Investment Outlook

INVESTMENT OUTLOOK SUMMARY

March 2016

Brief world economic outlook

Recent months have been dominated by worries about the strength of the global economy. These worries have led to sharp price declines in risk assets such as equities, which have fueled further worries. The biggest sources of concern are an increasingly apparent weakness in industrial activity – especially in the United States – questions about China's economy and currency policy as well as falling oil and other commodity prices, which intensify financial market worries via increased credit risks. We have accordingly lowered our economic growth forecasts for 2016 and 2017 marginally. But although recession risks have increased, there is still potential for a cautious acceleration in growth this year. In both the US and the euro zone, there is underlying strength, mainly driven by robust private consumption due to such factors as improved labour markets. Incoming data about the Chinese economy also indicate that worries about economic growth are exaggerated, while the normal growth-enhancing effects of lower oil and commodity prices will probably come into play during 2016 as oil prices stabilise. Overall, our scenario of cautiously accelerating growth remains in place, but with clear downside risks.

View on regions

US – Consumers, services drive GDP

The US economy continues to operate at two speeds. Sluggishness in the manufacturing sector is increasingly coloured by international developments, with a strong USD, lower Chinese demand and clearly lower energy prices souring the mood. The heaviest pressure is on energy companies; the oil price slide risks claiming more victims, despite successful productivity-raising efforts. On the other hand, there is good growth and resilience in domestic, service-oriented sectors. This is mainly because households are benefiting from a relatively robust labour market – more people are landing jobs and wage increases can be expected – while their wealth position is improving. We also believe that lower energy (including petrol) expenses will gradually lead to higher consumption. Since private consumption is by far the biggest single element of the US economy, we expect growth to overcome the drag from the manufacturing sector, which is shrinking in relative terms. Economic statistics also support this scenario; in recent decades, the service sector has led manufacturing, not vice versa.

Europe – Robust economy, shaky union

In contrast to the political storm clouds, the euro zone economy continues to stabilise, with slightly increasing growth. Drivers include lower energy prices (the region is a large net importer), while the weaker euro is benefiting exports. Lower energy prices are helping to push down inflation, enabling real household incomes to climb in spite of modest wage hikes. Gradually improving labour markets are also contributing to greater demand. In addition, there are signs of increasing business investment needs, which are reflected in rising credit demand.

There is also a risk factor here, however, since especially in southern Europe the banking sector is weighed down by a large percentage of bad loans. Other risks are primarily at the political level. The political challenges are apparent, for example given the European Union's inability to manage the refugee crisis and this summer's British referendum on a possible exit from the EU ("Brexit"). Yet the economic impact of Brexit would probably be limited – in the United Kingdom, too, households and the service sector are dominant economic forces that are providing decent growth despite some sluggishness in manufacturing.

Asia/China – Continued growth, with political challenges

We do not believe that the Chinese stock market crash early in 2016 is justified by any major weaknesses in the real economy. The market downturn is due to the inability of the authorities to deal with plunging share prices and their unclear signals about currency policy, which are increasing market worries about new policy mistakes. Of course there are some questions about economic growth, especially related to the manufacturing sector and China's inventory of unsold homes, but because of continued healthy activity in the service sector and an easing of economic policy, we still expect an economic soft landing as growth slowly decelerates.

Elsewhere in Asia some of the smaller countries look stable, with some of the increases in economic growth being driven by the private sector. In India, we expect continued high growth – the country is at the top of the international growth charts. But this increase is being slowed somewhat because the Narendra Modi government has not really succeeded in implementing its ambitious reform programme at the desired pace.

Latin America – Squeezed by commodity prices

The region is being squeezed by falling oil and other commodity prices, in many cases combined with structural problems and strong dependence on the US dollar. The situation is worst in Venezuela, but even Latin America's largest economy by far – Brazil – is struggling mightily. The country is experiencing a long, deep downturn, which has spread through much of the economy – it started with falling export revenue and capital spending, then plunging private consumption, driven by troublingly high inflation and a weak labour market. Although the decline in Brazil's currency has helped its exports a bit, that effect is offset by lower demand from China. Yet we expect the decline in GDP to slow somewhat this year; the picture will brighten further during 2017. In Mexico, the region's second largest economy, two-speed growth persists – with a depressed oil sector partly offset by exports to the US.

Eastern Europe – Central Europe is resilient to the Russian problems

Eastern (including Central) Europe is also showing two-speed growth, although the gap is not between economic sectors as in the West, but instead is geographic. In Central Europe, especially Poland and the Czech Republic, the picture is still relatively positive. Here, too, household demand is an important driving force, as real incomes rise and labour markets improve.

In Russia, the outlook will remain problematic for another while. Aside from structural problems, the conflict with Ukraine and related foreign trade sanctions, the fall in oil prices has slowed economic growth significantly. It is also pushing down the value of the rouble, forcing inflation higher and undermining household purchasing power. We expect continued negative growth this year. A stabilization in oil prices and an easing of sanctions will lead to weak positive growth next year, but structural problems will limit Russia's potential for a long time to come.

Nordic countries – Strength in Sweden, headwinds in Norway and Finland

The divergent outlook in the Nordic countries is intensifying. Finland is plagued by continued stagnation. Weak public finances and waning competitiveness are hurting its prospects, but we expect a slight acceleration in growth during 2016 and 2017. The Norwegian economy is increasingly weighed down by low oil prices, whose effects are also spreading through the economy, especially to households, but growth will still remain at a decent level thanks to economic stimulus policies and a weak currency. In Denmark, a strong labour market and household sector will enable the country's modest recovery to continue, but due to weak capital spending activity and other factors, we are adjusting our growth forecast a bit lower.

In Sweden, growth has delivered upside surprises. The main reason is higher consumption due to expanded refugee resettlement. Because of a strong fourth quarter, full-year 2015 economic growth ended up at just above 4%. We expect almost equally rapid growth this year, with higher consumption and residential investments as the biggest driving forces, again largely driven by immigration. Major challenges in housing and labour market policy, as well as political uncertainly, pose the biggest risks.

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	5,8%	11,0%	Due to weaker global economy growth, we have adjusted our corporate earnings expectations downward, thus lowering total expected returns to about 6%. Dividend yield has climbed to a bit above 3%. The broad exposure of this asset type provides stability in a highly volatile environment. The big differences between various sectors will persist.
Emerging markets (EM)	1 2 3 **4** 5 6 7	6,3%	14,2%	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. High growth and net imports of commodities will benefit Asian countries.
Sweden	1 2 3 **4** 5 6 7	9,0%	12,3%	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** 3 4 5 6 7	-3,9%	4,3%	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	1 2 **3** 4 5 6 7	2,8%	3,0%	Low yields provide low 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	1 2 3 **4** 5 6 7	7,8%	3,8%	Yields of around 4-8% stand out in the fixed income world, but as a consequence there is also clearly higher risk than with IG bonds, for example. Low liquidity and exposure to commodities are problems, but this is reflected in pricing. The percentage of bankruptcies is rising, mainly in the oil sector.
ALTERNATIVE INVESTMENTS				
Commodities	1 2 **3** 4 5 6 7	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. The oil price decline is primarily a supply side issue; if producers become more coordinated, conditions will change.
CURRENCIES				
Currency pair	**Feb 23, 2016**	**Q1 2016**	**Q2 2016**	**Reasoning**
EUR/USD	1,10	1,08	1,05	The ECB needs (is taking actions and will take actions via expansionary monetary policies) a weaker euro in order to halt deflationary tendencies in the euro zone. We expect a somewhat stronger dollar during 2016.

*"Weight" shows how we currently (Feb 10, 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, March 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.