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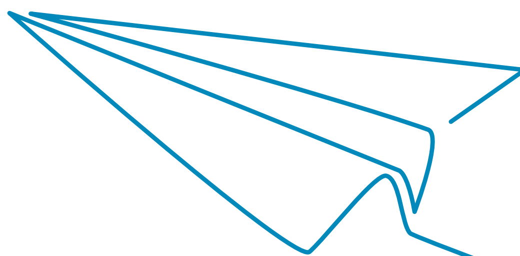
Handelsbanken
Wealth & Asset Management



Strategy Update

Taking a closer look at the landscape for financial markets, and what this means for our investment strategies

Key takeaways

Economic downturn has been a long time coming, but we anticipate that this is on the cards for late 2023 or early 2024

US employment markets remain extremely strong, but there are early signs of change, which the US central bank will be watching very closely

Stock market prices are yet to signal an impending economic slowdown, but we believe this must change as the year progresses

We continue to see better relative value in bond markets versus stock markets

We maintain the defensive mix of assets held in your investment strategies

It's been a very strange few years for the global economy. As well as the human costs of the COVID-19 pandemic, the crisis had an immediate economic effect on consumer spending and employment markets. Consumers were instructed to stay at home, and businesses struggled to maintain their payrolls, meaning that global economic growth took an extremely sharp hit. However, high levels of government intervention (such as wage support schemes) enacted across major developed economies allowed the economy to bounce back in record time – staving off the otherwise inevitable prolonged recession.

Government intervention like this, though, cannot take place without unintended consequences. When consumers were released from lockdown, they re-entered the marketplace brandishing significant sums of excess savings built up during their time at home. This helped to boost economic activity during what could otherwise have proven to be a much more challenging time for economic growth. Unfortunately, alongside supply chain issues, an energy crisis, and the war in Ukraine, it also allowed inflation to ramp up dramatically.

Since early 2022, central banks across developed economies have been attempting to get a handle on this runaway inflation, raising interest rates – sharply, and in quick succession – in an effort to slow down economic activity and reduce demand for goods and services. There are early signs that this is beginning to work. However, just as economic support programmes at the height of the pandemic crisis had lasting consequences for the global economy, the battle against inflation has not happened in isolation. As the ripple effects of higher interest rates take hold, we believe we are approaching a tipping point where a downturn is increasingly unavoidable.

What signals of slowdown can we see today?

We are always watching the global economy closely, looking for signals as to what comes next. In the US – the world's largest and most influential economy – consumers account for the overwhelming majority of economic activity, and by now, they've just about run out of their lockdown cash. We're already seeing signs of knock-on effect for consumer behaviour in the latest cooling (though still elevated) US inflation numbers. By the start of next year, consumers in the majority of other developed economies are also expected to have used up all their spare lockdown savings.

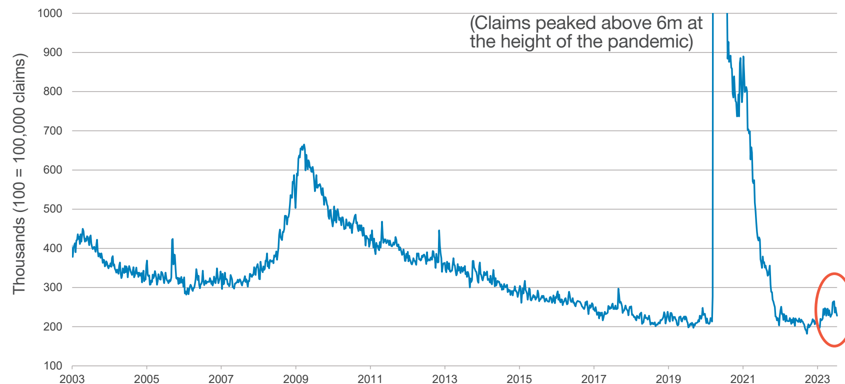
We've been keenly watching US employment markets too. Despite the best efforts of the US central bank to engineer a period of lower economic activity, employment levels have remained stubbornly high, to a point where employers have struggled to find freely available workers to fill new job openings. However, we believe we are seeing the beginnings of change, with new jobless benefit claims beginning to rise (albeit from very low levels). A rise in the unemployment rate may seem like a strange thing for the US central bank to welcome, but this could be a critical signal in their efforts to slow down economic activity in order to control inflation. We will be keeping a close eye on any further developments.

Due to their extremely fast-paced nature, financial markets are also an intriguing place to look for signals about the global economy (although it's worth remembering that moves in financial markets simply reflect consensus opinions among investors as a group). At the moment, stock market prices do not show signs of predicting an impending slowdown, but we believe this will change as we

move through the second half of the year. In bond markets, signals from areas like corporate debt are already showing some signs of strain.

New claims for unemployment benefits in the US have begun to inch upwards, albeit from a very low base

US initial jobless claims (seasonally adjusted)



Source: Macrobond and National Sources

When do we expect economic slowdown to begin?

Predicting periods of economic slowdown is a notoriously inexact science. History can offer us some hints, but is a rather unreliable guide.

Nevertheless, we can state with some confidence that the actions of central banks have a delayed impact on the global economy, typically taking around 18 months to fully make their presence known. Given that the first interest rate hikes (this time around) took place in early/mid-2022 in most developing economies, the full effect of these hikes should hit home in the coming months. As a result, our best guess is for a period of economic downturn to begin in late 2023/early 2024.

What does this mean for our investment strategies?

Over the past few months, we have adjusted the mix of assets held in your investment strategies to reflect our view that a period of slower economic growth is on the way. In practice, this has meant taking a slight step back from riskier asset types like shares and 'alternative' assets (i.e. assets beyond traditional bond and stock markets), and increasing positions in selective areas of bond markets, where we see better opportunities for the environment ahead.

On the right, we have highlighted some of the key convictions currently at work in our investment strategies.

Finding appealing opportunities in government bonds

Central banks in developed economies have made it clear that they are determined to bring inflation to heel, despite the inevitable cost to economic growth. This points to a favourable backdrop for longer-dated government bonds.

In recent months, we have adjusted our government bond holdings, increasing 'duration' (the responsiveness of a bond's price to interest rate changes), and reducing exposure to high-yielding, higher risk corporate bonds. In doing so, we've taken advantage of currently lower bond prices.

Remaining cautious about stock market valuations

We still believe that share price valuations remain unduly elevated, based on overly optimistic predictions for company earnings this year. Given the weaker economic outlook, we think earnings will struggle to meet market expectations for earnings.

Against this backdrop, bond markets look more attractive, and for the first time in a long time are providing a real alternative to stock markets for investors.

Maintaining our preference for small and mid-size businesses

Stock market performance has been heavily distorted this year, as shares in a tiny number of companies (technology giants) has accounted for a huge proportion of US stock market performance.

Nevertheless, we retain our preference for the shares of smaller and mid-sized businesses versus their larger counterparts. So far this year, this has not been fully rewarded, but our preference for the technology sector, and our limited exposure to energy shares, has been helpful.

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