. a panicked investor response to a reduction in central bank support) remains improbable in the near term.

Nevertheless, we acknowledge that inflation is likely to head upwards in the near term, driven higher by improving demand for goods which will lead to short-term pricing pressures. However, we believe that this pickup in inflation will be transitory and is set to fade over the medium term. For now, we can expect some volatility in financial markets as some investors move to reposition themselves. A fresh wave of economic stimulus via Biden's support package will likely add to this inflation story in the immediate future, but longer-term analysis does not show a consistent link between increased government deficits and sustained inflation.

Importantly, for now, the bigger concern for central bankers is not inflation but wider economic health in the wake of the pandemic. The labour market is a particular concern for the US central bank, with US unemployment levels still high at 6.2% (February data). It is perhaps worth noting that wage-related inflation is actively falling in the US. Overall, our view of the long-term inflation picture remains unchanged versus our view in 2020, and inflation does not currently factor significantly into our investment decisions.

Under the bonnet in our portfolios

A year on from the stock market lows of March 2020, a combination of vaccine rollouts and ongoing government support around the world continues to support the health of the world population, economic growth and financial assets.

At present, we have no plans for meaningful change in the balance of risk within our portfolios. In practice, this means maintaining our slight overweight to those assets intended to drive financial returns versus those designed to diversify risk.

Backing the switch to clean energy

Transitioning to clean energy is set to be something of a megatrend over the coming decades, and one which our various strategies are interested in.

Besides the obvious advantages for the planet in sustainability terms, this shift will also create huge investment opportunities as large amounts of private capital will be required to support public policy and climate goals.

At the most basic level, new energy transition is a shift from oil and gas to electricity. However, this shift will have broader ramifications than simply energy production, creating a large investable opportunity.

Maintaining our debt market positions

Despite apparent investor concerns to the contrary, central banks have confirmed that they have no near-term plans to withdraw the current generous liquidity conditions. Indeed, they are committed to looking through near-term inflation noise in order to support economic recovery.

This should be supportive for bond markets, and we have no plans for material changes in either our government or corporate bond positions.

Upholding conviction in our creative return drivers

We also maintain high conviction in our creative 'return drivers', such as our positions in music royalties and social housing.

Market moves in these areas appear uncorrelated to those in wider financial markets, creating compelling variety among the assets we hold for the purpose of generating returns.

Some of these alternative asset types can also offer attractive payouts to their holders, which we believe is especially valuable in a broadly low-yield world.

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