Monthly Newsletter

Savings and Investments

Earnings season to dominate equity markets the most

April 2017

Market overview

The first quarter of 2017 was very strong. It was worthwhile for investors to take risks. Both equities and fixed income rose. And lately evidence of solid growth has overshadowed President Donald Trump's stumbles and expectations of more aggressive Federal Reserve (Fed) tightening. In March the British government has formally applied to begin negotiations of withdrawal from European Union. We predict that by early autumn it will be possible to assess their progress and the probability of a soft or hard "Brexit". Upcoming French presidential election will be in the focus of investors. It will bring some volatility, but we do not expect the election to hold down equities. Companies started to publish 2017 Q1 earnings – this will dominate equity markets. Overall we expect the earnings season to surprise on the upside. Our view towards risky assets increased even more in the second half of March.

Stock markets*	Major events and expectations
USA (S&P 500 index, USD): **+0,0%** in March **+5,5%** YTD **+67,8%** *in 5 years* **Europe** (MSCI EURO, EUR): **+5,4%** in March **+6,6%** YTD **+49,8%** *in 5 years* **Eastern Europe** (MSCI EM Eastern Europe, USD): **+1,7%** in March **+0,1%** YTD **-31,7%** *in 5 years* **Asia** (MSCI EM Asia, USD): **+3,2%** in March **+13,2%** YTD **+10,9%** in 5 years **Latin America** (MSCI EM Latin America, USD): **+0,4%** in March **+11,6%** YTD **-36,4%** *in 5 years*	Yes, the first quarter of 2017 was very strong. Only at the end of the quarter markets took a pause for breath to question the new US administration's ability to deliver its policy agenda, particularly in light of the recent failure of health care reform. This has triggered some concerns about the practical implementation of D. Trump's proposed infrastructure investments and tax reforms. However, through all the political noise, what does seem clear is that both US consumers and businesses are significantly more positive about the outlook than they were this time last year. In Europe, various business surveys have risen to their highest levels in over five years. Consumer confidence has recovered to close to 2007-08 pre-crisis highs. The improvement in business confidence is widespread across the euro zone and European companies are finally starting to show broad-based earnings growth. This has helped European equities to keep up with the US so far this year, having underperformed last year. Furthermore, European elections have so far rejected euro-sceptical politicians, with the results in both Netherlands and Austria and the showing that the widely predicted political risks for euro zone's future is probably not as threatening. Upcoming French presidential election is increasing the focus of investors. According to opinion polls ahead of the April 4 independent centrist pro-euro Emmanuel Macron was even with – or slightly ahead of – far-right populist euro-sceptical Marine Le Pen Each enjoyed support from just over 25% of voters for the first round on April 23. Second round (to be held May 7 if needed) is very likely and the polls currently suggest E. Macron would defeat M. Le Pen in the second round of the presidential election, garnering 60% of the vote. We are not overly concerned about the French election. It will bring some volatility, but we do not expect the election to hold down equities. The UK government has now formally applied to begin withdrawal negotiations according to Article 50 of the European Union's Lisbon Treaty. Under Article 50, the Brexit process will take two years. The UK would thus leave the EU on March 28, 2019. On the other hand it is expected that UK-EU negotiations will not be easy and may take longer than two years. Negotiations are not expected to start in earnest before late May. We predict that by early autumn it will be possible to assess their progress and the probability of a soft or hard Brexit. Read more about Brexit in our monthly theme, page 2. Companies started to publish 2017 Q1 earnings. The majority of earnings (measured in terms of market capitalisation) is delivered in the last two weeks of April. We expect the earnings season to dominate the equity markets the most. We also expect the earnings season to surprise on the upside. On the other hand companies will be essential to justify the expectations to keep positivity in the markets.

* 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)	Despite recent decreases of government bond yields, since the Q3 2016 we see the trend of rising yields that are 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 March our balanced risk portfolios provided slightly negative returns mainly because of temporary risk tolerance decrease in markets at the end of March. Despite slight correction, in March we increased our tolerance towards risky assets even more. We have become more positive towards emerging market equities, as an effect of stronger economic growth and valuation discounts compared to the rest of the world. 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 at the beginning of March we increased it even more in the second half of March. Growth is and will be supportive for risk assets. We do not expect macroeconomic data to surprise as positively as it has in Q1 2017, but still enough to drive equities higher. We find it hard not to be bullish on the upcoming earnings season. Growth in Q1 has been surprisingly strong and this has in our view not been fully reflected in the earnings estimates. We are not overly concerned about the French election. Yes some volatility must be expected, but as the election is being held in the middle of the earnings season (which we expect will be positive) we do not expect the election to hold down equities. One thing we do want to make clear: in the unlikely event of a M. Le Pen victory we will most likely not buy into weakness as we did during Brexit and Trump.

Monthly theme

The United Kingdom has started Brexit: what will happen?

The European Union is at an existential crossroads, as the United Kingdom prepares to leave the EU. Both sides are navigating through uncertain territory. Although our main scenario is British withdrawal from EU in the spring of 2019, this is far from certain, among other things like a lot of new elections in EU. Below we list 14 questions and answers of the "Brexit" process and its tortuous path ahead.

1. The UK has started Brexit: what will happen?
The countdown has begun. The UK and EU have two years – until March 28, 2019 – to reach agreement on withdrawal terms and preferably a new trade treaty. This deadline may be extended, but requires a consensus by all 27 other EU countries. Late this spring, the UK will initiate the task of either phasing out or incorporating EU laws where desirable.

2. What will EU do – when do talks begin?
EU heads meet April 29 to decide on guidelines for the EU's position in the negotiations with the UK. These guidelines will show the EU's priorities in the talks and indicate the probability of a soft or hard Brexit. After decision is made, 27 countries of EU must formally appoint European Commission as their main negotiator. This mandate needs full EU-27 support. In practice this means Brexit talks will not begin before late May/early June.

3. What are the EU and UK negotiating positions?
The EU's hard demands can be summarised briefly in three points: 1. Accept the EU's four freedoms; 2. Stay under the jurisdiction of European Court of Justice; 3. Contribute to the EU budget. The British side wishes to proclaim national sovereignty and its message is that the UK intends to leave the single market, have its own immigration controls and seek a customs union with the EU. There are consequently many potential conflicts.

4. What must London and Brussels agree on?
The Brexit process is a three-stage process. The first stage is a withdrawal agreement with financial obligations: the EU believes the UK owes it 60 EUR billion, while British say they would pay EUR 9 billion. A bigger stumbling block, however, is what civil rights the British will be granted in the EU, and what rights EU citizens will enjoy in the UK. This includes access to health care of EU membership. Only once agreement has been reached on the first stage can the next stage begin: negotiating a trade pact between London and Brussels and transitional rules. In the final stage, the UK must negotiate new trade treaties with non-EU countries.

5. When will we know how the talks are going?
After the EU has agreed on negotiation strategy, the world's focus on Brexit will decrease somewhat. We expect that by sometime early this coming autumn, it will be possible to draw conclusions about negotiating situation and what outcome can be expected. If the talks reach an impasse, this is expected to happen quickly.

6. And if London and Brussels can't agree?
A lot is at stake for both sides. There is a great risk of delays, for example because individual EU countries oppose parts of the agreement. Most likely, negotiations will continue after March 28, 2019 if the two sides see there is a chance of reaching agreement. If not, the UK will leave the EU and its single market anyway and gain WTO status in relation to the EU. The UK probably has more to lose if negotiations fail.

7. Isn't the timetable a bit too optimistic?
In this context, two years is very short period. For example, when Greenland left the EU in 1985, it took 3 years. The new trade pact between the EU and Canada took more than 7 years to put in place. Another circumstance that will cause great difficulty is that early in the Brexit process, the EU will be focusing a lot of time on domestic politics, elections and its own future. Discussion of the EU's new strategic direction will be especially intensive until the organisation's December 2017 summit.

8. Who finally decides whether to leave the EU?
Theresa May's government has agreed that Parliament will have the last word; a final parliamentary vote will be held before withdrawal from EU occurs. This theoretically enables Parliament to go against the government and the agreements it has negotiated.

9. Can UK push the "Stop" button?
There are divergent views on whether it is possible to terminate a withdrawal process, but some "architects" behind the EU treaties argue that this is possible. If there is a political will to let the UK remain – which is probable – the process may reasonably be terminated. In many ways, the situation is unique and there are difficult problems in interpreting the EU treaties. But the British are full members until they have left the EU. This is also the reason why it impossible for the UK to initiate bilateral negotiations on trade agreements until it leaves the union.

10. How probable is a UK snap election?
From a tactical standpoint, Prime Minister May has good reasons to call a snap election relatively soon: 1. She will greatly strengthen her political position in Parliament; 2. She will postpone the next election until 2022, i.e. well after possible 2019 withdrawal from the EU. Otherwise her term of office will expire in the spring of 2020.

11. Can Scotland throw a spanner in the works?
The Scottish National Party (SNP) has said, to London's displeasure, that a new referendum on independence may be held at some time between autumn 2018 (when a Brexit agreement may be in place) and spring 2019 (before the 2-year limit has expired). However, Scottish public opinion surveys provide no clear indication that the Scottish people wish to leave the UK. Interest among EU capitals in pursuing concurrent membership negotiations with Scotland is also limited, among other things because of worries that contagion will affect Spain, due to Catalonia's independence ambitions.

12. What will happen with the British pound?
At present the pound is nearly 20% undervalued against a basket of various currencies. The pound is not expected to rebound in the near term, due to political risks, uncertainty about the Brexit process and the UK's large current account deficit against other countries. If negotiations should proceed smoothly and show signs of successfully reaching an agreement, however, the pound is likely to appreciate substantially compared to its level today.

13. Where is the UK headed?
On March 1 the European Commission published a white paper on the future of the EU. Over the coming months five different scenarios will be discussed, possibly with a decision being made in December:

1. Carrying on
2. Nothing but the single market
3. Those who want more do more
4. Doing less more efficiently
5. Doing much more together

Germany, France, Italy and Spain would like the EU to follow scenario 3 (a multi-speed EU). There are many indications that the negotiations will be complex but that the EU will move closer to the UK.

14. Who will plug the new hole in the EU budget?
The EU will lose nearly 15% of its budget when the UK leave the union. Today there is strong opposition from individual EU countries against offsetting this loss by raising membership fees. Two paths are thus being discussed to deal with situation: 1. entitling the EU to collect a new tax at the union level; 2. cost-cutting of some kind. Both parts are controversial. Collecting an EU tax would hint at steps towards federalism, and cost-cutting would be severe burden on already EU-critical countries in Eastern Europe. The issue of EU finances will probably become acute starting in 2019.

Source: SEB

Glossary

Terms used	Explanation
Article 50 of the Treaty on European Union	Article 50 of the Treaty on European Union is a part of European Union law that sets out the process by which member states may withdraw from the European Union. Once Article 50 is triggered, there is a two-year time limit to complete negotiations. If negotiations do not result in a ratified agreement, the seceding country and EU would follow World Trade Organisation rules on tariffs. This article was used for the first and so far only time by the United Kingdom on 29 March 2017.
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.
European Union's four freedoms	The four freedoms of the European Union are the freedom of movement of goods, people, services and capital over borders. These key principles lie at the heart of the EU and underpin the single market, originally known as the common market. The freedoms, which are enshrined in EU treaties, aim to remove trade barriers and harmonise national rules at EU level.
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.
World Trade Organisation	The World Trade Organization (WTO) is the only international organization that deals with the global rules of trade between nations. The WTO is built on WTO agreements signed by the majority of the world's trading nations; its main function is to help producers of goods and services, exporters and importers better protect and manage their businesses.
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 March, 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%	14,7%	5,5%
Europe	MSCI EURO	EUR	15,6%	19,6%	2,3%	6,1%	1,7%	17,0%	6,6%
Eastern Europe	MSCI EM Eastern Europe	USD	13,2%	-2,9%	-40,0%	-8,1%	33,0%	15,8%	0,1%
Asia	MSCI EM Asia	USD	18,1%	-0,2%	2,5%	-11,8%	3,8%	15,5%	13,2%
Latin America	MSCI EM Latin America	USD	5,4%	-15,7%	-14,8%	-32,9%	27,9%	20,4%	11,6%

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