



In our *Investment Outlook 2023*, published at the beginning of the year, we said that interest rates and inflation had hogged the limelight in 2022, and our expectation was that this would continue into the early part of 2023. Safe to say, this has happened: central banks have continued to increase interest rates (albeit at a slower pace than last year), and while inflation looks like it has peaked, its descent has not been as rapid as some would have hoped.

In the background, a familiar foe has reappeared: banking sector issues, largely focused in the US, but also claiming a large Swiss institution (Credit Suisse) in Europe. It's understandable that, for many people, this brings back memories of the 2008 financial crisis. However, it remains our view that this is not another 2008. Today, banks and their balance sheets are very different, with much lower ratios of loans to deposits, and much better quality assets.

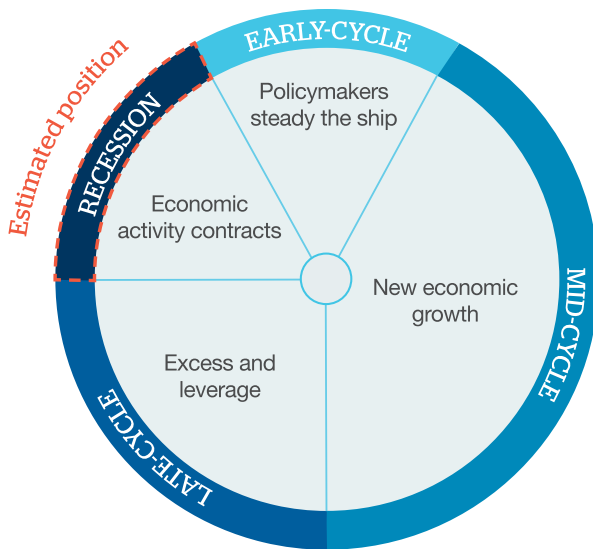
For some troubled banks, the recent issues have been down to bad management of the liquidity of their assets (the ease/speed with which these can be bought or sold), or the result of restructuring efforts. Others have been a casualty of the

'ripple effects' of a regime change from ultra-low (and even negative) central bank interest rates, towards a more positive and 'normal' interest rate environment.

### What does this all mean for the global economy?

We continue to believe that global growth will slow down before it gets better. As a result, we have moved our global economic cycle position marker from 'late cycle' (shown when we included this diagram in our *Investment Outlook 2023* at the start of this year) to 'recession'. As a reminder, the segments of this diagram mark the perpetual fluctuations in the global economy, between periods of relative growth and downturn.

## Economic cycle



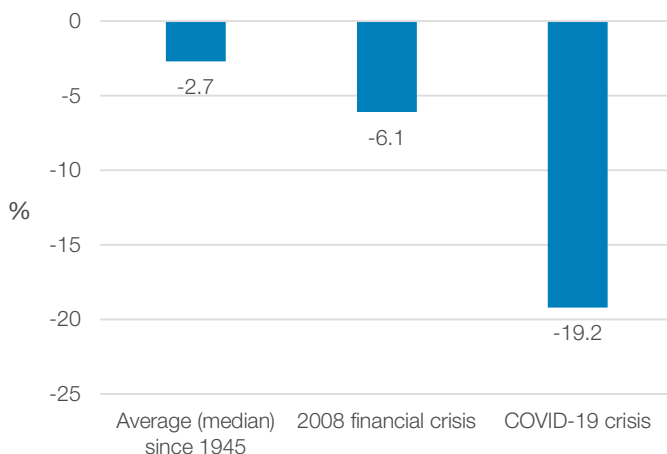
Source: Handelsbanken Wealth & Asset Management

'Recession' is a word that is used too frequently, and often with the wrong connotations. In literal terms, in the UK at least, a recession is merely two consecutive quarters (equating to half a year) of negative economic growth. When we talk about the recession stage of our economic cycle diagram, we are talking about a slowdown in growth over a period of 12 months or more. We do envisage this occurring, but we are talking about a classically-induced period of slower growth, triggered deliberately by policies from the world's leading central banks, rather than a sudden, deep contraction like those seen in 2008 or 2020.

'Recency bias' – a tendency to overemphasise the importance of more recent events – can make investors be extremely fearful when economic activity contracts, as it reminds us of the painful recessions of the recent past. However, as the chart below shows, 2008 and 2020's economic contractions were very outsized, and statistically unusual compared to more traditional downturns.

### Recent recessions have been statistical anomalies

Peak to trough falls (%) in US economic growth during recorded recessions



Source: Bloomberg, Handelsbanken Wealth & Asset Management

“

It remains our view that this is not another 2008. Today, banks and their balance sheets are very different, with much lower ratios of loans to deposits, and much better quality assets.

David Absolon, Investment Director

”

## Five reasons we think slower growth is inevitable

### 1. Stubbornly higher inflation

Inflation may have reached its peak, but it will likely stay elevated relative to central bank targets (2%) for the foreseeable future. And with inflation proving more stubborn than previously envisaged, central banks have been forced to keep their feet firmly pressed on the interest rate pedal this year.

### 2. Central banks' history of breaking things

When central banks, particularly the US Federal Reserve Bank (Fed), raise interest rates, history has shown that something usually breaks, culminating in economic slowdown.

### 3. A global economy sensitive to aggressive rate rises

Since 1955, the average (or median) rise in interest rates during a period of Fed interest rate rises has been around 3% from start to finish. Notwithstanding the ultra-low starting point this time around (0.25%), the Fed has raised interest rates by 5% – significantly more than the historical average. We think it's very unlikely that the global economy can merely shrug off such an aggressive set of interest rate rises, and is somehow much more immune to rate increases than the past. This suggestion is at odds with history, and not an assumption we are willing to make given the debt levels in today's global economy (debt is harder to service when interest rates rise).

### 4. A delayed response in the real economy

It's probably true that central banks are closer to the end than the beginning of the current set of interest rate hikes, and financial markets do expect developed market rates to be lower 12 months from now. However, the interest rate hikes already in play have not yet fully shown up in the real economy, as central bank policies typically work with a lag. The Fed estimates that it takes 5-6 quarters for a 1% rise in US rates to fully show up in the real economy. If so, then even when the Fed stops raising rates (likely in the coming months) much of 2022's interest rate rises will not yet be fully reflected in the US economy. This argument can also be applied to other regions, particularly in the developed world, and adds to the risks to growth from here.

### 5. Fewer loans to companies and consumers

When central banks tighten, the availability of credit to businesses and consumers generally falls. Banks become more discerning regarding who they lend to, as the rising cost of credit becomes punitive to some. As a result we also see the demand for loans fall. Taken together, these factors historically dampen growth in both the domestic and global economy. We are seeing this phenomenon again today. This situation is likely to be exacerbated by some of the issues currently at work in the banking system.



To find out more please get in touch:

[communications.hwam@handelsbanken.co.uk](mailto:communications.hwam@handelsbanken.co.uk)

## Assessing the performance of our investment strategies

### Our 'target return' performance benchmarks

Most of our investment strategies aim to deliver financial returns at levels linked to the rate of UK inflation (measured by the Consumer Price Index, or CPI). Over any given five-year period, these strategies target returns which are a pre-defined level above the rate of inflation. Our CPI-linked goals are known as the strategies' target return benchmarks, and are designed to help customers evaluate the strategies' performance in a real-world context. These targeted returns range from CPI+1% for our lowest risk (Defensive) strategies up to CPI+4% for our higher risk (Growth) strategies. Our highest risk (Adventurous) strategy is the exception, as it does not use a CPI-linked goal. Instead, this strategy aims to beat the returns offered by the global stock market (represented by the MSCI All Country World Index).

If the strategies deliver total financial returns to investors (after all costs and charges have been taken) equivalent to the total return of their target return benchmarks, we consider the strategies to have achieved their targets.

### Our financial market performance benchmarks

The performance of our investment strategies can also be compared to representative indices for two of the main asset types in which most of the strategies invest. These indices are 'MSCI United Kingdom (£) – net total return' (representing the performance of UK shares) and 'BoA Merrill Lynch UK Gilts' (representing the performance of conventional UK government bonds). These indices are known as the strategies' comparator benchmarks, and are designed to help clients evaluate the strategies' performance in a financial market context.

It is important to note that financial returns are not assured: there is no guarantee that the strategies' performance objectives will be met, or that a positive return will be delivered over any time period. When you invest, your capital is at risk.

Handelsbanken Wealth & Asset Management Limited is authorised and regulated by the Financial Conduct Authority (FCA) in the conduct of investment and protection business, and is a wholly-owned subsidiary of Handelsbanken plc. Tax advice which does not contain any investment element is not regulated by the FCA. Professional advice should be taken before any course of action is pursued.

- Find out more about our services by contacting us on 01892 701803 or visiting our website: [wealthandasset.handelsbanken.co.uk](https://wealthandasset.handelsbanken.co.uk)
- Read about how our investment services are regulated, and other important information: [wealthandasset.handelsbanken.co.uk/important-information](https://wealthandasset.handelsbanken.co.uk/important-information)
- Learn more about wealth and investment concepts in our Learning Zone: [wealthandasset.handelsbanken.co.uk/learning-zone/](https://wealthandasset.handelsbanken.co.uk/learning-zone/)
- Understand more about the language and terminology used in the financial services industry and our own publications through our Glossary of Terms: [wealthandasset.handelsbanken.co.uk/glossary-of-terms/](https://wealthandasset.handelsbanken.co.uk/glossary-of-terms/)

All commentary and data is valid, to the best of our knowledge, at the time of publication. This document is not intended to be a definitive analysis of financial or other markets and does not constitute any recommendation to buy, sell or otherwise trade in any of the investments mentioned. The value of any investment and income from it is not guaranteed and can fall as well as rise, so your capital is at risk.

We manage our investment strategies in accordance with pre-defined risk and reward targets, which vary from strategy to strategy to suit a range of customer needs. Portfolios may include individual investments in structured products, foreign currencies and funds (including funds not regulated by the FCA) which may individually have a relatively high risk profile. The portfolios may specifically include hedge funds, property funds, private equity funds and other funds which may have limited liquidity. Changes in exchange rates between currencies can cause investments of income to go down or up.

Registered Head Office: No.1 Kingsway, London WC2B 6AN. Registered in England No: 4132340

[wealthandasset.handelsbanken.co.uk](https://wealthandasset.handelsbanken.co.uk)