Handelsbanken
Asset Management

January 2022

Strategy Review

Key takeaways

Our interpretation of the signals being issued by the global economy is broadly consistent with our last update

The peak of government and central bank support is likely behind us, and the economy must increasingly stand on its own two feet

This is likely to create some volatility in financial markets, but positive returns should still be available to savvy investors

Consumers and businesses have ready cash to dispense, with the potential to fuel further growth ahead

We continue to believe that pricing pressures will fade throughout 2022, as economies normalise and supply chain issues are resolved

Our view on the wider economic landscape has held steady since our last Strategy Review in November 2021. Demand remains high among consumers, who have the power to keep spending, since household wealth has risen faster than economic growth over the past two years. Business confidence is also high at a global level, with capital expenditure rising. Production is still playing catch-up with heightened demand for goods and services. Inflationary pressures – though very distracting – should ease off in 2022.

Meanwhile, governments and central banks continue to step back from their forceful economic interventions in the early stages of the COVID-19 pandemic. This made all the difference in keeping the global economy afloat, and kick-starting an economic recovery, at just the right time. However, most government support programmes are now beginning to ebb away, having broadly completed the tasks they set out to achieve. Similarly, the peak of central bank support is likely already behind us, and (with some key exceptions) central bankers are set to become less accommodative as economies normalise. Expectations for interest rate increases are rising, which was predictable at this point in the journey.

Pricing pressures may already be starting to recede

The strength of 2021's burst of inflation took investors (including us) by surprise. However, we maintain our view that this should start to ease off in 2022 as supply chains normalise, commodity price rises ease off, and wage inflation in COVID-19-sensitive areas begins to fade. We remain watchful for any changes to this picture, such as the knock-on effects of rising consumer prices being converted into upwards wage pressure.

The so-called 'base effect' should also prove to be helpful for the inflation picture in 2022. Inflation is measured by comparing prices in the most recent time period to prices in a previous time period. This means that prices in 2022 will be compared to the elevated prices seen in 2021, which should automatically create lower inflation readings ahead.

At the moment, data is mixed, and could be indicating that we are approaching 'peak inflation'. US consumer prices (measured by the Consumer Price Index, or CPI) for December hit a 39-year high versus the same period in 2020. However, versus the previous two months (October and November 2021), the data indicated that pricing pressures could be beginning to slow down. The latest inflation data for US producers also showed signs of pricing pressures beginning to ease off, and some of the key factors pushing inflation higher (like gasoline prices) also appear to be receding from their recent highs.

Understanding where the economy is today, and where it's going next

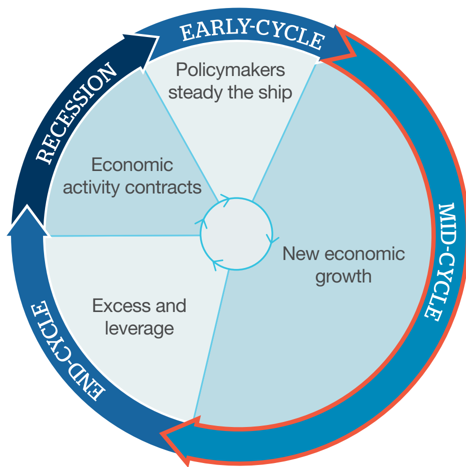
We think a lot about how best to identify our current position in the economic cycle (sometimes referred to as the business cycle). This is because our view on where we are in the economic cycle is critical to the mix of assets we hold across our investment strategies. However, pinpointing our position in this eternal cycle is not an exact science.

There are four phases in the economic cycle. The first is the recession phase, which marks a general decline in economic activity. The second is the 'early-cycle' phase, a time when policymakers intervene to set the scene for economic recovery. Third comes the 'mid-cycle' phase, an expansionary period, when new growth can be harnessed. The final phase – 'late-cycle' – is characterised by excess and the use of borrowed money as finance.

Our view is that the global spread of COVID-19 brought the last economic cycle to a close, with emergency support measures from governments and central banks in the early stages of the pandemic setting the scene for a new cycle to begin in March 2020. Today, having passed through the buoyant early-cycle phase, we believe we have entered the mid-cycle period. Historically, this favours riskier asset types like shares, but typically less so than the very optimistic early-cycle period.

Unpicking the four stages of the global economic cycle

(Sometimes termed the 'global business cycle')



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Handelsbanken Asset Management

However, there is something quite unusual about today's mid-cycle environment: consumers are much richer now than they ever have been at this stage of the economic cycle. Normally, early in the mid-cycle period, business and household balance sheets are being rebuilt, ready for later deployment. This time around, average household finances are already strong, having actively improved (on average) during the pandemic. As a result, the current mid-cycle phase might ultimately prove to have been more potent than its historical counterparts, due to the ready cash available to consumers, as well as the positive effects of robust corporate balance sheets.

But while consumers may be better off, data suggests that their confidence is volatile, impacted by a blend of factors including the pandemic and inflation. Fortunately, we believe that concerns surrounding these topics will start to ease off this year, with consumer confidence levels rising over the next 6-12 months, and high savings levels (alongside rising wages) supporting economic activity.

We think we are likely to remain in this mid-cycle environment for some time. From this point, we see low probability of an imminent mini-economic downturn (as demand from consumers is strong), and a high probability of inflation falling back. This sets the scene for economic expansion to continue. The gradual withdrawal of the central bank support introduced in response to the pandemic is likely to add more volatility to the picture for financial markets, but we believe that relatively steady positive returns should remain achievable over the long run through the right blend of assets.

Under the bonnet in our investment strategies

Given our presumed position in the current economic cycle, we remain comfortable with the levels of risk present in our investment strategies, which are roughly in-line with our long-term average. Typically, the mid-cycle phase of the economic cycle brings with it more volatility in asset prices and investor sentiment. As such, we believe that these 'neutral' risk levels are prudent.

High conviction positions within our allocation to shares

Within our stock market holdings, we favour growth-orientated businesses like healthcare and technology. Despite intermittent political and regulatory disruptions, we value the stability and persistence of this growth.

We also have meaningful exposure to the shares of small and mid-sized companies, and we like emerging markets, partly for their growth potential, but also (and perhaps more importantly) as a way of harnessing the rise in global economic activity.

Seeking out creative drivers of financial returns

We are always on the lookout for creative return drivers – assets whose performance is largely uncorrelated to either traditional financial markets or the economic cycle. For example, our strategies currently hold positions in music royalties, social housing and renewable energy.

While these asset types are subject to their own unique risks, they also offer something different, and can help to smooth financial returns within our strategies over time.

Diversifying risk is critical

Avoiding putting all our eggs in one basket – also known as diversification – is a critical feature of our investment strategies. However, we believe that true diversification is only possible if investors can look beyond traditional asset types and think creatively.

With this in mind, we aim to diversify risk through other tools besides government bonds (traditional 'safe havens' for investors), especially as we question their future effectiveness in a world of ultra-low bond yields. Among the assets we hold with the aim of diversifying risk, apart from cash, we are happy holders of gold, Japanese government bonds, specialist hedge funds and minimal quantities of UK government bonds.

Important information

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