Investment Outlook

INVESTMENT OUTLOOK SUMMARY

June 2017

Brief world economic outlook: optimistic, with an eye on risks

Record-strong forward-looking economic indicators and a clear surge in growth are providing a bright economic picture. We are raising our global growth forecasts, mainly driven by higher capital spending and good private consumption – especially in Europe and emerging market (EM) economies. Yet our upgrades are modest, due to restraining factors such as high capacity utilisation, weak demographics and productivity growth as well as large debts. Strong corporate reports and upward adjustments in earnings forecasts are helping drive stock markets. Since valuations are on the high side, while the investor community already has a fair amount of risky assets in its portfolios, we have a cautious short-term view of the stock market but see some upside potential during the coming year.

View of regions

US – Short-lived slowdown

We are not counting on any major economic stimulus measures from political leaders in 2017-2018, but some tax cuts are probable and will contribute marginally to growth. Still, continued labour market improvement and a much brighter capital spending outlook suggest that growth will speed up again, along with continued very strong forward looking sentiment indicators. Looking ahead, these indicators are likely to fall somewhat, but given the strong US labour market and relatively high savings ratio, households should open their wallets. Along with strong capital investments and industrial activity, this will lead to healthy growth over the next couple of years.

Euro zone – Growth is accelerating

Conditions for growth have continued to improve in recent months. Rising employment is contributing to more optimistic households, while a faster pace of business activity is pushing capacity utilisation higher, triggering investments that are driving growth. Forward-looking indicators are also continuing to provide a highly positive picture, while the relatively weak euro is helping to sustain exports, but growth is being held back by demographic challenges such as ageing populations and refugee inflows. Political uncertainty has diminished due to the election outcomes in the Netherlands and France. While the euro zone still faces substantial political challenges in the next few years, we do not expect these to have any crucial near-term impact on the economy.

Emerging markets – Wheels spinning faster

The outlook for emerging market (EM) countries has recently improved. Although there are still risks of protectionism, world trade is increasing again. This benefits EM economies, which are often export-oriented. Add in a continued stabilisation of commodity prices and improved current account balances in the most vulnerable countries, and the general picture looks better than for a long time.

Among major EM countries, India remains the shining star in terms of growth. Last year's problematic currency reform slowed the economy less than feared. Meanwhile India has implemented several important economic reforms, especially the national goods and services tax launched this year, which will favourably impact growth starting in 2018. Both Russia and Brazil have emerged from recession, but due to major structural problems growth will be weak in the next couple of years.

China – Economic surge, policy tightening

China's growth was robust early in 2017. Aside from an already strong service sector, there was a clear industrial upswing, thanks to stronger exports and more construction. We expect the authorities to tighten monetary policy and the credit market, thereby slowing growth. We are raising our growth forecast slightly and still believe that China will be an important contributor to global growth ahead.

Sweden – Upturn in domestic demand
Nordics ex Sweden – Divergent, but brighter prospects

Already strong optimism in the Swedish economy has intensified in recent months. We have seen impressive figures for both industrial production and the labour market, confirming our scenario of GDP growth well above the historical trend. Also contributing to this is the need for housing and public services, among other things due to the recent refugee crisis, but this effect will fade during 2017-2018. Weaker than expected private consumption is holding back growth. Along with historically strong economic indicators, this implies potential for better growth than expected.

Swedish economic indicators have also improved in recent months. Although our growth forecast was already higher than that of many others, we are choosing to adjust it slightly upward. This change is partly due to stronger exports, but domestic drivers still dominate. This includes very rapid expansion in housing construction and public sector consumption. Fiscal policy will remain expansionary in 2017-2018, mainly due to rising public sector consumption in the wake of the large refugee flows of recent years. Stronger international economic conditions, combined with a weak krona, have boosted manufacturing sentiment indicators to five-year highs. Household consumption increased somewhat more slowly than expected in 2016. This is probably due to worries about a future home price decline and low confidence in Sweden's economic future. But late in 2016, consumer confidence rose clearly, suggesting that consumption may accelerate this year.

Norway's "mainland" economy (excluding offshore oil and gas) is continuing the recovery that began about a year ago, but the energy sector is still holding back growth via falling capital spending to a greater extent than we had previously expected. Inflation is subdued, which will postpone expected key interest rate hikes. The Finnish economy has finally accelerated, leaving stagnation behind. Industrial production rose in 2016 for the first time in years, and the order situation has improved. Households are an important growth engine, and confidence has climbed noticeably. In Denmark, a major upward revision in the national accounts for 2014 and 2015 has resulted in data more in line with other indicators. The obviously good growth during these years looks set to persist, but household consumption slowed during early 2017, among other things due to tighter credit restrictions. Exports and to some extent capital spending will accelerate and take over as growth drivers.

View of asset classes

Equities – Earnings growth makes us cautiously optimistic

The first quarter corporate report season delivered upside surprises, with both strong sales and earnings growth. Strong earnings growth for listed companies, combined with non-existent interest income and a reduced risk of France leaving the European Union are helping to sustain the stock market, but high valuations and the fact that many investors already own equities limit their potential.

Fixed income – Expansionary monetary policy, but changing risks

We see few reasons for the market to again begin flirting with deflation risks and expect slowly rising long-term yields, driven both by gradual US Federal Reserve interest rate hikes and the Fed's plans to gradually begin reducing its balance sheet starting in late 2017. The European Central Bank (ECB) will continue to stimulate the market but will ease up on its stimulus again in September. Since we expect strength in the underlying economy, followed by higher interest rates, we see potential for high yield corporate bonds. Gearing looks set to fall in 2017 as a result of improved corporate earnings, while the default rate is expected to decrease significantly during the year.

Alternative investments – Upturn for hedge funds while the commodity segment struggles

This year has shown an initial upturn for most hedge fund strategies, after the challenges of 2016. Corporate bonds have performed well, in line with equities, but government bond yields have lost their lustre and are signalling some uncertainty.

This has created uncorrelated movements between asset classes. Some hedge funds have benefited from this, while others have found it a challenging environment. We advocate broad exposure among different strategies. While the OPEC cartel is cutting back oil production, the US shale oil industry has been boosting its output. OPEC's efforts to prevent price declines appear unlikely to be enough, unless it extends current production limits.

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

ASSET CLASS	WEIGHT*	EXPECTATION (12 months)	
		RETURN	RISK
EQUITIES			
Global	1 2 3 **4** 5 6 7	5.7%	13.9%
Emerging markets (EM)	1 2 3 **4** 5 6 7	6.7%	16.5%
Sweden	1 2 3 **4** 5 6 7	8.8%	13.7%
BONDS			
Government bonds	**1** 2 3 4 5 6 7	-1.7%	2.0%
Investment grade (IG) corporate bonds	1 2 3 **4** 5 6 7	0.4%	3.6%
High yield (HY) corporate bonds	1 2 3 **4** 5 6 7	2.4%	6.3%
Emerging market (EM) debt	1 2 3 **4** 5 6 7	5.8%	13.%
ALTERNATIVE INVESTMENTS			
Hedge funds	1 2 3 **4** 5 6 7	N/A	N/A
Commodities	1 2 **3** 4 5 6 7	N/A	N/A
CURRENCIES			
Currency pair	**May 11, 2017**	**Q2 2017**	**Q3 2017**
EUR/USD	1,09	1,09	1,10

*"Weight" shows how we currently (May 11, 2017) 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. **Hedge funds** – HFRX Global Hedge Fund Index in USD.*

GDP – YEAR-ON-YEAR PERCENTAGE CHANGE	2015	2016 (FORECAST)	2017 (FORECAST)	2018 (FORECAST)
United States	2,6	1,6	2,3	2,5
Japan	1,2	1,0	0,8	0,5
Germany	1,7	1,9	2,0	1,9
China	6,9	6,7	6,7	6,3
United Kingdom	2,2	1,8	2,0	2,0
Euro zone	2,0	1,8	2,0	2,0
Nordic countries	2,3	2,0	2,2	2,1
Sweden	4,1	3,3	3,1	3,2
Baltic countries	2,0	2,0	3,1	3,2
OECD	2,4	1,8	2,1	2,2
Emerging markets	4,1	4,0	4,8	4,9
The world (PPP)*	3,4	3,2	3,7	3,8

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

Source: SEB Investment Outlook, May 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.
Organization of Petroleum Exporting Countries (OPEC)	An organization consisting of the world's major oil-exporting nations. OPEC was founded in 1960 to coordinate the petroleum policies of its members, and to provide member states with technical and economic aid. OPEC is a cartel that aims to manage the supply of oil in an effort to set the price of oil on the world market, in order to avoid fluctuations that might affect the economies of both producing and purchasing countries.
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.