Investment Outlook

INVESTMENT OUTLOOK SUMMARY

December 2017

Brief world economic outlook: Healthy growth, but mounting risks

The world economy has now entered what looks like a mature expansion period. A good household mood and the increasing capital spending needs of companies normally drive growth in this phase, including this time around. There is healthy growth in all major economies and in most sectors. We are thus raising our forecasts a bit and expect an annual global growth rate of close to 4%. Despite political uncertainty, we also anticipate that this healthy growth can last for another couple of years, without inflation necessarily speeding up significantly, even though this is the biggest threat to our bright picture.

RISK EXPOSURE DURING 2017	
THIRD QUARTER	FOURTH QUARTER
OVERWEIGHT	SLIGHTLY OVERWEIGHT

Our risk exposure is based on the proportion of equities in a diversified portfolio. The weight of equities is described as underweight, neutral or overweight. What a neutral weight is will depend on what risk profile the individual portfolio has.

After having been cautiously positioned earlier in the summer, in August we raised our equity allocation. During the third quarter corporate report season, risk appetite increased and both the stock and credit markets performed strongly. We thus ended up in a situation where quite a lot was already priced in. We again chose to adjust our portfolios downward, closer to a neutral situation. That is where we are at this writing.

How do conditions look in the final stretch of the year and ahead of 2018?

Among the repercussions of the positive report season, which was accompanied by solid economic statistics, volatility in both the stock market and credit market reached levels that may very well turn out to be lows for this cycle, implying that at this very moment the economy was at its strongest and investors had the most risk in their portfolios – a reflection of great optimism.

If we look at the underlying economic drivers, the potential for growth remains good and inflation remains at rather moderate levels. Based on this, we expect the corporate sector to continue delivering earnings increases during 2018.

Offsetting this are various constraining factors, such as gradually more restrictive central banks – although we are not expected to reach the breakpoint until a year from now – as well as historically high valuations and an investor community that has aggressive portfolios.

If the expansion continues as robustly as today, we may very well enter a final phase of strong stock markets during 2018 before it is time for an economic deceleration or before central banks slow the process. One alternative scenario is that investors will not wish to add more risk. This would imply rather flat market movements despite an economic boom. Alternatively, the economy could turn downward sooner than expected and the market would probably follow suit.

Economic outlook – Regions

US – Back to healthy growth

After a weak start to the year, US economic growth has again accelerated. This growth is supported by capital spending and net exports thanks to the weaker USD. Private consumption is also contributing, but a low savings ratio is reducing the room for consumption increases. Our main scenario is that the Trump administration will push through a tax reform, but that the total contribution to growth from federal fiscal policy will be limited. We expect 2.6% growth in 2017 and 2.0% in 2018. Healthy growth, low unemployment and a degree of inflation will give the Fed reasons to hike interest rates and withdraw monetary stimulus at a controlled pace.

Euro zone – Showing strong growth

Europe is the region where economic growth has been the biggest surprise in recent months. The upturn is broad-based, driven both by rising employment and improved household sentiment, as well as by increasing capital spending and rising exports. We are again revising our forecast of euro zone GDP growth upward, to 2.3% both this year and in 2018. Political uncertainty has diminished after this year's elections, and we expect intensified efforts to strengthen cooperation at the European Union level. Meanwhile Brexit negotiations on British withdrawal from the EU are under way, with a significant deceleration in the British economy as the clearest consequence.

Emerging market countries – Wheels spinning faster

The emerging market (EM) sphere is also contributing to the good outlook. World trade has clearly accelerated again, benefiting the often export-oriented EM economies. Along with continued stabilisation of commodity prices and improved current account balances in the most vulnerable countries, the general outlook is better than for a long time. In India, growth has been disappointing, with political changes and a currency ("demonetisation") reform having slowed the economy, but we expect renewed economic acceleration ahead. Both Russia and Brazil have left behind their recessions and are growing at a steady pace, but due to major structural problems their expansion will be weak in 2018-2019.

Sweden – Robust expansion

The economic boom in Sweden has gained strength. Expansionary fiscal and monetary policies as well as strong construction activity have driven growth. Uncertainty in the housing market will probably weaken the construction sector, although we expect a relatively moderate decline in home prices. Better export momentum and increasing industrial capital spending will instead contribute to continued healthy growth, helped by a weaker krona. We nevertheless expect a slowdown in the growth rate from this year's 3.2% to 2.6% in 2018 and 2.4% in 2019.

Factors behind our market view

Growth and earnings: Global growth is expected to end up at nearly 4% in 2018, with inflation just below 2%. This in turn will lead to continued rising profits, but with a risk that near-term expectations are too high.

Central banks: The US Federal Reserve is continuing to hike its key interest rate and also intends to shrink its balance sheet, which will reduce liquidity in the market. Other central banks are lagging behind, and the net effect of their actions is expected to remain positive. Interest rates and yields should gradually rise. This will occur in an economic system that already has a high volume of debt, which will increase risks. Sweden's Riksbank is still among the most expansionary central banks.

Valuations: Share prices are high from a historical perspective. Compared to government bond valuations or risk-free interest, valuations of equities and corporate credits are more normal – provided that economic growth lasts.

Risk appetite and positioning: Positioning is at high levels, while risk appetite is falling slightly. This means that some profit-taking can be expected and that investors are relying on persistently strong economic growth.

Expected returns: Outcomes are dependent on a correct growth forecast. We expect positive returns for most asset classes over the next 12 months. These expected returns are lower than historical averages, while risk is intact.

Examples of risks: A downturn in the economic cycle would have a major impact, but recession risk is low. Valuations are high from a historical perspective. After major liquidity injections and record-low key interest rates, central banks are expected to gradually normalise their policies during 2018 and onward, which means that a large "subsidising" force will fade. Global indebtedness is high. There are signs of weaker home prices here and there.

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

ASSET CLASS	TACTICAL EXPECTATION (12 months)	
	RETURN	RISK
EQUITIES		
Global	6.4%	10.0%
Emerging markets (EM)	7.9%	12.0%
Sweden	9.3%	11.1%
Government bonds	-2.3%	1.8%
Investment grade (IG) corporate bonds	-0.7%	3.2%
High yield (HY) corporate bonds	2.5%	4.9%
Emerging market (EM) debt	5.1%	11.3%
Hedge funds	3.5%	6.0%
Commodities	N/A	9.9%

Tactical expected return is based on the SEB House View as of September 4, 2017. Index/basis for estimates: Global equities – MSCI All Country World Index in local currencies. Emerging markets – MSCI EM TR in local currencies. Swedish equities – SIX Portfolio Return Index in SEK. Government bonds – OMRX T-bonds in SEK. Corporate bonds (IG and HY), IBOXX Investment Grade Index in USD and IBOXX High Yield Index in USD. EM debt – JP Morgan Emerging Markets Bond Index in local currencies. Hedge funds – HFRX Global Hedge Fund Index in USD.

GDP – YEAR-ON-YEAR PERCENTAGE CHANGE	2016	2017 (FORECAST)	2018 (FORECAST)	2019 (FORECAST)
United States	1,5	2,3 (2,2)*	2,6 (2,4)*	2,0 (2,0)*
Japan	1,0	1,5 (1,3)*	1,2 (0,8)*	1,0 (0,7)*
Germany	1,9	2,2 (2,1)*	2,2 (2,0)*	2,0 (1,8)*
China	6,7	6,9 (6,8)*	6,6 (6,4)*	6,2 (6,1)*
United Kingdom	1,8	1,5 (1,5)*	1,3 (1,0)*	1,1 (1,2)*
Euro zone	1,8	2,3 (2,1)*	2,3 (2,2)*	2,1 (2,2)*
Nordic countries	2,2	2,7 (2.5)*	2,3 (2,3)*	2,1 (2,2)*
Sweden	3,3	3,2 (3,2)*	2,6 (2,8)*	2,4 (2,4)*
Baltic countries	2,2	4,0 (3,5)*	3,4 (3,3)*	3,1 (3,1)*
OECD	1,8	2,4 (2,1)*	2,3 (2,1)*	2,0 (1,9)*
Emerging markets	4,3	4,9 (4,9)*	5,1 (5,0)*	5,1 (5,0)*
The world (PPP)**	3,2	3,8 (3,8)*	3,9 (3,8)*	3,8 (3,7)*

* Previous forecast (September 2017)

** PPP= Purchasing power parities; economies have been adjusted to account for price differences.

Source: SEB Investment Outlook, December 2017

Terminology explanation

Terminology used	Explanation
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.
Investment grade bonds, high yield bonds	Investment grade bonds – bonds (sovereign or corporate) with credit ratings that indicates a relatively low risk of default. High yield bonds – bonds (sovereign or corporate) with credit ratings that indicates a relatively higher risk of default than investment grade bonds. Because of the higher risk of default, these bonds pay a higher yield than investment grade bonds. Two main credit rating agencies Standard & Poor's (S&P) and Moody's, use different designations consisting of upper- and lower-case letters 'A' and 'B' to identify a bond's credit quality rating. S&P designations of 'AAA' and 'AA' (high credit quality) and 'A' and 'BBB' (medium credit quality) are considered investment grade. Credit ratings for bonds below these designations ('BB', 'B', 'CCC', etc.) are considered low credit quality, and are commonly referred to as high yield or "junk bonds".
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 power parity (PPP)	An economic theory that estimates the amount of adjustment needed on the exchange rate between countries so that an identical good has the same price when expressed in the same currency.
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.