Investment Research

16 April 2021

Armchair Strategists

H2 is set to move us from early to late cycle allocation

- **Cross-market pricing generally seems fair. This shifts focus to marginal stories.**
- **Europe is set to underwhelm investor' hopes, while US rates climb further.**
- **We are likely to move into a 'late cycle'- like environment during H2.**

Over the last few months, we have been moving towards a global narrative of recovery. Looking ahead, macro seems easy to forecast as we head into H2 and everyone knows there will be re-opening, higher inflation and consumer spending on services. However, it seems to me like markets are well into pricing this. As we look ahead, I think the optimal allocation will increasingly be 'late cycle'-like. Thus, overweight DM equities over EM equities and credit, and underweight duration. Being long European equities should be kept tactical and viewed as a levered bet on declining EUR. We recommend to hedge dollar assets below benchmark and lean into the new cyclicality of the dollar. A stalling recovery in US jobs is the key risk, which may keep us in early cycle and make dollar weaken further.

US interest real 10-year rates have risen roughly 40bp in 2021, the dollar has strengthened and companies within industry, autos and airlines have faired well. Meanwhile, the 2020 winners have faded gains across e-commerce and Asia as spending is set to shift towards services, amid Chinese tightening. No asset classes appear distressed or mispriced, though we are pricing the right scenario. Focus will therefore turn to the marginal issues.

I think **European macro will underwhelm and that Fed will start to tighten liquidity conditions** in H2.

The June FOMC meeting will be key to the next step in re-pricing US yields as well as taking another step in holistically upgrading the US. The return of inflation after markets have repriced rates some and the recent scaling back of dollar shorts leave the dollar vulnerable in H2. The Fed's response during the summer will thus be key for where the broad dollar is headed next, though we suspect talks of tapering will support USD.

The base case for many seems to be that US data is simply leading Europe by a few months. I do not think so. Rather, the Chinese credit cycle is rolling over well and this will spill into European macro over the summer. That will happen amid rising US yields, which also spill into European yields at a smaller beta but at a point in time where ECB simultaneously contemplate fading support. As we look into H2, there is a cyclical European recovery story but surely not a new structural narrative: There might be a pent-up demand story but it will last 3 months and there is a risk of an ECB policy mistake by withdrawing policy support too early. I think investors will be disappointed and I would treat longs in European equities as a high-beta expression of being short EUR/USD. The key problem is there is not a premium for distressed European assets to be unwound. EUR/USD is quite high at 1.19 and analysts' expectations to earnings in Northern Europe and autos are well above their pre-COVID levels. I have a hard time seeing much of a potential turnaround story.

As with the market after COVID, the market cycles/themes run at an extremely compressed pace. So we will probably move from early-to-mid cycle, into a late cycle-like allocation quite easily during H2.

Description

Strategists Valtteri Ahti and Lars Merklin write pieces featuring topdown views on cross asset and asset allocation topics. Armchair Strategists expresses the views of the authors, which might diverge from the official views of Danske Bank Research. However, when that is the case it will always be made clear in the text.

Senior Analyst, FX Strategy
Lars Sparresø Merklin
+45 45 12 85 18
lsm@danskebank.dk

Disclosure

This research report has been prepared by Danske Bank A/S ('Danske Bank'). The author of this research report is Lars Sparresø Merklin, Senior Analyst.

Analyst certification

Each research analyst responsible for the content of this research report certifies that the views expressed in the research report accurately reflect the research analyst's personal view about the financial instruments and issuers covered by the research report. Each responsible research analyst further certifies that no part of the compensation of the research analyst was, is or will be, directly or indirectly, related to the specific recommendations expressed in the research report.

Regulation

Authorised and regulated by the Danish Financial Services Authority (Finanstilsynet). Deemed authorised by the Prudential Regulation Authority. Subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details of the Temporary Permissions Regime, which allows EEA-based firms to operate in the UK for a limited period while seeking full authorisation, are available on the Financial Conduct Authority's website.

Danske Bank's research reports are prepared in accordance with the recommendations of the Danish Securities Dealers Association.

Conflicts of interest

Danske Bank has established procedures to prevent conflicts of interest and to ensure the provision of high-quality research based on research objectivity and independence. These procedures are documented in Danske Bank's research policies. Employees within Danske Bank's Research Departments have been instructed that any request that might impair the objectivity and independence of research shall be referred to Research Management and the Compliance Department. Danske Bank's Research Departments are organised independently from, and do not report to, other business areas within Danske Bank.

Research analysts are remunerated in part based on the overall profitability of Danske Bank, which includes investment banking revenues, but do not receive bonuses or other remuneration linked to specific corporate finance or debt capital transactions.

Financial models and/or methodology used in this research report

Calculations and presentations in this research report are based on standard econometric tools and methodology as well as publicly available statistics for each individual security, issuer and/or country. Documentation can be obtained from the authors on request.

Risk warning

Major risks connected with recommendations or opinions in this research report, including as sensitivity analysis of relevant assumptions, are stated throughout the text.

Expected updates

Bi-weekly.

Date of first publication

See the front page of this research report for the date of first publication.

General disclaimer

This research has been prepared by Danske Bank A/S. It is provided for informational purposes only and should not be considered investment, legal or tax advice. It does not constitute or form part of, and shall under no circumstances be considered as, an offer to sell or a solicitation of an offer to purchase or sell any relevant financial instruments (i.e. financial instruments mentioned herein or other financial instruments of any issuer mentioned herein and/or options, warrants, rights or other interests with respect to any such financial instruments) ('Relevant Financial Instruments').

This research report has been prepared independently and solely on the basis of publicly available information that Danske Bank A/S considers to be reliable but Danske Bank A/S has not independently verified the contents hereof. While reasonable care has been taken to ensure that its contents are not untrue or misleading, no representation or warranty, express or implied, is made as to, and no reliance should be placed on, the fairness, accuracy, completeness or reasonableness of the information, opinions and projections contained in this research report and Danske Bank A/S, its affiliates and subsidiaries accept no liability whatsoever for any direct or consequential loss, including without limitation any loss of profits, arising from reliance on this research report.

The opinions expressed herein are the opinions of the research analysts and reflect their opinion as of the date hereof. These opinions are subject to change and Danske Bank A/S does not undertake to notify any recipient of this research report of any such change nor of any other changes related to the information provided in this research report.

This research report is not intended for, and may not be redistributed to, retail customers in the United Kingdom (see separate disclaimer below) and retail customers in the European Economic Area as defined by Directive 2014/65/EU.

Disclaimer related to distribution in the United States

This research report was created by Danske Bank A/S and is distributed in the United States by Danske Markets Inc., a U.S. registered broker-dealer and subsidiary of Danske Bank A/S, pursuant to SEC Rule 15a-6 and related interpretations issued by the U.S. Securities and Exchange Commission. The research report is intended for distribution in the United States solely to 'U.S. institutional investors' as defined in SEC Rule 15a-6. Danske Markets Inc. accepts responsibility for this research report in connection with distribution in the United States solely to 'U.S. institutional investors'.

Danske Bank A/S is not subject to U.S. rules with regard to the preparation of research reports and the independence of research analysts. In addition, the research analysts of Danske Bank A/S who have prepared this research report are not registered or qualified as research analysts with the New York Stock Exchange or Financial Industry Regulatory Authority but satisfy the applicable requirements of a non-U.S. jurisdiction.

Any U.S. investor recipient of this research report who wishes to purchase or sell any Relevant Financial Instrument may do so only by contacting Danske Markets Inc. directly and should be aware that investing in non-U.S. financial instruments may entail certain risks. Financial instruments of non-U.S. issuers may not be registered with the U.S. Securities and Exchange Commission and may not be subject to the reporting and auditing standards of the U.S. Securities and Exchange Commission.

Disclaimer related to distribution in the United Kingdom

In the United Kingdom, this document is for distribution only to (I) persons who have professional experience in matters relating to investments falling within article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the 'Order'); (II) high net worth entities falling within article 49(2)(a) to (d) of the Order; or (III) persons who are an elective professional client or a per se professional client under Chapter 3 of the FCA Conduct of Business Sourcebook (all such persons together being referred to as 'Relevant Persons'). In the United Kingdom, this document is directed only at Relevant Persons, and other persons should not act or rely on this document or any of its contents.

Disclaimer related to distribution in the European Economic Area

This document is being distributed to and is directed only at persons in member states of the European Economic Area ('EEA') who are 'Qualified Investors' within the meaning of Article 2(e) of the Prospectus Regulation (Regulation (EU) 2017/1129) ('Qualified Investors'). Any person in the EEA who receives this document will be deemed to have represented and agreed that it is a Qualified Investor. Any such recipient will also be deemed to have represented and agreed that it has not received this document on behalf of persons in the EEA other than Qualified Investors or persons in the UK and member states (where equivalent legislation exists) for whom the investor has authority to make decisions on a wholly discretionary basis. Danske Bank A/S will rely on the truth and accuracy of the foregoing representations and agreements. Any person in the EEA who is not a Qualified Investor should not act or rely on this document or any of its contents.

Report completed: 15/04/2021 14:28CET

Report first disseminated: 16/04/2021 07:00CET