Investment Outlook

INVESTMENT OUTLOOK SUMMARY

September 2016

Brief world economic outlook

Since the last Investment Outlook (published in June 2016), political uncertainty has increased while the economic picture has stabilised. One source of political worries is the Brexit process, which will mainly have political consequences. These effects may be significant unless the negotiations go well; the entire EU project may come under pressure. The US presidential election may thoroughly rattle financial markets this autumn, while new terrorist acts and the political disarray in Turkey are a source of concern. However, we expect a benign outcome from the Brexit process and a Hillary Clinton victory in November. All else being equal, this should provide stability to markets.

In economic terms, this past summer brought the prospect of some speed-up in growth, and it remains to be seen whether these hopes will finally be realised. The US economy is now showing clear signs of acceleration, while Chinese growth appears to be gliding into a calm slowdown, Europe continues to make modest progress, while the situation in emerging market countries is stabilising as commodity prices move slightly higher. The major central banks are also showing great sensitivity to the need for measures to help sustain growth. We do not yet foresee a traditional increase in economic activity (meaning a boom). Because of demographic headwinds, slower productivity growth and a huge mountain of debt, we will probably have to become accustomed to substantially slower growth rates ahead. A "low-everything environment" – with slow growth, low inflation, low interest rates and lower returns on risk assets – is probably about to become the new normal.

View of regions

US – improving climate forecast
The traditionally weak first quarter was followed by an equally pale second one, but the latest statistics have been more encouraging. Stronger indicators, help from financial markets in the form of lower interest and exchange rates and less drag from the oil industry suggest good growth acceleration in the second half. Because of relatively high saving (room for consumption to increase) and a robust labour market, households are likely to keep driving growth, while manufacturing has left its recession behind. The labour market will remain strong. We expect a tighter job situation, implying that wage inflation is likely to accelerate. Due to faster growth, core inflation will also rise. We thus expect another key interest rate hike in December, followed by two increases each in 2017 and 2018. This is higher than consensus forecasts but is well justified, given the strength of the economy and the tightness of the labour market. This autumn's presidential election will generate headlines and potential market turbulence. Because of Donald Trump's recent media setbacks, we expect a Hillary Clinton victory in November and this is the basis for our forecast.

Euro zone – Consumers defy storm clouds
There is no shortage of challenges and storm clouds in the euro zone, especially political ones. Yet economic developments continue moving in the right direction. As earlier, households are the main driver, thanks to job growth and rising asset prices. Partly due to relatively low resource utilisation, the European Central Bank (ECB) can continue its very expansionary monetary policy for a long time, but subdued global growth and persistently weak industrial production are holding back GDP increases, while a high share of bad loans in the euro zone banking sector risks limiting the supply of capital to companies, making business investments harder. In geographic terms, weaker performance in France and Italy (which has the weakest banking sector) is being offset by healthy growth in Spain and to some extent Germany. In the overall euro zone, we expect stable and decent growth in 2017-2018, but far from a boom. Brexit will mainly pose political risks.

China – Near-term focus, long-term worries
China's economy continues to grow at a healthy pace, while risks of weaker performance have decreased, at least in the short term. Official support, mainly via monetary policy, has provided a floor but has not speeded up growth. Fiscal policy is now expected to take over via government investments, but that effect will also fade and growth will decelerate at a controlled pace. Services remain the engine of the economy, with growth driven by a stronger labour market rather than higher productivity, in line with official targets. But there is a risk of goal conflicts; the desire to meet ambitious growth targets may hamper necessary long-range reforms. One clear example is the credit market, whose short-term expansion poses a risk to long-term stability. This is the biggest risk now that the housing market is improving, but we expect that the authorities can manage the risks arising from excessive lending, especially to inefficient state-owned industrial firms.

Emerging markets (ex China) – Commodity storm fading
In other emerging market (EM) countries, the picture remains mixed, although gaps between strong and weak economies are narrowing. In particular, commodity-dependent problem economies are now seeing the light at the end of the tunnel, due to the stabilisation of oil and other commodity prices. Another positive factor in Russia is lower inflation, which is slowing the decline in private consumption while industry is bouncing back. In Brazil, too, negative GDP growth will turn positive next year, with exports providing help after a sharp currency depreciation. But looking ahead, growth rates will be modest for both countries as well as other commodity-dependent economies.

Elsewhere in the EM sphere, the picture is generally brighter. India is still growing fastest, driven by private consumption. Also helping to maintain India's growth rate will be some important reforms, such as a long awaited national goods and services tax (GST). In other Asian economies, the picture is generally stable and growth is good. The same applies to countries like Poland, the Czech Republic and Hungary, where domestic demand and a decent export outlook (with Germany as the main trading partner) will ensure growth.

Nordic countries – Sweden ahead, others rebounding
The Nordic countries (excluding Sweden) are struggling with various headwinds, but their growth prospects look set to improve. In Norway, the negative impact of sharp cutbacks in the oil industry is likely to fade. Due to loose monetary policy and the resulting weaker krone, as well as stimulative fiscal policy, growth bottomed out last winter. The recovery is hampered, however, by a continued decline in oil investments and weak private consumption. We expect a sustained, cautious upturn. In Denmark, the economy is recovering after a weak 2015. This process is unexpectedly slow, but because of a decent pace of private consumption along with rising capital spending, growth will accelerate to a relatively good level next year. Finland has grappled with the biggest economic problems, but here too the situation is becoming brighter. The labour market, consumer confidence and the construction market are positive forces. Yet prolonged recession has left its mark, for example in the form of a weak labour market. Weak public finances are another reason why economic improvement will occur at a slow pace.

As a result of weaker-than expected exports during the first half, we are adjusting our 2016 growth forecast for Sweden downward. However, we expect continued good growth – among the highest in Europe. Growth is being driven mainly by a sharp upturn in housing construction and public consumption due to last year's refugee arrivals. These effects will fade in 2017-2018, leading to a slowdown, but growth will remain strong. The labour market has also performed strongly, leading to a tighter resource situation. On the other hand, due to international conditions, inflation pressure will remain low next year, falling short of the Riksbank's 2% target. Combined with continued expansionary monetary policy in other countries, we expect the Riksbank to extend its bond purchasing programme until next summer and postpone its rate hikes until autumn 2017.

SEB

Conclusions from our macro analysis

- Growth is stabilising in China and looks set to accelerate in the US, but lower recession risks are largely discounted in share prices.
- Political risks have increased: Brexit, the US election, geopolitical tensions.
- Brexit-vote effects on the economy have been less than expected – so far – and thus not on the market's radar. They may reappear next year as negotiations begin.
- The US presidential election may again cause market turbulence. The outcome is uncertain, but Clinton is favoured.
- More and more observers are talking about "secular stagnation" – long-term slow growth – which pushes down interest rates, bond yields and corporate earnings growth. Does it justify higher valuations?
- Continued central bank stimulus measures are needed in Europe and Japan, while the Fed's next rate hike is approaching.
- EM economies have stabilised, thanks to commodity prices and the Fed. Problem countries are rebounding, but risks remain.

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	5,5%	14,3%
Emerging markets (EM)	1 2 **3** 4 5 6 7	6,7%	17,1%
Sweden	1 2 3 **4** 5 6 7	9,1%	14,7%
BONDS			
Government bonds	**1** 2 3 4 5 6 7	-0,7%	2,6%
Investment grade (IG) corporate bonds	1 2 **3** 4 5 6 7	1,6%	2,8%
High yield (HY) corporate bonds	1 2 3 4 **5** 6 7	5,3%	4,9%
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	**Aug 31, 2016**	**Q3 2016**	**Q4 2016**
EUR/USD	1,11	1,10	1,08

"Weight" shows how we currently (17.08. 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.* ***Hedge funds*** *– HFRX Global Hedge Fund Index in USD.*

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

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

Source: SEB Investment Outlook, September 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.
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.

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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