



Danske Bank
Quarterly House View Autumn 2020
INSTITUTIONAL

Great comeback still has room to run

After dropping like a stone in the spring, equities and other risk assets have staged an equally dramatic comeback – and despite many economic and political risks we see even more upside potential.

The US government's chief medical advisor, Anthony Fauci. While the coronavirus still has a firm grip on the US, US equities have been a leading benchmark during the equity market's great comeback since March - headed up by a number of tech giants.

Equities still the best option for investors

We expect that any setback for the economy and the financial markets will prove temporary. As long-term investors, we are cautiously optimistic and see a more attractive potential in equities than in bonds.

Just six months ago, equity markets were in free-fall, plunging more than 30% in just over a month - a record decline. Yet, equity markets have largely bounced back, with US equities now

above their pre-corona highs, though European equities are still lagging.

The great equity comeback was no real surprise for us, though admittedly we had not expected the recovery to happen quite so quickly. Nevertheless, we still see potential for further equity market growth of 6-11% over the coming 12 months, although we also acknowledge the presence of several significant risks on the horizon. That is why we continue to have just a modest overweight in equities - in other words, we have slightly more equities in our portfolios than we expect to have in the long term. In contrast, we have a modest underweight in bonds.

Driving forces behind the comeback
The great equity and risk asset comeback had several driving factors:

Price increases were initially driven by the extremely accommodative monetary policies of the central banks - which saw sharp interest rate cuts in the US and huge asset purchase programmes to ensure liquidity and low yields - and then the fiscal relief packages enacted by the politicians ▶▶



By Danske Bank's chief strategist Henrik Drusebjerg



In recent months we have seen a noticeable pick-up in economic activity and improving labour markets - in fact, economic data have generally surprised positively over the summer.

Expected return from global equities of

6-11%

over the coming 12 months in local currency.



Overweight in equities



Underweight in bonds



In terms of the coronavirus, China has got off relatively lightly compared to many other countries, and Chinese equities are well into positive territory for the year.

to support squeezed economies. Investors subsequently began to price in the imminent reopening of societies around the world as lockdown was eased, and in recent months we have seen a noticeable pick-up in economic activity and improving labour markets - in fact, economic data have generally surprised positively over the summer.

Hence, a quick stocktake indicates that the global economic recovery is on course, while the coronavirus appears



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to be controllable using more targeted and local measures than the total lockdowns we saw in the spring.

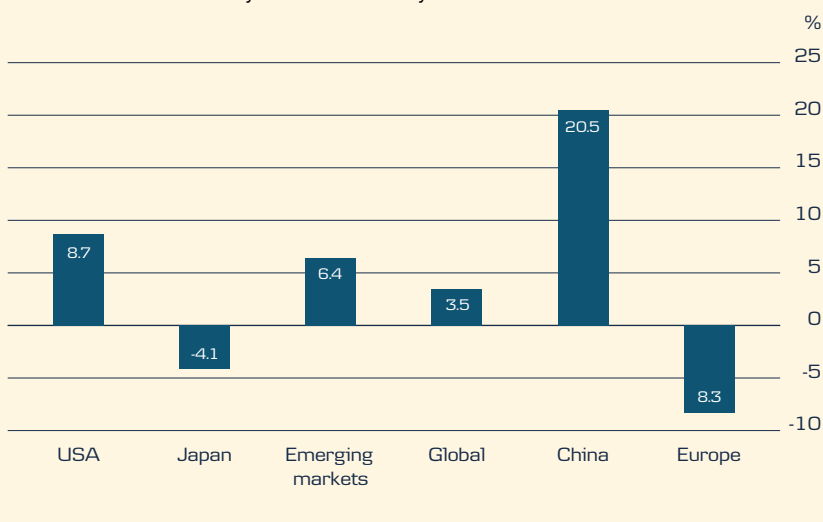
Lagging economy provides potential

Nevertheless, the coronavirus has inflicted a great deal of damage on the global economy that still needs to be fully repaired. In the US, unemployment remains markedly higher than prior to the coronavirus, even though some progress has been made, and unemployment remains higher in Europe too. Consumer confidence is still subdued, which in the short term could hamper consumption as a key driver for the economy. Companies, meanwhile, remain less enthusiastic about investing than in pre-corona times.

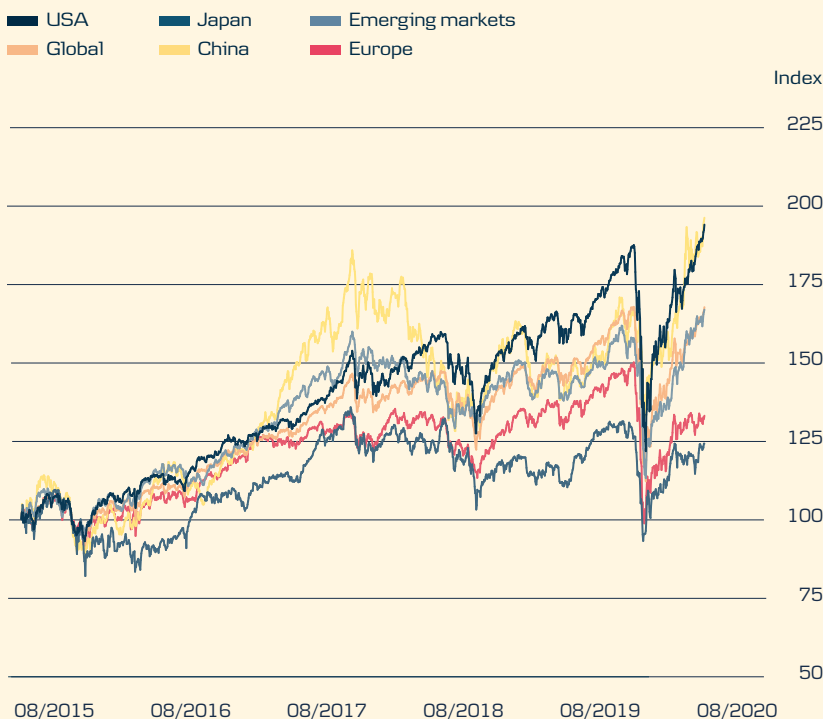
All the above factors add to the uncertainty about the pace of economic recovery - but at the same they also ►►

Return on equities so far this year

Return in local currency since 1 January 2020.



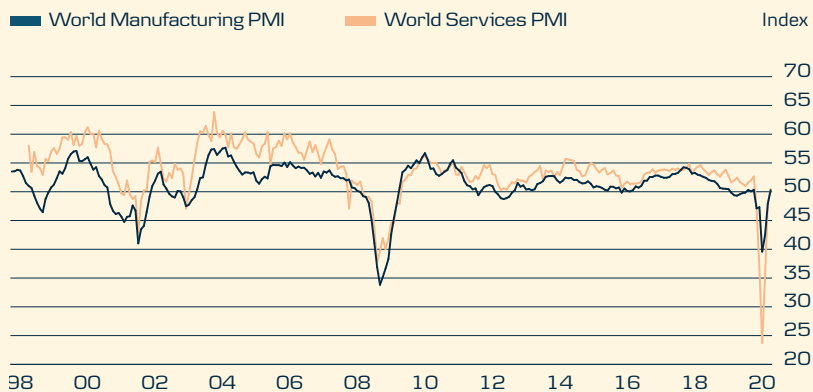
Accumulated return over past 5 years



Source: Macrobond, data for MSCI Index, total return in local currency. Calculated: 27.08.2020

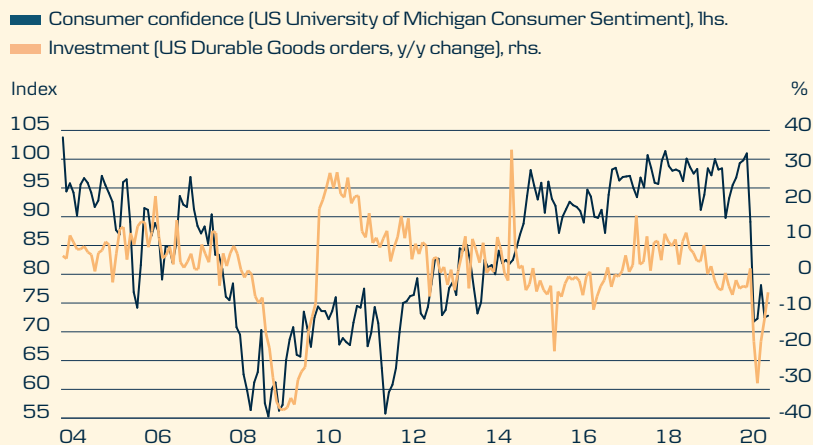
Business confidence bounces back ...

The corona crisis sent the so-called PMI business confidence indicators for both the manufacturing and service sectors of the global economy into free-fall - but these indicators have recently bounced back and point to a more buoyant mood about the future. Values above 50 indicate that a majority see growth, while values below 50 indicate contraction.



... but consumer confidence and investment lag

The corona crisis has also hit consumer confidence hard - and here we are still far below the level at the start of the year, as measured by the US University of Michigan Consumer Sentiment Index. We can also see that order books among US producers - US Durable Goods orders - for products such as computer equipment and industrial machinery are still some way behind when looking at year-on-year figures.



indicate a potential for further progress. Naturally, the big question then is if this potential will translate into additional growth in the time ahead?

Further growth expected

Our main scenario is generally one of further solid economic growth in the coming year that will gradually approach pre-corona levels, while an effective vaccine against the coronavirus will presumably support this positive trend once it becomes available - and vaccine research so far looks to be promising and moving ahead rapidly. Economic growth could also be self-perpetuating: solid growth figures, increased business confidence and an improving labour market may encourage consumers to spend more money and companies to up investment.

While you should never place too much significance on individual factors, a closer look at the US housing market is perhaps worthwhile. The US housing market usually suffers during protracted recessions, as many people have less money available to buy a home or prefer to save instead, but so far the housing market has performed well during the corona crisis. This could potentially indicate that other parts of the economy may also recover faster than we normally see after a recession.

Other factors that could drive the economy further forward include still accommodative monetary policies from the central banks and ongoing fiscal easing.

Coronavirus still the eye of the storm

However, we are not blind to the risks that could derail growth and the positive mood of investors, and progress will not be plain sailing. Setbacks are more or less inevitable - for example, during periods of disappointing economic data or new waves of lay-offs as companies adjust to a new reality.

With respect to risk, coronavirus is of course still centre-stage. ▶▶



The US-China trade conflict remains a risk factor that could suddenly flare up. Here, a police officer guards the former Chinese consulate in Houston. The US demanded that the consulate be closed in July after Chinese hackers had apparently targeted US companies.

While we do not expect a repeat of this spring's total lockdowns, new and extensive virus outbreaks in the autumn could still put a damper on growth and inflict further damage on the economy.

Furthermore, financial markets are likely to be very sensitive to economic trends, and growth indicators could be very volatile in the near term. Should growth appear to be running out of steam, market sentiment could swiftly turn negative, and given how much positivity has been priced into equities since they bottomed out, there is no room for major disappointments.

On the other hand, we may not need major positive surprises to maintain the buoyant mood among investors. Where the economy will be in just a few months, never mind a half or whole year, is still very uncertain – but every data point that confirms the economic recovery is on track will reduce this uncertainty a little, which is positive in itself.

Stimulus options not unlimited

As mentioned, accommodative mone-



In a negative scenario, we risk the recovery in economic activity stalling alongside one or more of the political risks materialising, which would hit equities and other risk assets, such as emerging market and corporate bonds.

tary and fiscal policies have been key drivers for the recovery in the economy and the financial markets since the height of the corona panic in February and March, and they will continue to be important factors going forward. However, stimulus options are not unlimited, and this tailwind could become a headwind.

The corona crisis has already created very large government deficits across many countries in 2020, so just how much more we can expect from fiscal policy, should the economy take a new tumble that requires further stimulation, is difficult to gauge.

In terms of monetary policy, we expect the very accommodative approach of the central banks to continue for as long as the economy is challenged and uncertainty is high. However, as the global economy recovers, investors will probably become increasingly worried about just how long the central banks will maintain their ultra-easy line. Paradoxically – growth outpacing expectations could fuel uncertainty and volatility in the financial markets. Hence, going forward, investors will be extra attentive to central bank announcements and rhetoric, seeking confirmation that accommodative monetary policy will remain in place.

The negative scenario

As readers will be aware, we still have several political risk factors that could trigger new periods of market turmoil. The EU and the UK have still not managed to agree the future terms of their relationship after the British definitively leave the EU as planned at the end of the year, which could generate political noise and market unrest in Europe this autumn if fears of a hard Brexit strengthen. Meanwhile, US-China relations remain strained and their trade war could flare up again anytime – particularly if Donald Trump feels the need to score political points ahead of the US presidential election in November.

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recovery in economic activity stalling alongside one or more of the political risks materialising, which would hit equities and other risk assets, such as emerging market and corporate bonds.

Equities the best alternative

However, we expect that any setback for the economy and the financial markets will be temporary; so, as long-term



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investors, we are cautiously optimistic and see a more attractive potential in equities than in bonds. All in all, we strongly expect to see the potential for further economic growth realised – though we are more uncertain about the pace and the level of volatility along the way.

Meanwhile, the accommodative monetary policies of the central banks have contributed to the expected return on many bonds being very low or negative, and we in fact estimate that bond returns will be further reduced in the coming year. We expect long yields to rise slightly – and thus bond prices to fall – as the economy continues to recover and inflation expectations begin to rise.

Despite the current uncertainty, we therefore still view equities as ►►

the best alternative for investors who want the chance to earn a decent return – and we expect that this will help support equity prices. Meanwhile, the accommodative policies of the central banks are helping to ensure there is still an ample supply of money in the economy, which can be expected to flow into equity markets.

Moreover, companies have been good at cutting costs during the corona crisis, which could also support equities going forward. Companies are leaner than before, and all else being equal that should boost earnings when revenues begin to accelerate again. This also partly justifies the relatively high valuations (P/E) of equities following the decline in corporate earnings (E), while equity prices (P) are now back around pre-corona levels.

We position for an upswing

Nevertheless, we would like to see further confirmation of the economic recovery and less uncertainty before

considering a further increase in our equity overweight. For now, therefore, our allocation between equities and bonds reflects cautious optimism.

However, we are gradually making other changes to our portfolio allocations to position for an expected upswing in the coming year:

In the equity sections of our portfolios, we have recently lifted Industrials from underweight to neutral, as Industrials is a classic cyclical sector that typically performs best during periods of positive economic growth. With respect to US equities, we have increased our exposure to small- and mid-cap companies, which have been particularly good at cutting costs and are typically slightly more cyclical than the very large companies.

As for bonds, we have also just increased our risk and exposure to an expected upswing by raising high-yield corporate bonds from underweight to a neutral weight at the expense of more secure government bonds.



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3 factors we are keeping an eye on in equity markets



Corporate earnings:

The corona crisis triggered a major decline in corporate earnings, so there will be a great deal of focus on earnings growth in the autumn and guidance for 2021. Analyst expectations for earnings growth in 2021 look rather optimistic in our opinion, which could result in disappointments. Further economic growth is a prerequisite for companies being able to deliver satisfactory earnings.

expensive at the moment in P/E terms – in other words, the price investors pay for one unit of earnings (DKK, USD, etc.) in the companies. However, we expect corporate earnings to experience a rise in the time ahead that will justify valuations.



Tech giants:

Significant price rises for a number of the biggest US tech companies, such as Amazon, Apple and Microsoft, have been key drivers for the great equity comeback since the spring. These tech giants now make up such a large part of the US equity market that movements here can send entire markets up or down. That is why we will be particularly attentive to see whether they can continue to deliver on earnings and help support equity markets.



Valuations:

While equity prices have largely recouped their losses since the spring, corporate earnings have yet to catch up. This means that equity valuations are generally

Always remember your risk as an investor:

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