Don’t jump the gun
Global Asset Allocation Strategy
March 2019
Don’t jump the gun

KEEP EQUITIES NEUTRAL

• The rebound this year has been almost as dramatic as the downturn in December. All of the December losses are regained, and sentiment has improved markedly.

• The tug of war is still playing markets, although the tables have turned. As opposed to December, central banks are currently a positive driver behind this rally, and global growth and earnings momentum is the weak link.

• We do not expect a recession this year, but we don’t see convincing signs of stabilization in key data either, which challenge further gains. We don’t want to jump the gun in either direction, and keep neutral.

EQUITY STRATEGY: Unchanged

• We stick to a neutral allocation in equity regions as relative value is hard to come by.

• Earnings outlook continues to deteriorate across the board, pointing to no obvious candidates for outperformance.

• We prefer Health Care over Consumer Staples amongst the equity sectors.

FIXED INCOME STRATEGY: Lift HY bonds

• The dovish pivot from Fed, and also other central banks, has improved the short term environment for credits, making us adjust the conservative tilt in the bond portfolio.

• Overall, we still expect modest returns from bonds in 2019, as spread and yield levels are low in a historic context.
Market performance & recommendations

Equity markets climbing rapidly towards last year's high

- ASSET ALLOCATION
  - Equities
  - Fixed Income

- EQUITY REGIONS
  - North America
  - Europe
  - Japan
  - Emerging Markets
  - Denmark
  - Finland
  - Norway
  - Sweden

- EQUITY SECTORS
  - Industrials
  - Cons Discretionary
  - Cons Staples
  - Health Care
  - Financials
  - IT
  - Comm. Services
  - Utilities
  - Energy
  - Materials
  - Real Estate

- BOND SEGMENTS
  - Government
  - Investment Grade
  - High Yield
  - Emerging Markets

Source: Thomson Reuters / Nordea
The global economic growth is facing headwinds. However, the pace is likely to remain decent and the markets have already priced in notable weakness.

Estimates now point to above-potential expansion. However, Brexit and trade wars continue to weigh on investments, tilting risks to the downside.

We do not expect a global recession this year, meaning sub-2.5% growth. But, we are in a downturn, which makes navigating the financial markets harder.
China is the elephant in the room

Despite slower growth, China dominates the global outlook

Credit cycle is yet to turn forcefully despite stimulus

- The ups and downs of the current cycle have been driven by China to a large degree. Hence, the outlook for the Middle Kingdom is central for investors.
- The key risk is still a rapid slowdown in growth due to last year’s deleveraging campaign, the trade war, and decreased efficiency of stimulus measures.
- On the upside, the authorities are likely to end up over-stimulating, leading to a pick-up in growth somewhere along the line.
Worrying trend in the earnings outlook

- Earnings wise, 2019 has started badly. Expected earnings growth is on a downtrend, and at this pace, an earnings recession cannot be ruled out.
- One possible light could be that the momentum in revisions seems to have turned, but we have a hard time seeing revisions turning positive anytime soon.
- The main question is how much is priced, especially after the YTD rally. If earnings continue to deteriorate, equities will have a hard time to rally further.
Global dovish pivot: Timely enough?

Bullish: The Fed is eyeing the end of balance sheet reduction...

• On top of its newfound patience on policy rates, an end to the balance sheet adjustment is likely in the beginning of 2H, with excess reserve ~1.3 trn.
• Other central banks are following suit in a dovish pivot: ECB signals flexibility to its forward guidance; BoJ highlighting the possibility of additional stimulus.
• Given the lag-lead relationship between monetary policy and economic activity, the question whether we are late or end cycle remains unanswered.
Global dovish pivot: The USD could dampen the upside

- Despite the Fed’s dovishness, the US Dollar has strengthened recently. As we highlighted before, a stronger US Dollar amounts to monetary tightening.
- This contrasts with early-2016, where the USD weakened in response to a Fed pause. So far the dollar is not confirming a 2016 redux.
- Bottom line: If the dollar continues to defy a dovish Fed, a stronger USD will limit the impact from the Fed put.
Brexit is nearing. Or is it?

Brexit or not? Here is where the reaction will most probably come

- 29th of March is fast approaching. Parliament is more or less fighting both Theresa May's government and to some extent, itself. In short, it is a mess.
- The main conduit for Brexit so far has been the pound, not other UK assets. A hard Brexit will see further weakening, an extension of time the opposite.
- We think an extension is the most probable outcome at this stage. Both sides have plenty of reasons to avoid a hard Brexit, and it is starting to show.
Re-rating due to rallying markets, but watch the e-component of p/e

- After last years massive de-rating, valuation has bounced back on the rally and falling earnings estimates. In absolute terms, valuation has deteriorated.
- While not high, equity valuation is hardly attractive with the earnings uncertainty. How much re-rating can markets withstand given the earnings outlook?
- On the bond side, lower yields also means less absolute value. In relative terms however, there has been less of a change between equities and bonds.
Markets sees few clouds on the horizon (we see a couple of them)

- Rallying markets means more bullish investors. The change in sentiment YTD is significant, and greed indicators are approaching stretched territories.
- Technical indicators confirms this and have reached overbought levels. However, investor positioning is still cautious and equity flows YTD are negative.
- During the rally all news (also bad) has been good news; should this change, sentiment is a risk at current levels.
High yield might see another leg up

- The dovish Fed pivot had a goldilocks-feel to it – meaning keeping the economy neither too hot nor too cold, which caused a risk rally so far this year.
- HY is a main beneficiary. Although the longer term outlook is still challenged by a slowly turning credit cycle, there is more upside in the short term.
- In this environment core bonds are less favored on a relative basis. Hence, we reduce core bonds and increase HY, which neutralize the defensive stance.
Stick to neutral across equity regions

- EM equities have lagged DM lately.
- The earnings outlook is weakening across the board.

We stick to a neutral allocation across equity regions as relative value is difficult to come by.

The earnings outlook continues to deteriorate across the board, pointing to no obvious candidates for outperformance.

The regional impact from Brexit and trade wars is hard to gauge given the global nature of supply chains. Hence, we feel a neutral allocation is warranted.
Keep the bet within the defensive sectors

- Without going outright defensive in the sector strategy, keep the relative bet within the defensive sectors by overweighting Health Care vs. Con. Staples.
- We have lately reduced the IT-sector to neutral, given the weaker earnings outlook and weaker guidance from leading companies.
- Among the defensive sectors Health Care looks fundamentally most attractive and is typically a good late-cycle performer.
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