Evli Nordic Investor Podcast

Transcript

Episode 3: Q3/21

Tomas Hildebrandt: Hello, and welcome to the Nordic Investor Podcast by Evli for professional investors, following the Nordic capital markets. Every quarter, we present a short-term outlook for the Nordic market, extract learnings from the previous quarter, examine changing cross-asset trends and highlight key things to keep an eye on. My name is Tomas Hildebrandt and I am the Market Strategist at Evli's institutional asset management in Helsinki.

Today, joining me for this summer version of our podcast is Mr. Thomas Thygesen from Copenhagen. He's the Head of Global Equity Strategy at SEB. Thomas, welcome to the podcast.

Thomas Thygesen: Thank you, Tomas, it's a pleasure to be here.

Tomas: We will be talking about what's going on in the Nordics now, recap the earnings season and look at the outlook for the rest of the year. So Thomas, I wanted to begin by asking you about the Danish perspective. Does your approach differ from that of Sweden and Finland or are the countries one big happy family?

Thomas: You know the funny thing about the Nordic market is that if you take them together, it actually is one big happy family in the sense that it's a fully diversified market, with exposure to pretty much all the important factors out there. But there are of course differences between the individual markets, mainly in the composition of indices in terms of the sectors that are present. And speaking from Denmark, what is special from here is that Denmark is a growth market. The market is dominated by some very large healthcare stocks that have predictable long-term earnings patterns that makes them market interest rate sensitive in a way that is not exactly the same if you look to Sweden, Norway and Finland. But from that perspective of course that means that global factors or global trends that hit the Nordic markets might hit a little bit differently in the Danish market than it does in the Finnish market. But I still believe that the main drivers here are global and the job is to figure out how the global trends will be reflected in the relative performance in the Nordics.

Tomas: One aspect in the Nordics overall is also company size. There are different sizes of companies, but dominated by mid-size and perhaps some smaller companies.

Thomas: That is also true, compared with the Nordic index. But then again, you have to look at the differences inside the market. All the Nordic markets have exposure also to global leaders within the sectors they operate, companies are essentially punching a little bit above their weight if you look at how many people live in the Nordic region. While it is true that there is an underforest of smaller companies, not least within energy, technology and also in healthcare, you can also find the global champions in each of these countries, companies that are global brands and also have a size that makes them relevant from a large-cap perspective. So, it is a very diversified set of countries we're operating with here. That's why we believe that you can in fact look at the Nordics as a complete market in the sense that you could pick up all of the exposures we like to look for in our global strategy as well.

Tomas: And what about some fundamental issues, lately not all seems to be calm up here in the Nordics: We've seen some political turmoil in Sweden, and Norwegians are talking about interest rate hikes already. So what impact are these factors having on the Nordic market overall?

Thomas: Again, I think you bring up a really interesting point. Because as I tried to explain earlier, what we're looking for is global trends. Compared with when I started out in this business 30 years ago, I mean if you go back to the early nineties, obviously local factors were much more important. The market was not integrated across borders in the way that it is today. Now I think we mostly find that there are shared common factors that drive the various markets. In the case of political turmoil in Sweden, I think we have to maybe make some reservations here, because what counts as political turmoil in the Scandies would probably not be seen as tumultuous events if you go to other parts of the world. It is my impression that most investors basically ignored that political crisis assuming that there would be a consensus as there always is in Sweden, and in fact they turned out to be right because it was pretty much status quo after the turmoil, there was no change in really anything at all.

It's a little bit different when you talk about Norwegian rate hikes. The one thing where the various Nordic countries can still differ is in monetary policy, with Finland in the Euro, Denmark having a peg, but Norway and Sweden can sometimes deliver surprises from their own central banks that might have an impact on markets. But in the case of the Norwegian rate hike, I think this has been very well flagged and it has been the case for some years now that Norway really is a little bit different from pretty much everywhere else in the world in terms of interest rates. So I don't think that these two factors you mentioned here are local factors in general, or major drivers of performance. We do of course monitor them, and as I said, monetary policy or interest rate policy in particular is the one area where local factors can still play a role. I don't think that's just a hot theme right now.

Tomas: So, Norway is not the canary in the coal mine with the monetary policy tightening?

Thomas: Oh yes, I think you could see it that way. Norway is a very strong economy; they benefit from the high oil prices right now. When they start talking about rate hikes, usually you see that as a very, very early canary in the coal mine. But I think it will be a year or two at least before anybody else starts talking about rate hikes outside of Norway and that makes it more of an isolated event.

Tomas: Right. Let's turn now to the second theme we have: the earnings season and looking a little bit at the expectations. So, the earnings season is coming to an end. What's your assessment, how has it played out?

Thomas: Well in fact, not just in the Nordics, but Nordics are what we follow most intensely, this has been a blowout earnings season. We were expecting to see strong reports going into this reporting season because in the last weeks before the end of Q2 is one of the indicators I like to follow. Our analysts at SEB research started upgrading estimates for the quarter. And you know how it works, there's a little bit of communication coming as the quarter nears its end from companies to guide the estimates in the right way. But looking at what actually happened, particularly in Finland and Sweden, this was even stronger than what we dared to expect, and our analysts have upgraded 2021 estimates since the beginning of July by more than 10% for Finland and more than 6% for Sweden. This is in my view highly unusual that you shift numbers that fast and it does suggest that the underlying earnings trend remains strong.

Now Q3, given that we're seeing a bit of a soft patch we saw in Q2, the maximum impact of the U.S. reopening and the very powerful increase in activity that came from that, it looks to us like Q3 may be a little bit less impressive. We have seen the peak in the U.S. and the European reopening is not yet gotten going. In Asia they still seem to be stuck without the vaccines to help them get rid of the pandemic. So Q3 might be a bit less impressive than Q2 but I think the overall message is that there is a very powerful foundation for those earnings expectations. And I still see the potential for upgrades, not least when it comes to 2022 where we are expecting single-digit growth. If we were to see reacceleration in global momentum this autumn as we expect to see, then I think that the earnings estimates for the next year also have the potential for significant upgrades.

Tomas: So the fastest pace of recovery is now peaking. We're still seeing positive growth in most economies and also in the Nordics. This gives a little bit of underlying rotation to different themes from the strong growth.

Thomas: Absolutely. And if you look at the sector composition of those upgrades I talked about, it's noteworthy that the biggest winner has been materials, followed by IT, financials and industrials. These are classic cyclical sectors, and the fact that they're leading in the upgrades it's also, in our view, an indication that we're not close to a peak in earnings. The other thing is, there has been a lot of focus in the media and among investors too about peak growth. In the past, it would maybe have made more sense to discuss this issue, but we have to be clear here that the pandemic was not your usual garden-variety economic cycle. And we go straight down the way we did last year and growth will be bouncing back the year after with some numbers that will be hard to beat. It's not really the issue, you don't have to sell your shares just because the fastest growth rate has been coming. What we want to be looking for is the end of the surprise element. It's the quarter where it becomes clear that analysts have now factored in all the good news and maybe a bit more so even good earnings growth becomes a disappointment.

But what we saw in Q2 is an indication that we are not there yet and that there is still positive momentum also when it comes to earnings upgrades. The bigger question from the investor perspective right now is in our view not whether there's going to be a big earnings disappointment. If the sectors I just explained here are correct, if the cyclical leadership actually means that we're still in the process of driving estimates higher, in that case we should see some kind of reaction from interest rates later this year. And I don't think in that case it would be the bank of Norway or the Riksbank in Sweden, it's the Fed and the ECP we're looking for. So I think the next big thing for equities would be growth becoming so strong and so well entrenched that we can start removing some of the liquidity support. Going back to where we started earlier than in the discussion, in such a scenario with earnings momentum under cyclical side remaining strong but pressure coming from the rise in interest rates on valuations that would be beneficial in a relative sense for Sweden and Finland that have this strong cyclical exposure. Whereas the Danish market in the Nordic sense would be the relative loser because it is much more interest rate sensitive. But overall for the Nordics as a whole, I don't necessarily see a tightening of liquidity conditions as being negative in a relative sense. I would expect the Nordics to continue outperforming the rest of Europe. It's just going to be with overall returns that are a bit lower than what we've seen so far. And of course we need to be mindful that making 20% in 7 months in a number of years, you'd say that is a very very strong return for a full year. If we get somewhat lower absolute returns in the second half but we continue to see earnings upgrades that also would give some encouragement for the next year.

Tomas: Thomas, do we dare to mention the outlook for 2022? What do you believe is in store for the Nordics in the next 18 months to come?

Thomas: You could say I am a bit colored. I have worked for many years as an economist and when I look at the global macro picture right now, if you look at this from a traditional economic perspective when you see the powerful positive forces that are lined up, continuing support from central banks, continuing support from fiscal policy even after the end of the recession, that's something we've rarely seen before. And something that is likely to continue in the future. We have those two factors in place and there is ample reserve capacity in the economy in the shape of people who haven't got a job yet. Then it is in my view very unlikely that we are about to see a peak in the cycle. I would expect to see business investments start to kick in and join consumption as a growth driver. And that makes me optimistic for 2022.

And the point I made before, if we can continue raising our estimates for company earnings in 2022, then I don't see why the market should not resume its increase even if there is some kind of correction that we have to pay higher bond yields and high real yields in particular in fixed income markets.

Tomas: How is it then concerning inflation, that has been a hot topic lately as well. Do you see that unexpectedly high inflation could derail this outlook?

Thomas: You know, Tomas, how this works, right? The market likes to hit you when you're not prepared. The fact that we've had this set up this year where initially we spent several months in the markets pricing inflation prematurely, in my view, we were expecting to see inflation pick up. There were increases in bond yields and increases in inflation expectations and then it turned out that the initial shock was really just a temporary supply shock, that we were struggling to get the global economic machine back into gear after the pandemic. That's not really inflation and for that reason markets have now lowered their guard again. They have been pricing on low inflation expectations for the past couple of months. But the real underlying inflation story does not come from supply chain constraints or rising commodity prices: it will turn up when wages start accelerating. That's what I think is going to happen in the second part of this year, and that's why I believe that central banks will have to come back and start the discussion about inflation.

I don't think they will talk about rate hikes, but I do think they would start preparing for not pumping several hundred billion dollars into the system every month in fresh liquidity. I'm getting to the point where I think that would actually be a good idea. It might cost us a short-term correction, but I don't think it's healthy in such a strong economy to keep force-feeding the markets with fresh liquidity like this. So that’s what we expect to see going forward, that inflation is actually out there, it is coming but it came more slowly than markets were expecting. I don't know if that's the same experience you have, Thomas, but I think I've seen that one before, markets prepare for some risk and then it fails to materialise immediately and in fact it just hurts you twice as much because then by the time when it actually does materialize you've just like, okay it wasn't anything in and you go back to as you were.

Tomas: Either markets forget it or then it hits back with revenge.

Thomas: That's what I think is going to happen. You look at those U.S. wage numbers we got last week. There is a clear acceleration. We’re only in the early stages of the job creation that’s coming. I think it’s going to be the same thing here and I don't know if you've noticed this in Finland, but when we look around here in Copenhagen and our own business, I think it's maybe more than a decade ago since I got the sense that there was such a demand for labour that the employers actually have to work hard now to attract labor. That's what you see in the early stages of an increase in real wages. I don't think that's a bad thing. I think we had pushed too far into a high profit and low wage income regime, but it will have a little bit of a cost bump if we start repricing the interest rate outlook. So we’re cautious, I guess, in terms of overall return in the second half of this year, but we do expect rotation towards value stocks because that's what you typically get when inflation comes with pricing power in the way that we see right now.

Tomas: The inflation issue and the central banks’ support for the economy has a lot to do with the continuation of the pandemic and the Corona. So how do you feel the Nordics are coping with the pandemic compared to the rest of the world and how will it impact our region going forward?

Thomas: I think this is clearly one of the reasons why the Nordics have performed so well as a market during the pandemic in all four Nordic countries. With a combination of luck and public policy, we managed to avoid the worst-case outcomes from the pandemic. I mean we saw extremely limited declines in GDP growth last year. Even if there were lockdowns, it also means of course that the level of very severe sickness or even fatalities has been low, so that people are relatively comfortable to start behaving like normal again. So in a relative sense from a growth perspective, the Nordics have done extremely well.

And it does indicate one of those things we like to see as our strength, namely the trust in the public organisations that leads to a very high compliance when you put in restrictions and also to a high degree in take of vaccines when governments recommend that you do it. I suspect that this will continue because the pandemic is not over, it's going to be lingering out there. And the ones that have the highest vaccine levels and highest compliance with restrictions are also likely to have the lowest economic effects.

But I’m mindful that we should be humble when it comes to making predictions about the virus, right? It has been unpredictable from day one. I've just returned from a trip to Spain and it was my first trip in 17 months so I was very happy to be there, but I also got the sense that when you come to a country that has experienced the most serious effects of the pandemic, of course it means that the restrictions will linger for a while longer. It might also mean of course in the future that they will be more cautious. And that's the risk for the Nordics that we should not lower our guard now because the pandemic is not over. But we have a head start in combating it and we have a tradition as societies for handling this kind of story well. Fingers crossed, I guess that's the best we can say. If we can just continue what we've been doing, the Nordics would come out of this relatively better than most other countries.

Tomas: So it’s not quite over yet. But our time is ending and we’re coming to the end of this episode. Thomas, today we have talked about the earnings seasons, different factors affecting the Nordic markets and unmasked our crystal balls to discover what may lay ahead in the next year-and-a-half.

Dear listeners, join us for the final episode of the year which will be released later in autumn in which we look back at 2021 as a whole and discover what awaits us in 2022. Until then please visit our Evli blog hub and feel free to send us questions at fundinfo@evli.com.

Now it just remains for me to thank my guest, SEB's Head of Global Equity Strategy mr. Thomas Thygesen. Thomas, thank you for your time, it has been a great pleasure talking to you

Thomas: Thank you, Tomas, the pleasure was all mine.

Tomas: I'm Tomas Hildebrandt and this is the Nordic Investor Podcast by Evli. Bye bye, ciao, auf Wiederhören!