Monthly Newsletter
Savings and Investments
Focus on US presidential election

October 2016

Market overview

September was a month of low returns, with the global stock market moving up less than one half per cent. Emerging markets performed better than developed markets, and in terms of sectors, commodities and technology outperformed the rest. Recently positive macro data in US increased expectations close to 70% probability of that the US central bank's next rate hike will be made in December (it is also SEB's forecast). US presidential election brings more tension in the markets. SEB estimates: 75% probability for Clinton vs 25% probability for Trump. The market begins to expect that the European Central Bank (ECB) may start gradually scaling back their stimulus program of bond purchases. The International Monetary Fund's (IMF) latest economic forecast pointed out the political risks as the biggest threat to the world economy. We continue to be a bit more cautious in short-term.

Stock markets*	Major events and expectations
USA (S&P 500 index, USD): **-0,1%** in September **+6,1%** YTD **+91,6%** in 5 years	**Economic statistics in US** painted a relatively **bright picture of the economy** lately. Consumption remains the engine of the US economy and consumer confidence has risen to a new post-crisis high. Sentiments in manufacturing sector are indicating economic expansion (The ISM manufacturing index rose to 51.5 in September from below 50 in August). Labour market remains strong. The housing market also continues to show signs of recovery. The market is now factoring in over a **68% chance of a US interest rate hike in December**. The **earnings season for Q3** has started. Expectations are low and analysts expect the fifth consecutive quarter of negative earnings growth. At the same time, it is well known that companies tend to exceed expectations. Keeping this relationship we would thus expect **positive earnings of 2.7 in Q3**. The question is whether that is enough to convince investors to buy equities. At the same time we have the **US presidential election risk** to take into account. On November 8 it is the time for US voters to make their decision – Clinton or Trump for President? Admittedly **Clinton is the favourite to win** the battle between two unusually unpopular candidates. But given the experiences from the Brexit referendum in June we are a bit cautious. SEB estimates: **75% probability for Clinton vs 25% probability for Trump**.
Europe (MSCI EURO, EUR): **-0,3%** in September **-6,2%** YTD **+49,0%** in 5 years	Macroeconomic data in the **euro zone** continued to indicate **lacklustre growth and low inflation**. Annual inflation increased a bit more in September to 0.4% from 0.2% in August while GDP expanded by 0.3% in Q2, slowing from 0.6% in Q1. **The ECB** left monetary policy unchanged during Q3, moreover, as rumours suggest it is likely the ECB **may begin reducing its stimulus purchases** (similar scenario to US Federal Reserve's "tapering"). However, euro zone equities were supported by a generally **encouraging Q2 reporting season** and now the **focus** will shift to **Q3 reporting season** while expectations are not high.
Eastern Europe (MSCI EM Eastern Europe, USD): **+2,2%** in September **+17,0%** YTD **-26,8%** in 5 years	In the **UK** the prime minister has confirmed to **trigger Brexit by March 2017**, which will begin two years of formal negotiations. New concerns about **"hard" Brexit** emerged lately, which could involve the UK refusing to compromise on issues like the free movement of people, leaving the EU single market and trading with the EU as if it were any other country outside Europe. Now more clarity about UK's choice is anticipated. Brexit was the first of many potential upsets on the Europe's horizon. There is plenty of upcoming **important political events** in Europe like re-run of presidential elections in Austria (4 December 2016), Constitutional referendum in Italy (4 December 2016), General election in Netherlands (15 March 2017), Presidential election in France (23 April and 7 May 2017), Federal election in Germany (August-October 2017). Market participants will closely follow all these events as Brexit has taught not to underestimate protest movements. However, **current polling shows** more than half the population is **in favour of the European Union** in France, Italy, Germany, Spain and Greece.
Asia (MSCI EM Asia, USD): **+1,1%** in September **+10,9%** YTD **+21,9%** in 5 years **Latin America** (MSCI EM Latin America, USD): **-0,9%** in September **+30,1%** YTD **-28,8%** in 5 years	Elsewhere. At the informal meeting of the **OPEC** in Algeria, many of the major producers surprisingly agreed to consider an **oil production cut**. Without any specific promises also joined Russia. This news caused **oil prices to climb** recently. Last time OPEC agreed to a production cut was in 2008. An OPEC committee will determine how the cut will be allocated among member countries and report back at the next OPEC meeting in November. The **IMF** latest economic forecast pointed out the **political risks** as the biggest threat to the world economy, such as increased protectionism (advocated including Donald Trump), Brexit and plenty of political risks within the EU. IMF lowered growth outlook for the US economy to 1.6% this year and revised down global growth for 2016 to 3.1%, but expects a slight recovery to 3.4% next year. It is in line with SEB's forecasts.

* 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)	After rumours that ECB may begin to reduce its stimulus bond purchases and increased probability of interest rate hike by FED this year, government bond yields were tend to increase and prices to fall during September. This is one of the reasons why among fixed income assets we have a negative view of government bonds.
Medium risk (balanced)	The risk increased in our balanced medium risk portfolios after Brexit referendum materialised in July more than we have expected and from the beginning of August we see risky assets to seem a bit less attractive, therefore we continue to be a bit more cautious with a reduced risk to a bit lower than pre-referendum level. Therefore, the volatility in our balanced medium risk portfolios lowered. Portfolios generated positive results during September. Looking at high yield (HY) bonds, we still have a positive view. Higher oil prices reduces risk in US HY market; for European HY corporate bonds, we expect continued support from such factors as bond purchases by ECB, however we see a bit more risk related to ECB decision to reduce stimulus.
High risk (aggressive)	We are sticking to our long-term positive view of equities, but also to our more cautious short-term attitude. The main arguments for a somewhat cautious attitude towards the stock market are valuations combined with continued sluggish global economic growth and the consequent limited ability of companies to generate earnings increases. On the plus side there are tendencies towards somewhat more stable world economic performance. Manufacturing and the commodity segment have improved from low levels. The consumption and service portion of the global economy continues to grow at a healthy pace. Risk appetite and optimism suffered reversals during 2015 and have recovered since then, but with a certain lingering scepticism. Although oil prices have stabilised, we remain cautious about commodities.

Monthly theme

Financial advisory in digital age

We live in a world where every company, industry, country and city is being disrupted by new technologies at a very fast pace. In this ever-accelerating world of technological advancement, which is now called the Digital Age, a lot of opportunities emerges for both – the consumers and manufacturers/service providers. As it is in any other industry, this brings new trends in financial industry. Financial technology innovations in the financial sector can include advances in financial education, retail banking, investment, etc. For example, the takeover of the robots in the classic field of financial advisory and wealth management is an emerging trend across this industry. However, recent history proves that in this digitization age new winners are emerging and past champions are afforded no certainty. In this transition to the Digital Age within this article we review new trends, new opportunities and threats in financial advisory from both perspectives – customers' and service providers'.

Digital age

To describe the Digital Age we should start with The Information Age which is described as a period in human history characterized by the shift from traditional industry that the Industrial Revolution brought through industrialization, to an economy based on information computerization. The Information Age started in the 1980's when the term was first adopted. The Information Age formed by capitalizing on computerization advances. This evolution of technology in daily life and social organization has led to the fact that the modernization of information and communication processes has become the driving force of social evolution.

The Information Age still continues, however the current phase of it is better reflected naming it the Digital Age. The Digital Age began around 2010 and is expected to continue until 2030. It is estimated that it will be 5 to 10 times bigger than the Information Age from 1980s until 2010. This Digital Age is driven by the Internet of Things (IoT) and is estimated to have an economic benefit over the next decade of USD 20 trillion, or the equivalent to the US economy today.

What is IoT? Simply put, this is a concept of basically connecting any device with an on and off switch to the internet (and/or to each other). This includes everything from cellphones, coffee makers, washing machines, lamps, wearable devices and almost anything else you can think of. This also applies to components of machines, for example a jet engine of an airplane or the drill of an oil rig. As mentioned before, if it has an on and off switch then chances are it can be a part of the IoT. Therefore, the IoT is a giant network of connected "things" (which also includes people). The relationship will be between people-people, people-things, and things-things.

In the context of IoT, the Digital Age takes us beyond simply accessing volumes of data. It moves us closer to controlling and predicting complex outcomes. Advancements in software analytics and operational automation will drive a major wedge in the growing digital divide.

When it comes to financial sector in the Digital Age, financial technology is becoming a cornerstone for the companies working in this industry.

Financial technology

Financial technology, also known as FinTech, is an economic industry composed of companies that use technology to make financial services more efficient. Essentially, FinTech is any technological innovation in the financial sector. This can include advances in financial education, retail banking, investment, etc.

The rise of financial technology is going to improve the ways that financial advisers (FAs) engage with and deliver services to clients, including investment, wealth management and financial planning.

When it comes to financial planning, for example, think about how investment statements have changed over the past 15 years. In the late 1990s and early 2000s, the internet was just beginning to take over. Most people still relied on a physical statement in the mail. Now, we have interactive web portals that we can view on a computer, laptop, smartphone, or tablet that present a live, interactive readout of exactly where all of our investments stand at any point in time.

We have made the transition in the context of investment statements. Over the next 10 years, it will happen with the entire, holistic financial plan. Eventually, more and more of the holistic advice elements will be built in. However, today financial planning is still living mostly in the past. FAs gather all the client's information, type it into some software, print out a plan or update, and send it to the client. That process will soon be gone. Once the process is digitized, all of this information will flow smoothly and directly to clients. And without printed physical financial plans, the whole concept of plan updates becomes obsolete. There is no need for updates when the technology keeps the numbers updated 24 hours a day, 7 days a week.

Digitization will completely transform how FAs deliver advice and engage clients. It is going to change FAs from reactive to proactive. Right now, FAs are very reactive because often, they do not have the opportunity to advise clients until they come in and tell what is going on in their lives. That process actually leads to an astonishing number of unproductive meetings. When this process is automated, the technology will tell FAs when there is a conversation to be had, but it will no longer be needed to have meetings just to find out if there is something to talk about in the meeting.

Does this mean that less communication with clients will be needed? Quite the contrary. Looking at growing future generations, like millennials, it is obvious that they are so used to communicating with technology and some people may wonder whether they will even want a human adviser. But millennials spend so much time on social media because they are communicating with other human beings. In fact, they are addicted to communication. They want more communication than the prior generation does, not less. In the context of an adviser/client relationship, this means that, for example, setting up a meeting to discuss an issue next week is, for most millennials, 6.9 days longer than they were expecting to wait to have the conversation. It is not that they do not want to have a conversation with a human; it is that they expect it to happen now, via technology, because they are addicted to communication. Ultimately, this process of using technology to communicate will save advisers time, but it also means they will be communicating with clients faster and more often than ever before.

Robo-advisory

There are a lot of examples of how technology is driving the evolution of financial advisers. 40 years ago, financial advisers were stockbrokers and literally sold stocks and other securities for a living. Then, brokerage firms used technology to sell stocks more cheaply and undermined the value of being a stockbroker. By the 1980s and 1990s, advisers were being driven out of stockbrokering and began to sell mutual funds instead. Then, online mutual fund superstores came along, so advisers became asset allocators and developed diversified portfolios. Now, in the Digital Age robo-advisers are arriving. There is a transition again.

Robo-advisers can be described as a class of financial advisers that provides financial advice or portfolio management online with minimal human intervention. In the word "robo-advisor" "robo" stands for an automated process without the influence of a human being, utilizing mathematical algorithms to support investment decisions. "Advisor" usually stands for financial advice or wealth management services, in this case in an automated manner, making use of regular online or mobile channels.

Putting these terms together we are talking about an online portfolio management solution that aims to invest client assets by automating client advisory. Encouraging self-management of financials, robo-advisers provide necessary information in a totally different way that doesn't require a deep financial background. Robo-advisers translate client input into investment logic such as objectives, risk appetite or liquidity factors into proposal of adequate investment opportunities.

Estimates for the future robo-advisory market by several well-known institutes predict up to USD 4 trillion in assets to be managed with the support of robo-advisory services in 2020 (currently USD 0,2 trillion). By the year 2025 this figure is expected to rise to over USD 16 trillion assets under management (AuM), roughly three times the amount of assets managed by BlackRock, the world's biggest asset manager to date.

Conclusion

Financial technologies in the Digital Age will bring many great things for the customers of financial services providers. The focus will shift on the customer experience. We are seeing the rise of a whole phenomenon that has been named "the experience economy", where – as the Harvard Business Review so eloquently put it – "a company intentionally uses services as the stage, and goods as props, to engage individual customers in a way that creates a memorable event". Customers pay for a product, they pay more for good service, but they will pay the most for a good experience.

That is as much of an opportunity with financial advisory as it is in any other industry, but it requires entirely rethinking of how to deliver it. And there are good news and bad news to financial advisers. The good news is that most of humans working in this sector will not be replaced by technologies like robots. The bad news is that those who do not adopt technology to improve their value proposition to customers really will be replaced by robots.

Sources: Deloitte, CFA Institute, A.T. Kearney, Forbes, "Digital Technology and Social Change" by M. Hilbert.

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.
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".
The Institute of Supply Management (ISM) ISM manufacturing, non-manufacturing indexes	An index based on surveys of manufacturing/non-manufacturing firms by the Institute of Supply Management in US. An index with a score over 50 indicates that the industry is expanding, and a score below 50 shows a contraction. By monitoring ISM manufacturing and non-manufacturing indexes, investors are able to better understand national economic conditions. When this index is increasing, investors can assume that the stock markets should increase because of higher corporate profits. The opposite can be thought of the bond markets, which may decrease as indexes increases because of sensitivity to potential inflation.
International Monetary Fund (IMF)	The IMF is an organization of 188 countries whose stated objectives are to promote international economic co-operation, international trade, employment, and exchange rate stability, including by making financial resources available to member countries to meet balance of payments needs. The IMF provides technical assistance and training for countries requesting it.
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.
Organization of Petroleum Exporting Countries (OPEC)	An organization consisting of the world's major oil-exporting nations. OPEC was founded in 1960 to coordinate the petroleum policies of its members, and to provide member states with technical and economic aid. OPEC is a cartel that aims to manage the supply of oil in an effort to set the price of oil on the world market, in order to avoid fluctuations that might affect the economies of both producing and purchasing countries.
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 (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.
US Federal Reserve's "tapering"	This is an expression of the US Federal Reserve Bank's (Central Bank) decision to reduce the volume of bond purchases (quantitative easing). Quantitative easing is a central bank's monetary policy occasionally used to increase the money supply by buying government securities or other securities from the market. Quantitative easing increases the money supply by flooding financial institutions with capital, in an effort to promote increased lending and liquidity.
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 30 September, 2016

Region	Index	Currency	Performance						
			2011	2012	2013	2014	2015	12 months	2016 YTD
USA	S&P 500	USD	0,0%	13,4%	29,6%	11,4%	-0,7%	12,9%	6,1%
Europe	MSCI EURO	EUR	-16,5%	15,6%	19,6%	2,3%	6,1%	-0,5%	-6,2%
Eastern Europe	MSCI EM Eastern Europe	USD	-23,3%	13,2%	-2,9%	-40,0%	-8,1%	9,4%	17,0%
Asia	MSCI EM Asia	USD	-19,1%	18,1%	-0,2%	2,5%	-11,8%	14,3%	10,9%
Latin America	MSCI EM Latin America	USD	-21,9%	5,4%	-15,7%	-14,8%	-32,9%	25,7%	30,1%

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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.