Nordea ASSET MANAGEMENT

**Press release**

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# The week ahead:
# When will the global carry trade die? What is the value of flexibility? – Canary in the coalmine

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## When will the global carry trade die?

We are in an equity overshoot supported by better economic data as we move to the right part of the U-shaped recovery. Fear of missing out and very low interest rates are supporting this process amid high cross-asset correlation and in some cases very low risk premiums. Most of us suspect that a short squeeze is coming and much as in the explosive rise of bitcoins initially, it can move far more than anyone expects. The more interesting question is what will kill this carry trade eventually beyond this expected risk event. The answer is a complex one:

1. Inflation in 2022/2023 should be higher with a Federal Reserve only belatedly tightening.
    a. Assuming the Fed gets it right, cyclicals and some value stocks should do well from more solid internal demand, while the lower ability to leverage and some profit margin compression should hurt small growth stocks and thin-profit non-cyclical businesses such as in manufacturing (e.g., Ford both loses and wins in this scenario).
    b. If the Fed undershoots, it will be forced to rapidly tighten in 2023/2024, sending shockwaves in the economy, force de-leveraging and lead to a sharp correction in risky assets.
    c. If the Fed overshoots, the same will happen, but sooner. That is the essence of the difficulty for the Fed. When inflation is close to being de-anchored, we are close to a potential catastrophe. That means that interest rate risk as measured by swaptions should be far more expensive.
2. Excessive valuations and leverage can jeopardize this carry trade especially as it is concentrated only in a few stocks which is typical of advanced carry trades.
3. Given that gains were concentrated in a few stocks, risks specifics such as retaliatory measures taken by China for instance could shake the entire stock market.
4. The global economy could suddenly decelerate should a trade war accelerate, a health crisis (e.g., USA) go out of control or a sudden loss of confidence in businesses due to higher corporate taxes as we should experience in the UK.

**Implications**

All of these events are the known knowns, the question is what we don't understand. In an unstable system as we are currently in, such events are far more likely, particularly in politics. That continues to support the idea of holding some global hedges (e.g., gold, long-duration US treasuries) and especially increasing exposures to flexible solutions that can quickly adapt their asset allocation.

## What is the value of flexibility? – Canary in the coalmine

A ship moving from port to port does this by minimizing its fuel expenses and riding out a storm. Flexibility, on the other side, is the ability to quickly adapt to new circumstances, to load onto new winds, sea currents and the likes. Both will get you to the port—though not necessarily in the same shape, time and speed. Preferences dictate the combination of the two. One way to look at flexibility is that it better allocates risk premiums in a timely fashion, typically much faster than traditional asset allocation. Another way to look at it is that the asset allocation is derived from a multiplicity of markets giving a far broader understanding of fault lines or new trends developing in one place. Hence, the value of flexibility is also in the signal it gives you for your wider asset allocation.

*-End-*

**About Nordea Asset Management**

Nordea Asset Management (NAM, AuM 223bn EUR*), is part of the Nordea Group, the largest financial services group in the Nordic region (AuM 311bn EUR*). NAM offers European and global investors' exposure to a broad set of investment funds. We serve a wide range of clients and distributors which include banks, asset managers, independent financial advisors and insurance companies.

Nordea Asset Management has a presence in Bonn, Brussels, Copenhagen, Frankfurt, Helsinki, London, Luxembourg, Madrid, Milan, New York, Oslo, Paris, Santiago de Chile, Singapore, Stockholm, Vienna and Zurich. Nordea's local presence goes hand in hand with the objective of being accessible and offering the best service to clients.

Nordea's success is based on a sustainable and unique multi-boutique approach that combines the expertise of specialised internal boutiques with exclusive external competences allowing us to deliver alpha in a stable way for the benefit of our clients. NAM solutions cover all asset classes from fixed income and equity to multi asset solutions, and manage local and European as well as US, global and emerging market products.

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