Investment Outlook

INVESTMENT OUTLOOK SUMMARY

December 2015

Brief world economic outlook

The sizeable stock market decline this past summer signaled widespread stress among investors and indicated clearly mounting worries about slowing economic growth and, further ahead, a possible recession. In reality, worries about a recession mainly concern the manufacturing sector, with a focus on commodities. Consumer and service-oriented companies are experiencing a rather favourable situation. We still expect economic growth to take off during the next couple of years. We believe that the manufacturing slump is temporary in nature. We also expect the downturn in oil prices to ease and we believe that low interest rates will continue to stimulate consumption. We do not believe that the Chinese economy will suddenly come to a halt either. Even though Chinese growth keeps decelerating, growth in the emerging market sphere is rising. A speed-up in India and a slowing decline in Russia and Brazil will provide greater stability. The impact of the refugee crisis on Europe is more political and humanitarian in nature; the economy will be only marginally affected.

Even though central banks around the world are still maintaining record-low key interest rates and pumping money into the system, 2016 may be a year when interest rates begin to normalise and climb. Such a trend may be triggered, for example, by the Fed gradual key rate hikes combined with easing deflation pressure, since commodity prices should not fall as fast as before.

Risks may be related to decreasing Chinese growth, further weaknesses in manufacturing, a clearly higher percentage of commodity companies going bankrupt or similar events. Rising interest rates combined with mediocre growth may lower risk appetite.

View on regions

US – Consumers, services drive GDP
The US has a dual-track economy, and this trend is gaining strength. The gap between purchasing managers' indices in manufacturing and service sectors is the widest in more than 10 years, with services being higher. This sector's strength is mainly due to good household demand, a strong labor market, low interest rates, rising asset prices and lower petrol prices. A strong private sector combined with rapid formation of new households is making construction investments the single strongest growth component.

US industry remains in a slump. ISM's purchasing managers' index (PMI) for manufacturing is fluctuating around the neutral level, while a stronger USD – combined with weaker demand from major EM economies like China and Brazil – is holding back exports. Meanwhile the oil price downturn is hurting the energy sector. But a PMI below the neutral 50 reading does not mean that the whole economy is in recession. Because of strong demand from households, the risk of recession is low. In our opinion, market worries are exaggerated – especially since we expect the industrial slump to be temporary.

Europe – Growth is increasing, structural problems are becoming clearer
The refugee crisis and structural challenges in the wake of the debt crisis are putting pressure on European politicians and underscoring both cooperation problems and major long-term challenges, but in terms of economic activity the situation is moving in the right direction. The economy is being stimulated by lower energy prices and the expansionary policies of the European Central Bank (ECB). Growth will accelerate a bit further in the next couple of years, mainly driven by exports and private consumption. Yet structural problems are limiting potential growth, even though debts are not an acute problem due to low interest rates. The direct economic impact of the refugee crisis will probably be marginal. We expect both budget deficits and GDP to increase in the near term by a few tenths of a percentage point (somewhat more in Germany). Growth is relatively evenly divided between countries, with a stable situation in Germany, decent growth in France and Italy and healthy momentum in Spain.

The British economy is continuing its stable growth. Low inflation and pay increases will allow solid private consumption, while productivity increases will drive the corporate sector. Fiscal austerity will slow growth during the next couple of years, and so will currency appreciation.

Asia/China – Persistent growth
Asia will remain the world's fastest-growing region, but the picture is not uniform. Exports are being squeezed, especially for commodity exporters like Malaysia and Indonesia, while domestic demand is still good. The coming US Fed interest rate hikes are a source of concern, but we do not expect any major turbulence.

This past summer's financial market turmoil was driven by increased uncertainty about China's economic growth. Concerns about possible continued deceleration have been accompanied by scepticism about official Chinese statistics. GDP growth is probably lower than the official figures and is likely to continue slowing, though to a lesser extent than before. In China, as well as globally, the service sector and private consumption are driving growth, while manufacturing is weaker. We also expect continued official stimulus measures that will help sustain growth.

In India, growth will accelerate somewhat less than we had forecast. This is mostly because reform efforts are proceeding more slowly than expected. Because of stronger industrial production, falling inflation and more stable government finances (which have made stimulus measures possible), India will still be a global growth winner in the next couple of years.

Latin America – Squeezed by commodity prices
Still-depressed commodity prices are squeezing Latin American economies. Meanwhile various countries are struggling with structural problems. The region's largest economy, Brazil, illustrates this well – growth has fallen since 2014 and is expected to continue doing so well into 2016. Falling commodity prices, combined with faltering domestic demand due to high inflation and rising unemployment, are squeezing growth. Brazil's cheaper currency is providing only partial relief by lifting industrial exports. Corruption problems and political tensions provide very little hope for improvement without external help. In Mexico, the region's second largest economy, growth is also being squeezed by lower commodity (oil) prices, but large exports to the US are a positive factor that still enables the country to maintain decent growth.

Eastern Europe – Russian problems and Central European stability
Russia is still grappling with major problems including continued Western sanctions, low oil prices and the conflict with Ukraine, which we expect to be long-lasting. GDP will thus probably continue to fall next year, although the slide will be gentler thanks to easing of sanctions and some recovery in oil prices. The Ukrainian economy will also continue to shrink, but we expect some stabilisation via debt relief from the International Monetary Fund (IMF) and other lenders.

Elsewhere in Eastern and Central Europe, the picture is brighter. Growing domestic demand is the main growth engine, thanks to good house old economic conditions. Exports are also gradually gaining strength, with higher German demand benefiting Central European countries while the Nordic region helps to sustain exports from the Baltic countries. Looking ahead, we foresee the best growth in Central Europe, especially in Poland and the Czech Republic, while the Baltic countries will be weighed down by Russia's problems.

SEB

Expected risk and return in asset classes in the next 12 months

ASSET CLASS	WEIGHT*	EXPECTATION (12 months)		REASONING
		RETURN	RISK	
EQUITIES				
Global	1234**5**67	7,5%	10,1%	At the current level of growth, the global corporate sector should be able to deliver 12-month earnings growth in the 5-7% range and dividend yield of 2-3 per cent. The broad exposure of this asset type provides stability in an environment of rising volatility. The major differences between sectors will continue, though hardly remaining at their 2015 level.
Emerging markets (EM)	123**4**567	7,4%	13,5%	Weaker EM economic performance and sluggish international trade will have a negative impact, while historically low valuations compared to global equities, make EM attractive. Heavy dependence on commodities, the negative effects of a strong US dollar and rising US interest rates are disadvantages. Commodity-exporting countries will be attractive only when we see pricing stabilization.
Sweden	123**4**567	11,0%	12,1%	Due to a combination of well-run companies and a balanced allocation among cyclical, defensive and growth companies, at current valuations the Swedish stock market is attractive as long as economic growth remains solid. The weak krona has provided support but is a factor that may change in the near future. Further ahead, there are clear risks connected to the real estate market and higher future interest rates.
BONDS				
Government bonds	1**2**34567	-1,6%	4,9%	A strengthening of economic conditions or a somewhat higher inflation rate may lead to gradually rising yields during the coming year, with a risk of negative returns.
Investment grade (IG) corporate bonds	12**3**4567	2,0%	2,9%	Low yields provide limited potential, but this asset type may work well as a stabiliser in a portfolio that includes other higher-risk assets.
High yield (HY) corporate bonds	123**4**567	4,9%	3,6%	Yields of around 3-4% stand out in the fixed income world, but as a consequence there is also clearly higher risk than with IG bonds, for example. High indebtedness and exposure to commodities are problems for this asset type, which is reflected in pricing.
ALTERNATIVE INVESTMENTS				
Commodities	12**3**4567	N/A	N/A	Gradually lower demand from China and elsewhere, combined with increases in production capacity, has resulted in sharply falling commodity prices. In a longer-term perspective, this asset class is attractive if inflation rises along with commodity prices.
CURRENCIES				
Currency pair	**Nov 17, 2015**	**Q4 2015**	**Q1 2016**	**Reasoning**
EUR/USD	1,06	1,05	1,02	A coming Fed rate hike may weaken the dollar in the short term, but the ECB will probably offset a strong euro via expansionary monetary policies. We expect a somewhat stronger dollar during 2016.

"Weight" shows how we currently view the asset type as part of a portfolio. These weights are changed continuously, based on our tactical market view, and may thus diverge from our long-term strategic view. Index/basis for calculation: ***Global equities*** *– MSCI All Country World Index in EUR.* ***Emerging markets*** *– MSCI EM TR in EUR.* ***Government bonds*** *– OMRX T-bonds in EUR.* ***Investment grade corporate bonds*** *– IBOXX Investment Grade Index in EUR.* ***High yield corporate bonds*** *– IBOXX High Yield Index in EUR. Forecast for* ***commodities*** *refers to a basket of energy (33%), industrial metals (19%), agricultural (36%) and precious metals (13%) in EUR. As for* ***currencies****, the forecast refers to most central currency pair EUR/USD.*

Source: SEB Investment Outlook, December 2015

Terminology explanation

Terminology used	Explanation
Domestic demand	Total purchases of goods and services, regardless of origin, by country's consumers, businesses, and governments during a given period. Domestic demand equals gross domestic product minus net exports.
Fiscal policy	Fiscal policy relates to government spending and tax collection. Fiscal policy refers to the use of the government budget to influence economic activity. For example, when economic growth is slowing down, the government can step in and increase its spending to stimulate demand and economic growth. Or it can lower taxes to increase disposable income for people and businesses.
Gross Domestic Product (GDP)	The monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments and exports less imports that occur within a defined territory.
Household (private) consumption	Transaction of the national account's use of income account representing consumer spending. It consists of the expenditure incurred by resident households on individual consumption goods and services, including those sold at prices that are not economically significant.
International Monetary Fund (IMF)	The IMF is an organization of 188 countries whose stated objectives are to promote international economic co-operation, international trade, employment, and exchange rate stability, including by making financial resources available to member countries to meet balance of payments needs. The IMF provides technical assistance and training for countries requesting it.
Monetary policy	Monetary policy is the process by which the monetary authority (usually the central bank) of a country controls the supply of money (the size and rate of growth of the money supply), for the purpose of promoting economic growth and stability. For example, if the money supply grows too fast, the rate of inflation will increase and the economy will "overheat". If the growth of the money supply is slowed too much, then economic growth may also slow. The main tools to control money supply include open market operations (buying or selling assets), changing interest rates and changing reserve requirements for commercial banks.
Purchasing managers' indexes (PMIs)	An indicator of the economic health of the manufacturing sector. The PMI indexes are based on five major indicators: new orders, inventory levels, production, supplier deliveries and the employment environment. A PMI of more than 50 represents expansion of the manufacturing sector, compared to the previous month. A reading under 50 represents a contraction, while a reading at 50 indicates no change.
Recession	A significant decline in activity across the economy, lasting longer than a few months. It is visible in industrial production, employment, real income (real income refers to the amount of goods and services you can buy today compared to the price of the same goods and services you could have purchased in another time period) and wholesale-retail trade. The technical indicator of a recession is two consecutive quarters of negative economic growth as measured by a country's gross domestic product (GDP).
SEB House View	Economic forecasts prepared by economists, strategists and analysts of SEB bank.
SEB Investment Outlook	A public release prepared by SEB economists, strategists and analysts. Investment Outlook gives readers an in-depth look at the investment climate and the prospects for seven asset classes. It also provides advice about current risks and opportunities in the art of investing. The report can be read in its entirety at www.sebgroup.com
Yield	The income return on an investment. This refers to the interest or dividends received from a security and is usually expressed annually as a percentage based on the investment's cost, its current market value or its face value.