Investment Outlook

Summary

March 2017

Brief world economic outlook: Get ready for more volatility

Strong economic growth without troubling inflation, stable and increasing earnings, continued very low interest rates and central banks that were pumping liquidity into the economic system were factors that last year resulted in substantial growth in equity markets and record low volatility. However, we expect headwinds from some of these parameters during 2018 and have already experienced higher volatility. In reality, this means we must expect weaker periods and profit-taking, but as part of continued positive trend. Overall, this means that we expect positive but lower returns in 2018.

Risk exposure	
2017 Q4	2018 Q1
Slightly over-weight	Overweight

Our risk exposure is based on the proportion of equities in a diversified portfolio. The weight of equities is described as underweight, neutral or overweight. What a neutral weight is will depend on what risk profile the individual portfolio has.

Economic outlook – Regions

US – Moving ahead at a healthy pace
In recent months, US economic statistics have generally surpassed expectations. Growth continues to be driven by strong private consumption, good export momentum and higher business investments. The tax cuts enacted by the Trump administration also look set to have somewhat greater impact on growth than previously expected, especially in 2019. The tax cuts are unfunded which, however, will weaken federal finances. We foresee continued healthy US expansion and have revised our GDP forecast to 2.8% in 2018 and 2.5% in 2019.

Euro zone – Continued economic strength
The euro zone remains optimistic about its political economic future. The region's growth is geographically broad-based. Company orders are good both for domestic sales and for export. GDP growth will accelerate further from last year, reaching 2.5% in 2018 and 2.2% next year. There are questions about cooperation mechanisms in euro zone, but the reform process has taken some steps forward, and we foresee no adverse impact on markets in the near term. We believe that Brexit process can also move ahead without serious effect, aside from the headwinds for British economy. Our forecast is that ECB will end it quantitative easing (QE) programme in the autumn and that the first interest rate hike will occur in 2019.

Emerging market countries – Plenty of positive news
Most emerging market (EM) countries are contributing to healthy global growth. World trade has clearly rebounded, benefiting these often export-oriented economies. Along with continued commodity price stabilisation and improved current account balances in most vulnerable countries, this makes the overall situation better than for years. EM growth is fastest in Asia, whereas Russia and commodity-dependent Latin American countries are growing more slowly – but with better momentum that in recent years. Many Eastern European nations are also showing favourable economic performance,

China – One foot on the gas pedal, one on the brake
The Chinese economy remains impressive, powered from two directions. First, stronger global economic conditions have stimulated exports. Second, easier credit terms have stimulated mortgage lending activity and home prices, helping drive increased construction and favourably affecting household wealth. The economic speed-up will enable authorities to tighten China's monetary policy and the credit market, reducing financial risks but curtailing growth. The outcome of the last Communist Party congress will also give leaders greater freedom to implement reforms. Our forecast is that the Chinese economy will decelerate in a controlled fashion, with GDP growth of 6.6% in 2018 and 6.2% in 2019.

Sweden – Good momentum
Most signals show continued Swedish economic strength, but the recent decline in home prices will hamper growth, with housing construction shifting from positive to a negative GDP growth contributor this year. There is also a downside risk if the overall price declines exceeds 10% in our forecast. Meanwhile GDP growth is being sustained by robust international conditions, with a strong European Union economy being especially important. The weak Swedish krona is providing extra stimulus to exports and industrial capital spending. Nor are there any signs that households are adversely affected by falling home prices. Rising purchasing power – driven by strong job growth and expansionary fiscal policy – suggests a continued upturn in consumption over the next couple of years. A record-high household savings ratio provides further potential. Overall, we expect the GDP growth rate to slow down to 2.6% in 2018 and 2.4% in 2019.

Factors behind our market view
Growth and earnings: Global growth is expected to end up at nearly 4% in 2018 and 2019 with inflation staying around 2%. This is a good environment for companies to further increase earnings. Many companies will also receive extra help from tax reform that US has launched. Global earnings growth is expected to end up above 10% this year. High resource utilisation is beginning to have impact. This means we may see short-term inflation tendencies, but we believe that a persistently rising inflation will have difficulty in taking hold.

Central banks: We expect US Federal Reserve to hike its key interest rate four times in 2018 and shrink its balance sheet (decrease the volume of fixed income investments it owns), which will reduce liquidity in the market. Other central banks are lagging behind, and the effect of their actions is expected to remain positive, though clearly less than before. The break-point may occur as early as this coming September, when ECB may well end its bond-buying. Sweden's Riksbank continues to pursue expansionary monetary policy. The overall outcome may be rising interest rates, which will increase risks since the global debt level is high.

Valuations: Most financial assets carry high valuations compared to historical levels. This is risky, and to prevent market worries from increasing, growth must remain healthy.

Risk appetite and positioning: Risk appetite and positioning generally go hand in hand with valuations when the world is in the latter part of economic cycle, which is also true this time around. Valuations are high, and investors with high risk appetites have aggressive portfolios.

Expected returns: We expect positive returns for most asset classes over the next 12 months. These expected returns are lower than historical averages, while risk is unchanged. This forecast is dependent on our optimistic economic outlook proving correct.

Examples of risks: A downturn in the economic cycle would have a major impact, but recession risk is low. Valuations are high from a historical perspective. After major liquidity injections and record-low key interest rates, central banks are expected to gradually normalise their policies during 2018 and onward, which means that a large "subsidising" force will fade. Global indebtedness is high. There are signs of weaker home prices here and there.

Expected risk and return in asset classes in the next 12 months

Asset class	Tactical expectation (12 months)	
	Return	Risk
Equities		
Global	6.9%	12.6%
Emerging markets (EM)	9.3%	14.3%
Sweden	9.0%	13.0%
Government bonds	-3.0%	1.7%
Investment grade (IG) corporate bonds	1.1%	3.1%
High yield (HY) corporate bonds	3.0%	5.2%
Emerging market (EM) debt	3.5%	11.3%
Hedge funds	3.5%	6.0%
Commodities	N/A	1.6%

Tactical expected return is based on the SEB House View as of February, 2018. Index/basis for estimates: 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. Corporate bonds (IG and HY), IBOXX Investment Grade Index in USD and IBOXX High Yield Index in USD. EM debt – JP Morgan Emerging Markets Bond Index in local currencies. Hedge funds – HFRX Global Hedge Fund Index in USD.

GDP – YEAR-ON-YEAR PERCENTAGE CHANGE	2016	2017	2018 (FORECAST)	2019 (FORECAST)
United States	1,5	2.3	2,8 (2,6)*	2,5 (2,0)*
Japan	1,0	1.5	1,2 (1,2)*	1,0 (1,0)*
Germany	1,9	2.2	2,5 (2,2)*	2,2 (2,0)*
China	6,7	6.9	6,6 (6,6)*	6,2 (6,2)*
United Kingdom	1,8	1.8	1,4 (1,3)*	1,1 (1,1)*
Euro zone	1,8	2.3	2,5 (2,3)*	2,2 (2,1)*
Nordic countries	2,2	2.4	2,4 (2,3)*	2,3 (2,1)*
Baltic countries	2,2	4.2	3,5 (3,4)*	3,2 (3,1)*
OECD	1,8	2.4	2,5 (2,3)*	2,2 (2,0)*
Emerging markets	4,3	5.0	5,2 (5,1)*	5,1 (5,1)*
The world (PPP)**	3,2	3.9	4,0 (3,9)*	3,9 (3,8)*

* Previous forecast (December 2017)
** PPP= Purchasing power parities; economies have been adjusted to account for price differences.

Source: SEB Investment Outlook, February 2018

Terminology explanation

Terminology used	Explanation
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.
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.