SEB

Monthly Newsletter Savings and Investments

Recovery in a complex environment

September 2020

Market overview

The last month of summer was the fifth straight month of global equity prices recovery from sudden and massive drops in March. After hard hit in Q2 we started to see signs of recovering economies in Q3, however environment remains complex. Reopening economies has proven at least as hard as locking them down, but in recent months households and businesses have shown a strong desire to return to normality. The risk of renewed outbreaks of COVID-19, after economies started to reopen, should not be underestimated, but we believe that future infections outbreaks will be met with "smart" lockdowns that limit their economic impact. We are also approaching the launch of both new virus suppressant and vaccines, so even if virus outbreak unfortunately continues in nearest future, the economic consequences will probably not be critical in longer-run. An unprecedented crisis response by governments and central banks (of almost 20 trillion USD) helped to put economy back on track and kept the demand for riskier assets. And these public sector interventions dominate the outlook. The light at the end of the tunnel has grown stronger. There is potential for a long-awaited recovery. Where we end up will depend on how businesses, households, politicians and central bank governors react to the prevailing extreme situation.

Stock market indexes' performance (until 31 August 2020)

Region	Index	Currency	Performance							
			2020 Aug	2020 YTD	12 Months	2015	2016	2017	2018	2019
USA	S&P 500	USD	7,0%	8,3%	19,6%	-0,7%	9,5%	19,4%	-6,2%	28,9%
Europe	MSCI EURO	EUR	3,2%	-12,6%	-5,2%	6,1%	1,7%	8,7%	-14,2%	22,0%
Eastern Europe	MSCI EM Eastern Europe	USD	0,8%	-23,6%	-11,7%	-8,1%	33,0%	12,9%	-8,3%	26,9%
Asia	MSCI EM Asia	USD	3,1%	7,6%	22,9%	-11,8%	3,8%	40,1%	-17,3%	16,6%
Latin America	MSCI EM Latin America	USD	-6,4%	-33,7%	-25,6%	-32,9%	27,9%	20,8%	-9,3%	13,7%

Major events and expectations

Positive surprises despite COVID-19 setbacks. The pandemic has in fact unfolded in a more negative direction than assumed in our previous main forecasts. Despite of this, the economy has generally recovered slightly faster than anticipated in advanced economies especially in terms of consumption and manufacturing. Yet preliminary GDP figures for the Q2 of 2020 show unexpectedly wide divergences, markets have not weakened as much as feared. Unemployment in the United States has fallen in recent months, while relief measures in Europe limited the upturn to a considerably greater extent than expected. This is one reason why the recession and stimulus measures have not burdened public sector finances as much as anticipated, thereby creating room for additional programmes in the future.

Our latest GDP forecasts. We have made small upward revisions in our 2020 forecasts for large developed countries. We now expect GDP among the 37 nations of the Organisation for Economic Cooperation and Development (OECD) to fall by 6.6%, compared to 7.0% in our earlier forecast. Yet we have revised our global GDP forecast about a point lower, since the spread of COVID-19 in many emerging market (EM) countries has caused more economic damage than expected. We have generally lowered our GDP forecasts for 2021 a bit, among other things since the pandemic looks set to impede some sectors for longer than expected. There will be a gradual recovery with above-trend growth, especially in 2021. But even at the end of 2022, resource utilisation will be lower than normal, with jobless rates in most countries well above pre-crisis levels.

Strong globalisation forces – after all. Global trade flows decreased sharply last spring when international supply chains were broken. Despite some recovery in June, world trade fell by 20 per cent year-on-year in Q2. Although the recovery is continuing during the second half, we expect a downturn of 10-12% for this year as a whole. By late 2020, however, we believe that most of the loss will have been regained. In 2021 we expect an upturn of 8 per cent. In 2022, we believe that world trade will be back at about the same level as in 2019.

Risk appetite in financial markets has continued to improve. Corporate reports for Q2 generally surpassed low expectations, mainly due to resolute cost savings. Our macro forecast implies a continued relatively favourable environment for stock markets and risk appetite. Economic conditions will gradually move up to firmer ground. Meanwhile central banks are prepared to help sustain economies for a long time with record low key interest rates, as well as to expand their asset purchases as needed. In such an environment, it is natural for stock market valuations to climb to levels that are high in a historical perspective. Central bank actions also enlarge the manoeuvring room for fiscal stimulus, which will assume an increasingly important role ahead. Although there are long-term drawbacks to ultra-loose monetary policy in the form of widening wealth gaps and weak pressure for change in the economy it is too early to begin speculating about future central bank exit strategies.

The stock market upturn of recent months has largely been driven by "digital giants": mainly US-listed technology companies. Their share of overall market capitalisation has increased – which in itself poses a risk – and their valuations have climbed to historically high levels, and recently we saw higher market volatility especially in US technology sector, but these companies are also showing large profits and very rapid earnings growth, not least due to the current worldwide digitisation megatrend. This suggests that today's valuations are defensible.

Massive stimulus measures causing some inflation concerns. One important factor behind rapid recovery has been massive stimulus measures by central banks around the world. In the US, the Federal Reserve (Fed) slashed its key interest rate to near zero, where other major central banks had already kept key rates close to zero for a long time. Enormous central bank bond purchases expanded significantly. This quantitative easing (QE) supports financial markets and economic growth in various ways, but has created concerns that such a dramatic increase in money supply will generate inflation. We already have some inflation in the system (around 1.5% in major economies), but because of continued globalization and subdued inflation expectations, we do not expect inflation to climb very high. This, in turn, means that central banks are likely to keep their key rates low for a long time. As long as they continue to buy government bonds, they also serve as a source of funding for future stimulus packages.

The US dollar continues to weaken. In recent months the convergence of key interest rates and bond yields at low levels has been an important foreign exchange (FX) market driver. We expect this trend to continue. This implies that the dollar will weaken now that it no longer enjoys a positive interest rate differential against other major currencies, while a more stable economic outlook also weighs down the dollar in its role as a defensive currency. Our forecast is that the EUR/USD exchange rate will be 1.25 at the end of 2021.

US-Chinese tensions, the US elections are among the risks than can cause higher volatility in markets. The pandemic has focused attention on the increased importance of national boundaries, for example with governments having to re-assess their need for national emergency stockpiles. In a long-term perspective, it is not hard to conjure up threats of growing protectionism, a decline in democracy, weakened international organizations and perhaps even armed conflicts. Increasing tensions between China and the Western world, especially the US, are by far the most important issue. Unfortunately, US-Chinese conflicts have recently escalated. This raises questions about the bilateral trade agreement that was signed after exhaustive negotiations. By midyear, China had met only one fourth of its stipulated import-expansion target for 2020.

US elections. Green investments, tax hikes for high income earners and companies as well as less trade-related drama are among the policy changes that can be expected if Joe Biden who leads in the opinion polls takes over the US presidency. This time around, there is uncertainty not only about the candidates but also the election process itself. Assuming a high percentage of postal votes, it might take weeks before the election is decided. The final winner may not be the candidate who leads the race on election night. This creates a risk of financial market volatility and increased political tensions.

Vaccine issue increasingly important. Given today's continued high level of virus spread at global level and flare-ups in hotspots around the world, it is increasingly obvious how important a vaccine will be to the normalization process. It is hard to get a clear picture of when large-scale vaccinations can take place, since there are major disparities in the assessments of experts. Today six vaccine candidates have reached the final phase of clinical testing. This critical phase, which is expected to take 2-3 months, will determine whether one or more vaccines meet various requirements. In the best case, a vaccine may be in place by early 2021, which would be a major success for the world's medical researchers.

However, many other issues are being discussed about mass vaccinations: for example, how fast enough doses can be produced, the competition between countries for access, allocation of the vaccines, and their effectiveness and duration. Other factors contributing to uncertainty are the degree of anti-vaccine sentiment especially in the US and the economics of carrying out mass vaccinations in poorer countries. Our main scenario assumes that the world must "suffer through" the coming northern hemispheric winter without mass vaccinations. There is consequently a risk of a temperature-driven worsening of the pandemic situation, although this too is controversial. However, we assume that vaccinations during the second half of 2021 will reach such a scale that it will greatly reduce the need for restrictions.

Alternative scenarios for economic recovery. The great uncertainty about vaccines and the spread of COVID-19 is one reason why we are continuing to work with various alternative scenarios. On the downside, the dominant risk is that the pandemic will take off during the winter in such a severe way that large new lockdowns and tougher restrictions are absolutely necessary. Aside from direct effects on GDP, this would probably have a severe negative impact on confidence, both in the real economy and in financial markets. Large-scale vaccinations starting in early 2021 could generate a more positive scenario. It is also possible that we have underestimated the power of economic policy stimulus when it has better conditions to work in. We are sticking to a symmetrical probability for these alternative scenarios: a 60% probability for our main scenario and 20% each for the negative and positive scenarios, respectively.

Sources: *SEB Nordic Outlook (2020 September), SEB Investment Outlook (2020 September)*

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