Stockholm, March 9, 2010

PRESS RELEASE

Investment Outlook, March 2010: In search of the best

Financial markets are in a sort of holding pattern. The spring and summer of 2010 will be characterised by various challenges, such as worries about economic policy tightening. In our investments, we are thus moving from beta to alpha. In other words, we now need to find good returns with an emphasis on quality following the first rapid market upturn phase, but in a somewhat longer perspective the prospects for economies and financial markets are bright. The key to this is a slow economic upturn, coupled with low inflation. Especially in the largest industrialised countries, the upswing will take time. This will demand greater selectivity in our investments.

This year has begun with a new trend. The economic upturn has consolidated. Meanwhile the markets have been fretting about such things as the government finances of various European countries and an economic policy tightening in China.

Later this year, growth rates in the OECD will slow as positive inventory effects and fiscal stimulus packages fade. This means we are now focusing on assets that can perform well without strong cyclical support. In this phase, the wheat will be separated from the chaff. We must refine our investment strategy. Today there are still good potential investments. The global economy is continuing to grow - though rather slowly, which is nevertheless an advantage. As the market perceives the future as more predictable, risk appetite will climb. This, in turn, will lead to greater interest in alternative asset classes.

“Market conditions have become more uncertain. In today’s financial climate, investors are drawing a sharp distinction between high and low quality. This will demand greater selectivity in our investments. We have the advantage of being able to employ a broad spectrum of investment opportunities,” says **Hans Peterson**, CIO Private Banking and Global Head of Investment Strategy.

The global economic slowdown and the launch of gigantic stimulus packages have dug deep holes in many Western government budgets. In searching for quality, investors are thus more interested in countries that have managed their budgets well and can show solid cash balances and current account surpluses (such as Sweden, Norway, Canada and Germany).

“Asset classes that are connected to these countries are thus likely to encounter increased demand,” says **Carl Barnekow**, Global Head of Advisory Team at Investment Strategy.

“This year it will be extra important for investors to choose good risk assets,” Barnekow continues. “In our view, during 2010 good risks will be a selection of emerging market countries (stock markets, currencies and bonds), the US (the dollar and US stock exchanges) and quality companies.”

At present, much of the world economy is characterised by strong cyclical momentum, with only portions of Eastern Europe lagging behind. The OECD countries are benefiting from continued powerful economic stimulus measures, a major shift in the inventory cycle from draw-down to build-up and a very strong surge in manufacturing. During the latter part of 2010, however, the OECD countries will lose a great deal of their growth dynamic as the prevailing stimulus effects fade. In the emerging market (EM) sphere, expansion will meanwhile continue in high gear, with the fast-growing Asian economies in particular leading the way. China is expected to account for nearly 1/3 of global GDP growth of 4.5 per cent during 2010.

“In the short term, the road ahead is lined with various challenges. Financial markets are in somewhat of a ‘treading-water’ phase, but there is a good chance that the current phase in risk asset markets will be followed by renewed improvement in growth towards the end of this year and early in 2011,” according to **Lars Gunnar Aspman,** Global Head of Macro Strategy at Investment Strategy.

“Looking ahead about one year, monetary policy in the OECD is thus likely to remain loose – short-term interest rates will remain historically low, while long-term yields will climb only modestly. Meanwhile tightening measures will be imposed in the EM sphere, but these seem unlikely to be of the aggressive kind. Overall, this should be a global environment that benefits risk assets. Reversals may occur at times, however, as the market focuses on and becomes concerned about moves towards tougher monetary policy, as illustrated by the negative reaction to the Federal Reserve’s announcement in mid-February that it was raising the discount rate on Fed lending to banks,” Aspman says.

The question of whether China will solve its growth puzzle is one theme of the spring issue of *Investment Outlook*. If China succeeds during the coming year in navigating through the existing inflation threats and the risk of overheating by means of timely, well-balanced economic tightening measures, there will be potential for sustainable long-term growth, Aspman continues.

Stock markets have left their easy period behind and have entered a phase dominated by more contradictory forces. The current phase is also equity-friendly. What will be important now are selectivity, profits, profit estimates and valuations.

“OECD stock markets have now entered an environment characterised by higher quality and selectivity. This favours sectors and companies with stable earning power, strong finances and limited cyclical sensitivity - a category that includes consumer goods, information technology and pharmaceutical companies,” Hans Peterson says.

“Geographically speaking, there are more arguments in favour of the emerging market sphere than stock markets in industrialised countries,” Peterson continues, pointing to their high economic growth, good financial stamina and - compared to the OECD - larger profit increases and lower P/E ratios.

“Rising government bond yields and the focus on public sector deficits and debts mean that government securities remain unattractive in the fixed income asset class. It is true that corporate bonds are not as attractive as before. Yet 2010 looks as if it will be a good corporate bond year, though not close to the record year 2009,” says Lars Gunnar Aspman.

“We expect better returns on High Yield bonds than Investment Grade bonds,” Aspman continues, pointing to higher effective yields on HY bonds and thus also greater remaining room for narrowing the spread above government bonds than for IG bonds.

The return of politics is affecting hedge funds, with Barack Obama and others proposing increased regulation. Meanwhile hedge funds, having undergone perhaps the greatest crisis in their history, now appear to be emerging with renewed vigour.

“We believe that the best time for hedge funds is now. Most of 2009, all of 2010 and certainly well into 2011 will be a period of good conditions for hedge funds,” says **Rickard Lundquist**, Portfolio Strategist at Investment Strategy. He also stresses the importance of investing in high quality hedge funds. This will be even more vital during 2010 and 2011 than in 2009, which was a year of recovery. It takes skilled managers to take advantage of good times in order to generate extraordinary earnings.

The outlook is also finally beginning to turn brighter for real estate as an asset class, Lundquist believes.

“The sun is beginning to rise over real estate markets, although it is still necessary to be selective in choosing investments. As usual with real estate, location is crucial, along with quality property management. Though not all parts of the real estate market are healthy, there are nevertheless many opportunities,” Lundquist says. “We are choosing to begin investing in properties, especially in the low-risk segments. In opportunistic property management there may also be good opportunities, but there it is even more important to find the right property manager.”

Private equity companies have had a tough time, but the situation is beginning to improve in this asset class as well.

“The gradual stabilisation of economic conditions is good news for private equity companies,” says **Johan Hagbarth**, Investment Strategist. “Equally important, though, is that credit markets have now begun to thaw. In recent months, transactions have taken off again. Sellers and buyers have begun to find each other. Granted that many companies are hard-pressed after the recession and credit crisis, but for those that have weathered the crisis and have capital to invest, the business opportunities now appear very good. We believe that strong private equity players will perform well and that it is more important than ever to choose quality.”

“Looking at commodity markets, positive and negative factors are quite evenly balanced. Our conclusion is thus that commodity prices are likely to move generally sideways during 2010 - but subject to rather large volatility. This means that compared to late 2009, we have lowered our return expectations on commodity investments,” says Lars Gunnar Aspman. “While we predict that energy and industrial metals will follow the general price trend, there are certain upside chances for agri-commodities and precious metals."

"This year, fundamental statistics will become a major driving force in the foreign exchange market," according to Carl Barnekow.

"Taking advantage of interest rate differentials will also have an impact. Sweden's well-run economy, improved export prospects and relatively early interest rate hikes will provide a good starting position for an appreciation of the Swedish krona," Barnekow continues. "Various emerging market countries are also likely to see their currencies gain strength. The EM sphere has weathered the global economic slowdown with little damage, and EM countries are about to raise interest rates from already relatively high levels. The budget problems of the economically weakest euro zone countries will not be solved overnight and will continue to weigh down the euro. The US is early in the economic cycle and has demonstrated far better growth than the euro zone and the UK. That will benefit the US dollar, in a period when the market is focusing on fundamental factors."

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