Handelsbanken
Asset Management

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Strategy Review

Key takeaways

The threat posed by the Delta variant of the COVID-19 virus appears to be manageable, for now at least

Economic data has been mixed in recent weeks, offering causes for both optimism and caution

Momentum in the global economy is set to persist, but we may be entering a chapter of slower (albeit still positive) growth

Inflationary pressures still look temporary, but we remain watchful for factors which could change this picture

We are comfortable with the current risk levels in our strategies, having modestly reduced risk over the summer

It remains impossible to discuss the outlook for the global economy and financial markets without taking a good look at the latest developments in the COVID-19 pandemic.

Over the summer months, the UK has served as something of an international test case, with broad economic reopening amid ongoing vaccination rollouts. Hospital admissions have steadily risen in recent weeks, with the latest increase in cases driven by people in their late teens. Fortunately, the typically younger demographic profile of these newer cases also appears to be leading to better outcomes, and fatalities are not picking up in tandem. According to some estimates, as much as 95% of the UK population may now have some immunity to the virus, thanks to a combination of concerted vaccination efforts alongside natural immunity due to prior infections. As well as playing a part in lessening the relationship between case numbers and deaths, this is also lowering the likelihood of the UK government re-imposing lengthy lockdown restrictions.

On a global level, despite the rapid spread of the Delta variant of the virus, the number of reported COVID-19 cases appears to be plateauing, alongside the number of related deaths. In most major economies, vaccination programmes are well underway, but there are exceptions and setbacks. In the US, some momentum has been lost as we head into the cooler (riskier) months. This has the potential to impact economic growth expectations over the winter, should a fresh wave of the virus take hold of an unvaccinated population. However, it is worth noting that in the southern US states, where vaccine take-up is generally lower, winters tend to be milder – this could lower the impact of the virus in these areas as we head into a higher risk season for respiratory illnesses.

While not without challenges then, the outlook for the next phase of the pandemic seems relatively optimistic, and the Delta variant appears to pose only a manageable threat to global growth for the time being. This should support confidence among financial market investors, though the world remains watchful for factors (such as new variants of the virus), which could challenge this benign outlook.

The global economy continues to recover, but growth may be easing off

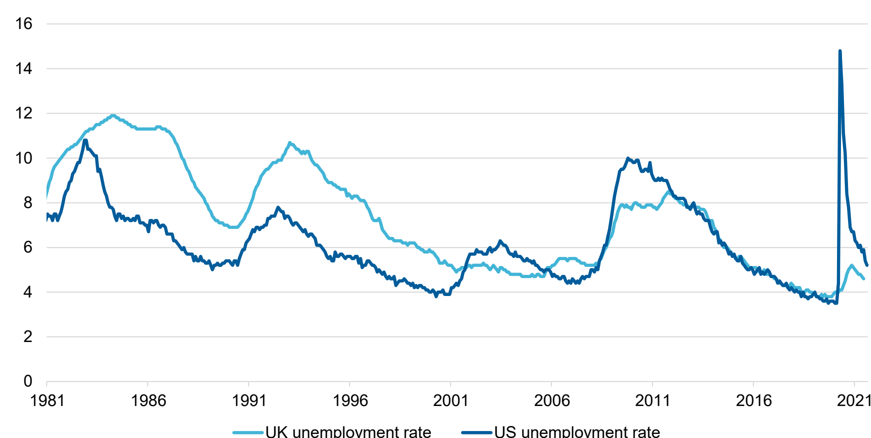
Measures of momentum in the global economy remain at high levels by historical standards. And despite a lack of agreement between US policymakers on a new income support package, the world's leading economy has actually proven surprisingly resilient. US housing and retail sales have returned to pre-COVID levels, while consumer sentiment has reached levels last seen over a decade ago. The global re-stocking agenda continues too, as businesses rebuild their inventories following the events of the past 18 months. Taken together, this all suggests that – even as income support measures fade away – economic activity continues to be driven forward by a backlog of pent-up demand.

However, US unemployment remains a concern. The good news is that August's data showed that half of the US jobs lost in March and April have now been recovered (11m jobs regained out of 22.5m lost), and that unemployment has also fallen by nearly 2%. But the next half of the jobs recovery may be harder, and permanent job losses could rise from here.

Similarly, while huge gains in economic activity have been made, it is fair to wonder if we have moved beyond the 'easy' part of the recovery. We believe we are seeing signs that the world economy is already moving on to the next phase of its cycle, where growth – though still positive – begins to slow down. For now, government stimulus and supportive central banks around the world are still enabling economic data to deliver positive surprises, though this will not continue indefinitely.

Despite gains in economic activity levels, unemployment remains elevated

US and UK unemployment rates (%)



Source: Macrobond, national sources.

Inflation still looks transitory, but watch this space

Inflationary pressures are elevated, but we continue to believe that these will prove to be temporary, as economies rebalance and pricing slowly normalises following the pandemic. Central banks also appear to be sticking to the view that inflation is transitory, and financial markets look convinced too – for now at least.

A range of data supports this theory, with demand beginning to fall for transport factors like trucks and the railroad transportation of raw materials. While bottlenecks in supply chains remain an issue, some well-reported events (such as the closure of a busy port in China over the summer due to a COVID-19 outbreak) may have had less of an impact than initially anticipated. There are signs that bottlenecks are easing off in ports in other parts of the world too.

Of course there are risks to this transitory inflation view, particularly around wage growth and rental costs, and we continue to monitor this area closely. It is also important to note that – in the near term at least – the inflation narrative could yet lead to more volatility and changeability in financial markets.

Under the bonnet in our investment strategies

Over the summer, we modestly trimmed some risk across our investment strategies. This was not designed as the start of a major de-risking programme, but reflected our observation that some of the factors driving our previously very risk-positive position could be beginning to ease off. We maintain this view, and are currently holding risk levels at a fairly neutral position versus our long-term average.

Against this backdrop, our creative 'return drivers' (see next column) remain very important to us. Within our allocation to stock markets, we favour growth-focused positions like healthcare and technology, as well as the shares of small and mid-sized businesses. Emerging markets remain an area of high conviction for us too, and we hold positions in both bonds and shares in developing economies.

Maintaining our neutral stock market position

Having slightly reduced our allocation to riskier assets over the summer, we have no desire to lower our global stock market positions further at this point.

The fundamental backdrop for share prices remains supportive, and there is still plenty of potential for upwards movement in share prices.

However, this is likely to come from healthy corporate earnings rather than a general reappraisal of prices ('re-ratings') by financial markets.

Bond markets have been noisy, but with little cause

Readers of the financial press will know that bond markets have delivered significant noise in recent months.

UK bond yields (and their prices, which move inversely to yields) have moved up and down, as investors price in a supportive Bank of England. Meanwhile, yields in China have fallen (prices have risen) amid nervousness about a policy clampdown from China's authorities.

Nevertheless, despite media headlines picking up on bond market topics like yields and credit spreads, in reality not much has happened in bond markets over the summer.

Creative return drivers within our diverse range of alternative assets

The creative drivers of financial returns in our investment strategies are centred on areas where returns are largely uncorrelated to wider financial markets/the economic cycle.

In practice, this area covers a broad range of positions including music royalties, social housing and renewable energy.

Many of these 'alternative' asset types (i.e. investments beyond traditional asset classes like stocks and bonds) are also able to deliver compelling payouts to their holders – an especially attractive trait in a world of generally low yields.

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