Investment Outlook

PRIVATE BANKING • INVESTMENT STRATEGY

The dawn is discernible

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SEB

Contents

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The dawn is discernible

Amid problem-filled political processes, the economic recovery has been pushed into the background. Recession risks are down sharply and there is a growing likelihood of better times ahead.

In recent years, discussions and investor behaviour in capital markets have largely been determined by crisis issues: the existence or non-existence of the euro, the debts of industrialised countries and the risks of a hard landing in China. This has led to generally defensive behaviour. Market participants have sought low risk in different ways, largely avoiding investments connected to economic growth. One consequence is that prices of stable assets have risen greatly and thus may not be able to continue providing the same good returns. It may soon be time to begin questioning and challenging these investments. Such a challenge is not risk-free, however. A trend may last longer than we believe, and it takes time for investor perceptions to change, thereby turning around this trend. Yet the potential returns from today's defensive assets should be questioned. It may be time to seek other sources of returns.

Right now two extremely important political processes are under way globally: a fiscal management debate in the United States and leadership changes in China. What is interesting is that the related discussions are occurring against a backdrop of continuing economic recovery. This may indicate that if political leaders "only" do their job reasonably well, growth may accelerate and carry the capital markets with it – above all because the attitude of investors towards capital markets remains largely defensive. We face an interesting and challenging period ahead, and there is hope of a brighter future.

To some extent, we can view capital markets as communicating vessels. Capital flows into one asset until it is full (expensive), then gradually into another that is available (cheap). Fundamental events serve as the mechanism that moves capital. Perhaps debt deleveraging has come such a long way in parts of the world that the risks which drove investors into defensive behaviour are no longer so relevant, but instead have become manageable. The euro zone crisis, US household debt and the Chinese economic situation are examples of such risks. If these risks "normalise" and if the relatively good underlying trend in the US and China instead becomes the main theme, then capital will gradually seek out risks in order to boost potential returns.

In this issue of *Investment Outlook*, we focus on China, discuss gold as a store of value and introduce a new country model in our global equities section. China will continue to account for a significant proportion of global growth and is extremely attractive from the standpoint of both equities and bonds.

Today the risk of inflation leads to a lot of speculation, especially since central banks are stimulating liquidity by "printing money". Meanwhile, banking systems in many countries are shrinking their balance sheets even more, which we might fail to notice. Yet the question remains, and the upturn in gold prices is worth discussing.

Putting money into stock markets will make more and more sense if there is a greater focus on the recovery. The road to recovery will still be lined by financial risks. Yet opportunities exist, and returns will be generated in places other than traditional industrialised countries. We need a strategy for approaching these opportunities. Today a lot of new value is being generated in Mexico, Turkey, Indonesia and other countries outside our usual field of vision. Our method for locating and filtering these opportunities is a new quantitative country model. We have based it on stock markets, not on the macro-economy, thereby better capturing the exporters in various markets. We have supplemented the model with qualitative assessments of macro fundamentals, before the results lead to recommendations or become the basis for portfolio allocation decisions.

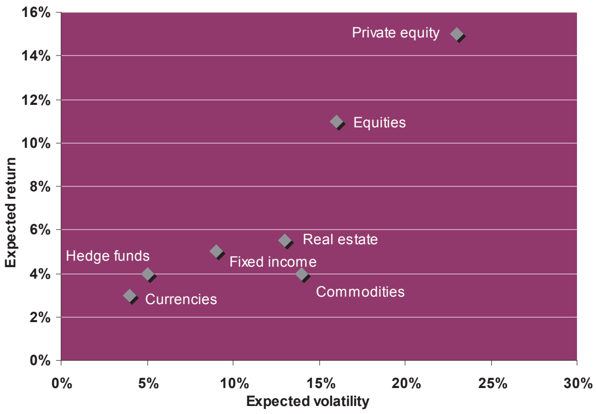
Our bottom line message is that the world is probably moving towards a period of faster growth, in which recession risks will have sharply decreased. We foresee a likelihood that market players will seek out new types of investments: more risks, more equities – gradually and slowly, with an awareness that we still live in a world of problems, but one where the dawn is discernible...

HANS PETERSON
CIO Private Banking
and Global Head of Investment Strategy

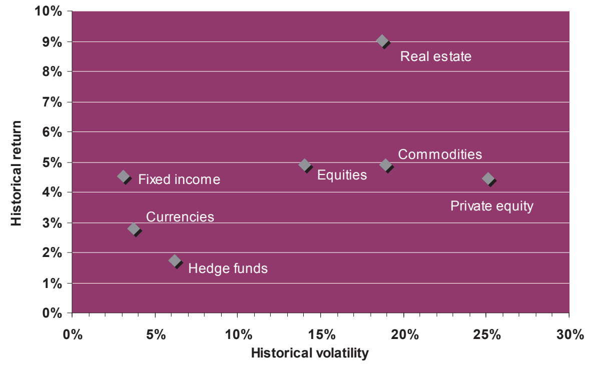
	Expectations* Next 12 months Return	Risk	*Forecasts are based on the SEB House View and our economic growth scenario (see page 8). Reasoning
Equities [1]	11%	16%	**NEUTRAL** in the short term: The economic picture has brightened, but the biggest driving force behind the year's stock market upturn is expectations about the world's central banks. **POSITIVE** in the long term: The markets that still appear to have the greatest potential are emerging markets and countries and regions that will grow on their own power. Such characteristics as a large domestic market and decoupling from problem areas are preferred.
Fixed income [2]	5%	9%	For some time, the US Federal Reserve and European Central Bank have supplied liquidity via the banking system and, taking into account low inflation worries, have further manoeuvring room available. **NEGATIVE** in the long term towards government bonds in OECD countries. Purchases of government securities and mortgage bonds lead to lower yields, which are at historical lows today in many places. Rising unemployment and low inflation expectations strengthen our assessment that Sweden's Riksbank will continue lowering its key interest rate in December 2012 and February 2013. **POSITIVE** in the long term towards corporate bonds: The strong performance we have seen in the corporate bond segment will probably not retain the same strength but interest in bonds issued by companies is here to stay.
Hedge funds	4%	5%	**POSITIVE** in the long term: We still maintain that Credit L/S and Systematic Macro strategies belong in a portfolio as absolute return, diversifying holdings. We expect a continued difficult environment for this asset class, since we foresee continued zigzag patterns in markets in the near future.
Real estate [3]	5.5%	13%	Primary markets remain attractive in a low interest rate environment. **POSITIVE** in the long term: Major differences in return figures between primary and secondary markets will create attractive investment cases further out on the risk scale. The REIT market is continuing to perform strongly during 2012.
Private equity	15%	23%	The strong increase in underlying net asset value (NAV) was reflected in prices of listed private equity companies during the autumn. **POSITIVE** in the long term: The risk of a short-term decline has increased as valuations have climbed, but a rising number of transactions along with stable growth prospects indicate continued long-term stable growth.
Commodities [4]	4%	14%	Geopolitical risks with the potential to sharply lift oil prices remain, but prices of both oil and precious metals are expected to stand at around their current level a year from now. **NEUTRAL/ POSITIVE**: Accelerating growth in China is essential to higher base metal prices. We believe this is likely and expect base metal prices to be about 10 per cent higher in one year. NEGATIVE towards grain prices, which are still too high, and assuming that no extreme weather conditions disrupt the picture, prices should fall.
Currencies [5]	3%	4%	**POSITIVE** in the long term towards currencies in economies with strong fundamentals. Low valuations and persistent interest rate and growth differentials between the EM sphere and OECD countries are still arguments in favour of EM currencies.

[1] The forecast refers to the global stock market. [2] The forecast refers to a basket of ½ investment grade and ½ high yield corporate bonds. [3] The forecast refers to the REIT market. [4] The forecast refers to a basket in which the energy, industrial metal and precious metal categories are equally weighted. [5] The forecast refers to the alpha-generating capacity of a foreign exchange trading manager.

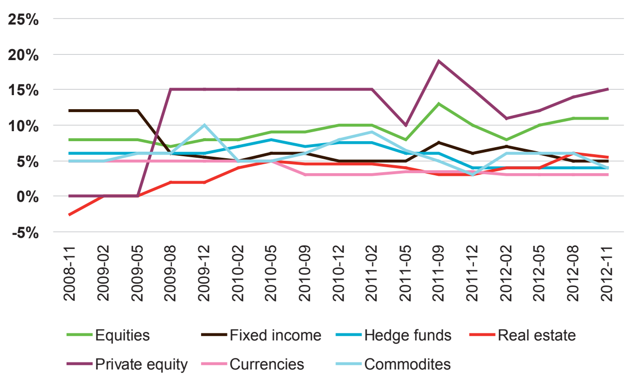
EXPECTED RISK AND RETURN (NEXT 12 MONTHS)



HISTORICAL RISK AND RETURN (OCTOBER 31, 2002 TO OCTOBER 31, 2012)



CHANGE IN OUR EXPECTED RETURN

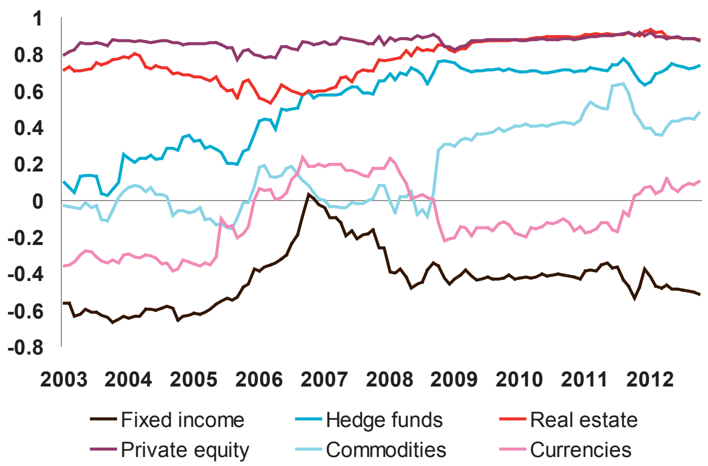


HISTORICAL CORRELATION (OCTOBER 31, 2002 TO OCTOBER 31, 2012)

	Equities	Fixed income	Hedge funds	Real estate	Private equity	Commodities	Currencies
Equities	1.00						
Fixed income	-0.42	1.00					
Hedge funds	0.63	-0.30	1.00				
Real estate	0.83	-0.20	0.56	1.00			
Private equity	0.86	-0.33	0.68	0.88	1.00		
Commodities	0.30	-0.19	0.68	0.30	0.41	1.00	
Currencies	-0.09	0.22	0.18	-0.07	-0.01	0.08	1.00

PLEASE NOTE: In August 2012 we changed real estate index from SEB PB Real Estate to EPRA/NA-REIT

ROLLING 36-MONTH CORRELATIONS VS. MSCI WORLD (EUR)



Historical values are based on the following indices:
Equities = MSCI AC World EUR
Fixed income = JP Morgan Global GBI EUR Hedge
Hedge funds = HFRX Global Hedge Fund USD
Real estate = EPRA/NA-REIT EUR
Private equity = LPX50 EUR
Commodities = DJ UBS Commodities TR EUR

On the threshold of a better global economy

- *A period of decelerating world growth...*
- *... looks set to be followed by a slow upturn*
- *There are risks, but our forecast of a brighter economic future is not in jeopardy*

Parts of the world economy – especially Europe and Japan – have weakened in recent months, but a global stabilisation seems under way. In many countries, leading indicators have gained strength, among other things due to central bank programmes announced and launched since mid-year. In the United States, households have greatly reduced their debts and the housing market has entered a more viable recovery, while indicators in China currently predict a rebound in growth this winter. Lower inflation is also generating greater purchasing power, especially in many emerging market (EM) economies, while also opening the way for more economic policy stimulus. In the euro zone, sovereign borrowing costs in Spain and Italy have fallen, mainly due to the actions of the European Central Bank (ECB). Imbalances in terms of competitiveness, government finances and foreign trade have eased, but major challenges remain both in the short and long term. Higher unemployment and a broader economic slowdown that now also includes Germany are impeding political efforts to stabilise and eventually ensure the survival of the currency union. US fiscal policy is a short-term source of economic concern.

US economic outlook a little brighter

GDP growth in the US accelerated to 2 per cent in the third quarter as the housing market showed clearer signs of a viable recovery, and higher home prices benefited private consumption. Looking at federal budget policy, the looming "fiscal cliff" – automatic austerity measures totalling about USD 600 billion (4 per cent of GDP) in 2013 – can probably be avoided, but some belt-tightening will still be implemented. This will stiffen the fiscal headwind to a predicted 1.5 per cent of GDP next year. Yet there are reasons to foresee a somewhat brighter US economic outlook than a few months ago. We predict GDP growth of more than 2 per cent this year, about 2.5 per cent in 2013 and 2.5-3.0 per cent in 2014. The Federal Reserve's September launch of a third round of quantitative easing (QE3), using purchases of mortgage-backed securities, shows that the central bank is paying greater attention to the labour market and less to inflation. Further purchases of Treasury securities (QE4) and zero key interest rate for an extended period are in the Fed's plans.

Falling euro zone GDP, but a less acute crisis

Indicators in the euro zone point towards declining economic activity for another while. Households are squeezed by rising unemployment as well as austerity measures. Uncertainty about the survival of the currency union is hampering corporate capital spending. We expect GDP to fall by nearly 0.5 per cent this year, stagnate in 2013 and grow by less than 1.0 per cent in 2014, but the government financial crisis became somewhat less acute early this autumn when the ECB unveiled its Outright Monetary Transactions (OMT) government bond purchasing programme. OMT has not yet been used, yet has still helped push down borrowing costs for crisis-hit countries. The ECB is now in wait-and-see mode. Its key interest rate is likely to remain at 0.75 per cent over the next couple of years. But although the euro zone outlook has improved – with steps towards a banking union also taken – it remains uncertain whether the euro project will survive in its current form.

London Olympics inflated British growth

Although British GDP topped the EU charts in the third quarter, one of the main reasons was the positive impact of the Olympic Games in London. Fiscal austerity policy remains in place. Combined with weak export demand – nearly half of exports go to the euro zone – this will hold back the underlying recovery. We predict stagnant GDP this year, with growth in the range of 1.5 per cent in both 2013 and 2014. This autumn the Bank of England has taken a break, which is likely to be followed this spring by increased bond purchases or steps to expand credit, but the BoE will leave its key rate unchanged at 0.5 per cent for an extended period.

Germany holding back the Nordics

The Nordic countries are now clearly affected by the international slump, especially by the German slowdown. The Swedish, Finnish and Danish economies are stagnating. A deceleration has occurred in Norway, too, but the economy is still maintaining a good pace of expansion. Looking ahead, we expect modest recovery in line with other countries. In Sweden, both monetary and fiscal policy will provide support. Norway will continue growing more strongly than its neighbours. Overall Nordic GDP will increase by less than 1.5 per cent this year, more than 1.5 per cent in 2013 and more than 2 per cent in 2014.

Japan's economic engine sputtering alarmingly

Japanese GDP is likely to fall during the second half of 2012, among other things due to lower exports to China. The economy is thus sputtering alarmingly after an upturn last spring. A weak growth outlook and continued deflation are opening the way for new stimulus measures from the Bank of Japan, mainly in the form of securities purchases. There are mounting worries, and consolidation of government finances seems remote. Japan's credit rating is thus in jeopardy. We predict GDP growth below 2 per cent this year, about 1 per cent next year and less than 1.5 per cent in 2014.

Asian EM countries easily outpace other regions

GDP growth in many Asian emerging market countries slowed in the third quarter but was still substantially faster than in the US and Europe. Good domestic demand will provide solid support in 2013. We expect inflation to climb somewhat in the near term due to more expensive food, but inflation pressure in Asia is generally low. We foresee no major shift in monetary policy during 2013, although a number of countries may begin raising key interest rates towards year-end.

Despite the economic deceleration of recent quarters, the risk of a hard landing in China has decreased, judging from unexpectedly strong economic data this autumn. We predict GDP growth of more than 7.5 per cent this year, about 8 per cent in 2013 and more than 7.5 per cent in 2014. So far, the official policy response to the economic slowdown has been limited, among other things due to the change in political leadership.

India's economic performance has remained fairly weak, but there are signs of stabilisation. GDP growth accelerated slightly in the third quarter, and business surveys currently foresee an imminent improvement. We expect GDP to increase by 5.5 per cent in 2012, about 6 per cent in 2013 and more than 6 per cent in 2014. Inflation is now undesirably high, leaving extremely little room for key rate cuts now, but lower inflation in India next year will set the stage for stepwise rate cuts.

From slowdown to acceleration in Latin America

For two years, growth has been slowing in Latin America. In 2012, GDP in the region looks set for a modest increase of just above 3 per cent. Thanks to acceleration in pace-setting economies like Argentina, Brazil and Chile, growth is likely to be at or above 4 per cent next year and probably even higher in 2014. This year and next, inflation will level out at some 6 per cent, while the overall deficit in Latin American public finances will shrink a bit. Total public sector debt in the region will remain around 33-34 per cent of GDP in 2013, a level that would probably make political leaders in most OECD countries envious.

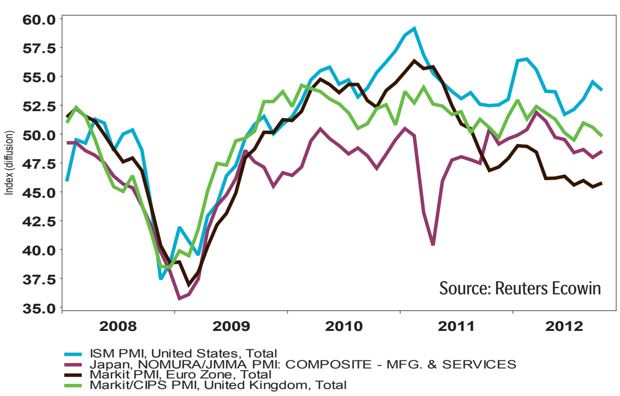
Varying economic prospects in Eastern Europe

The economic "heavyweights" of Eastern (including Central) Europe – Russia and Poland – are now affected by the global economic slowdown, but because they are less export-dependent and have fairly good public finances, they have coped with the euro zone crisis better than most Eastern European countries. This is especially different from central and southern parts of the region, where countries like the Czech Republic, Hungary, Croatia and Slovenia are showing weak economic performance. Our crystal ball shows that Poland and Russia have good potential for decent growth, while their inflation prospects diverge. Because of higher Russian inflation, the central bank in Moscow will keep raising its key interest rate. Meanwhile Polish inflation will decline further, providing room for key rate cuts.

Continued healthy domestic demand is sustaining growth in the Baltic economies, as exports recuperate only slowly. Inflation will remain low in Latvia and Lithuania, but higher in Estonia. Current account deficits will widen in Latvia as well as Lithuania, which will also note a slightly higher budget deficit, but Estonia and Latvia will still show small negative figures in their public finances. Latvia looks set to join the euro zone in 2014, as planned.

World economy poised for gradual acceleration

After last year's reading of nearly 4 per cent, we foresee global GDP (adjusted for purchasing power parities) growing by somewhat above 3 per cent this year, above 3.5 per cent in 2013 and some 4 per cent in 2014. With growth rates in the range of 5.5 per cent annually, the EM sphere is easily ahead of the OECD countries, which are expected to see yearly economic growth of about 1-5-2 per cent. In our scenario, the world economic slowdown will end late in 2012, followed by a gradual upswing.



DIVERGENT US AND EURO ZONE ECONOMIC PROSPECTS

During the 2008 economic crash and the 2009 recovery, major OECD countries followed similar paths, but for the past couple of years the pattern has changed. The economic dynamic has been much better in the US and – in part – the UK, compared to weakness in the euro zone and Japan. These differences are closely reflected in regional purchasing manager expectations.

Portfolio commentary: Modern Investment Programmes

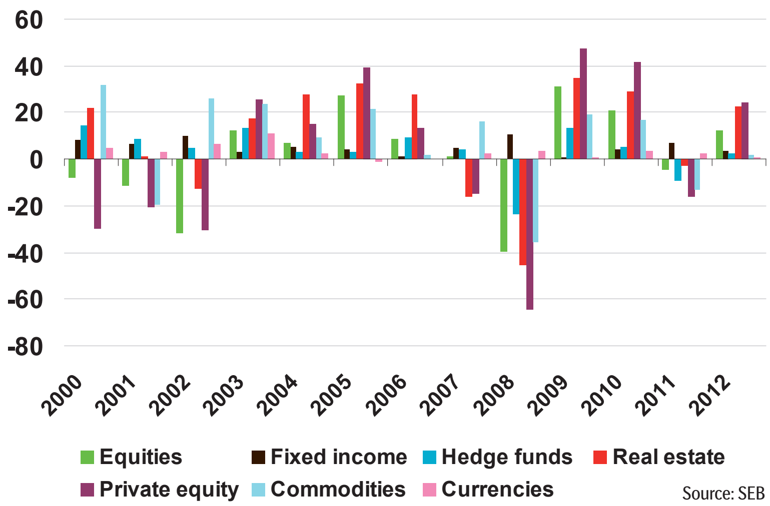
Gradual shift in focus towards fundamentals

In the Modern Investment programmes, we have long had a cautious approach to risk, mainly because political manoeuvring, especially in Europe, has been the largest market-driving force – which has resulted in low visibility. Our focus has been on maintaining sound risk, rather than on chasing the last percentages of returns.

Our approach to risk-taking has not changed. We still expect events in the political arena to affect financial markets, but as we wrote in the previous Investment Outlook (published on September 11, 2012), we predict that market players will gradually let go of political issues and focus more on fundamentals. Meanwhile, low interest rates and bond yields are forcing capital to seek out riskier assets in order to stay abreast of inflation.

In Modern Growth we have increased the proportion of equities in order to move closer to the portfolio's more long-term return target, while reducing the duration risk in the fixed income sub-portfolio. We have also increased the proportion of equities in Modern Aggressive. In both portfolios, we have meanwhile switched managers in order to improve alpha potential. In Modern Protection, we have invested cash in leveraged loans and high yield and supplemented our Absolute Return managers with a low risk mandate.

PERFORMANCE OF DIFFERENT ASSET CLASSES SINCE 2000



Source: SEB

Return in 2012 is until October 31. Historical values are based on the following indices: Equities = MSCI AC World EUR. Fixed income = JP Morgan Global GBI EUR Hedge. Hedge funds = HFRX Global Hedge Fund USD. Real estate = EPRA/NA-REIT EUR. Private equity = LPX50 EUR. Commodities = DJ UBS Commodities TR EUR. Currencies = Barclay Hedge Currency Trader USD.

MODERN PROTECTION

Credit spreads have dropped steadily in the second half of 2012, greatly boosting both corporate bonds with high credit ratings (investment grade) and those with low credit ratings (high yield) generally. Our view is that the yields on government bonds will rise slightly, but the large output gap and high unemployment in Western countries, coupled with central bank interventions such as Operation Twist, are likely to keep yields at low levels. This more or less forces capital to seek riskier assets to stay abreast of inflation.

When yields are low in absolute terms, the risk of negative returns becomes larger when interest rates rise. To illustrate this, let us use a simple example.

A 5-year bond costs 100 and provides a coupon of 5, which means that interest rate risk (duration) is about 4.3 per cent. This means that if interest rates rise 1 percentage point, the price of the bond falls by 4.3. Meanwhile we get a coupon of 5, which means that in that year, net return is 0.7 (100-4.3 +5 = 100.7).

Assuming instead that the bond has a coupon of 2, a recalculation gives us a duration of about 4.7 percent, which means that interest rate risk is slightly higher. A 1 per cent interest rate rise means that the price falls from 100 to 95.3. Even taking into account the coupon, net return for the year is -2.7 (100-4.7 +2 = 97.3), or negative.

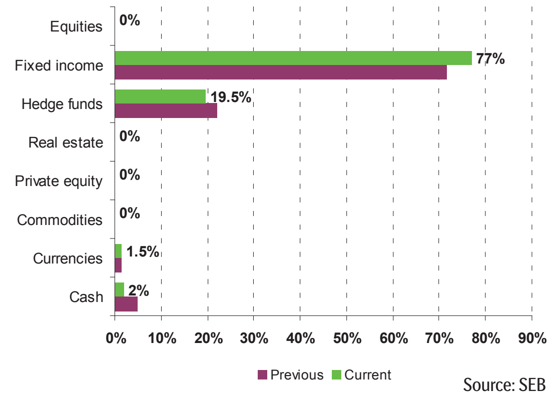
This example is not completely applicable to corporate bonds, since they have a credit component that tends to go in the opposite direction and should compensate for rising interest rates, but it illustrates that interest rate risk plays a larger role in the overall risk picture when absolute levels are low.

In Modern Protection, we have made no major changes but instead continue to focus on investments with low interest rate risk. In the investment grade segment (5 percent of the portfolio), we only invest in BlueBay Investment Grade Libor, which eliminates duration by means of credit derivatives. High yield exposure, which we have up-weighted to 12 per cent from the previous 8, is mainly invested in leveraged loans and short duration high yield.

About a third of the portfolio is invested in Absolute Return managers, who have free mandates and full flexibility to take advantage of changes in the yield curve and thereby maintain interest rate risk neutral exposure. Here, we have added a new manager who maintains lower risk compared to the other Absolute Return managers, but who should be able to generate a 1-2 percent better return over time than risk free yields. This lowers risk from Absolute Return as a whole and compensates for the increased risk from high yield.

Overall, the portfolio is well positioned within its risk mandate and should be able to generate good future returns.

WEIGHTS IN MODERN PROTECTION



Source: SEB

MODERN GROWTH

As mentioned in previous issues, a recurring theme in recent years has been to find stable income streams, with a risk scale ranging from investment grade and high yield to equities with high dividend yields. In Modern Growth, we have chosen high yield as our primary exposure to this theme due to its attractive risk-adjusted returns and current yield of 6-7 per cent.

In 2012, nearly 30 percent of the portfolio has consisted of high yield bonds, which have benefited significantly from shrinking credit spreads. This credit spread contraction means that looking ahead, we do not expect high yield returns to be as strong as so far this year, but 6-7 per cent is a reasonable forecast. Meanwhile we believe that stock market risks have decreased, partly thanks to the efforts of the European Central Bank (ECB) and a gradual decoupling from politics. We have thus gradually increased the equity portion of the portfolio in the current quarter to move closer to the portfolio's long-term targeted return of 7-8 per cent.

Equities now account for 28 per cent of Modern Growth, up from 17. The up-weighting is divided among emerging market (+6 per cent), global (+4.5 per cent) and Nordic equities (+0.5 per cent). To avoid over-exposure to the "yield" theme, in the equities asset class we are investing with managers who seek high growth and return potential rather than dividend yield.

To cushion the portfolio's overall risk, in the fixed income sub-portfolio we meanwhile reduced duration (interest rate sensitivity) by replacing 4 percent of high yield with 2 percent short duration high yield and 2 per cent leveraged loans.

We have also switched managers in commodities as well as equities, but describe this in detail under Modern Aggressive, where we made the same changes. In Modern Growth we are instead focusing on what reallocation means more concretely in terms of expected return and risk.

MODERN GROWTH, CONTINUED

Given current weights and our forecasts for each asset class, the portfolio has an expected return of 6.7 per cent at a risk (volatility) of 8 per cent. In Table 1, we have analysed how much each asset class contributes to the portfolio's expected return and risk. The figures are rough and should only be seen as an indication of where the portfolio's main risks lie. For example high yield, amounting to 27 per cent of the portfolio, accounts for 27 percent of its expected return and 31 percent of its risk.

More notable is that equities, amounting to some 28 per cent of the total portfolio, account for more than half of expected return (51 per cent) and risk (57 per cent). This means we are relying more on the stock market than before as an engine of returns, but also that this asset class will account for almost 60 per cent of the portfolio's fluctuations. This may sound like a lot, but in this context it is quite reasonable considering the portfolio's long-term target of a 7-8 per cent return.

The analysis also shows that to achieve a more balanced risk picture, emerging market debt can be increased relative to other asset classes. Increased EM debt means indirect exposure to a positive global economic scenario, however, so we are holding off on such an increase and settling for an up-weighting of equities. At present, we have a cautious view of commodities as a whole and thus do not wish to increase the percentage of commodities in the portfolio either.

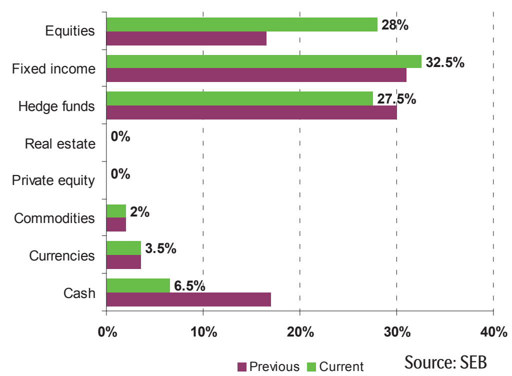
As the table also indicates, the hedge fund sub-portfolio contributes 17 per cent to expected return but accounts for a modest 9 per cent of risk. This attractive characteristic is due to its relative lack of correlation with other asset classes in the portfolio.

But in 2012, as in 2011, the hedge fund sub-portfolio has hovered around zero and has not lived up to our expectations. We have thus initiated a comprehensive restructuring analysis, the results of which are not yet complete, but that is likely to lead to a more concentrated hedge fund portfolio and possibly less emphasis on CTA strategies. The analysis also shows that we can increase our exposure to currencies, but we generally prefer to do this more through EM debt in that case.

Asset class	Portfolio weight	Expected return		Expected risk	
		Contribution	%	Contribution	%
Global equities	17%	1.8	27	2.3	29
EM equities	10%	1.4	20	1.8	23
Nordic equities	2%	0.2	3	0.3	4
EM debt	2%	0.3	4	0.2	2
High yield	27%	1.8	27	2.5	31
Commodities	2%	-0.1	-1	0.2	2
Currencies	4%	0.1	2	0.0	0
Hedge funds	28%	1.1	17	0.7	9
Cash	9%	0	0	0.0	0
	100%	**6.7**	**100%**	**8.0**	**100%**

Table 1: The first column shows the weight of each asset class in the portfolio. Column 2 shows how many percentage points each asset class contributes to overall expected return and Column 3 expresses it in per cent. Column 4 shows how many percentage points each asset class contributes to portfolio risk (volatility). Column 5 shows this in per cent.

WEIGHTS IN MODERN GROWTH



Source: SEB

MODERN AGGRESSIVE

Because Modern Aggressive's long-term objective is a return that exceeds the stock market over a business cycle, equities play a far greater role as an engine of returns. As in Modern Growth, this quarter we have gradually boosted the proportion of shares, from 38.5 per cent of the portfolio to 46.5 per cent. Of these 8 percentage points, 2 have been allocated to global shares and 6 to emerging markets. In emerging markets, we are putting more emphasis on Asia, which makes up nearly 7 per cent of the portfolio.

We have also made some changes in managers. In global equities, we have narrowed down from four to two managers, JO Hambro Global Select and Treetop Global Opportunities. Both focus on equities with potential for high earnings growth. These managers thus had long periods of difficulty in 2011 and 2012 when capital mainly poured into defensive shares with high dividend yields. On the other hand, they have performed strongly during periods where the market has focused more on fundamental company valuations and better risk appetite, as during the third quarter of 2012. In more positive market environments, we have not seen the same "surge" in Labrusca, which we have chosen to leave. Odey Allegra International has a structurally undesirable exposure to Europe – we prefer to independently steer this exposure to specific regions.

Emerging market holdings still consist of the same "big four": Carmignac Emergents, Eaton Vance Emerging Markets, JO Hambro Emerging Markets and William Blair Emerging Leaders. Returns vary significantly between managers because of their different styles, but they have all basically outperformed the MSCI Emerging Markets Index this year.

Asian equity exposure consists of T Rowe Price Asia ex Japan, Coupland Cardiff Asia Alpha and China AMC – China Opportunities. The former has a tighter relationship with the index but over time has performed better than benchmark and serves as a good base for Asian holdings. The other two have flexible mandates with various thematic specialisations, such as Asian consumption. Together they have great potential for strong out-performance.

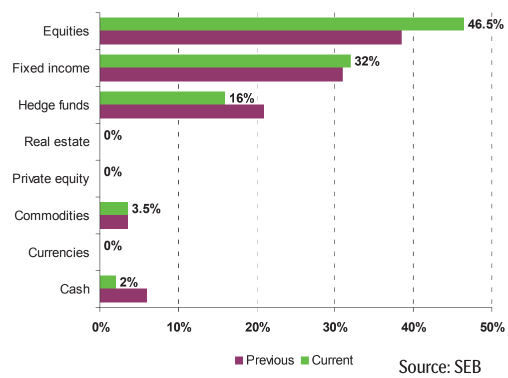
Commodity exposure is unchanged at 3.5 per cent. Again, we have changed managers, from Schroder Commodities and Vontobel Belvista Commodities to Threadneedle Enhanced Commodities. Like the first two, this manager uses the curvature of commodities futures to achieve the "cheapest" exposure to a specific commodity, but also has more "index-free" management that provides even higher potential returns over commodity indices.

So far this year, the fixed income sub-portfolio has generally risen as much as global equities (+12 per cent), accounting for about 45 per cent of the portfolio's total return. Unlike Modern Growth we are keeping our full exposure to high yield bonds with "normal" duration in order to keep a more aggressive profile. The sub-portfolio consists of 23 per cent high yield and 9 per cent EM debt.

As in Modern Growth, we are conducting a comprehensive analysis of the hedge sub-portfolio to improve its yield potential. This task is not yet completed but it is likely to lead to a more aggressive portfolio that fits better into Modern Aggressive's risk mandate. As a first step, we have begun the process of replacing some CTA managers. We have also reduced our allocation to hedge funds by about 5 per cent (re-allocated to equities).

After these re-weightings, the portfolio has an expected return of just over 8.5 per cent at a risk (volatility) of 11 per cent. For natural reasons, sensitivity to global economic trends is higher, but assuming lower systemic risk and our main scenario of a growing global economy (though at a slow pace), we regard it as justified.

WEIGHTS IN MODERN AGGRESSIVE



Source: SEB

Theme

China is slowing – and accelerating

- *The period of gradually higher growth is over*
- *Growth is trending downward in China*
- *A mini-cyclical upswing may benefit China's stock market*

For the past seven quarters, the Chinese economy has been decelerating. This loss of momentum was accentuated in the autumn of 2011. In the third quarter of 2012, Gross Domestic Product (GDP) growth slowed to 7.4 per cent year-on-year, compared to 7.6 per cent in the preceding quarter. Worries about continued deceleration and a Chinese hard landing have affected global macroeconomic forecasts as well as financial markets in various ways. This caused the stock market in China to fall steeply during the summer, while stock markets in most other countries were climbing.

Several reasons behind slower growth

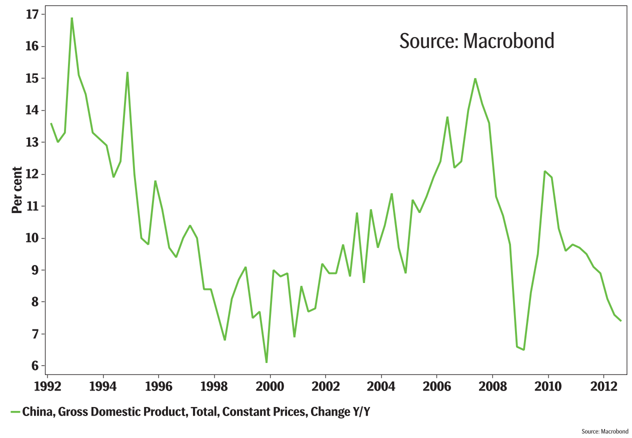
The decline in Chinese growth since 2010 has both cyclical and structural causes. Cyclical headwinds began when 1) exports were hurt because major OECD economies went through a consolidation period characterised by budget austerity and debt deleveraging (the recession-hit EU is China's largest export market), 2) the Chinese housing market weakened due to large inventories of unsold homes, 3) Chinese companies saw a greater need to trim their inventories, 4) profit growth in China cooled and 5) Chinese capital spending lost momentum.

During the 2008-2009 financial and economic crisis, China had a large output gap (plenty of idle production capacity), diminishing growth and clearly falling inflation. Authorities responded with a large dose of stimulus, which quickly caused the economy to accelerate again. Today's output gap is far smaller – in itself evidence that the earlier crisis policy was successful – inflation is again higher, and official willingness to use fiscal stimulus is hampered by the political transformation now under way.

Four mega-trends explain the growth miracle

The Chinese growth miracle of recent decades can be attributed to four megatrends/structural factors: industrialisation, modernisation, urbanisation and globalisation. These, in turn,

CHINA LEAVING BEHIND DOUBLE-DIGIT GDP GROWTH



During the first decade of the new millennium, GDP growth averaged more than 10 per cent. For various structural reasons, trend growth will gradually decelerate in the next few decades. In the short term, however, a cyclical upswing in China is imminent.

have been fuelled by various reforms in agriculture and the state-owned company sector. Also behind China's export-led growth is its membership in the World Trade Organisation (WTO) since 2000. Furthermore, China was in a favourable starting position, with a good supply of labour, high savings and a low level of economic development. These structural factors have nevertheless gradually become less powerful, as reflected in the decline in China's annual GDP growth from 11.7 per cent in 2004-2007 to 9.9 per cent in 2008-2011 and less than 8 per cent in 2012-2014 (SEB forecast).

The most important ingredients for economic growth consist of three production factors: labour/human capital, physical capital and productivity (chiefly new technology that allows greater output per hour worked).

Labour as a production factor

An ample supply of labour has been an important driving force behind China's successful growth in recent decades, especially urbanisation – mass migration from the countryside to coastal regions. Since 1995 China's coastal population has increased by about 20 million per year, with 2/3 consisting of labour migration from rural areas. The World Bank estimates that this in itself has contributed 1 percentage point to Chinese GDP growth each year since then.

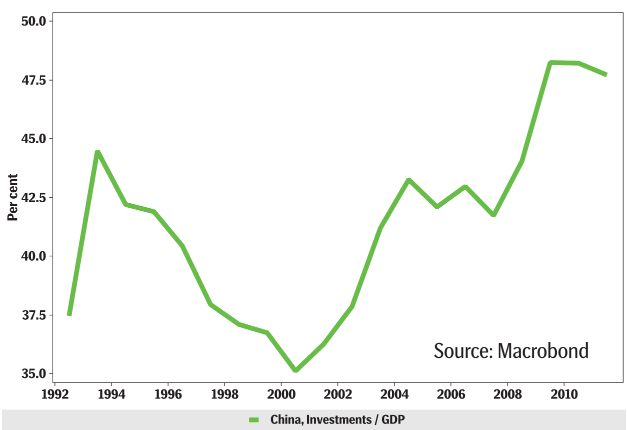
Judging from the noticeable slowdown in this mass migration, coastal population growth looks set to decelerate to about 13-15 million annually over the next five years. This is not primarily due to a reduced labour supply in rural areas – which now account for 30 per cent of total employment in China – but instead weaker demand conditions in the wake of lower economic growth in the country.

Physical capital as a production factor

Capital spending – building up the stock of physical capital and replacing its worn-out elements – has been a powerful growth force in China. As a share of GDP, it has increased from just over 35 per cent in 1990 to about 45 per cent at present. Artificially low financial capital costs are one important reason for this rapid expansion.

The investment ratio (capital spending as a percentage of GDP) has nevertheless declined during the past couple of years. This trend looks set to continue because 1) the margin of return on capital investments is diminishing since capital intensity has risen so much, 2) various previously completed investment projects have demonstrated shortcomings and misallocation of capital, 3) today it is harder to find economically defensible projects and 4) there is a political ambition to shift resources from capital spending and exports towards private consumption. Today private consumption accounts for only 35 per cent of GDP, down from 47 per cent in 1990.

CAPITAL SPENDING IS STARTING TO COOL



Since 2000, capital spending as a share of GDP in China has greatly increased due to economic policies that have prioritised export- and investment-led growth. The ratio appears to have peaked, however, and there are many indications that it will continue to fall as the focus of growth shifts towards private consumption.

In order for this re-allocation to be successful – which is likely to take a rather long time to implement on a large scale – the percentage of income going to corporate profits must decrease, the share of national income going to households must increase and the savings ratio must decrease. In turn, making households willing to lower their savings ratio probably requires expansion and improvement of the social safety net and the introduction of special economic incentives.

Productivity as a production factor

Non-farm productivity in China is higher in sectors subject to international competition – mainly manufacturing in coastal regions – than in sectors not exposed to competition, such as construction, retailing and wholesaling focusing on the interior of China. During 2004-2011, average productivity growth in the first-mentioned sectors was 9.4 per cent and in the latter 6.9 per cent. In other words, one major political task will be to undertake reforms aimed at boosting productivity in China's domestic market.

Due to slower labour migration from agriculture into coastal cities and the politically desired shift of the focus of growth from industry/capital spending/exports to sectors not exposed to competition, there has been a gradual deceleration in China's productivity growth: from an average of 8.3 per cent in 2004-2007 to 7.4 per cent in 2008-2011. The potential growth rate in China has thus fallen in recent years.

Other factors are that the rate of increase in the labour force is generally declining and that expansion in the economies that purchase a large proportion of Chinese exports is tending to slow (lower export market growth).

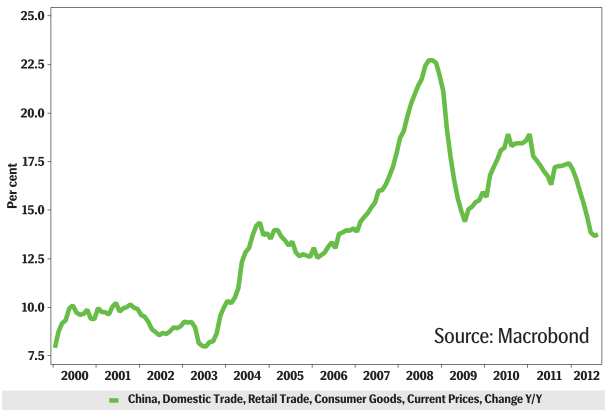
We expect growth to trend downward in China

Conclusion: For various structural reasons, the period of gradually higher economic growth in China is over. Growth is likely to trend downward during the next few decades.

The contribution of labour to GDP will shrink due to a slower increase in the total labour force and a falling rate of urbanisation. The contribution of capital spending to GDP will decrease because the investment ratio has reached an unjustifiably high level, combined with the political ambition to shift the focus of growth from capital spending and exports towards private consumption. Productivity growth in China will gradually slow as the focus of growth shifts from sectors that compete internationally to the domestic market.

China's GDP growth increased from an annual average of just above 9 per cent in the 1980s to more than 10 per cent in the first decade of the new millennium. A reasonable estimate – based on the above analysis – is that the rate will decelerate to an average of about 7 per cent in 2010-2019 and 5-6 per cent in 2020-2029. In other words, Chinese growth will shift to lower gear but will not seize up.

GOOD TIMES AHEAD FOR CHINESE RETAILERS



Viewed in retrospect, Chinese retail sales have essentially fluctuated in response to general economic conditions. We now foresee an upward trend for retailers, assuming that the focus of economic growth shifts to the domestic market and household consumption.

The political transformation

During the autumn every five years (in October or November), a political transformation occurs in China. The leadership of the ruling Communist Party is chosen for a five year term, but many top leaders customarily serve for ten years. First the national party leadership is selected. Early the following year a new government and head of state are appointed.

This year's 18th national congress of the Communist Party of China began on November 8 and ran for about one week. Around 2/3 of the country's most senior political leaders are being replaced. At the top of the hierarchy is the Politburo Standing Committee, which was trimmed from nine to seven members, of whom five are new. Those remaining on the Committee are Xi Jinping, who is replacing Hu Jintao as general secretary (and as president of China in March 2013), and Li Keqiang, who will replace Wen Jiabao as prime minister next March.

The leadership change is not expected to imply any radical changes in China's economic policy direction – especially since two of the three candidates with clear reformist leanings were left off the Standing Committee. Instead, the current five-year plan is likely to be followed in essential respects, especially during the first year of the new leadership. We expect future reforms to be aimed at somewhat lower but more balanced growth, with greater emphasis on private consumption and less emphasis on exports and capital spending.

Economic policy vacuum not unusual

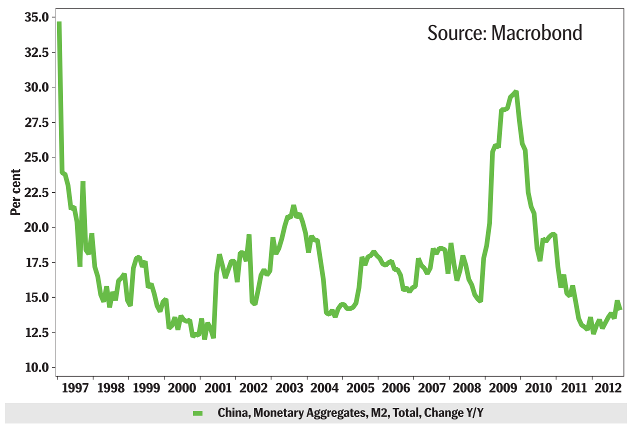
These political changes usually create a certain vacuum in economic policy execution and thus a delay in fiscal stimulus measures, if they are needed. Another reason for the recent wait-and-see approach towards both fiscal and monetary policy may be that the Chinese labour market situation remains fairly good, and that the authorities have learned lessons from their stimulus policies in 2008-2009.

At that time, the government injected a very large dose of stimulus (equivalent to 7 per cent of GDP), which led to the build-up of numerous economic and financial imbalances. In addition, Chinese authorities seem a bit uncertain about the main causes of the recent deceleration, which in itself may mean that stimulus measures will be applied very cautiously and perhaps be delayed.

Massive central bank stimulus in 2008-2009...

The recovery from the 2008-2009 financial and economic crisis was also supported by massive credit and liquidity stimulus from the People's Bank of China (PBoC). As a share of GDP, lending has thus risen from less than 100 per cent in 2008 to 125 per cent today. Money supply (M2) and the percentage of non-performing loans (NPL) have also risen rapidly. Yet Chinese households have very little debt; their debts are only 20 per cent of GDP, compared to 83 per cent in the US and 95 per cent in the UK.

THE PBOC POURED LIQUIDITY INTO THE ECONOMY



In response to the financial and economic crisis of 2008-2009, the People's Bank of China (PBoC) flooded the economy with liquidity, causing the money supply to rise at record speed. Side effects included a growing number of doubtful loans. Given this background, PBoC policies are more cautious today.

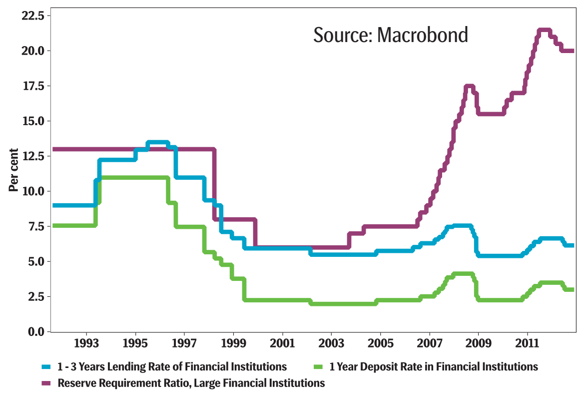
This time around, there are indeed infrastructure projects in the Chinese fiscal stimulus pipeline – especially in the transport sector – but on a substantially smaller scale (about 2 per cent of GDP) than those started in 2008-2009. In addition, this type of capital spending has rather long lead times and cycles and is thus not especially effective as a short-term stabilisation policy tool, though such projects are of great importance to long-term economic development.

...but a cautious People's Bank of China today

The PBoC has been cautious in its monetary policy this autumn, apparently due in part to the consequences of earlier credit and liquidity stimulus (see above). Concerns that housing prices may begin climbing again may be another reason for the central bank's passivity.

In May 2012, the PBoC lowered its cash reserve requirement to 20 per cent for large banks. In July, the bank cut its key interest rate to 6 per cent, but since then it has instead used "reverse repos" to supply liquidity to China's financial system (purchases of fixed income securities from banks, with increased liquidity to them as payment). We predict that the PBoC will chug along on its cautious path and let the key rate remain at 6 per cent for an extended period – assuming that the Chinese economic outlook does not radically change.

MODERATE MONETARY STIMULUS MEASURES



Although the PBoC has lowered both its cash reserve requirements for banks and its key interest rate, the reductions have been small. There is room for a larger dose of stimulus if the economic performance should prove significantly weaker than expected.

Cyclical rebound in China...

Although GDP growth has consistently slowed since early 2010, the risk of a hard landing has recently decreased. Macro data for both September and October related to industrial production, corporate capital spending, retail sales and exports all showed an economic upturn in China. This is supported by the latest purchasing managers' indices for both manufacturing and services. Meanwhile inflation fell at consumer level, while producer prices continued to fall year-on-year.

Early this autumn the Chinese stock market – which performed very poorly this past summer – responded to the more positive economic signals in the country and was among global winners in September-October. From January 1 to November 8, however, at -8.4 per cent, the Shanghai Stock Exchange Composite Index still lagged the global stock market (+6.4 per cent for the MSCI World Index in local currencies). But looking ahead, there is potential for the Chinese stock market to catch up and surpass the World Index.

...is also kindling stock market hopes

This is because during the first half of 2013, there is a good chance that the economy will enter a mini-cyclical upswing. By then, global economic headwinds are likely to have abated, and the Chinese political system will be reactivated. Political uncertainty in China and the US (assuming it avoids the fiscal cliff) will have diminished. If so, the mood among both households and businesses in China should improve, contributing to accelerating demand and growth in the country.

Looking back, during periods when the Federal Reserve has expanded its quantitative easing (during Q2, especially August-November 2010), emerging market assets including those in China have shown strong growth in value. The picture has also included improved economic conditions in the EM sphere and ample room for economic policy stimulus.

A scenario dominated by the Fed's QE3 (and perhaps QE4), improved macro data in China and a slightly more active Chinese fiscal policy is indeed also what seems to be in the cards for the first half of 2013...

Assuming that the Chinese economy rebounds more clearly early in 2013, the country's equities as well as sectors and companies elsewhere in the world that depend on China's economic growth are likely to perform well in the stock market.

Short-term stock market winners:
Industrial and commodity sectors. By all indications, many Chinese capital spending decisions have been postponed due to the leadership change.

More long-term stock market winners:
Consumer goods, pharmaceuticals and medical technology, cars and automotive safety, telecommunications and construction companies specialising in simple private residential properties, i.e. sectors making products more focused on the needs of households.

Equity valuations in China are no deterrent. The price/earnings ratio for 2013 (MSCI China Index) stands at 9.5, compared to an average of 12.4 over the past 10 years and a current S&P 500 P/E ratio for the US of 12.6 in 2013. The price-to-book ratio in China has also decreased to 1.4 for 2013, compared to more than 4 in 2007.

Gold glitters when worries enter the scene

- *Gold still a monetary asset with a globally accepted value*
- *The gold price trend is linked to the rise in debt*
- *A continued rise in debt justifies including gold in a portfolio*

The price of gold has risen almost 300 per cent over the past ten years, and gold is now trading at near-record highs. Meanwhile, in the United States alone, two trillion new dollars have been created in about four years "out of thin air." The main argument for owning gold is that the world's central banks will continue to expand their balance sheets and increase the monetary base.

Gold is unusual because it is both a commodity and a monetary asset. By far the biggest demand for gold (about 70 per cent) is driven by its use in jewellery production. The wedding season in India has long stood out as a period when people can immediately discern whether there is greater demand in the market. India has been the world's largest consumer of gold for some time, but rapid economic growth in China means that country is now about to overtake India. In recent years, use in the jewellery industry has been greater than actual mine production. A small share of demand for gold goes for industrial use, while the rest is for investment items such as coins and gold bars.

Although gold has been among the very best-performing assets since 2008, critics maintain that gold, unlike equities, for instance, does not have any growth or provide any return; it is a non-productive asset that generates no income. Nor does gold, in contrast to silver and platinum, for example, fulfil any major industrial function.

History shows global acceptance of its value

However, for as long as people have extracted gold and carried on trade, precious metals like gold have held a value. Gold and silver long constituted the basis of many countries' currencies, with standards regulating how much precious metal each coin must contain. Throughout history, the metal content of coins has been adjusted repeatedly in most countries.

A more modern version of the gold standard was introduced in 1945 and remained in place until the early 1970s. This so-called Bretton Woods system was established following a number of economic crises. It was based on pegging the currencies of different countries to the US dollar (Sweden became a member in 1951). The US in turn guaranteed a fixed rate at which dollars could be redeemed for gold.

The purpose of backing the dollar with gold, aside from increased economic stability, the elimination of trade barriers, stable exchange rates and so forth, was to prevent a situation like the one we see today – where central banks, more or less on their own authority, explosively increase the monetary base for various reasons. In popular parlance, this is usually described as the central banks "printing more money." In 1971, President Richard Nixon severed the link between the US dollar and gold, thus ending the Bretton Woods system (by 1973 the most important currencies once again had floating exchange rates). The reason the US cut this tie to gold then was so it could print money to pay for the costly war in Vietnam.

So gold is our oldest means of payment, but at the same time it is no longer a generally accepted form of payment today. In other words, it is difficult to go into a shop and hand over gold in exchange for a good. Yet there are some indications that precious metals may be about to regain their status as a means of payment. The US state of Utah, for instance, has taken steps towards making gold and silver legal tender, due to lack of faith in the US Federal Reserve's monetary policy. While Utah's move may mostly be political posturing, it should be remembered that gold is sometimes used as legal tender when countries settle transactions.

Gold and silver as money

Given the history of gold, its general acceptance and the fact that essentially every major central bank is sitting on large gold holdings as part of its currency reserve, we would argue that gold still enjoys the status of money and a monetary asset, defined as a way of preserving or measuring value. Many central banks have also decided in recent years to increase their gold reserves.

It should also be noted that not just countries but also organisations are sitting on large gold assets. For example, gold is the basis of the monetary standard used by the International Monetary Fund (IMF), and that organisation has a significant gold reserve at its disposal as well.

For those who are sceptical of gold as an investment, it is worth mentioning that one of the very largest exchange traded funds (ETFs) in terms of assets under management, AUM, is a gold ETF with underlying physical gold assets.

At the same time, it is important to state that building an investment portfolio often involves two fundamental concepts:

- Protecting against the risk of permanent losses
- Protecting against the risk of lost purchasing power

Different assets usually address these two points to varying degrees. Gold primarily satisfies the requirement of protection against the loss of purchasing power. However, it is not considered useful as protection against the risk of permanent losses. Still, gold is often included in large investment portfolios where the main argument for holding it is as protection against 1) inflation or 2) system crashes.

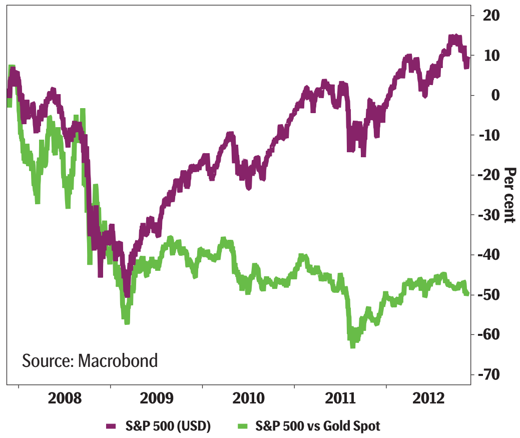
1) Inflation (and/or an increase in the monetary base)
The amount of money in the economy can in principle increase in two ways. Either a central bank increases the money supply by "printing money" (increasing its monetary base) or banks grant new credits and loans through the current banking system (fractional reserve banking).

When central banks increase the monetary base, in practice this does not involve any increase in the number of bank notes and coins in circulation; it is instead done via the banking system. Perhaps contrary to what one might have hoped, the velocity of money has fallen sharply in many countries around the world. Meanwhile, central banks have sharply increased the monetary base and lowered the key interest rates at which they lend money to banks. Such key rates have historically had a major impact in regulating the money supply. When central banks sharply increase the monetary base, there is in any case the chance that this money will cause the economy to pick up speed. As a result of higher economic activity and increased demand, this money will sooner or later filter into the economy via the banking system, where the consequences could be increased inflation pressure (a general price increase). Today's market climate, with near-zero interest rates (the price of money), increases the risk of inflation significantly.

Historically, the price of gold has reacted primarily to an excessive fiat money supply, that is, when the creation of new money can be said to exceed what is defensible, for instance, in terms of population size, economic activity and the like. The price of gold has also reacted to the velocity of money in the economy, as a sign of inflation.

Even if the money does not filter into the economy in the form of a sharp rise in inflation, the fact remains that the holdings of anyone with paper money will be greatly diluted over time if the central banks continually increase the monetary base. Let us say, for the sake of simplicity, that an individual or institution owns 10 per cent of all the dollars in the world. Meanwhile the US Federal Reserve decides to double its monetary base. Whoever previously held this 10 per cent would find the holding greatly diluted, with it now constituting only 5 per cent of the total number of dollars.

EQUITIES VERSUS GOLD



Measured in dollars, the stock market recovery has been astonishingly good. When we take into account the dollar's performance during this period, that is, measuring share price performance in gold instead of dollars, the trend has not been as spectacular at all.

One way of trying to describe this situation is that, unlike with paper money, no one can "print" more gold (limited supply). For those who see gold as money, the dilution effect will thus be limited, and when the value of paper money falls, they will maintain their purchasing power by owning gold. As we noted earlier, some of gold's attractiveness has been due to its limited supply and because it has universal acceptance.

The World Gold Council, which represents the leading gold mining companies around the globe, estimates that some 158,000 tonnes of gold have been extracted over the course of time. If all this gold were gathered together and formed a cube, the sides would be about 20.2 metres long.

2) Crash put – protection against system crashes
Another argument for owning gold is as a "crash put" (option to sell). The investor owns gold as protection against a major system crash, for instance, if the euro project were to end, war were to break out etc. In times of great financial worries, gold has served as a "safe harbour".

The value of gold is linked to "fiat" money

Gold is valued primarily based on its usefulness, as an alternative medium of exchange (form of money) to "fiat" money (see box). The value of gold is determined by how everyone views ordinary paper money. The value of money is backed entirely by faith in the issuer (country). Paper money in people's wallets is really nothing more than paper, often mixed with cotton. Obviously, faith in gold and its general acceptance are at least as important. If people's faith in gold were to disappear or diminish, this would immediately have a detrimental effect on its value.

"Fiat" or paper money is usually defined as government-controlled currency that cannot be redeemed or pegged to a specific value. The value of paper money is thus directly linked solely to people's faith in the issuer, which in practice is a country. Fiat is the Latin word for "faith".

Increase in global debt

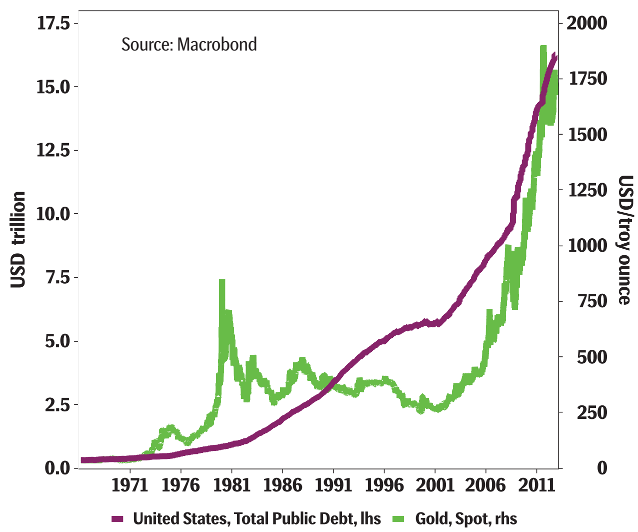
Over time, the gold price trend has correlated closely with the increase in debt, especially that of the United States, since gold is traded in dollars and the dollar has been tied to gold for extended periods. Recently, the focus has increasingly been on the increase in public and global debt levels. Many view the exponential growth in global debt as a serious threat.

There is massive deflation pressure when a large percentage of the consumers in the industrialised world simultaneously deleverage (pay down their debts and loans). The world needs growth, and political leaders and central bank governors have shown that they are prepared to take extraordinary steps to achieve their objectives. The objective in this case is economic growth and inflation. In spite of extremely low interest rates historically, growth is modest and general inflationary pressure is low.

Central banks have various monetary policy measures at their disposal. One that has received considerable coverage in the media is quantitative easing (QE). Through QE, the US Federal Reserve (Fed) creates new money digitally and then uses it to purchase different assets. Thus far, these purchases have been concentrated in the bond market. In practice, the Fed uses the new money, for instance, to buy US government bonds; the US Treasury Department issues the bonds, which the Fed then purchases. In this way, the Fed lends money which then goes towards funding the US government's expenditures and funding its deficit. The Fed also helps to artificially keep down interest rates and interest expenditures by purchasing bonds in the secondary market. Its hope is that these measures will lead to increased economic activity (capital spending and private consumption).

The Bank of Japan has gone one step further and is buying basically anything that it believes may bolster the country's underlying economy. The central bank is purchasing not only bonds but also equities in the form of exchange traded funds (ETFs).

All in all, this means that we are now in a situation where the old rules and past experience do not always apply or work. This obviously contributes to a situation in which it is more difficult than before to try to predict the future. How much money can be created without undermining the faith of its users? Just as Germany in the 1920s printed large quantities of money to pay its war reparations and the US got the presses rolling to fund its costly war in Vietnam, today's central bank governors are trying to buy growth and fight deflation through the printing press.



GOLD RELATIVE TO US PUBLIC DEBT

Over time, the price of gold has correlated fairly well with the exponential increase in US debt. After the US decided to sever the dollar's link to gold in the early 1970s, the rate of increase in debt rose sharply. Gold prices have been quick to respond.

The Germans have still not forgotten the tales of how people needed a wheelbarrow in the 1920s to carry all the paper money required to buy a loaf of bread. Although hyperinflation is not a real threat, people are still aware that there is always a risk that paper money can quickly lose its value.

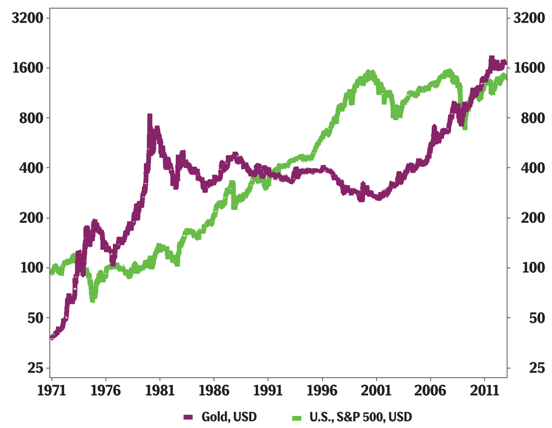
In the event of deflation (generally falling prices) and a situation where the monetary base stops increasing, gold would most likely lose value along with many other assets.

Two sides to every coin

A friend of mine went to the local swimming pool with his daughter. Once there, they went to the concession stand and bought some ice cream. The ice cream cost SEK 16, which he paid for with a twenty-kronor bill. He got four one-krona coins back in change. One of the kronor was from 1967. In 1967, a one-krona coin contained 40 per cent silver, which today corresponds to a value of about SEK 19. Not only was the ice cream free – he was also paid to eat it.

As with all coins, there are two sides. How people view the situation today depends on what perspective they have. Is the price of gold rising, or is the price of paper money (the dollar) falling?

GOLD VS THE S&P 500 SINCE 1971



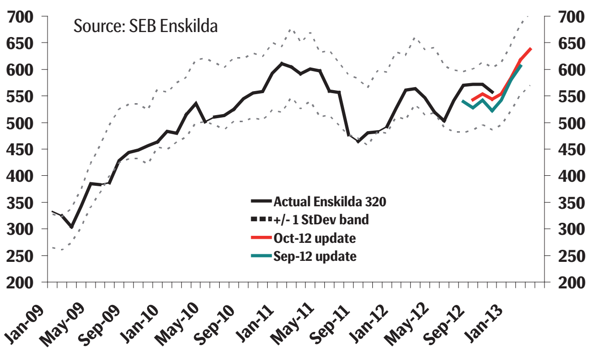
The strong performance of gold since the turn of the millennium has caused many investors to question today's high gold price level. While gold is at a historical high against the US dollar, history shows that during certain periods, the price of gold has been far more expensive relative to other assets – in this case, equities.

Focusing on macro trends and earnings

- *Macro-driven stock market ahead*
- *Record earnings may surprise the market*
- *Low valuations provide support*

For a long time, Nordic stock markets have moved up or down primarily in response to news related to the euro zone crisis. At present, there is a relatively limited focus on euro zone problems. It is unlikely that the stock market can rebound in the short term due to a further reduction in worries about events in the common currency area. Fortunately, nor we do not believe these worries will escalate in the near future, adversely affecting stock market performance. Instead, we expect the focus to shift to a traditionally important stock market driver: the earnings outlook. Earnings, in turn, are affected by macroeconomic developments. We thus believe that early economic signals such as purchasing managers' indices and confidence indicators will play a prominent role in stock market performance over the coming months.

MACRO SIGNALS EXPECTED TO HELP LIFT EQUITIES



The chart shows the performance of the Enskilda 320 index of 320 equities traded on Nordic stock exchanges and forecasts of future performance based on a historically normal correlation with the expected trend of leading indicators in OECD countries.

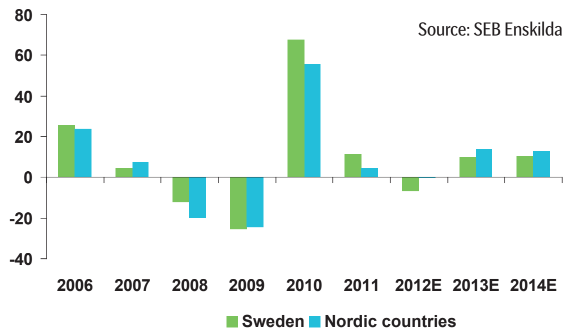
Sound basis for optimism

Happily, our GLEI indicator points towards an improved flow of economic signals over the next few months. Provided these signals materialise, we foresee strong stock markets, primarily driven by cyclical sectors. However, we should warn that there will probably be downward adjustments in forecasts if the economic signals we are now expecting fail to appear and that downward revisions usually coincide with stock market downturns.

Strong earnings trend may lead to surprises

On the whole, corporate reports for the third quarter of 2012 were not encouraging. Instead, they led to a small downward revision in our 2013 earnings forecast. However, companies once again showed an impressive ability to offset lower demand with cost reductions. Overall margins in cyclical industrial companies thus provided positive surprises. The skill of these companies in managing economic slowdowns is leading to a more stable earnings trend and should eventually justify higher share valuations.

GOOD EARNINGS GROWTH IN 2013



The chart shows earnings growth in per cent (adjusted for nonrecurring items) for listed companies in the Nordic countries and in Sweden.

After a weak trend in 2012 we expect an improvement of nearly 14 per cent next year. This would mean new record earnings. In our judgement, few observers today dare to believe in such a favourable trend, but stronger economic signals over the next few months may bolster investor optimism. Greater confidence in a trend that is consistent with our forecasts for 2013 is probably sufficient to trigger positive stock market performance.

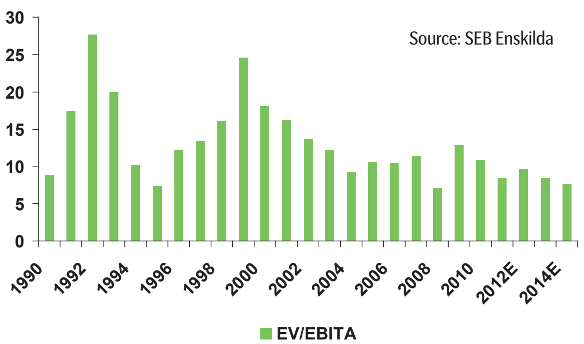
EARNINGS HAVE DOUBLED IN 10 YEARS

The chart shows the total earnings in millions of euros at 213 large Nordic companies that have been listed since 2002 or longer.

Doubling of earnings, stronger finances

This year, earnings are at the same level as in 2007. Next year we expect new record earnings. Companies have also strengthened their balance sheets, but stock market indices have fallen. Valuations of corporate operating earnings on a debt-free basis are low. Over the past 20 years, these valuations have only been lower in 1995/96, when the yield on 10-year Swedish government bonds was close to 9 per cent, and after the Lehman Brothers crash in the autumn of 2008.

LOW VALUATIONS OF EARNINGS



The chart shows valuations of operating earnings at Nordic listed companies on a debt-free basis (enterprise value/earnings before interest, taxes, depreciation and amortisation = EV/EBITA).

Will the China effect change again?

China's miraculous growth over the past 15 years has contributed significantly to the growth of Nordic listed companies during the same period. For more than a decade, sales growth in major industrial companies has been generated almost entirely in emerging economies, led by China. Although this has helped boost profits, during the past year a large exposure to the Chinese market has occasionally been a negative factor in investor sentiment, since many people have feared an economic hard landing in China. Today we believe (see the theme article on China) that China is poised for an economic acceleration. Classic winners from strong growth in China, primarily including a number of major industrial companies and commodity exporters, may thus become stock market favourites once again. Since their exposure to China today is significantly larger than 10 years ago, we believe that relatively low Chinese growth in a historical perspective (which is nevertheless rapid growth in an international perspective) will be regarded as favourable for these shares. But if China successfully rebalances its growth, making it more consumption-driven and generating better living standards with less environmental impact and smaller construction investments, the list of winners among Nordic companies will shift towards such sectors as consumer goods and health care.

Perfect environment for equities

To summarise, we note that valuations of Nordic equities are unusually depressed. During the ongoing economic slump, their earnings have once again shown good resilience to worse economic conditions, and Nordic listed companies have solid balance sheets. Today investors have limited confidence in forecasts of a sharp upturn in profits during 2013, but their optimism should gain strength soon. Low valuations, low alternative returns, greater company stability and indications of imminently more favourable economic conditions in 2013 are an almost perfect environment for equities; all that now remains is for the expected economic signals to materialise.

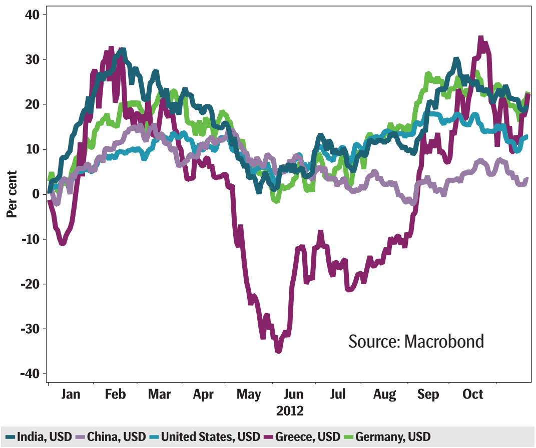
Global equities

Hesitation creates long-term opportunities

- *World economy moving in the right direction, but sluggishly*
- *Asia, emerging markets, cyclical companies the most attractive*
- *China's stock market has lagged: time for a recovery*

On the whole, world stock markets have performed favourably in 2012. The year began strongly, but after peaking in March the markets deflated. Worries about European debt problems, weak macro statistics and uncertainty about China's future growth potential dominated the stock market climate during the spring, with falling share prices as a consequence. In August and September, risk appetite increased again and stock markets rose. The driving forces behind this were improved macro figures and hopes of further stimulus from the US Federal Reserve and the European Central Bank. In October, a degree of hesitation crept into stock exchanges due to greater political uncertainty and because financial market players saw no clear signs of an economic upswing.

BIG VARIATIONS IN STOCK MARKET PERFORMANCE



Germany and India are examples of countries with top-performing stock markets so far in 2012. The Greek stock market has shown surprising strength since bottoming out last spring. Share prices of Chinese listed companies have been weak, opening up opportunities ahead.

Since January 1, the MSCI World Index in local currencies has gained more than 8 per cent. Many European stock exchanges have performed strongly, especially in Germany, but problem-plagued countries like Greece and Portugal have also provided upside surprises. US listed companies chugged along earlier in the year but lost momentum in October. Company reports that did not live up to expectations – especially in the information technology (IT) sector – weighed down the market. Uncertainty about the US presidential election also hung over the market. In Asian and other emerging markets, returns have been very good in many places. Hong Kong is up 17 per cent so far this year and India a full 22 per cent in local currencies. China, on the other hand, has struggled and share prices have fallen. Unlike its peers, the Shanghai Stock Exchange has fallen by 6 per cent this year, but the downward trend has reversed in the past month and the Chinese stock market has gained ground.

Emerging markets will grow fastest

The third quarter company reporting season was mixed. Generally speaking, sales figures were weak for the world's listed companies while earnings came in as expected. Fourth quarter company forecasts were cautious, tilted in a negative direction, leading to downward revisions of earnings estimates. On a global basis, corporate earnings are expected to grow by 12 per cent in 2013, with the outlook for emerging markets somewhat higher at 13.5 per cent. American earnings estimates stand at 10 per cent expected growth, while European estimates are a bit higher (11 per cent). Asia and emerging markets are at the top, with Korea, Taiwan, Indonesia and Thailand among markets where earnings are expected to increase by 15-25 per cent next year. Valuations must be viewed as attractive, with global equities trading at price-earnings (P/E) ratios of 12 times expected 2013 earnings. The US pulls up the figure with a P/E ratio of 12.6, while Europe is trading at 11 and Japan 11.5 times next year's projected earnings. Equities in emerging markets stand out as the cheapest, with a P/E ratio of 10.

Cyclical sectors will show better than average earnings growth in 2013. Companies in the commodities, technology and financial sectors will grow fastest (+22, +14 and +13 per cent, respectively) but companies in the durable goods category are expected to show earnings growth of a full 18 per cent. In contrast, such defensive sectors as energy, pharmaceuticals and telecoms are expected to show lower than average earnings growth.

Potential in China

The investment focus is still on Asia, emerging markets and cyclical companies. American company shares performed amazingly well earlier this year, while China lost ground and the valuation gap between the US and China reached extreme levels. It is interesting to note that this trend seems to have ended in October, opening up opportunities to invest in China. China's P/E ratio for 2013 is 9.5, with expected earnings growth of 10 per cent. Macroeconomic statistics such as industrial production, retail sales and exports unveiled in September and October provided a brighter picture of China. The leadership change in Beijing during November also means that we will probably soon have a clearer idea of planned reforms and indications of future growth rates. China's investment-led growth may have levelled out after pointing upward for years, but will now be replaced by strong growth in private consumption. Generally speaking, the Chinese have money in the bank and low debt compared to their disposable income. When they eventually feel more confidence about reforms in the social safety net, there will also be room for a sharp increase in private consumption.

Aside from China, we also have a positive view of less-developed countries in Asia with major growth potential, such as Indonesia, Malaysia and Thailand. Russia and Eastern (including Central) Europe are also attractive investment alternatives; given their low valuations and high earnings growth, shares from these regions should be part of a global equity portfolio.

Europe has gained a larger role in our portfolios

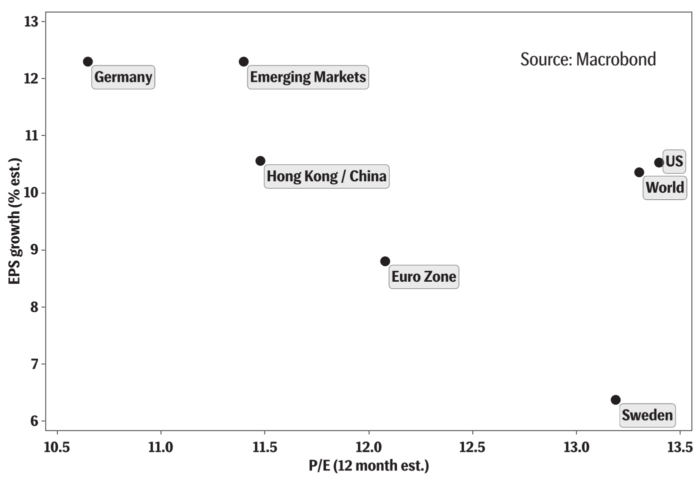
Although Europe's debt problems remain, a clear desire by political leaders to find solutions will provide market support. It is a two-speed region, with the debt-burdened countries of southern Europe on the one hand and a number of "healthy" countries (Germany, the Nordics) on the other. In the latter countries, macroeconomic data look far more promising, and well-managed listed multinational companies benefit from having a sizeable percentage of their sales in high-growth emerging markets.

The pieces must fall into place

Right now we are in a wait-and-see situation. The world is moving in the right direction, but sluggishly. The world economy is slowly healing, but without being fully convincing. Investors need greater confidence in the sustainability of the recovery. There is lingering uncertainty about the debt problems of Europe and the US. The damage left by Hurricane Sandy along the US east coast may at worst cause a dip in the growth curve in the final quarter of 2012, but on the other hand this creates opportunities next year because of the need to restore and rebuild damaged areas.

The uncertainty about the US presidential election is over and the outcome is relatively favourable to the market, but President Obama already has an agenda loaded with economic challenges. The greatest cause for concern is the "fiscal cliff". An agreement on how to resolve the federal government's gigantic financial problems needs to be reached soon. Otherwise the American people will face enormous belt-tightening in the form of tax hikes and expenditure cuts next year, which will hurt private consumption just as it is beginning to recover.

To summarise, market players need greater clarity about the strength of the economy, the actions of political leaders and the pace of China's recovery. Long-term forecasts and macro indicators are showing growth, and because stock markets are comparatively undervalued, this creates room for higher share prices. While there is some hesitation in world stock markets right now, we are choosing to be cautiously optimistic. We foresee good opportunities for a positive trend once all the pieces fall into place.



LOW EXPECTATIONS ABOUT CHINA ALLOW ROOM FOR SURPRISES

Emerging markets have higher expected growth than the US and the world average. Germany also appears very attractive in terms of future earnings, with low valuations. In China expectations are low, reflecting the country's weak stock market performance this year. This leaves room for upside surprises, which may have an impact on the market.

The Country Model

The Country Model

A company's earnings, its growth and valuation and the market's expectations are factors that affect its stock market performance. It is thus relevant to stay updated on how these factors evolve, both in absolute terms and in relation to other companies. In light of this, in 2012 SEB Investment Strategy looked closely at a number of factors that have historically proven to be good guides to stock market performance. Based on this, we have also designed an allocation model, the Country Model, whose purpose is to support the management of global equities.

The Country Model is a quantitative screening model. It basically consists of a screening of analysts' forecasts of the following factors at companies:

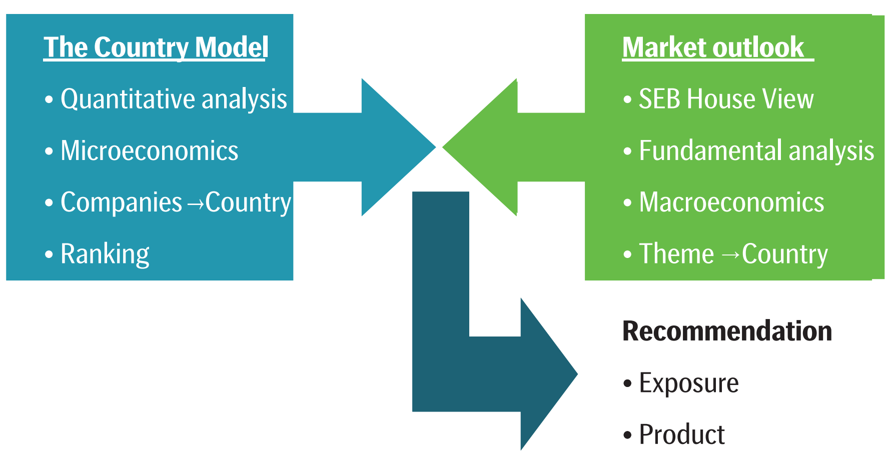
1. Earnings growth
2. Earnings revisions
3. Return on equity
4. Market valuation
5. Dividend

Behind this selection of factors is a study covering the years 2002-2012, where the ability of each factor to provide guidance in choosing shares has been studied. A factor that has generated positive returns and demonstrated continuity in its predictability has earned a place in the model. If a factor has not generated a return or has been too uncertain as indicator, it has been excluded.

In addition to the analysis of each individual factor, we have also analysed interactions between the factors in the model. If two factors generate excessively similar results, it means that if one of them is wrong the second is probably wrong as well. For this reason, great care has been taken to minimise the co-variation between variables in the model.

The review includes companies worldwide with a market capitalisation exceeding EUR 500 million and monitored by at least six analyst organisations. Companies are scored relative to each other based on each factor, then all of each company's factor scores are added up to yield a total score. Once scoring is done at company level, we create a score at country level as a market-weighted average of all companies with the same domicile. The total country level score is then used to rank the countries.

We have based the model on stock markets, not macroeconomics. In this way, we are better able to capture the exporters in various markets. The model is of course supplemented with qualitative fundamental macro assessments before leading to recommendations or becoming the basis for portfolio allocation decisions.



The Country Model vs. MSCI World in 2012

We have studied how a portfolio in the global equity market would have performed if it had relied blindly on rankings from the Country Model during 2012.

Seventy-five per cent of the portfolio is allocated to the global stock market (MSCI World AC) and 25 percent is allocated to the top five countries in the Country Model (equally weighted). On the first Monday of each month, the Country Model is updated. If the country rankings have changed, this also implies a reallocation of the portfolio.

On November 14, the portfolio was up 9.07 per cent for the year, while the global stock market was up 6.28 per cent measured in Swedish kronor. An excess return of 2.79 percent for the year must be regarded as a very strong outcome, considering the comparatively low risks the portfolio has taken relative to its benchmark index. Whether this year's outcome is a mere coincidence or is not, it is interesting enough to use in quantitative analysis as tool in the management of global equities.

STOCK MARKET PERFORMANCE SHOWS LARGE VARIATIONS

Top three		
Ranking	**Country**	**Comments**
1	Norway	High score for market valuation and dividends
2	Indonesia	High score for return on equity
3	Turkey	High score for earnings revisions and market valuation
Rankings for major markets		
Ranking	**Country**	**Comments**
4	Germany	High score for earnings revisions and market valuation
6	Russia	High score for market valuation
7	China	High score for market valuation
11	India	High score for return on equity, low score for dividend
14	US	Medium scores for most factors
15	UK	Medium scores for most factors
17	Sweden	High score for dividend, low score for earnings growth
18	Spain	Medium scores for most factors
25	Brazil	Low score for earnings growth, earnings revisions and dividend
26	Japan	Low score for earnings growth, earnings revisions and return on equity

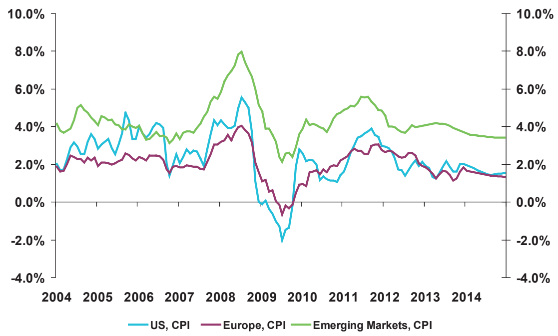
Source: SEB

Corporate bonds go from fantastic to good

- *Major OECD central banks continue quantitative easing*
- *Norwegian and Swedish central banks take key interest rates in opposite directions*
- *Corporate bond yields lower going forward – but better than government bond yields*

Yields are usually determined by inflation and growth expectations. High expectations lead to rising yields and lower expectations cause yields to fall in an economic slowdown. For several years, central banks have actively intervened in capital markets. The European Central Bank (ECB) has added liquidity via the banking system, the US Federal Reserve (Fed) has purchased government and mortgage-backed securities, and the Bank of Japan (BoJ) is actively weakening the yen (JPY) while buying securities on a very large scale.

EVEN LOWER INFLATION IN SIGHT



Source: Macrobond

Unless there is a surprisingly steep rise in commodity prices, inflation may be even slightly lower on both sides of the Atlantic and in emerging markets during 2013-2014. Low resource utilisation in the OECD countries means salary increases should decelerate.

Inflation has been falling since early 2011, and there is reason to believe this trend will continue or in any case flatten out at low levels. The main factor signalling this is the prospect of stable commodity prices. Energy prices have levelled off, resource utilisation is still low – giving companies room to increase production – and last but not least unemployment is still high. In light of this, it is difficult to detect signs of widespread concern about rising inflation, which gives central banks room to manoeuvre.

The US Federal Reserve, headed by Ben Bernanke, has focused on unemployment and keeping interest rates low until 2015. Its explicit goals are unemployment below 7 per cent (now just under 8 per cent) and inflation not above 3 per cent. The Fed will also buy about USD 40 billion worth of mortgage-backed securities in 2013 and 2014, while its government bond purchases remain at a stable USD 45 billion a month. The result of these extensive purchases is low interest rates, which affect consumption, bolstering confidence and retail sales. Low interest rates also enable consumers to pay down their debts and, ideally, increase their consumption. Rising real estate prices are another key factor in getting the economic wheels to spin faster in the US. But naturally there are threats and risks. The risk attracting the most attention is that the US economy will drive head-long over the “fiscal cliff”.

Growth in the euro zone will remain weak. As a result of unemployment, household consumption is falling, while governments continue their budget cuts. The ECB's refi rate will most likely remain at 0.75 per cent. Uncertainty about the future is confirmed by investors' preference for good liquidity and safety, as they put their money in German two-year government securities at a negative yield, which means they are paying for safety. But there are some bright spots in Germany, which exports goods and services to areas with sustained demand such as China and South America. Early this autumn the ECB implemented a new bail-out programme in the euro zone known as Outright Monetary Transactions (OMT). If the OMT programme is activated, the ECB will start to purchase a country's government bonds in the secondary market once it applies for and is granted financial aid from the EFSF/ESM bail-out funds. So far, no country has applied, but in SEB's view, Spain will submit an application within six months. The combination of ECB measures and bail-out funds is aimed at reducing/keeping down borrowing costs for the countries involved.

In Japan, the key interest rate will remain just above zero in the foreseeable future, and the BoJ will most likely make large additional securities purchases over the coming year.

Elsewhere in Asia, fears of a hard landing for the Chinese economy have eased considerably, replaced by a certain degree of optimism. During the autumn, China's monetary policy has remained stable, with the key rate at 6 per cent. We believe this rate will be unchanged in 2013. Growth in India, in contrast to China, has been weaker. GDP growth will reach 6 per cent in 2013 and 6.2 per cent in 2014. Inflation will fall to about 7 per cent, and some measures have been taken to reduce the country's budget deficit. India's central bank sees the falling inflation trend and the need for stronger growth as reasons for a more active monetary policy. Three rate reductions totalling 75 basis points are in the cards for the first three quarters of 2013.

Sweden and Norway

Norges Bank is struggling to cool an overheating economy in Norway. The key interest rate today is 1.50 per cent (the last change was in March 2012), and we still expect at least three rate hikes in 2013. In Sweden, we believe the Riksbank will continue along its rate reduction path, lowering the repo rate in December (to 1 per cent) and in February to 0.75 per cent. A growing number of lay-off notices, rising unemployment and low inflation expectations in 2013 point towards Riksbank rate cuts.

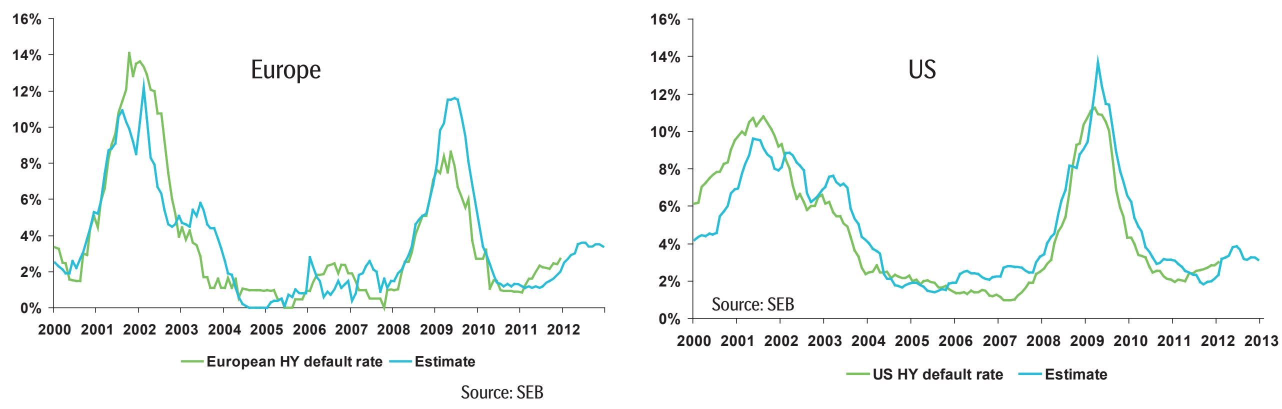
In our view, Swedish government bonds will yield more than 0.5 per cent over the next twelve months while bonds in the euro zone and US will generate yields of about 1 per cent. Corporate bonds with the lowest investment grade rating (BBB-) are expected to yield more than 2.5 per cent. Finally, there is still value in the segment with slightly higher risk (high yield bonds), which we believe will yield more than 6.5 per cent.

Corporate bonds merit a little more attention. They turned in a fantastic performance over the past 12 months. Some high yield funds have had returns of 13-16 per cent. Investment grade bonds have generated returns of up to 8-9 per cent. So the question is whether this asset class is past its peak. We will most likely not see the same high returns over the coming year, but the interest in bonds issued by companies is here to stay. That applies not only to investors but also issuers, who see the capital market as a new and useful complement to bank funding. Sweden stands out as one of the markets with growth potential in this area.

During 2012, there has been a clear tendency for companies to extend the maturity of their debt, which bodes well for their liquidity situation.

The question is whether we are facing a valuation bubble with respect to high yield bonds. Our answer is no. If there is any valuation bubble in the bond market, in that case it is found among the government bonds of various OECD countries. In the US, 10-year Treasury notes are trading at their lowest yields since 1900.

NO FEAR OF A SURGE IN BANKRUPTCIES



The recessions early in the new millennium and in 2008-2009 caused the bankruptcy rate in the US and Europe to soar. That rate is significantly lower today and about the same as in 2007. It is expected to be only slightly higher over the next year. This reflects our forecast of a slightly stronger global economy in 2013-2014 and the fact that companies are in better financial health than in a long time.

Less impact from politics = better potential

- *Better risk sentiment led to a good quarter for Equity Long/Short...*
- *...while Credit Long/Short was able to benefit from central bank measures*
- *Our focus remains on fleet-footed managers and market-neutral strategies*

The third quarter was dominated by increased activity on the political front. In July, markets were driven by the now familiar anxiety about peripheral euro zone countries. Risk assets fell and yields rose on assets in those countries. However, in late July European Central Bank (ECB) President Mario Draghi announced that the ECB would “do whatever it takes” to save the euro, followed by a pledge of unlimited bond purchases in crisis-afflicted euro zone countries that applied for financial support. These announcements immediately had a positive impact on market sentiment, setting the tone for the rest of the quarter. Overall, it was a positive quarter for hedge funds. The HFRX Global Hedge Fund Index rose 1.45 per cent while the MSCI World Equities Index rose 6.1 per cent (in EUR). The HFRX Equity Hedge Index performed best in light of the strong equities market, followed by the HFRX Event Driven Index. Strategies that did worse were Net Short Bias and Merger Arbitrage. However, there was considerable variation as always between fund managers. In Macro CTA, many of the biggest players posted negative or unchanged results, while the index rose about 1 per cent during the period. We will continue to focus on managers who are free to quickly rotate their portfolios and have less structural exposure and focus on markets. We are avoiding less liquid strategies although we realise there is good potential in Distressed and Structured Credit. We are reducing our CTA holdings but still see value in their diversified characteristics relative to other asset classes.

We divide the hedge fund market into four main strategies:
- Equity Long/Short
- Relative Value
- Event Driven and Distressed
- Macro and Trading

Equity Long/Short
This strategy has had a difficult period, with the share price trend more or less de-coupled from companies’ fundamental values. Returns have thus been more closely linked to managers’ net exposure to the stock market rather than to their choice of equities, so managers with a high net exposure to equities have followed the market both up and down. Equity Market Neutral has had the hardest time – this strategy has fallen over 5 per cent in 2012 (HFRX Equity Market Neutral Index in USD). Risks were generally reduced during the second quarter, while managers have been more temperate about taking on more risk during the current quarter.

We predict that the market will continue to be driven by political developments rather than company fundamentals. The best potential in the Equity Long/Short category is thus fleet-footed strategies like Trading and Variable Net Exposure, where exposures can quickly be adapted to swings in market sentiment. Managers who can generate returns by going both long and short should fare better than those who are more dependent on the general direction of the market. Equity Market Neutral will most likely be resilient over the somewhat more uncertain period we see just ahead. If there is a stock market rally, the strategy will not perform particularly well, but overall it should contribute a positive return at a very low risk.

Relative Value
Fixed income strategies have had a difficult quarter, with growing credit spreads and high volatility for fixed income instruments that have longer maturities. Managers were, and are, general cautious about investing on the short end of the yield curve, where interest rates are low. The HFRX Relative Value index fell 1.6 per cent (in USD) in May and has trended flat since then. Managers who tend to short the credit market generally did well in the second quarter, but the situation has reversed in the current quarter, with credit spreads narrowing.

Management styles focused on short-term yields will probably continue to have a difficult time ahead, so we prefer strategies focused on the medium to long end of the yield curve. After ECB President Mario Draghi’s announcement in late July, indicating that the ECB can begin buying government bonds issued by peripheral euro zone countries (Spain and Italy in particular), the yield gaps between northern and southern Europe have narrowed. However, we have not yet seen any concrete steps, and the ECB's actions going forward are likely to have a major impact on Relative Value strategies. On the other side of the Atlantic as well, a new dose of quantitative easing is being discussed, which also creates opportunities for the strategy – regardless of whether it is implemented or not. We are therefore positive towards Relative Value and especially managers focused on fixed income instruments.

Event Driven and Distressed

Event Driven strategies generally depend on corporate events such as restructurings, acquisitions and divestments. However, higher volatility and falling share prices in the second quarter led many companies to postpone such decisions, and the HFRX Event Driven Index lost 2.7 per cent (in USD) during the period, most of this in May.

Should the stock market continue to soften, it is possible that the number of corporate events will increase again. Low demand and slow growth generally mean that companies will try to grow through acquisitions to a greater extent, which favours Merger Arbitrage. Meanwhile, companies are finding it increasingly hard to get bank loans, leading them to focus on restructuring their balance sheets. Event Driven managers with exceptionally good expertise in credits and equities thus have the best potential.

Macro and Trading

Macro and Trading strategies have the best potential on paper given global tensions, but they have also been the biggest disappointments in recent months. Some managers have had a negative outlook on the euro since the turn of the year, and those positions finally paid off in the second quarter. Nonetheless, gains were basically generated by bond holdings. As we noted earlier, the market is largely driven by sentiment, which is in turn driven by decisions in the political arena. These decisions are difficult to factor into model-driven strategies, and this year CTA has lost over 3 per cent (in USD), compared to Macro generally, which is down 0.3 per cent.

We still believe that CTA and Systematic Macro belong in a portfolio as holdings that generate an absolute return and provide diversification. The CTA model today is generally more negative towards equities and commodities, so it includes positions in government bonds and US dollars. These strategies thus offer good diversification in a pro-cyclical portfolio. However, we expect the market to swing back and forth, so models with a shorter time frame are preferable.

STRATEGY	INDEX	PERFORMANCE % (USD)				
		Oct-Nov 2012	Q3 2012	2012 YTD	2011	2010
Global Hedge	HFRX Global Hedge Fund	-0.44	1.45	2.24	-8.87	5.19
Equity Hedge	HFRX Equity Hedge	0.33	2.19	3.74	-19.08	8.92
Relative Value	HFRX Relative Value Arbitrage	-0.57	0.66	2.22	-4.00	7.65
Event Driven	HFRX Event Driven	-1.01	1.86	3.84	-4.90	1.98
Macro	HFRX Macro	-0.59	0.94	-1.47	-4.88	-1.73

Source: SEB

Real estate

Liquid markets bolster sales activity

- *Primary markets – a substitute for government bonds*
- *REITs are this year's winner*
- *2012 – a good year for risk assets*

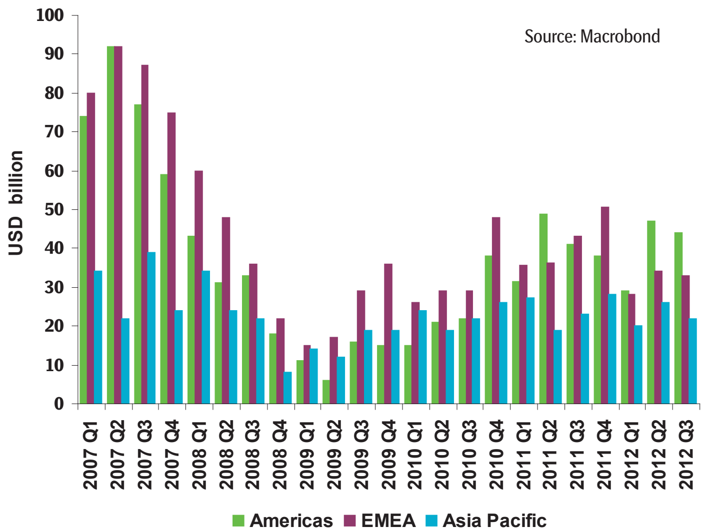
Transaction activity in the global market for commercial real estate stabilised during the third quarter of 2012, although it was down somewhat on a quarterly and year-on-year basis. For the full year, the strongest performance was in North America, with the US and Canada both posting higher sales activity compared to 2011. In Asia, performance was in line with the previous year, whereas the level of activity in Europe as a whole was lower, although many of the larger markets in the region managed to maintain their sales activity, thanks to increased interest among international investors.

At the sector level, transaction activity in retail properties has fallen while investor interest in office properties has grown in 2012. After a number of years of declining market share, investors have returned this year to the office property sector. In 2012, the sector has accounted for a full 50 per cent of the global transaction volume and is one of the few sectors to show increased transaction activity even though the market for commercial properties has generally shown a decline in activity.

Uncertain economy favours liquid markets

Going forward, it is mainly the larger and more liquid markets that will attract investments, a trend that has been evident for the past three years. This trend has squeezed returns and lifted asset prices in primary markets to far less attractive levels. The fact that the trend still persists suggests that investors primarily want to minimise their investment risk. Maximising return has been secondary.

Traditionally, government bonds are an asset class that investors have moved into when risk appetite subsides, but with today's extremely low government bond yields that asset class is not as attractive. Investors are thus finding alternatives to government bonds by putting their money into less risky segments of the real estate market. However, growing demand in this market for quality at low risk has resulted in returns in primary markets that may not be justified given the state of the current market and economic prospects. Considering that



ACTIVITY IS STABILISING

Activity in the global market for commercial real estate stabilised during the third quarter of 2012 but was down somewhat on a quarterly and year-on-year basis. It was mainly the larger and more liquid markets that continued to attract investment.

people can make a short move from these core markets and find properties that offer far higher returns, it is fully understandable that transaction activity in secondary markets has also been on the rise recently.

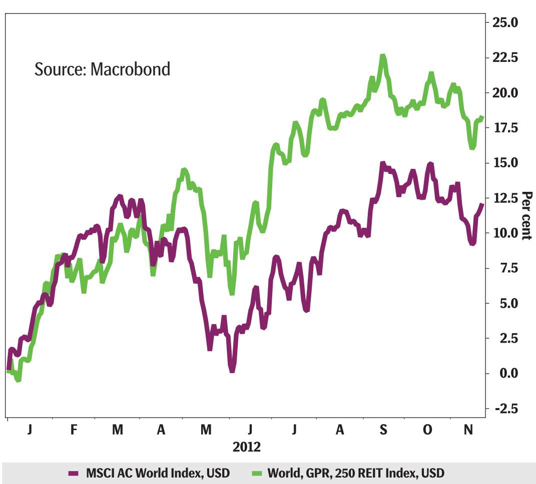
Growing interest in real estate exposure

In the last issue of *Investment Outlook* (published September 11, 2012), we noted the growing interest in investments in the real estate sector this year. We mentioned the sharp rise in the number of corporate bonds issued in the market as a result of the increasingly stringent lending conditions facing real estate companies and greater demand among investors for bond holdings.

We also noted the growing interest in real estate exposure via real estate investment trusts (REITs). Not only are investors attracted by the generally high dividend yield these companies offer (for legal reasons, a REIT must pay out a dividend of at least 90 per cent of the company's taxable income), but the liquidity aspect also appeals to those looking for real estate exposure but not prepared to tie up capital for an extended period.

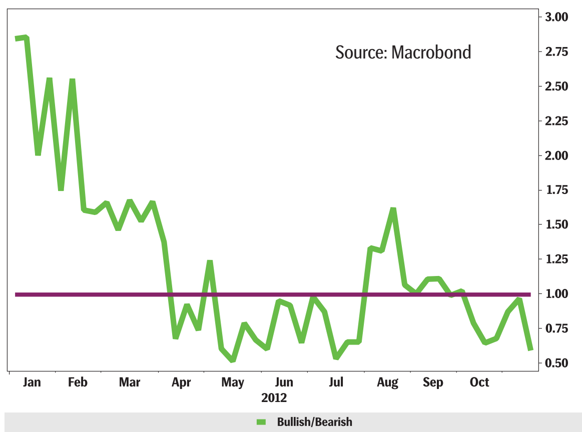
Today REITs represent the largest purchasers by far of commercial properties. As with the growing number of real estate bonds, we also foresee a growing number of REIT funds turning up in the market. Investing in REITs has also been one of the most successful strategies in 2012. One global REIT index (GPR World REIT) is up almost 20 per cent this year, compared to a rise in global equities (MSCI World) of about 10 per cent in local currencies.

STRONG PERFORMANCE FOR REITS THIS YEAR



As the REIT market has grown in 2012, it has also turned in a strong performance in both absolute and relative terms. One global REIT index (GPR World REIT) is up almost 20 per cent, compared to a rise in global equities (MSCI World) of about 10 per cent.

SUPPRESSED RISK APPETITE FOR MUCH OF THE YEAR



Although risk appetite has generally been suppressed since April, risk assets have performed well this year. High yield corporate bonds, equities and REITS are among the winners in 2012.

Strong performance for risk assets despite low risk appetite

This year, investors have mainly been on the lookout for stable, steady returns. Risk appetite has been fairly low during much of 2012, but many risk assets have nonetheless performed well. One explanation for this trend could be that investors have been tempted to move farther out on the risk scale to find returns in today's low interest rate environment. They have shifted from government bonds to corporate bonds and emerging market debt, which have both turned in a tremendous performance this year. From there, they have been pushed farther out on the risk scale and into the equities market. Once in the equities market, they have not taken more risk than necessary, thus investing primarily in the most stable sectors, companies with the most reliable dividend yields. The results of this investor behaviour include strong performance by many non-cyclical sectors in the stock market but also, as noted above, strong performance by the REIT market, which benefits from its attractive dividend structure. Investor behaviour is also one reason why correlations between asset classes and sectors have fallen from the extreme levels we saw at the turn of the year, thus creating a more pleasant investment climate from a diversification perspective.

High risk with increased confidence

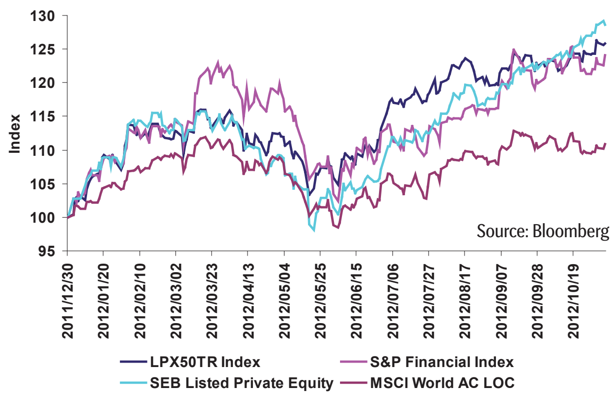
- *Defensive PE positioning after a strong performance*
- *Activity remains high, with the aim being to clarify underlying values*
- *High transaction levels together with good growth prospects provide long-term potential*

In the last issue of *Investment Outlook*, we noted a strong performance for underlying net asset values (NAV) of the index for listed private equity (PE) companies. The surge in NAV began in October 2011 and, except for a few occasions where there was a sharp decrease in risk appetite, this has been reflected in the prices for listed PE companies. During the spring, we saw how the index for these companies was freed from its historically strong coupling to financial shares. The relatively weaker performance of listed PE companies was explained by the weaker growth outlook and uncertain funding conditions.

However, in line with the sharp rise in underlying NAVs, the roles were reversed during the summer in favour of the index for listed PE companies. Generally falling debt-to-asset ratios probably contributed to a decrease in volatility and thus a steadier trend. Nonetheless, at this writing, the historical coupling between asset classes has once again converged. It remains to be seen whether this is a sign of a temporary decline in risk appetite or the effect of a deceleration in valuation increases.

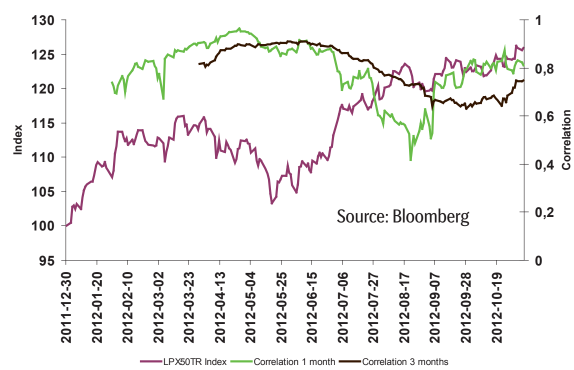
During the autumn, fundamental macroeconomic improvements contributed to the strong performance of most risk assets. Sustained risk appetite in the investor community has largely been driven by the loose monetary policy pursued by many central banks. The debt problems in the euro zone will most likely not be resolved in the near future, and in the US there is a risk that the budget deadlock will continue. Greater awareness of the problems among political leaders has eased tensions, but the difficult funding situation in the euro zone will most likely persist for some time. While this presents obstacles to many PE companies, it also creates opportunities for those that can find funding from other sources.

STRONG PERFORMANCE FOR LISTED PRIVATE EQUITY



During the autumn, the index for listed PE companies has performed far better than the broad MSCI World equities index. The de-coupling of PE shares from financial shares now looks like it has been reversed, while SEB Listed Private has has continued to outperform.

INCREASED RISK APPETITE, BETTER CORRELATION



While the index for listed PE companies has risen, the one- and three-month rolling correlation with the broad MSCI World equities index have both fallen. The three-month rolling correlation is down from 0.9 to 0.63 and the one-month rolling correlation is down to 0.42.

Many PE companies are more cautious today and have been reducing their debt levels for some time. A more cautious allocation is attracting new capital, which is also indicated by the total funds under management in this asset class. The price trend reflects the qualities of an asset class like private equity along with the lack of potential returns on risk-free assets. The index for listed PE companies, LPX50 Total Return, is up 22 per cent in local currencies this year, with almost 20 per cent of this attributable to its performance since May.

This autumn has been surprisingly calm despite political worries. The VIX volatility index has been trading at historical lows for some time, which might indicate increased risk aversion in the short term. The recent positive trend in prices and resulting higher valuations have led investors and managers to reduce their risk appetite in the short term. Many listed PE funds are more defensively positioned, given high valuations and lingering tail risks such as debt negotiations in the euro zone and the risk of a "fiscal cliff" in the US.

Increased activity in the secondary market

During the first half of 2012, the volatile market climate resulted in a persistently sluggish exit market. However, during the summer, a narrowing gap between discounts on NAV in the primary and secondary market indicated a rise in transaction activity. Record transaction levels in 2011 contributed to a continued rise in activity in the secondary market. Many reports also suggest transactions this year will surpass last year's levels, which points to sustained activity in 2013.

New opportunities are attracting new capital

The discount to NAV on listed PE companies has continued to shrink and is now below its short-term historical average. In the September issue of *Investment Outlook* (published September 11, 2012), we explained how narrowing discounts to NAV should be seen as a sign of good financial health. The large discounts recorded in the crisis years 2007-2008 have remained in place, contributing to the inefficient pricing of listed PE companies. One widespread trend now seems to be that many PE companies are taking steps to improve the investor community's general understanding of this asset class. These steps include higher dividends and share buybacks, with the aim being to clarify ongoing value creation and strengthen the financial position of PE companies. Value creation arising from active ownership is becoming more transparent and, combined with the security produced by monetary policy interventions, has most likely contributed to the strong recent performance.

The search for capital in the private equity sector during the third quarter eased up compared to the levels we saw during the second quarter. However, investor confidence in this asset class was evidenced by total managed assets for the first time exceeding USD 3 trillion. Investors are becoming increasingly sophisticated and continue to look for new ways to approach attractive investments in this asset class. For instance, ongoing debt problems in the euro zone are shaping a new environment in which many banks and credit institutions are wary of lending.

Good – and volatile – return potential

Growth prospects for 2013, combined with persistently low sovereign bond yields, look like they may continue the trend towards rising risk appetite. Given SEB's forecast of returns in the stock market for the next twelve months, prospects for listed PE companies are good. The ten-year historical beta value of the index for listed PE companies compared to the MSCI World Index for global equities is 1.4, which indicates potential for this asset class in a risk-friendly investment climate. But there is also a risk accompanying that potential, and if we measure the historical standard deviation over the past ten years, the deviation from the average return is 25 per cent.

Apart from the short-term risk of a correction, other conditions point to good opportunities for long-term investors to take advantage of value creation and good diversification qualities by investing in listed PE funds. More stable growth prospects together with a continuing increase in activity also bode well for this asset class. While many PE companies have reduced their debt-to-asset ratio, the number of transactions and underlying NAV have both increased – a change that will no doubt continue to attract new capital.

Economic upturn vital to commodity prices

- *Historic price differential for oil*
- *Good potential but no rise in precious metals*
- *Grains still too expensive*

Most commodities have performed dismally this autumn. While it has been a bumpy ride in many cases, especially for precious and base metals, virtually all commodity prices are now lower than they were at the end of the summer. Worries about the global economy have weighed prices down.

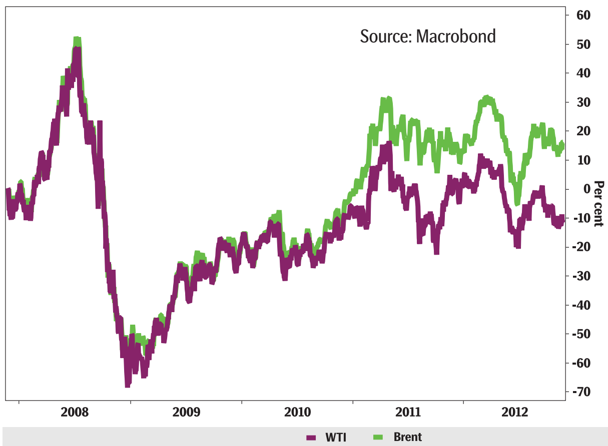
Historic price differential between WTI and Brent

During the autumn, oil prices (Brent) have fluctuated between USD 105 and 115/barrel and at this writing are around USD 110/barrel. Assuming that our forecast of an improved global economy holds, we believe oil prices will remain at current levels a year from now. However, there is still a risk of sharp price movements, with both rising and falling prices. Geopolitical tensions, mainly between Iran and Israel, are one factor that can cause a surge in oil prices. However, a larger supply than we are currently forecasting combined with an economy that is doing worse than expected could lead to falling prices. Still, the fact that countries such as Saudi Arabia need oil priced at USD 80-100/barrel to maintain a balanced budget would limit the decline.

During the autumn, the oil supply was larger than the consensus estimate. This is in part because Libya continued to surprise analysts and is now essentially back to its pre-conflict production capacity, but Iraq has also increased its production and exports. Furthermore, the development and production of "tight oil" in the US (oil extracted from petroleum-bearing shale formations) have exceeded expectations. This is an expensive way of extracting oil, and oil prices of at least USD 80/barrel are needed for sustainable margins.

At present there is a larger price differential than usual between Brent (North Sea) and West Texas Intermediate (WTI) oil. This differential has long fluctuated between USD 5 and 20/barrel, with Brent being more expensive. At this writing, it is about USD 25, a historic high. There are a number of explanations for the price differential. WTI oil is priced in Cushing, Oklahoma, which has an oil surplus due to insufficient pipeline capacity. The differential has now increased as a result of record disruptions to North Sea production in conjunction with the maintenance season, an effect that will dissipate over time.

FIVE-YEAR PERFORMANCE OF BRENT AND WTI PRICES



The above chart shows the trend in WTI and Brent oil prices over the past five years. As indicated, the difference in prices is at a historic high.

Base metal rally faded, but count on higher prices

In September, base metals staged their second rally this year, driven by stimulus measures in different parts of the world and easing concern about a hard landing for the Chinese economy. However, prices quickly retreated and are now basically at the same level they were before the rally, and not much higher than the lows posted in 2010. Our assessment in September was that base metals had the greatest potential in the commodities asset class in a one-year perspective, and we are sticking to this view. China, which accounts for a significant share of global metal consumption (40-50 per cent), is an important parameter in this forecast. Concern about base metal price trends has long focused on whether the Chinese economy will have a hard or soft landing, but stronger recent statistics from China support our forecast and have reduced the risk of a hard-landing scenario.

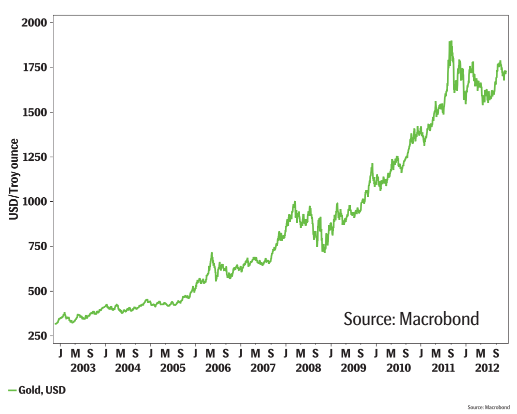
Although we are not counting on a vigorous recovery in China, we believe that a cautious recovery should be sufficient to lift prices by up to 10 per cent in one year. However, for a more sustainable rally in base metal prices, increased market confidence in a positive economic trend in China will be needed.

Most metal prices are still lower than their marginal cost of production. Nickel is priced with the largest gap to its marginal cost of production, which limits the downside risk in the price of nickel, but aluminium is also priced too cheaply relative to its production cost. However, copper is trading at a margin above its production cost, which can be explained in part by there being virtually no increase in supply. Current copper inventories are at a three-year low, although Chinese inventories are fairly large (but not larger than usual during an economic slowdown). Should Chinese consumption deliver an upside surprise, copper inventories will quickly empty, which could potentially cause copper prices to jump to previous peak levels (about a 30 per cent probability). Stable Chinese copper imports and an improved US housing market would buoy copper prices.

No precious metal rally despite favourable conditions

Expectations of powerful measures from the US Federal Reserve and European Central Bank lifted precious metal prices in August and early September. When the measures were announced, precious metals rallied, but this was of short duration. Many investors had probably counted on more long-lasting rises. The climate we are now in should be very favourable to precious metals, with powerful central bank measures, low real interest rates and rather significant continuing uncertainty. We see it as a sign of weakness that precious metals are not rising in this climate. However, one must take into account that, aside from the consolidation of the past two years or so, gold and silver prices have both risen sharply in a ten-year perspective.

GOLD PRICE TREND OVER THE PAST TEN YEARS



As the chart indicates, the price of gold has been in a consolidation phase for about the past two years. However, in a ten-year perspective, the upward trend has been especially strong.

Turmoil in South Africa's mines, where strikes and violence have caused significant supply disruptions, further fuelled the rally, which is not surprising since that country accounts for a significant share of global precious metal production. For platinum, this share is 75 per cent. Although we cannot yet dismiss the threat, the situation in South Africa's mines has calmed down considerably.

We expect precious metal prices to be relatively unchanged a year from now. For a sharp rise in prices, inflation expectations would most likely have to increase or the US dollar would have to weaken. For precious metals like platinum and palladium, global auto sales are also an important parameter, since about 50 per cent of production is used in the auto industry – platinum for diesel engines and palladium for petrol engines.

Grain prices still too high

In September, we noted that the almost unprecedented summer rally in grain prices had come to an end and that prices would most likely retreat. Since then, prices have fallen 5-10 per cent, and while we do not foresee a collapse, we expect prices to be 10-20 per cent lower in a year than today. As the risk of extreme weather conditions falls, grain prices should also drop.

As for forecasting agricultural products in general, the weather is always a risk factor and one that is never easy to predict. But the information now available suggests more normal weather conditions during the coming winter, that is, no "Niños" are expected to disrupt this scenario, which supports our forecast of falling prices. One factor that might prevent a sharp fall in prices in the short term is that inventory levels remain low, especially for maize (corn), but also for soya beans. Maize and soya bean prices may therefore trend flat in the short to medium term, but we expect falling prices in the longer term.

China's acceleration is critical to commodity prices

The risk of the Chinese economy making a hard landing has decreased, and in the US macroeconomic statistics have in many cases exceeded expectations. These are important factors for commodity markets going forward. China consumes an ever growing share of global commodity production, and if the economy there decelerates, that will affect most commodity prices. China is undergoing a transfer of power and the uncertainty associated with this, but in our view growth both in China and globally will accelerate somewhat in 2013, which should bolster commodity prices.

Separating the wheat from the chaff

- *The traditional reserve currencies are weighed down by problems in their countries...*
- *... whereas alternative currencies are backed by well-managed economies*
- *Among the latter are the Norwegian krone and emerging market currencies*

The global foreign exchange (FX) market has recently been characterised by a decline in activity, which means price movements have also been smaller than usual. When fluctuations were small in the past – for instance in 2006 and 2007 – it was not as difficult to predict changes in currencies because exchange rates were driven by strong trends. However, today's calm market cannot be linked to unusually high predictability about where the economy is headed but is instead the result of the unprecedented financial and economic drama in recent years. This drama has caused FX market players to be exceptionally cautious and reduce their exposures to a minimum, which has curbed price movements considerably.

For a long time, a strong driving force in the FX market has been global capital investors, who have increasingly been seeking alternatives to the major reserve currencies – the US dollar, yen, euro and British pound (USD, JPY, EUR and GBP). Capital has flowed out of these currencies and into smaller currencies backed by countries with well-managed economies, such as the Swedish krona and Norwegian krone, as well as the commodity currencies of Australia and Canada. Given substantial economic and political problems, along with uncertain prospects looming over the euro zone and the US, this should remain a key driving force in the FX market – though not always dominating it.

By all accounts, prevailing uncertainty will continue to suppress global investor appetite for financial assets in the euro zone and US. The risk that the EUR in its present form will come to an end has diminished since the European Central Bank (ECB) launched its Outright Monetary Transactions (OMT) bond-purchasing programme and the euro zone took steps towards increased economic integration, including plans for a banking union that may commence in early 2013. But at the same time, many fundamental problems persist in a number of crisis-hit economies, especially very weak international competitiveness. The latter is also very true of the second largest economy in the euro zone, France.

Meanwhile, on the other side of the Atlantic, pressure is growing on political leaders in Washington to reach a budget deal to avoid drastic spending cuts and tax increases next year (the "fiscal cliff"), which would push the economy into a recession. The Congressional Budget Office projects a 0.5 per cent decrease in GDP in 2013 if the fiscal cliff is not averted, compared to SEB's forecast of roughly 2 per cent growth (based on far less financial tightening). As long as the risk of a fiscal cliff persists, the EUR/USD rate is likely to remain at around 1.30 – the USD could temporarily weaken somewhat before the end of the year if US budget talks heat up.

In our main scenario the US government's financial problems will be handled in a responsible way, while there is a risk of new political setbacks in the euro zone integration process, which would weaken the euro. Over the course of 2013, we thus expect the EUR to depreciate against the USD, and the exchange rate next autumn should be around 1.25.

The GBP and JPY have also traditionally been viewed as reserve currencies. But both economies are now suffering from rising debt levels and a weak economic outlook. Meanwhile, the Bank of England and the Bank of Japan continue to pursue a highly stimulative monetary policy characterised by extremely low sovereign debt yields and unconventional measures such as bond purchases. In light of this, the prospects for these currencies are also negative.

Today the JPY is unreasonably expensive, so it should weaken against other currencies until next summer. The same is largely true of the Swiss franc (CHF). However, the GBP is trading at fairly close to a reasonable long-term level against both the EUR and USD. At the same time, the UK needs a weak currency. British industry is struggling against strong headwinds in overseas markets. In August, the country posted its second largest trade deficit ever. In order to carry out the necessary long-term economic re-balancing towards increased demand for British exports, the GBP must depreciate against the EUR as well as the USD. The euro zone accounts for almost 50 per cent of British exports.

After its summer rally, the SEK once again lost strength against the major reserve currencies. One reason is that the euro zone sovereign debt crisis has successfully been stabilised by the ECB's OMT programme (see above), which has lowered the risk premium on the euro and strengthened it against many other major currencies. Another reason is that the Swedish economy has slowed significantly in the past few months, after rolling along at a good pace – especially compared to the euro zone – in the spring and early summer.

Partly for this reason, foreign investors in particular have reverted to their old SEK trading pattern: selling SEK when the economy is slowing. Weak growth, combined with projected inflation in Sweden far below the Riksbank's target of 2 per cent in a multi-year perspective, has fuelled expectations of a cut in the repo rate this winter in one or several steps, which has also weighed down the SEK.

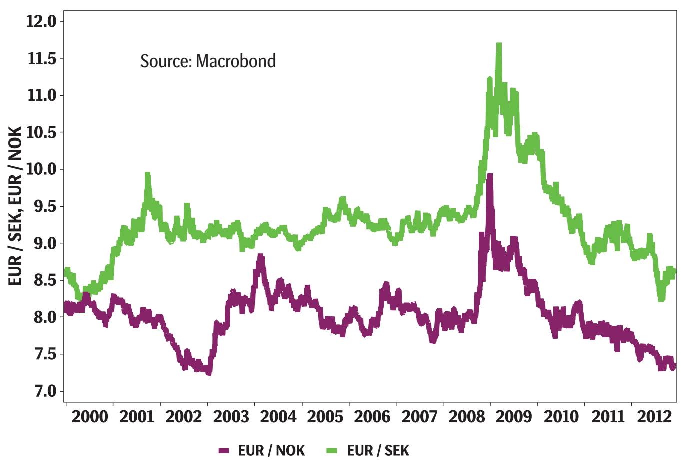
But Sweden's currency is not just trading according to old patterns; foreign portfolios are important, and they help sustain the SEK in times of financial and economic worries. Meanwhile, many domestic Swedish players – companies as well as financial institutions – have remained historically underweighted in the SEK via long FX hedges and have large foreign exchange account balances. Our forecast is that Swedish exporters and institutions will seize the opportunity now that the SEK has weakened somewhat and will buy kronor while increasing the hedge ratio for their foreign currency exposure, although this may take some time given weak export orders at present.

Once the global economy accelerates again – which SEB believes will happen in early 2013 – Swedish exports will increase more rapidly, which should also favour the SEK. Sweden is also one of the few industrial countries with strong economic fundamentals in the form of a nearly balanced government budget, a small public debt as a percentage of GDP and large current account surpluses. Unlike the euro zone countries, Sweden also looks set to avoid a recession.

The SEK thus has a good chance of bouncing back in the slightly longer term. The same is true to an even greater extent of the Norwegian krone (NOK), which in SEB's view is the currency with the best potential to appreciate going forward. In addition to extremely strong economic fundamentals in Norway and higher growth than in most European countries, a higher key interest rate for Norway is in the cards for 2013.

Other currencies with potential to appreciate can be found in the emerging market (EM) sphere. They are still priced low – despite a third quarter rally. The prospects for these currencies are favourable, for several reasons. Like the Swedish and Norwegian currencies and the OECD commodity currencies (see above), EM currencies benefit when global investors – with good reason – look for alternatives to the traditional major reserve currencies.

Differences in interest rates and economic growth between the EM and OECD countries are also still clearly to the advantage of EM currencies. Threats to this scenario include economic and/or political events in the US, China, the euro zone or the Middle East that reduce risk appetite in the financial markets, causing a flight to high-liquidity currencies (the OECD's heavy hitters). Our forecast is that the EM currencies as a group will appreciate by roughly 5 per cent against the USD over the next 12 months.



NORWEGIAN AND SWEDISH CURRENCIES WILL APPRECIATE

After sizeable depreciations against the euro during the financial and economic crises of 2008-2009, both the Norwegian and Swedish currencies have appreciated significantly against the euro. The SEK, which has weakened this autumn as the result of an unexpectedly sharp economic deceleration in Sweden, has good potential to bounce back after a while. Meanwhile, in SEB's view, the NOK is the industrial country currency with the greatest appreciation potential going forward.