SEB

Investment Outlook

Summary

June 2019

The stock market's performance until May was impressive, but do not forget that much of the fuel was 2018 weakness. In May, the US Chinese trade talks generated new share price movements. During last autumn's market volatility, there was great concern among investors about an imminent recession, as economic statistics and the capital market sent signals of a rapid deterioration. We commented on this to continue believing in our then optimistic growth forecast and not to sell shares and other risk assets. This turned out to be a correct call. The tailwinds enjoyed by the market in 2016 and 2017 became headwinds in 2018. We still had good economic expansion, combined with US tax stimulus. However, the US Federal Reserve (Fed) was hiking interest rates and shrinking its huge holdings of fixed income investments. Along with trade wars and Brexit, this resulted in an ever-weaker market, culminating in severe turbulence during the final quarter of 2018. Market turbulence and worries about declining economic activity eventually persuaded the Fed to ease its tightening policy and led Chinese authorities to step up their growth-supportive initiatives. These actions led to a rebound in falling risk appetite, and market worries faded. The fact is that stock markets, after their sharp upswing this year, are back at about the same levels as before the fourth quarter 2018 turbulence. The trend has thus become flatter and volatility has increased, which is quite normal late in a cyclical upturn. We are now in the interesting situation that shares are priced much higher than one quarter ago, while the economic turmoil of the past autumn and winter has receded. Looking ahead, however, already relatively high valuations suggest that we will also see a period with more volatility. If we now experience a scenario of upward-revised earnings, there is potential for a more positive stock market trend. However, due to share price upturns we have chosen to reduce the risk level in our portfolios

RISK EXPOSURE	
2019 Q1	2019 Q2
SLIGHTLY OVERWEIGHT	SLIGHTLY UNDERWEIGHT

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.

Macro and other market drivers

In several ways, the situation has improved. The obvious shift in monetary policy by the Federal Reserve was the main factor. Early this year the US central bank clearly indicated that it was abandoning its path of increasing interest rates, adjusting its monetary policy to the growth situation and the financial markets. Meanwhile Chinese credit easing seems to have had an impact on both global trade and growth in China, partly driven by US-Chinese trade talks.

Partly offsetting improvements in economic policy, underlying growth has been more fragmented. In the United States, signs of strength have predominated. In China the deceleration has continued, though recent data provide some hope. In Western Europe, weakening tendencies have remained pervasive. The American economy has assumed a slightly different role in this phase of the global economic cycle. The US is normally first in the cycle. Since we are now in a mature phase, the US economy should thus be the first to show signs of weakness. Instead its first quarter growth was surprisingly strong. This is partly due to temporary factors, but underlying growth is robust. We expect US growth of 2.3% in 2019, driven especially by a continued strong labour market. Our forecast for 2020 is 1.7%.

For emerging market (EM) countries, growth will be somewhat slower this year than in 2018. But we believe their deceleration has already largely occurred, since we now see signs of stabilisation in trade flows and industrial activity. We thus expect some acceleration in growth going forward. This will make the EM sphere a reliable global engine in the next couple of years, with annual growth of 4.5-5%.

Overall, we have adjusted our growth outlook somewhat lower for 2019 and are forecasting a global GDP increase of 3.3%, down from 3.5% earlier. We are sticking to a forecast of 3.5% in 2020.

Examples of risks

An economic downturn would still create problems, but the short-term probability of such an event has decreased. Efforts to reach a US-Chinese trade agreement are moving forward. It is in the interest of both countries to achieve a solution. Once this is in place, it will be time for Europe and the rest of the world to sign trade agreements with the US, which may then become a focus of market attention. Brexit has been postponed, along with related risks, but market worries should increase this autumn. Another risk connected to economic and credit cycles is the build-up of debt around the world since the 2008-2009 financial crisis.

Conclusion

Our recommendation is to maintain a total risk level around respective neutral positions and make sure not to have an overly concentrated portfolio, since the risk of major errors is higher than usual.

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

ASSET CLASS	TACTICAL EXPECTATION (12 months)	
	RETURN	RISK
EQUITIES		
Global	7.3%	12.6%
Emerging markets (local currencies)	7.9%	14.2%
Sweden	8.5%	13.0%
FIXED INCOME INVESTMENTS		
Government bonds	-1.3%	1.2%
Investment grade (IG) corporate bonds	0.9%	2.7%
High yield (HY) corporate bonds	3.7%	3.9%
Emerging market (EM) debt	7.0%	8.1%

Tactical expected return is based on the SEB House View as of May 2019. 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.

Because of the late-cyclical phase, with all-time highs on various stock exchange and the return of narrow credit spreads (yield gaps between government and corporate bonds), we are a bit more conservative regarding taking risk.

Central banks and investor positioning stand out on the plus side. Investors remain wary after last year's stock market slide. On the minus side this time around are valuations (P/E ratios), which have surged during the early 2019 rally. A more neutral signal is being provided by global economic activity and the earnings- generating capacity of companies, which are the source of both threats and potential gains ahead. If the economy regains momentum the risk situation will improve, and vice versa. Given the information we have at the moment, as well as the strong period we have already experienced so far during 2019, however, we regard it as suitable to have a more neutral portfolio. It is also important to emphasise that in the late phase of the economic cycle, it is usually profitable to shift between over- and underweighting of risk exposure when the trend levels off and volatility increases. In earlier phases, such as the recovery phase and the stable growth phase, investors should be cautious about underweighting.

Equities

- Nervousness, risk aversion and falling share prices late in 2018 have been replaced by greater optimism and rising stock markets.
- The MSCI All Country World Index in local currencies, including dividends, reached all-time highs in early May.
- Share prices have climbed more sharply than earnings. We thus foresee limited potential from current levels.
- The quarterly corporate report season has been better than feared. The low earnings expectations have been exceeded.
- We are sticking to our forecast of low single-digit growth figures for global earnings.

Fixed income investments

- The US Federal Reserve is signaling an unchanged key interest rate in 2019 and 2020. We believe the US Federal Reserve will leave its key rate unchanged in 2019 and 2020.
- The European Central Bank is being forced to postpone its rate hike until at least 2020.
- Credit markets are benefiting from the more dovish central bank policy stance.
- Economic growth and undervalued currencies will provide support to emerging market bonds.

Source: SEB Investment Outlook, May 2019

Glossary

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.
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.
Price-earnings ratio (P/E)	A valuation ratio of a company's current share price compared to its per-share earnings for the past year. For example, if company's share price is EUR 100 and it reported EUR 10 per share in annual earnings, the P/E ratio would be 10. In general, a high P/E suggests that investors are expecting higher earnings growth in the future compared to companies with a lower P/E. However, the P/E ratio does not tell us the whole story by itself. It is usually more useful to compare the P/E ratios of one company to other companies in the same industry, to the market in general or against the company's own historical P/E.
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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Before making investment decisions, we would recommend thoroughly analyzing the financial, legal, regulative, accounting and taxation issues related to investing in the fund and assessing all of the risks associated with the investment and the relevance and suitability of the investment. If necessary, more detailed explanations should be sought from an SEB adviser, and in taxation issues from a specialist of the relevant area. General information about investing as well as securities is available at SEB's website https://www.seb.lv