Investment Outlook

INVESTMENT OUTLOOK SUMMARY

September 2015

Brief world economic outlook

The current state of the world economy is twofold. Developed market (DM) countries are leaving the crisis behind as emerging market (EM) countries grapple with problems. In the DM sphere the most stable, fastest-growing economy is the United States, but recovery is also continuing in Europe. In DM households and thus the service sector are driving growth, while manufacturing and commodities are performing more weakly. Due to EM problems – economic turmoil in China, weak commodity prices and structural imbalances – the biggest global growth risk is now greater weakness in the EM sphere, led by China. Aside from EM worries, we are keeping a close eye on weak inflation tendencies. Although we do not anticipate a deflation scenario, the lack of a pricing component (the ability to raise prices when inflation is low) risks holding down corporate earnings, wages and – in the next stage – growth. Yet our main scenario is that strong households, stimulus measures and low interest rates will suffice to ensure healthy DM growth ahead.

View on economic cycle and risks

Economic cycle

To some extent, developments in China and other emerging markets are disrupting our cautiously positive economic view, but not enough to make us change our opinion. Assuming that the US, Europe and perhaps also Japan are on the right track, global growth in the coming year should end up in the 3-4% range. Inflation remains very low, and various major central banks will pursue expansionary monetary policies. This suggests a suitable environment for businesses to operate in and should lead to higher earnings. It should also keep down market interest rates and bond yields. This would imply that exposures to the corporate sector are preferable to equivalent sovereign exposures. The recent major correction has also helped eliminate some of the earlier questions about equity and corporate bond pricing and valuations.

Risks

Just as during the modest growth of recent years, it is obvious that an economic slump would cause problems. The most recent statistics from China show weakness, so the risk that markets have reacted to is real, although we believe that the reaction is a bit exaggerated. Another risk is low commodity prices and their consequences. If current price levels should persist, the proportion of defaults and problem loans in highly commodity-dependent companies and countries will rise.

View on regions

US – Rapid, stable growth. View – positive.

After a weaker start to the year, the US economy is again growing at a healthy pace, driven especially by the service sector. Households are an economic engine, among other things reflected in a strong housing market. We expect this year's consumption growth to be the highest since 2006. Dampening the mood among manufacturers are the stronger dollar and sluggish key export markets. Looking ahead, the picture will become brighter, which bodes well for the pace of investments and thus growth. Although we expect stronger growth than consensus forecasts for this year and next, we foresee no economic "boom". Unemployment is already down to equilibrium, while private consumption is indeed growing but not really at the very high speed.

Europe – Recovery, with obstacles. View – positive.

Since late 2014, growth has gradually speeded up in the euro zone – a trend that we expect to persist – driven by a weaker euro, low oil prices and powerful stimulus measures by the European Central Bank (ECB). Household consumption is also accelerating after several years of crisis and austerity. Growing credit demand also points to a faster increase in business investments. Still, private consumption and capital spending are rising from low levels. Meanwhile unemployment, though falling, remains troublingly high. In terms of momentum the euro zone is among the winners, but its growth still lags behind most other regions of the world. The euro zone is also grappling with structural issues. Greece's problems should not be underestimated, from a Greek perspective, but we expect minor effects on the rest of Europe. But Greece's problems also highlight the sluggishness of efforts to achieve political and economic integration, which may create concerns about the euro project.

Asia/China – Persistent growth rate, with India surpassing China. View – neutral.

Emerging Asian economies are growing, though the pace of change has stagnated this year. Weaker external demand is slowing exports. Looking ahead, this effect will be countered by US economic acceleration, while domestic demand will remain good. China's deceleration is also being offset by an upswing in India, driven by expansionary policies and lower commodity prices. India is thus taking over China's role as the fastest growing economy in the region. To retain this position, however, the N. Modi government must speed the pace of necessary economic reforms. Overall, regional growth should stabilize at current levels in the next two years, keeping emerging Asia at the top of global growth tables.

China started the second half of 2015 with relatively poor economic momentum. Industrial production, purchasing managers' indices and export/import figures are disappointing, along with the sharp correction in previously overpriced local stock markets. But government authorities are responding to the deceleration with fiscal policy actions in the form of infrastructure programmes and monetary policy actions such as interest rate cuts, lower bank reserve requirements and other. Along with accelerating growth in other countries, we expect our soft landing scenario to prove correct. Due to uncertainty about China's economic policies, illustrated by its surprising yuan devaluation – and the risk of new disappointments, especially from a continued weak housing market – we view China as the biggest threat to our global growth scenario.

Latin America – Commodities and imbalances cause the engine to sputter. View – negative.

Latin America is still squeezed by weak economies with large deficits and imbalances, coupled with falling commodity prices. The region's biggest economy, Brazil, is no exception. Aside from an increasingly weak economy and fiscal austerity needs, it is suffering from political deadlock due to the corruption scandal surrounding the government-owned oil company Petrobras. As a result of its strained situation, Brazil risks seeing its credit rating downgraded, which would squeeze the economy further. In the long term, the weaker currency is likely to stimulate exports, but problems will probably overshadow opportunities for another while.

Eastern Europe – Central Europe on track, Russia hurting. View – neutral.

The picture in Eastern (including Central) Europe is obviously mixed. Conflict-embroiled Russia and Ukraine have major economic problems, while the Central European countries continue to perform well and the Baltic countries are somewhere in between.

Russia is in a deep recession. The latest oil price decline will be another setback for an economy already weighed down by a continued drop in private consumption and capital spending as well as ongoing Western sanctions. One reason behind the economic downturn is high inflation, which has led to large real wage declines. In Central Europe, the outlook appears brightest for Poland and the Czech Republic, which are both seeing economic growth close to potential that is driven by strong private consumption due to real wage increases and falling unemployment. From a trade perspective, they are benefiting from their ties to Western Europe, especially Germany, which is more important than their business with Eastern Europe. In the Baltics, growth is also being sustained by an improving situation for households, while proximity to Russia is hampering exports and creating uncertainty.

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	8,2%	12,1%	Stronger economic growth, continued stimulus measures and a corporate sector that has been enacting efficiency-raising measures for years will provide potential for higher earnings. Slower emerging markets growth, weak inflation and deflation risks may counteract this. Valuations have now fallen and look more attractive.
Emerging markets (EM)	1 2 3 **4** 5 6 7	6,2%	14,3%	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.
BONDS				
Government bonds	1 **2** 3 4 5 6 7	-2,6%	4,2%	Because of very low government bond yields, portions of the bond market are unattractive. Stronger economic conditions may lead to gradually rising yields over the next few years, with a risk of negative returns.
Investment grade (IG) corporate bonds	1 2 **3** 4 5 6 7	1,2%	2,4%	Low yields provide limited 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	3,5%	3,6%	Yields of around 3-4 per cent stand out in the fixed income world, but as a consequence there is also clearly higher risk than with IG bonds, for example. HY bonds will benefit from rising growth and market liquidity, which boost risk appetite. However there is a risk in some segments, the proportion of bankruptcies will rise as an effect of low commodity prices, but this is discounted in market pricing.
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. We are taking wait-and-see approach despite the turnaround potential.
CURRENCIES				
Currency pair	**Sep 11, 2015**	**Q4 2015**	**Q1 2016**	**Reasoning**
EUR/USD	1,12	1,08	1,04	There is a short-term upside risk (EUR appreciation) if risk appetite worsens, but there is a possibility the Fed will hike rates before year end while the ECB moves towards further loosening (EUR depreciation trend).

*"Weight" shows how we currently 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 EUR. **Emerging markets** – MSCI EM TR in EUR. **Government bonds** – OMRX T-bonds in EUR. **Investment grade corporate bonds** – IBOXX Investment Grade Index in EUR. **High yield corporate bonds** – IBOXX High Yield Index in EUR. Forecast for **commodities** refers to a basket of energy (33%), industrial metals (19%), agricultural (36%) and precious metals (13%) in EUR. As for **currencies**, the forecast refers to most central currency pair EUR/USD.*

Source: SEB Investment Outlook, Septemeber 2015

Terminology explanation

Terminology used	Explanation
Deflation	A general decline in prices of goods and services. Deflation can be caused by a reduction in the supply of money, also by a decrease in government or personal spending. The opposite of inflation, deflation has the side effect of increased unemployment since there is a lower level of demand in the economy, which can lead to an economic depression. Central banks attempt to stop severe deflation, along with severe inflation, in an attempt to keep the excessive drop in prices to a minimum.
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.
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 managers' indexes (PMIs)	An indicator of the economic health of the manufacturing sector. The PMI indexes are based on five major indicators: new orders, inventory levels, production, supplier deliveries and the employment environment. A PMI of more than 50 represents expansion of the manufacturing sector, compared to the previous month. A reading under 50 represents a contraction, while a reading at 50 indicates no change.
Quantitative easing	An unconventional monetary policy in which a central bank purchases government securities or other securities from the market in order to lower interest rates and increase the money supply. Quantitative easing increases the money supply by flooding financial institutions with capital in an effort to promote increased lending and liquidity.
SEB House View	Economic forecasts prepared by economists, strategists and analysts of SEB bank.
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