Investment Outlook

INVESTMENT OUTLOOK SUMMARY

June 2016

Brief world economic outlook

The economic growth outlook has provided both good and bad news since the last issue of Investment Outlook (published in March 2016). Another weak first quarter for the US economy and a still subdued global manufacturing sector have forced us to lower our worldwide GDP forecasts – especially for the US. The much anticipated acceleration will thus remain elusive for some time to come. Meanwhile some of the storm clouds from last winter look significantly less threatening. Oil and other commodity prices have rebounded, industrial activity has stabilised and China's growth and currency policy have both unfolded more in line with expectations.

Central banks have (once again) "rescued" economic growth – especially the US Federal Reserve (Fed), which softened its message about future rate hikes in response to such events as falling commodity prices, but also the European Central Bank (ECB) and Bank of Japan, which are continuing their stimulus measures. But we now see signs that stimulus effects are fading, while underlying demand is not really picking up momentum and is being hampered by structural problems in some economies. We thus expect continued sluggish growth this year but believe that a relatively favourable trend for household finances and consumption in the US as well as Europe and China may still provide some acceleration during 2017.

View of regions

US – Back to decent growth

As in prior years, first quarter US growth was clearly below expectations. Unlike before, there is no obvious explanation this time around such as extreme winter weather or the like. Yet we still do not believe that this weakness reflects an underlying economic deceleration. Instead we are more inclined to view seasonal effects as an explanation. Worries about a manufacturing-led recession have faded, while financial conditions have again improved. Despite good household finances, the savings ratio is relatively high. Looking ahead, we see potential for improved consumption. Job growth and the broad impact of lower oil prices suggest this. Because of an increasingly strong labour market, we expect somewhat higher wage and salary inflation, which will put pressure on the Fed. The gentler tone adopted by the Fed this spring in response to international market turbulence and falling oil prices has served its purpose, but we believe that renewed economic strength will justify a Fed key interest rate hike.

Europe – Economy overcomes politics

Despite the refugee crisis, "Brexit" (potential UK exit from the European Union) worries and "Grexit" (potential Greek exit from the European Union) discussions, euro zone growth remains stable. Here too, households are the most important growth engine, thanks to rising employment, low inflation and low interest rates. Meanwhile capital spending is cautiously gaining momentum from low levels, hand in hand with increased credit market activity. Yet weak balance sheets at banks, especially in southern Europe, threaten to hold back economic activity. The ECB continues to pursue expansionary monetary policy, but inflation is expected to remain low for a long time. Overall, we foresee stable though not vigorous growth. The biggest risks are political: in the near term the referendum on a possible British exit from the European Union, and a bit further ahead structural issues related to the future path of the EU. The new opt-outs recently negotiated by the UK create uncertainty, not only about the speed of the EU's progress towards an "ever-closer union" but also about what countries will follow that path towards integration. In the UK, economic growth has slowed sharply during the first half of 2016 while awaiting the outcome of the "Brexit" referendum.

Asia/China – Soft landing and consumers are creating stability

China forecasts have long been dominated by worries about an economic hard landing, due to the transition from an export- and investment-led economy to one more driven by private consumption and services. After a turbulent start to the year, we are now seeing clear signs of stabilisation. The service sector, accounting for more than 50% of the economy, is growing rapidly because of a strong household sector, while Chinese authorities are using looser monetary policy and higher capital spending to help sustain the financial system and growth. This supports our unchanged forecast of a continued soft landing.

Elsewhere in Asia, the Indian economy is still growing at a healthy pace but is being held back by the Narendra Modi government's inability to maintain a desirable pace of major reforms that are needed and have been promised. After delays, the national sales tax will probably be enacted this year. Land purchase and labour market reforms are moving sluggishly. In other countries, the economic picture is mixed but relatively stable. In Indonesia, growth has steadied in response to rising commodity prices. South Korea and Taiwan should benefit from future global acceleration.

Latin America – Continued problems may lead to new disappointments

More dovish interest rate signals by the Fed have weakened the US dollar, leading to rising commodity prices and a greater appetite for emerging market assets. This is why Latin America, led by Brazil, is among this year's currency and stock market winners. Although the commodity price upturn is easing some of the pressures, many big problems remain – especially in regional giant Brazil, where political turbulence remains severe, high inflation is undermining purchasing power and capital spending is down. Bright spots include falling imports and slowly rising exports, which are improving Brazil's external balance, though from unfavourable levels. The positive market trend is most likely being fuelled by hopes of major policy shifts in case of a (probable) change of president, but the government has little manoeuvring room and there is a risk that the market will exaggerate Brazil's potential.

Eastern Europe – Russia bottoming out, other economies maintain growth

Due to the oil price recovery, slower inflation and expectations that EU sanctions will be eased this year, we believe that the Russian economy is past its worst period. With oil prices around USD 50/barrel, government finances remain squeezed and cost-cutting is necessary. Economic data such as industrial production, retail sales and exports are continuing to fall, but the downturn is showing clear signs of decelerating. Despite continued problems, we expect Russia's real economy to gradually improve, with a weak upturn in GDP growth in the second half of 2016.

The countries of Central Europe will maintain their growth at a healthy pace, with Poland leading the way followed by the Czech Republic and Hungary. Stable finances, strong household sectors and decent demand from the EU are important drivers, while low global price pressures and interest rates will keep inflation down.

Nordic countries – Sweden ahead, others rebounding

The performance of the Nordic economies remains divergent, though most indicators are generally favourable. Norway, which has been hard pressed by falling oil prices, seems to have bottomed out during the first quarter. Demand in the mainland economy is providing upside surprises, driven by household consumption and fiscal stimulus measures. The Finnish economy is struggling against headwinds, but surprisingly strong statistics during the winter and spring and a brighter export outlook will lead to weakly positive growth, despite hard-pressed households. In Denmark, we view the slump during late 2015 as temporary and expect economic growth to accelerate somewhat this year, driven by job growth and stable export markets. Unlike its struggling neighbours, Sweden is showing a very solid economic growth rate. This rapid GDP increase is attributable to strong domestic demand, while the relatively weak krona is benefiting exports. Domestic demand is mainly being driven by record levels of public sector consumption and investments, largely due to refugee-related spending aimed at achieving an ambitious level of integration into Swedish society. Strong private consumption is helping to sustain growth, while imbalances in the labour market and other sectors are causing some concern.

SEB

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

ASSET CLASS	WEIGHT*	EXPECTATION (12 months)		REASONING
		RETURN	RISK	
EQUITIES				
Global	1 2 3 **4** 5 6 7	5,5%	12,3%	Dividend yield is expected to exceed 2 per cent. The broad exposure of this asset type provides stability in a highly volatile environment. The big differences between various sectors will persist. From a Swedish perspective, we expect extra returns due to a stronger USD.
Emerging markets (EM)	1 2 **3** 4 5 6 7	6,4%	15,6%	After a strong recovery due to a weaker USD and rising commodity prices, we now expect a more modest trend but do not foresee a price slide again, like that of early 2016.
Sweden	1 2 3 **4** 5 6 7	9,6%	13,6%	Swedish equities have higher expected returns than global equities, due to weak performance in the past year. Further ahead, there are clear risks connected to the real estate market and higher future interest rates.
BONDS				
Government bonds	**1** 2 3 4 5 6 7	-2,2%	3,1%	Due to low government bond yields, portions of the bond market are unattractive. A strengthening of economic conditions or a somewhat higher inflation rate may also lead to gradually rising yields during the coming year, with a risk of negative returns.
Investment grade (IG) corporate bonds	1 2 **3** 4 5 6 7	1,9%	2,8%	Low yields provide low but positive returns in the IG segment. This asset type may work well in a portfolio that includes other, higher risk assets.
High yield (HY) corporate bonds	1 2 3 4 **5** 6 7	5,7%	4,4%	Yields of around 4-7% stand out in the fixed income world, but as a consequence there is also significantly higher risk than with IG bonds, for example. Worth pointing out is that default risks have decreased thanks to the commodity price upturn.
ALTERNATIVE INVESTMENTS				
Commodities	1 2 **3** 4 5 6 7	N/A	N/A	In a long-term perspective, this asset class is attractive if inflation rises along with commodity prices. The oil price decline was primarily a supply side issue and the crisis early in 2016 increases the likelihood that producers will become more inclined to reach a consensus on suitable production volumes.
CURRENCIES				
Currency pair	**May 25, 2016**	**Q2 2016**	**Q3 2016**	**Reasoning**
EUR/USD	1,12	1,10	1,09	Euro weakness is part of our forecasts, but will depend on the US Federal Reserve (Fed) initiating key interest rate hikes.

"Weight" shows how we currently (May 2016) 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 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.* ***Investment grade corporate bonds*** *– IBOXX Investment Grade Index in USD.* ***High yield corporate bonds*** *– IBOXX High Yield Index in USD. As for* ***currencies****, the forecast refers to most central currency pair EUR/USD.*

Source: SEB Investment Outlook, June 2016

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.
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.
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.

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