Danske Bank
Quarterly House View Spring 2021
INSTITUTIONAL

A shot of optimism

The rollout of corona vaccines heralds a gradual recovery in the global economy and paves the way for further equity market growth, even though a good deal of positivity has already been factored into equity prices. We outline the most attractive investment opportunities.

Danske Bank

Reopened restaurants in Milan. The European economy has been hard hit by this winter's lockdowns and restrictions but has much to gain from a reopening.

Glass is more than half full

After a long, dark, corona winter, spring is now knocking at the door and stoking optimism in equity markets, though the best times could well be behind us.

By investment strategist Lars Skovgaard Andersen

The financial markets have for some time now been riding a wave of exuberance over the prospect of economies again being able to run at full steam in the foreseeable future. This has lessened the impact of the slowdown in Europe and the US prompted by this winter's new lockdowns and restrictions, and of growth slowing a little in China after the authorities turned down the level of economic stimulation.

> *While there is still considerable uncertainty on the speed and strength of the global recovery, we, too, continue to have a positive view on risk assets, such as equities.*

Instead, the financial markets have looked ahead – beyond the crisis. Meanwhile, the vaccine rollout is beginning to accelerate as more vaccines gain approval from health authorities around the world and production is ramped up. An unequivocal farewell to restrictions and lockdowns is probably still some way off, but recent developments naturally give grounds for optimism. So, while there is still considerable uncertainty on the speed and strength of the global recovery, we, too, continue to have a positive view on risk assets, such as equities.

Several reasons to be optimistic
Investor enthusiasm has not only been driven by the vaccines but has also gained sustenance from other areas.

Warmer weather as we move into spring is expected to curtail the spread of the coronavirus in Europe and the US, while this winter's lockdowns have, despite everything, not had the same negative effect on the economy as the first round last spring – for example, the manufacturing sector has continued to grow in Europe and the US. More-

Expected return from global equities for the coming 12 months, in euro:

3-7%

↑ Modest overweight in equities

↓ Modest underweight in bonds

Emerging markets – here India – had a strong 2020, and emerging market equities have also had a considerably better start to 2021 than global equities.

over, many companies have managed to adjust their business models and costs to the new coronavirus reality, as was evident in January and February when Q4 2020 earnings reports were released. Corporate earnings generally surprised positively, which has further fuelled optimism on 2021.

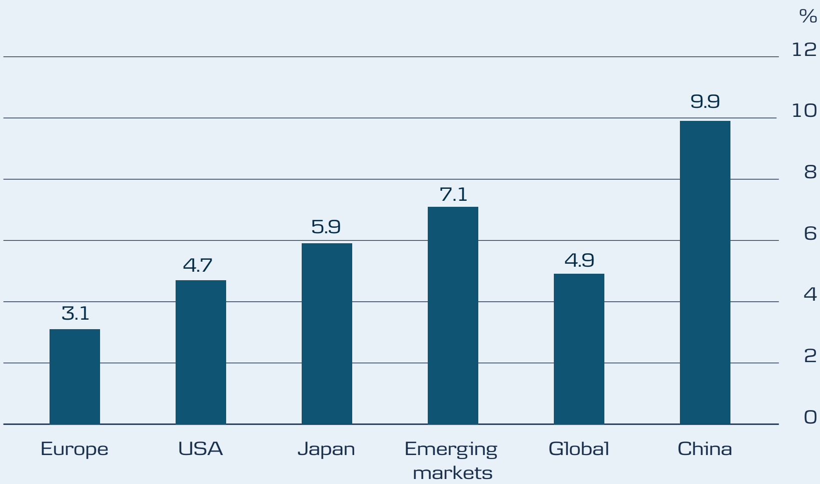
Finally, a few important pieces of the political puzzle have fallen into place – first, in relation to Brexit and, second, in relation to US politics, where Democratic control of both chambers in Congress increases expectations that the US economy could receive a significant fiscal shot in the arm. Despite the brighter economic outlook, central banks look set to maintain an accommodative monetary policy stance for quite some time yet, and low interest rates and massive asset purchase programmes will only provide further support for risk assets.

Apart from a few wobbles, equity markets have thus defied this winter's significant coronavirus outbreaks and risen steadily. In bond markets, expectations of an upswing and a major new relief package in the US have pushed long yields up, which in turn means lower bond prices. ▸▸

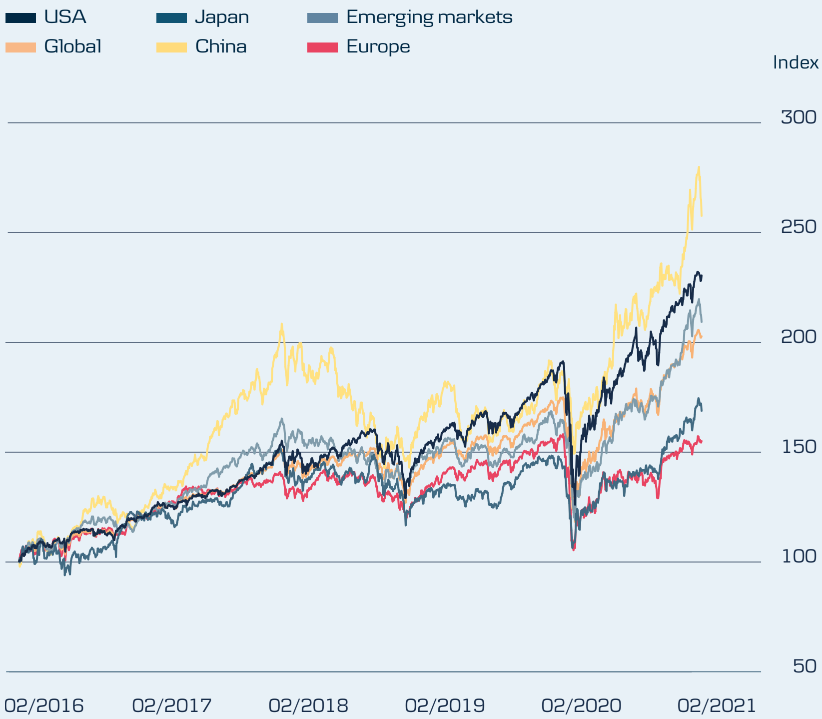
> *Another risk attaches to central banks, as the expected economic upswing is causing some investors to question whether central banks might tighten their very accommodative monetary policies*

Return on equities so far this year

Return in local currency since 1 January 2021.



Accumulated return over past 5 years



Source: Macrobond, data for MSCI Index, total return in local currency. Calculated: 24.02.2021. Historical return is not reliable indicator of future return.

Why equities are set to trend higher
With equities, economic growth is a key driving force for rising prices. Equities and other risk assets tend to perform well during periods of increasing growth, which is why the trend looks set to be generally up for equities in 2021.

Naturally, there may be bumps along the way. Let us not doubt that. The recovery in the global economy might take longer if the vaccine rollout is not as speedy as hoped, or new mutations render some of the existing vaccines less effective and, at worst, prompt health authorities to stop using them. Another risk attaches to central banks, as the expected economic upswing is causing some investors to question whether central banks might tighten their very accommodative monetary policies, which have been a key driver for the financial markets in the past year. In our opinion, this question is premature – nevertheless, investors could become increasingly sensitive to central bank signals and announcements.

While the above issues could prove troublesome in the coming months, we do not believe they could derail the overall economic upswing in 2021, but rather just create uncertainty about its strength and speed. True, that could be enough to trigger new periods of volatility, but in our view it will not prove sufficient to pull the rug out from under equities and other risk assets. While rising yields have triggered some turbulence in equity markets in recent weeks, we do not view higher yields as a major problem as long as they rise for the right reason - namely increased growth.

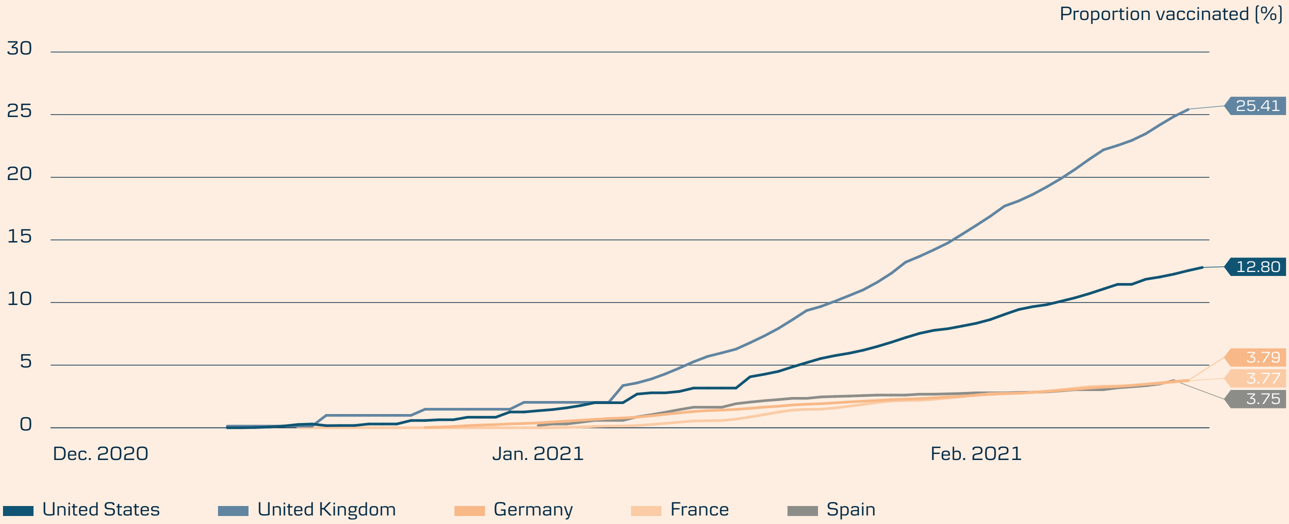
> *Despite the apparently brighter times ahead, we must remember that the financial markets are naturally forward-looking and focus on what the world is expected to be like in 6-9 months.*

Anatomy of the upswing
Digging a little deeper into the expected upswing, it seems to rest on several factors:

- First of all, the economy reopening would in itself provide a marked boost to economic activity compared to right now.
- Moreover, we expect the lengthy restrictions and lockdowns to have resulted in an accumulation of ▸▸

Growth in number of vaccinated

Vaccine rollout is key to reopening of the global economy in the course of the spring and summer.



Source: Macrobond.

Expectations of the global economy reopening and pronounced corporate earnings growth have been key equity market drivers for some time now.

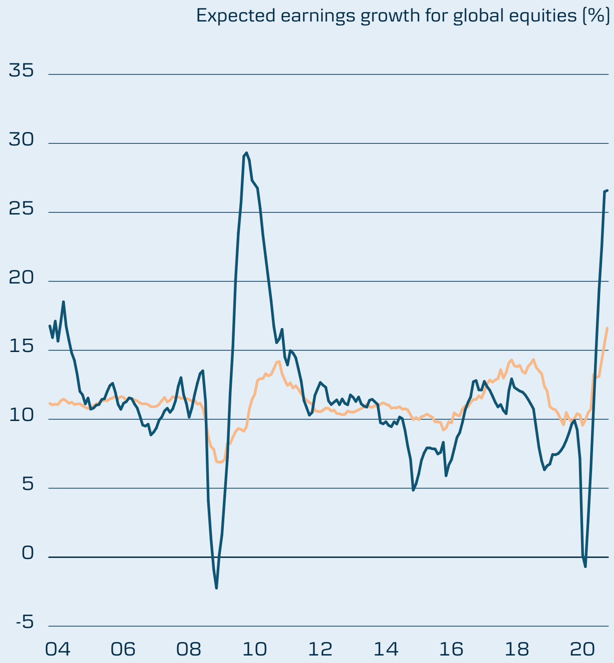
What is driving equities – and are they too expensive?

Equity valuations are currently high in P/E (price/earnings) terms, which is the price investors pay for one unit (DKK, USD, EUR, etc.) of a company's earnings. But the big question is whether equity prices have actually risen too much relative to corporate earnings.

The answer depends not only on corporate earnings this year, where analyst expectations are for pronounced earnings growth, but also corporate earnings in the slightly longer term. The past year has seen a marked increase n expected earnings growth for global equities in the coming 3-5 years [see chart below-left]. In our view, this indicates the increase in equity prices is not completely out of step with reality.

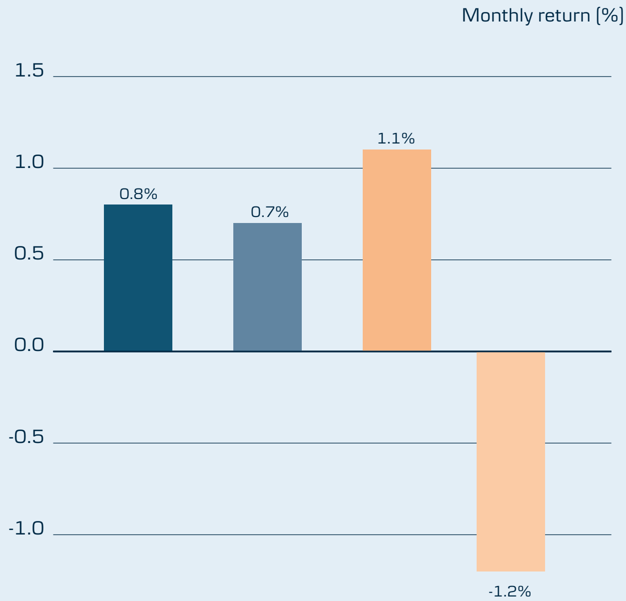
In the shorter term, however, economic growth has a much greater influence on market developments than P/E and expected long-term earnings growth. The right-hand chart shows the average monthly return from global equities assuming various scenarios for developments in the economic confidence indicator World Composite PMI. A PMI above 50 indicates economic growth, while a level below 50 indicates a slowdown. Historically, the highest equity returns have come in the months after PMI values have been below 50 and increasing. The latest PMI figures have been above 50 and decreasing which, nevertheless, still points to higher equity prices. Remember, though, that historical return is not a reliable indicator of future return.

Expected earnings growth for global equities
Analysts expect pronounced corporate earnings growth both in the short term (12 months) and in the slightly longer term (3-5 years).



12 months
3-5 years

Equity returns fluctuate with the economy
Average monthly return from global equities assuming various scenarios for developments in the economic confidence indicator World Composite PMI.



PMI above 50 and increasing
PMI above 50 and decreasing
PMI below 50 and increasing
PMI below 50 and decreasing

Source: Macrobond.

postponed consumption that is waiting to be activated. We can see, for example, that bank deposits have increased overall in Europe and the US during the crisis.
- The service sector reopening could get the unemployed back in work, which should lead to increased consumption and reinforce growth.
- Still accommodative monetary policies, with low interest rates and ample liquidity, could further stimulate consumption and corporate investment.
- Finally, new relief packages could throw more coal in the boilers – especially in the US, where we are still awaiting clarification on Joe Biden's huge relief package totalling USD 1,900 billion. Many investors expect the actual amount will have to be less before the politicians in Congress agree, but we could be positively surprised.

Biggest increases may be behind us

Despite the apparently brighter times ahead, we must remember that the financial markets are naturally forward-looking and focus on what the world is expected to be like in 6-9 months. We should therefore also assume that a significant share of the expected upswing is already priced in by the financial markets, something illustrated by the high level of equity valuations at the moment.

Hence, the most significant equity price rises may well be behind us, and while we are maintaining an overweight in equities in our portfolios – i.e., we currently have more equities in our portfolios than we expect to have in the long term – it is just a modest overweight. More specifically, we expect a return of 3-7% from equities over the coming 12 months (calculated in euro).

Within the equity sphere, we are focused on having a good balance between cyclical sectors, such as industrials and materials, which tend to thrive during economic expansions, and sectors enjoying structural growth – in other words, underlying growth that is independent of the economic cycle. Structural growth is a much-sought-after trait during periods of high uncertainty, and despite our optimistic view on the future, uncertainty remains high. Among sectors experiencing structural growth, we see the greatest return potential in the IT sector, which we also expect will benefit from an increased appetite for corporate investment as the world reopens.

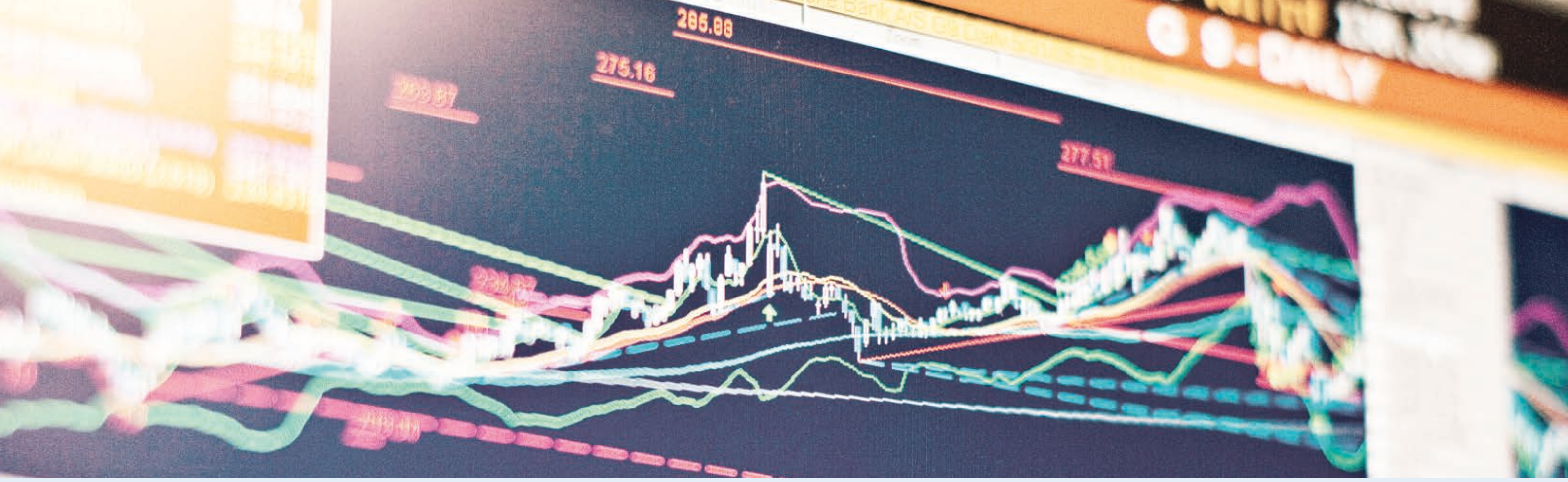
No celebration for bonds

In the world of bonds, an economic upswing can be expected to push inflation and long yields higher – a trend we have already seen recently. This in turn means falling bond prices, which would erode investor returns from bonds, where interest payments are already limited. While the accommodative monetary policies of the central banks can put a lid on how far yields can rise in the near future, the return potential from bonds is extremely limited, so we are maintaining our modest underweight here.

Among sectors experiencing structural growth, we see the greatest return potential in the IT sector, which we also expect will benefit from an increased appetite for corporate investment as the world reopens.

Good news from Italy

In February, Mario Draghi became the new prime minister of Italy with broad political backing, which is very positive news. The former president of the European Central Bank is a keen supporter of the EU. Hopefully, he can hopefully help stabilise the distressed Italian economy and rein in the EU-critical tendencies that have at times stoked fears Italians would follow in the footsteps of the British and leave the EU.



Who are we?

Strategy & Macro | Danske Bank House View

Lars Skovgaard Andersen
investment strategist

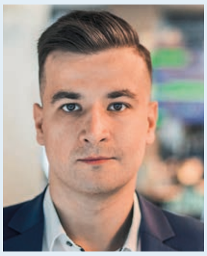
Christian Lie
Senior strategist

Kaisa Kivipelto
Senior strategist

Maria Landeborn
Senior strategist

Tuukka Kemppainen
Senior strategist

Sofie Manja Eger Huus
Senior strategist



Povilas Stankevičius
Senior strategist

Natalia Kornela Setlak
Strategist

Always remember your risk as an investor:
This publication is based on Danske Bank's macroeconomic and financial market expectations. Deviations from our expectations could potentially affect the return on any investments negatively and result in a loss.

Danske Bank has prepared this material for information purposes only, and it does not constitute investment advice.

Always speak to an advisor if you are considering making an investment based on this material to establish whether a particular investment suits your investment profile, including your risk appetite, investment horizon and ability to absorb a loss.

Danske Bank A/S
Holmens Kanal 2-12
1092 Copenhagen K

Phone +45 33 44 00 00
CVR no. 61 12 62 28
danskebank.com