Monthly Newsletter
Savings and Investments
Despite political noise, economic data remains robust

February 2017

Market overview
The first month of 2017 has been dominated by political headlines, with the inauguration of President Trump followed by a flurry of executive orders from immigration to trade; the immediate market implications have been hard for investors to interpret, but slight cautiousness is noticeable. Despite the political noise, economic data has remained robust. The global growth expectations are rising, corporates' reporting season is going well. Meanwhile inflation and inflation expectations are rising, which points to tighter monetary policy. Yet, the Federal Reserve (Fed) and European Central Bank (ECB) monetary policy remains unchanged. However it is expected that the Fed will hike interest rates 2-3 times this year and the ECB will start tapering bond purchases in April. Global purchasing managers' indices (PMIs) show optimism, which traditionally signals stronger economic growth ahead. Our view towards risky assets remains to be a bit more positive than neutral, but higher volatility is possible in short-term.

Stock markets*	Major events and expectations
USA (S&P 500 index, USD): **+1,8%** in January **+1,9%** YTD **+73,6%** in 5 years **Europe** (MSCI EURO, EUR): **-1,3%** in January **-1,3%** YTD **+43,7%** in 5 years **Eastern Europe** (MSCI EM Eastern Europe, USD): **+2,0%** in January **+2,0%** YTD **-28,3%** in 5 years **Asia** (MSCI EM Asia, USD): **+5,9%** in January **+5,9%** YTD **+10,6%** in 5 years **Latin America** (MSCI EM Latin America, USD): **+7,5%** in January **+7,5%** YTD **-37,9%** in 5 years	**US equities started the year** with all of the major equity indexes **hitting record highs** despite uncertainty over the transition to a new presidential administration. However, after entering the office at the end of January D. Trump have stirred up worries about global trade, for example his decision to carry out the construction of a Mexican border wall and a ban on travel to the United States by citizens of seven mainly Muslim countries. The president's ambition is to create jobs in the US and reduce the trade deficit. This means that the US also needs to balance its trade with other biggest trading partners like China and Canada. Yet behind the rhetoric there are signs that the worst fears will not necessarily materialise. Trade agreements with Mexico will be re-negotiated, not abolished, and the Trans-Pacific Partnership pact from which Trump withdrew will be replaced by agreements with individual countries. The **US Q4 GDP** figures showed that the US economy grew by 1.6% year-on-year in 2016, the **slowest annual growth rate since 2011**. However, economists remain positive about future growth, with consensus estimates for 2.3% growth in both 2017 and 2018. Such upbeat estimates are driven primarily by the prospect of looser fiscal policy in the coming years. However, seems like investors counted it into equity prices already and now they are beginning to become concerned about the timing and scale of any future fiscal policy stimulus. **European economies** are showing resilience to heightened political uncertainty, with the aid of job growth and an awakening capital spending cycle sustained by expansionary monetary and fiscal policies. One example of positive labour market data is that in December euro zone unemployment fell to 9.6%, its lowest level since May 2009. Euro zone inflation climbed to 1.8% in January, largely due to higher energy prices. The outcomes of upcoming elections in the Netherlands, France, Germany and possibly Italy are expected to confirm the continued strength of anti-establishment forces. Despite the EU's far-reaching and profound identity problems, this year's elections are unlikely to result in major influence for anti-EU forces, but France may prove an exception. The ECB met in January and left monetary policy unchanged. This was in line with expectations given that policymakers had announced last month that they were reducing asset purchases from EUR 80 billion per month to EUR 60 billion per month from April 2017 to December 2017. The **Q4 corporate report season looks set to turn out nicely**; for example, European banks have shown much-needed signs of strength. More than half the US companies in the S&P 500 index have reported, and earnings are about 3.3% higher than expected (and especially good for financial, energetic and technology companies), while sales are in line with expectations. After a tough end to 2016, **Emerging Market equities bounced back** in the first month of 2017, rallying the strongest start to a year since 2012. The rebound was mainly triggered by slight USD depreciation, improving growth prospects on the back of higher commodity prices. On page 2 read more about what to expect in Emerging Markets in 2017. We believe that the **overall global economy is showing signs of strength**, with a growth rate above the lukewarm expansion of recent years. Despite the political noise, economic data has remained robust. Global purchasing managers' indices (PMIs) show the strongest optimism for nearly six years in the once gloomy manufacturing sector. The service sector in the US and elsewhere also shows continued high activity. Optimistic PMIs traditionally signal stronger economic growth ahead. But while the economy is showing signs of strength, we cannot disregard major risks. Political events right now are clearly momentous, and the uncertainty surrounding both the Brexit process and Trump's policies has actually increased in recent months.

* More information regarding indexes' performance can be found at the end of the document

Impact on investments of different risk categories

Product group	Impact during the last month and expectations looking forward
Low risk (conservative)	Government bond yields have been rising since the 2016 Q3 triggered by more favourable economic growth outlook, less accommodative monetary policy by Fed, ECB tapering and inflation expectations that picked up, driven by higher oil and commodity prices,. The trend of rising yields remains and we remain having a negative view of government bonds.
Medium risk (balanced)	In January our balanced risk portfolios provided slightly negative returns mainly because of more cautiousness among investors at the end of the month. In January we increased risk level in portfolios a bit more by decreasing fixed income investments and increasing equity exposures. Among fixed income investments we see better long-term value in high-yield corporate bonds. Rising commodity prices have stabilised the previously acute situation in portions of the credit market, now resulting in a better balance between actual yields and the expected percentage of defaults.
High risk (aggressive)	After increasing our risk tolerance in January, we are retaining a slight overweighting for risk assets. We see continued signals of stronger economic growth, increasing the probability that there will be a much anticipated upturn in corporate earnings. The odds of this have also improved, since the commodity sector is benefiting from better pricing and the financial sector from a reversal in low interest rates. Meanwhile the stock market greatly needs actual delivery of earnings in order to justify valuations. Because of somewhat high valuations, at present we do not wish to take excessive risks.

Monthly theme

What to expect in Emerging Markets in 2017

Aggregate Emerging Markets GDP growth will accelerate to around 4.7% in 2017. While Donald Trump's upcoming presidency may hurt particular countries, it should not impact aggregate growth. Prospects for BRIC economies are improving, We expect Brazil and Russia to return to positive growth, While India's recent currency reform has adversely affected near-term activity, those effects will subside as 2017 progresses. Moreover, although China's GDP growth will decelerate as heavy industry and manufacturing slow, it will do so gradually. We expect EM assets to continue the recovery that began in January 2016.

Emerging Markets growth is rebounding
Economic growth in Emerging Markets (EM) has been recovering since last spring. We expect GDP to increase by 4.7% this year from 4.1% in 2016, exceeding that of developed countries, where we forecast OECD growth of 2.0% this year, up from 1.7% in 2016. Consequently, the EM share of global GDP will continue to rise. However, aggregate EM growth will remain below levels achieved during 2000s, which were largely due to temporary factors including these countries' rapid integration with the global economy and very strong Chinese activity. While Donald Trump's recent victory in the US presidential election may adversely affect growth in particular economies (notably Mexico), aggregate EM growth is unlikely to suffer much.

Trump put an end to the EM rally
Donald Trump's win exerted pressure on EM asset values, particularly currencies. Still, despite depreciating sharply, EM currencies remain higher than they were a year ago. Moreover, while the Republican Party controls Congress, Trump is unlikely to be able to fulfil all his protectionist campaign promises. In particular, he would face stiff opposition from US business interests and risk triggering a trade or currency war. Assuming that worst-case scenario of prohibitive trade barriers is avoided, EM assets will continue to recovery that began in January 2016. Having recovered only approximately one third depreciation they posed against major currencies between May 2013 and January 2016, we see upside potential against a background of accelerating economic growth. Key risks include faster than expected US rate hikes, a renewed fall in oil prices and sharp slowdown in China causing major decreases in commodity prices and reductions in trade.

Improving BRIC prospects
Both Brazil and Russia have weathered the worst of their recessions with both economies set to resume positive but weak growth this year. There are several similarities. In both countries, the recovery is expected to be driven by manufacturing and exports. Higher oil prices will provide some stability. Further, while so far there are only tentative signs of improvement in retail sales ad private consumption, particularly in Brazil, we also expect these sectors to pick up as inflation decelerates. Indeed, lower inflation will enable central banks in both Brazil and Russia to cut rates this year, providing support for growth.

However, no help can be expected from fiscal policy. In **Brazil**, the biggest near-term challenge facing the Temper government is the country's budget deficit, which stands at 10% of GDP. After announcing a public expenditure ceiling in December, its key challenge this year will be enacting a large scale pension reform, which is vital if administration's austerity plan is to succeed. Although domestic politics have become more stable, corruption investigations continue. Despite the risk that the temper government could fall our main scenario is that it will survive until the 2018 general election.

Russia also suffers from a budget deficit that country's Finance Minister has pledged to reduce from around 4% of GDP to 1.2% by 2019. Interestingly, the government has recently changed tack and announced plans to cut defense spending this year. However, we expect these reductions to be opposed by vested interests.

Russian domestic politics will be stable in 2017 following recent parliamentary election in September 2016 when President Vladimir Putin and his United Russia party further strengthened their grip on politics. The next presidential election is scheduled for March 2018, when we expect Putin to win a second term.

Brazil key issues in 2017: Temper government survival, pension reform, public finances.

Russia key issues in 2017: relations with the Trump administrations, sanctions, oil prices.

India has been a bright spot due to the country's attractive GDP growth and reduced budget and current account deficits. The Modi government has also progressed reforms, most importantly the national goods and services tax. However, the currency overhaul in early November 2016 was poorly executed and has undermined the near term outlook. Specially, the government declared over 85% of total cash in circulation void. While the reform forms part of wider policy to fight corruption, it has adversely affected both financial markets and real economy. The ensuing rush by citizens to deposit old notes depressed bond yields sharply and also hurt the rupee and equities. Although financial markets recovered, the reform also resulted in a cash shortage that has yet be resolved. Retail sales have been particularly affected. Economic activity has suffered a severe setback causing us to cut our GDP projection for 2017 to 7.6%. Lingering effects of the currency overhaul pose a downside risk to our forecasts.

Concerning general reform efforts, failure to make significant progress in the two most important areas, the labor market and purchase laws, makes reaching the government's target of 8-10% GDP growth very difficult to achieve. Several important state elections are scheduled for 2017. Modi will take care not to alienate voters by introducing unpopular reforms, especially given his experience of the poorly executed currency measures.

Demonetization problems do not alter our view on the rupee. Inflation targeting combined with smaller current account and budget deficits provide greater resilience. We estimate the rupee will weaken only slightly this year.

India key issues in 2017: Lingering demonetization effects, reform progress, state elections.

In **China** economic activity stabilized in 2016, largely due to stimulus measures. In 2017, we expect growth to decelerate mainly as a result of slower heavy industry and manufacturing activity. Currently, Chinese authorities are switching from supporting growth to addressing structural concerns. Monetary policy is no longer being relaxed, while effects of previous easing are fading. For example, structural issues now drive housing policy which is presently focused on tightening in order to slow price increases. Further, measures have been announced to reduce overcapacity in industry although progress has been limited so far. With numerous members of the political elite set to be replaced in late 2017, the government likely wishes to ensure continued stable economic growth and financial markets ahead of the transition.

Primarily, policymakers are concerned to avoid a sharp weakening of labor market that might cause social unrest. However, there are presently no obvious signs of such deterioration. Relations with the Trump administration have started poorly. However, more significant US tariff barriers are likely to be introduced later in the Trump presidency rather than in 2017. Potential triggers include slowing US growth.

The yuan has come under downward pressure from USD appreciation, Fed tightening, capital outflows and concerns regarding future US trade policy. The yuan depreciated sharply in November and December but has recovered in January. We expect only slight weakening in 2017 – limited due to Chinese political transition.

2017 will be a challenging year for several smaller economies
In **Argentina**, the Marci-led government has spent last year reforming the economy. While it will continue to do so in 2017, the key question will be whether it will noticeably improve before voters lose patience ahead of legislative elections in October. **Mexico** has been targeted for protectionist measures by Trump and the peso has weakened sharply. However, any trade barriers would also impose significant costs on US manufacturing. Uncertainty surrounding Trump's policies will still hurt business confidence, while also expect the depreciating peso to force the central bank to raise its policy rate further in 2017. Markets in **Turkey** will underperform other EM this year. The key factor weighing on Turkish asset values is political pressure on the central bank not to hike interest rates despite inflation running 8.5% in December (y/y) and inflation expectations for 2017 above the 5% target rate. Given reliance on short-term portfolio investment flows to finance its large current account deficit, the authorities' reluctance to tighten monetary policy makes Turkish lira one of the most vulnerable currencies. Another factor set to weigh on Turkish markets in 2017 are plans to reform the constitution to confer on presidency almost absolute power over government. **Ukraine** has passed the worst of economic downturn and is set to return to positive growth this year. However, no solution has been found to the conflict in eastern Ukraine, and government will struggle to ensure reform momentum remains sufficiently strong to persuade the IMF to continuing disbursing its all-important bailout loan.

Sources: SEB

Glossary

Terms used	Explanation
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.
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.
Investment grade bonds, high yield bonds	Investment grade bonds – bonds (sovereign or corporate) with credit ratings that indicate a relatively low risk of default. High yield bonds – bonds (sovereign or corporate) with credit ratings that indicate 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 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.
Organization for Economic Cooperation and Development (OECD)	A group of 34 member countries that discuss and develop economic and social policy. OECD countries are democratic countries that support free market economies.
Quantitative easing (QE)	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.
Tapering	Tapering is the gradual winding down of central bank activities used to improve the conditions for economic growth. Activities can include changes to conventional central bank activities, such as adjusting interest rates or reserve requirements, or more unconventional ones, such as quantitative easing (QE). As a financial term, tapering is best known in the context of the Federal Reserve's quantitative easing program.
Trans-Pacific Partnership (TPP)	The Trans-Pacific Partnership (TPP) is a proposed free trade agreement to lower tariffs and other trade barriers among Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the U.S. and Vietnam.
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.

Stock market indexes performance information covering the immediately preceding 5 years till 31 January, 2017

Region	Index	Currency	Performance						
			2012	2013	2014	2015	2016	12 months	2017 YTD
USA	S&P 500	USD	13,4%	29,6%	11,4%	-0,7%	9,5%	17,5%	1,8%
Europe	MSCI EURO	EUR	15,6%	19,6%	2,3%	6,1%	1,7%	7,2%	-1,3%
Eastern Europe	MSCI EM Eastern Europe	USD	13,2%	-2,9%	-40,0%	-8,1%	33,0%	38,9%	2,0%
Asia	MSCI EM Asia	USD	18,1%	-0,2%	2,5%	-11,8%	3,8%	18,6%	5,9%
Latin America	MSCI EM Latin America	USD	5,4%	-15,7%	-14,8%	-32,9%	27,9%	44,3%	7,5%