Handelsbanken
Asset Management

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Strategy Review

Key takeaways

We still see signs of positive economic momentum in the global economy, but the pace of growth appears to be slowing

Inflationary pressures have taken financial markets by surprise, but we continue to believe that pricing pressures will fade as economies normalise and supply chain issues are resolved

Central banks are poised to step back from some of their emergency economic stimulus measures

The pandemic picture looks relatively stable, with new tools emerging in the fight against the effects of the COVID-19 virus

As the COP26 event draws to a close, sustainable investment options are likely to come ever more under the spotlight

As we enter the final weeks of 2021, global economic momentum remains positive. We continue to believe that we are now likely to be beyond the 'easy' part of the COVID-19 recovery in economic terms, and are already moving on to the next phase of the cycle. In this phase, growth – while still positive – typically begins to ease off. In practical terms, this means that economic growth is set to remain robust, but is likely to be somewhat lower than in the initial phases of the COVID-19 recovery.

Inflation is distracting, but should be transitory

Economies continue to find their feet in the wake of the pandemic-induced shock, and inflation has taken investors by surprise in 2021, boosted by a range of factors from supply chain issues to commodity price rises. From this point, we believe that inflationary pressures are likely to remain elevated for a short period, but that as supply chains rebalance and economies normalise, these pricing pressures should prove to be temporary.

Taking a look at US data, inflation is already showing some signs of falling back in those areas most sensitive to economic reopening. This includes prices for airfares and used vehicles. Shipping costs also appear to have peaked – a positive step towards resolving the supply chain issues which have been well-publicised throughout the year.

Nevertheless, risks remain, and we are closely monitoring critical areas such as US rental costs (which make up a third of the basket of goods used to create US inflation data) as well as changes in wage levels. However, investors should note that the key risks to financials assets emerge not with the spectre of higher inflation itself, but when central banks make it clear that they are willing to act in order to stop inflation in its tracks. At the time of writing, no major developed world central bank has hiked interest rates in response to higher inflation, suggesting that most of the globe's key policymakers remain relatively unconcerned by inflationary pressures.

Financial markets are braced for a reduction in central bank support

Over the coming months, financial markets increasingly expect central banks to ease back on their ultra-supportive policies, in response to encouraging economic data. This makes sense: these policies (a multitude of variations on low interest rates and new spending) were emergency measures, intended to cushion against the sharp drop in economic activity engendered by the COVID-19 pandemic. With the economic troughs of the crisis behind us, and economic recovery well underway, it makes sense that these policies would now be unwound.

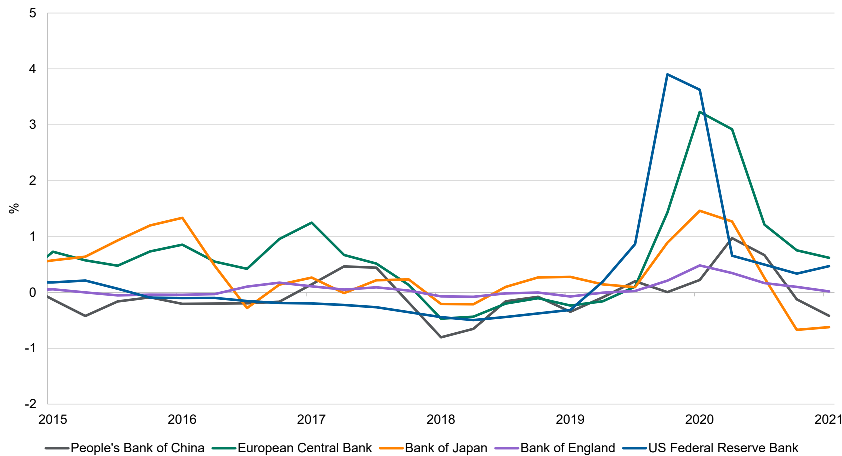
The narrative from central banks has shifted accordingly, though support is unlikely to be removed quickly, or without warning. Indeed, the Bank of England may have surprised everyone by sidestepping an interest rate rise at their November meeting, but has certainly laid the groundwork for rate hikes in the coming weeks. Similarly, investors anticipate multiple interest rate increases from the US Federal Reserve Bank (Fed) in 2022.

Of course, interest rates are just one aspect of the highly accommodative policy stance enacted by the world's leading central bankers: the expansion of balance sheets (i.e. spending to support financial markets or the economy more directly) is another. Growth in central bank balance sheets is also ready slowing dramatically, particularly among the highest spenders, like the People's Bank of

China (China's central bank). In the US, the Fed has a dual mandate – unlike the Bank of England, it is charged with managing not only inflation levels but also responding to employment markets – which could mean that it holds out for a little longer than its international peers as it waits for broad-based improvement in employment data.

Growth in central bank balance sheets is slowing dramatically

6 month change in balance sheets as a perentage of GDP



Source: Macrobond, Bloomberg, national sources.

New weapons in the fight against COVID-19

For almost two years, it has been impossible to talk about the economic and financial market landscape without making reference to the COVID-19 pandemic. For now, the picture looks relatively stable: confirmed new cases and deaths are marginally rising at a global level, but remain some way below their prior peaks.

Vaccines continue to prove their worth as safe and effective tools in the management of the pandemic, and a potential new addition to the toolkit may also have emerged in the form of a new anti-viral drug from Pfizer, which has proven to be highly effective in trials on high-risk patients. If approved by healthcare regulators, new tools like this could help to further ease the strain on hospitals and healthcare systems, as well as lessening the chances of additional lockdown measures being introduced.

Such progress remains crucial, as politicians across the world continue to face the challenges of reopening their economies amid an increasingly mature pandemic. At present, authorities in China continue to lock down local areas at the first sign of any new COVID-19 cases. This comes in stark contrast to the UK approach, which is focused on ongoing economic reopening. In the US and EU, policies for managing the pandemic vary from state to state and nation to nation respectively.

Under the bonnet in our investment strategies

In the middle of 2021, we modestly trimmed some risk across our investment strategies, reflecting our belief that some of the factors driving our previously very risk-positive position were beginning to fade.

We maintain this view, and are currently holding risk levels at a fairly neutral position versus our long-term average.

Maintaining our thematic stock market positions

Thematic stories are well-established among our stock market holdings, and we favour key areas like healthcare and technology. We took the opportunity to add to holdings in these areas during a pandemic-induced weak spot for stock markets in May 2020.

These sectors represent structural growth opportunities as a result of demographic changes, technology-driven innovation and changing habits among consumers. Increased US government spending should also support the healthcare sector.

Ongoing conviction in alternative diversifiers of risk

When it comes to diversifying risk in our investment strategies, we look beyond mainstream asset types like bonds and shares.

Our 'alternative' diversifiers range from traditional safe-haven asset types like gold (which has had a challenging 2021 amid a broadly risk-positive investment environment, but which serves an important role in spreading our investment risk) to specialist strategies ('tail risk hedging') designed to protect against quick and dramatic market falls.

Backing the move to more sustainable investments

Against the backdrop of this year's COP26 event in Glasgow, we have a number of holdings which stand to potentially benefit from increased attention on environmental issues – especially (though not exclusively) within our sustainable investment strategies.

The transition to clean energy is one such example. Besides the obvious advantages for the planet in sustainability terms, this shift will create huge investment opportunities, with large amounts of private capital 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 energy production alone, creating a large investable opportunity.

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