Investment Outlook

PRIVATE BANKING • INVESTMENT STRATEGY

Rising values in sight

MAY/JUNE 2013

SEB

Table of contents

This report was published on May 28, 2013.
The contents of the report are based on information and analysis available before May 21, 2013.

Hans Peterson
Global Head of Asset Allocation
+ 46 8 763 69 21
hans.peterson@seb.se

Anders Olsson
Deputy Chief Investment Officer
+ 46 8 763 69 04
anders.s.olsson@seb.se

Lars Gunnar Aspman
Global Head of Macro Strategy
+ 46 8 763 69 75
lars.aspman@seb.se

Victor de Oliveira
Portfolio Manager and
Head of Investment Strategy Luxembourg
+ 352 26 23 62 37
victor.deoliveira@sebgroup.lu

Lars Granqvist
Fixed Income Strategist
+ 46 8 763 69 38
lars.granqvist@seb.se

Esbjörn Lundevall
Equity Strategist
+46 8 763 69 62
esbjorn.lundevall@seb.se

Helene Cronqvist
Equity Strategist
+46 8 788 62 52
helene.cronqvist@seb.se

Jonas Evaldsson
Economist
+46 8 763 69 71
jonas.evaldsson@seb.se

Reine Kase
Economist
+352 26 23 63 50
reine.kase@sebgroup.lu

Carl-Filip Strömbäck
Economist
+46 8 763 69 83
carl-filip.stromback@seb.se

Cecilia Kohonen
Communication Manager
+46 8 763 69 95
cecilia.kohonen@seb.se

Pernilla Busch
Communication Manager
+46 8 763 69 02
pernilla.busch@seb.se

Rising values in sight

Capital markets are well on their way forward. Prices are moving upward in stock markets, reinforcing a sense of economic healing since the crisis years.

As always, the picture is complex. Today's situation is very much an effect of the global debt crisis. It is now accompanied by dynamic and, in many cases, unusual central bank policies. A number of events in modern economic history have made it into the history books. One of them is the abandonment of the Bretton Woods system with its dollar-gold peg, a second is the taming of US inflation in the 1980s and a third is the recent global debt crisis and its ongoing resolution. Worth noting in this context is that Paul Volcker, former Chairman of the US Federal Reserve, played a leading role during all three of these events: a remarkable career.

Today a fourth problem is being attacked – the lengthy period of deflation in Japan due to very high private saving after the stock market crash of the 1990s. Japanese decision makers, both the central bank and political leaders, are on their way towards implementing an economic stimulus and restructuring programme that is among the most far-reaching in any country for a long time. It is comparable to the US inflation-taming efforts. The programme is a combination of monetary and fiscal policies. Right now we are seeing the impact of this monetary policy. Central banks in other countries – even the European Central Bank – are now lowering their key interest rates to sustain demand and help the markets.

The current situation leads to some crucial questions. One of them is whether the unusual monetary policies we are seeing will generate better demand in the real economy, or only boost market valuations. The price movements we are seeing now are in fact normal, since markets move ahead of earnings, but if earnings do not materialise the markets will probably soften again. This issue of *Investment Outlook* includes our reflections on these issues. We examine the role of central bank policies in the economy as well as their methods and effects in relation to current economic conditions. We also describe what we see as we peer into the future.

Tradition is an important element of all investment activities, but it can also be a hindrance. Sometimes people may miss what is happening because they are too rooted in history. Investments and how markets perform also involve a large dose of behavioural science. This is reflected, for example, in recent Nobel Prizes in economics.

The world is changing, and so are the ways value is generated. Will the driving forces we have seen in the past 10-20 years be repeated? Probably not. Saving and debt in various sectors of the economy have changed, and future demand will partly come from new directions. This may be important to commodity prices. The demand for commodities is often driven higher in the early growth phases of economies, but when demand later matures, new patterns emerge. We may be on the threshold of such a phase today.

The market prospects we describe in *Investment Outlook* have a mildly positive tilt, including a belief in rising markets and value generation. Active central banks, reforms in Japan, stabilisation in the US labour market and gradually increasing risk appetite and optimism are factors that will sustain the underlying trend. Rising asset values should lead to greater willingness to set the economic wheels in motion in the form of consumption and investments. This is probably the course of events we are about to witness.

HANS PETERSON
Global Head of Asset Allocation

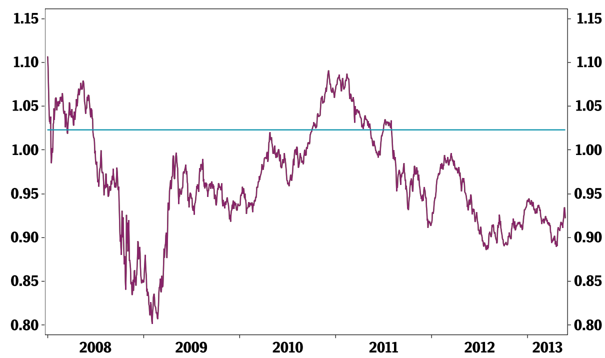
Markets are providing new opportunities

We have an interesting situation in financial markets, where the strongest driving force today is a powerful contribution to liquidity from aggressive monetary policies being pursued right now in many places around the world. Japan and the United States are two important examples. This means that capital is seeking returns in different places right now. One important circumstance of this search is that there is still some scepticism about the strength of the global economic recovery.

As a consequence, capital has been relatively consistent in seeking out assets with low cyclical risk – bonds and those portions of the stock market that are least sensitive to economic cycles (defensive sectors). This, in turn, leads to relatively high valuations in portions of the market. Meanwhile it creates opportunities in more cyclical portions of the market.

Tactically speaking, market players need information about the strength of the economy via signals in macroeconomic statistics and from companies. A change in view (less scepticism) would lead to a different market trend. While waiting for the macro picture in particular to stimulate greater risk appetite, there is thus reason to analyse various asset classes in greater depth, focus more on microeconomic analysis and thereby identify the sources of return that have the greatest potential.

DIFFERENCE IN THE PERFORMANCE OF DEFENSIVE AND CYCLICAL EQUITIES GLOBALLY



Source: Macrobond

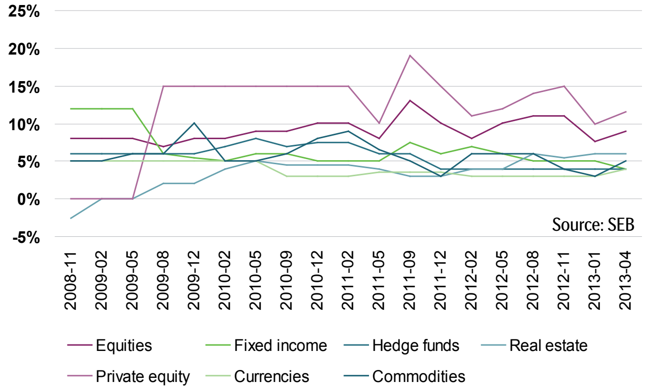
The weak performance of cyclical sectors is evidence of doubts about the strength of the economy.

EXPECTED RISK AND RETURN IN THE NEXT 12 MONTHS

Our risk and return expectations are taken from the SEB House View and are based on our macro scenario (see page 16). These expectations cover the next 12 months. For equities, the forecast refers to the global stock market. For fixed income, the forecast refers to a basket of ½ investment grade and ½ high yield corporate bonds. The real estate forecast refers to the real estate investment trust (REIT) market, while the commodities forecast refers to a basket in which the energy, industrial metal, precious metal and agricultural categories are equally weighted. As for currencies, the forecast refers to the alpha-generating capacity of a foreign exchange (FX) trading manager.

Since the previous edition of *Investment Outlook* (published on March 5, 2013), in order to improve transparency we have chosen to change our methodology for estimating expected risk in those asset classes where it is relevant. Put simply, this change means that instead of forecasts we use historical risk as a norm; in stable markets it is more relevant. Among the consequences is that in the fixed income asset class, the risk of high yield bonds fell from 11 to 6 per cent. For fixed income as a whole, risk fell from 9 to 6 per cent, since investment grade bonds were also adjusted downward from 7 to 4 per cent. Otherwise it is worth noting that expected return on global equities increased from 7 to 9 per cent, while their expected risk was lowered from 18 to 16 per cent.

When we make forecasts, we work with 12-month assumptions in order to have a common time horizon for the portfolio simulations we perform.



CHANGES IN OUR RETURN EXPECTATIONS

Since the last issue of Investment Outlook *(published on March 5, 2013) we have made adjustments mainly in expected return in the equities asset class, which has increased (while risk has decreased). Private equity also has a somewhat higher expected return, but this will depend on the market's attitude towards risk.*

ASSET CLASS	EXPECTATIONS NEXT 12 MONTHS		REASONING
	RETURN	RISK	
Equities	9%	16%	Higher earnings and attractive valuations provide good potential. A focus on fundamentals, where emerging market (EM) equities have lower valuations and better earnings prospects than those in developed markets. Europe has major growth potential, with a lot of recovery remaining, but will require increased risk appetite.
Fixed income	4%	6%	Somewhat lower return assumptions for both high yield (HY) and investment grade (IG) bonds, but also less risk. We prefer HY with shorter durations and emerging market debt. IG bonds carry too much price risk, and returns on sovereign bonds are too low.
Hedge funds	4%	5%	A strong first quarter generated high returns. The choice of strategy and especially manager within each strategy is increasingly important. We prefer market neutral strategies as an alternative source of return for the portfolio.
Real estate	6%	13%	Pressure on primary markets is resulting in lower yield levels and greater interest in moving further out on the risk scale. Global recovery combined with a low interest rate environment points to a continued rise in transaction volume and increased value generation, especially in secondary markets.
Private equity	12%	21%	Growing risk appetite has benefited listed private equity through increased transactions and a functioning exit market.
Commodities	5%	15%	A mixed picture, with industrial metals as our first choice despite the effects of economic uncertainty. Gold has had a fantastic upward ride, which is probably now over. Oil production is again in balance after a winter of surplus production. Grain prices will keep falling unless drought unexpectedly strikes.
Currencies	4%	5%	Monetary policies will determine developments in the foreign exchange (FX) market. We expect a strong USD and a weakened JPY. The EUR will hold its own, thanks to current account surpluses.

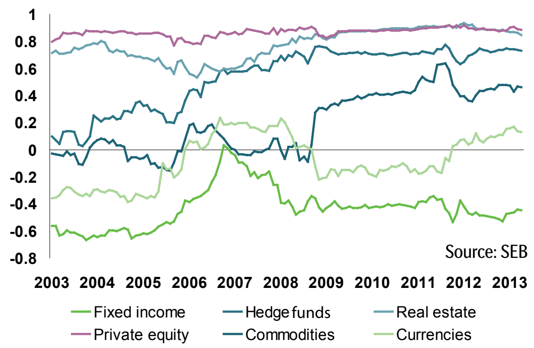
Source: SEB

HISTORICAL CORRELATION (MAY 31, 2003 TO APRIL 30, 2013)

	Equities	Fixed income	Hedge funds	Real estate	Private equity	Commodities	Currencies
Equities	1.00						
Fixed income	-0.39	1.00					
Hedge funds	0.68	-0.32	1.00				
Real estate	0.84	-0.17	0.58	1.00			
Private equity	0.86	-0.32	0.70	0.88	1.00		
Commodities	0.35	-0.23	0.68	0.31	0.42	1.00	
Currencies	0.01	0.18	0.17	-0.03	0.02	0.05	1.00

Source: SEB

ROLLING 36-MONTH CORRELATIONS VS. MSCI WORLD



Historical values are based on the following indices: Equities = MSCI AC World EUR; Fixed income = JP Morgan Global GBI EUR; Hedge funds = HFRX Global Hedge Fund USD; Real estate = SEB PB Real Estate EUR; Private equity = LPX50 EUR; Commodities = DJ UBS Commodities TR EUR; Currencies = BarclayHedge Currency Trader USD

MAIN STRATEGIES IN OUR PORTFOLIO MANAGEMENT

- **The stock market is recovering and will experience a favourable trend in 2013**
  The global economic outlook is positive and we foresee a good second half and a good 2014 ahead of us. In this scenario, stock markets will be driven higher and risk appetite will gradually increase. This will mean a flow of capital from other asset classes into the stock market in search of returns. It may be the start of a long-lasting positive phase for equities.

- **Increasingly growth-oriented, moving towards higher risk appetite in the market**
  During the recent period of weakness, stock market investors focused on defensive companies, while cyclical companies lagged behind. Now they can focus on a growing number of countries and stock market sectors that are more dependent on economic cycles. These will also benefit from the prevailing low interest rates.

- **Asian assets in equities, currencies and bonds will remain of interest**
  Recent softer statistics in China have raised the question of what is happening to the growth rate there, but earnings forecasts are being adjusted upward, and elsewhere in Asia the momentum is good. An expected upturn in global trade normally benefits these countries, and Japan's aggressive stimulus programmes will favourably impact the rest of Asia.

- **Europe – recovery from a low level, attractive valuations, the ECB will provide new energy**
  Europe has major growth potential, with a lot of recovery yet to come. Political leaders will probably not impose more fiscal austerity, and a positive shift in current account balances and gradually in productivity can be expected, but will be postponed. Right now there is a lack of good macro data to boost European markets, but there are many indications that they will materialise as risk appetite rebounds.

- **Bond yields are gradually on their way up**
  Given our scenario of a gradually strengthening world economy starting this summer, sovereign bond yields in a number of major countries are likely to rise, causing bond prices to fall. A strategic challenge for portfolio managers, with a likely increase in the percentage of capital allocated to such assets as hedge funds and free fixed income investment mandates.

- **Corporate bonds have limited potential, and selectivity is important**
  Yield spreads against sovereign bonds remain attractive for corporate bonds with lower credit ratings (high yield), while prices of corporate bonds with top credit quality (investment grade) now have too much risk to be attractive.

ASSET CLASS	WEIGHT*	REASONING
Equities	1 2 3 4 **5** 6 7	In the short term some caution is preferable, but equities are reasonably valued, assuming that earnings forecasts prove correct. A better period for equities will build up gradually, and confirmed growth forecasts and improved underlying economic conditions would increase stability. Stable earnings and flows into the stock market will provide good potential. The shift from defensive to cyclical equities will be in focus, with Asia and emerging markets as the most attractive alternatives.
Fixed income	1 2 **3** 4 5 6 7	Corporate bonds are preferable, with high yield attractive (less risky segments with shorter durations). Continued low default assumptions. Price risk in the investment grade segment is too high, since yield spreads against government securities have become so narrow. Government bonds are less attractive, since interest rates will move upward rapidly when a more positive economic scenario is discounted. Emerging market bonds are attractive.
Hedge funds	1 2 3 **4** 5 6 7	The climate for hedge funds is now better, as evidenced by more stable returns. We prefer Market Neutral strategies and those with some element of equity risk, as well as Long/short Credit funds.
Real estate	1 2 **3** 4 5 6 7	The market has matured, but transparency remains low. We do not currently have this asset class in our portfolios.
Private equity	1 2 3 **4** 5 6 7	Good economic growth and reasonable valuations will provide fine potential in a climate of increasing risk appetite. In case of uncertainty and high volatility, this asset class is more severely affected than equities. We are choosing not to take this risk in our portfolios right now.
Commodities	1 **2** 3 4 5 6 7	Selectively attractive, with industrial metals as our main investment choice.
Currencies	1 2 **3** 4 5 6 7	A strong euro market right now; otherwise a lot of attention on currencies of Asian countries with strong fundamentals. Focus on the yen.

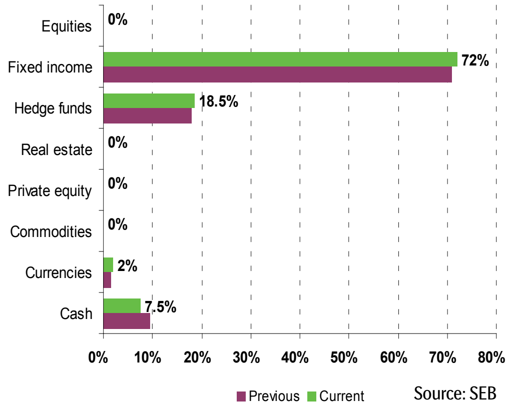
Source: SEB

** "Weight" shows how we currently view the asset class as a part of a portfolio. Level 4 is a neutral situation. These weights are changed continuously based on our tactical market view and may thus diverge from our long-term strategic view of an asset class. At customer level, portfolios are individually tailored.*

MODERN INVESTMENT PROGRAMMES
– ALLOCATION OF CAPITAL ACROSS SEVEN ASSET CLASSES AT THREE RISK LEVELS

MODERN PROTECTION

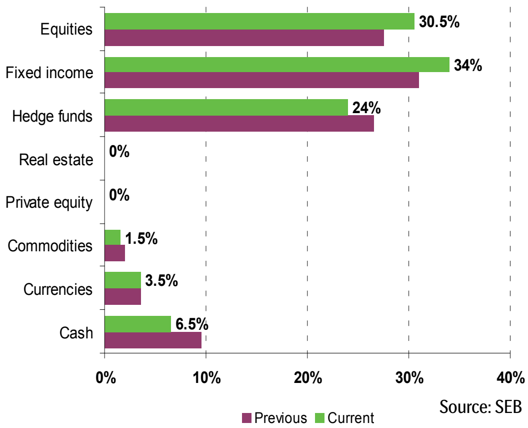
The focus is still on interest rate risk neutral investments. Portions of cash holdings, which one quarter ago totalled about 10 per cent of the portfolio, have gradually been invested. About 35 per cent of the portfolio is allocated to Absolute Return fixed income managers, who have free mandates and full flexibility to take advantage of changes in the yield curve, thereby maintaining interest rate risk neutral exposure. The high yield corporate bond allocation, which consists mainly of short duration high yield bonds and leveraged loans, has been stepped up to 13.5 per cent from the earlier 12. In the hedge fund sub-portfolio (about 18.5 percent of Modern Protection), as earlier we focus on market neutral strategies for uncorrelated returns and Credit Long/Short in order to offset the portfolio's total credit risk. Exposure to Asian currency funds has been marginally increased to 2 per cent from the earlier 1.5.



Source: SEB

MODERN GROWTH

During the first quarter we had a relatively large cash position in Modern Growth as preparation for a weaker second quarter, but the outlook for risk assets is still good, so we gradually invested surplus liquidity. We have increased equities exposure to about 30 per cent through European equities (3 per cent). Meanwhile we have boosted fixed income to 34 per cent from 31 per cent, mainly in the form of interest rate risk neutral leveraged loans. The hedge fund sub-portfolio (24 per cent) is being restructured to achieve a better return profile, and changes in managers are under way. Our exposure to Asian currencies is unchanged, while we have marginally lowered the share of commodity holdings.

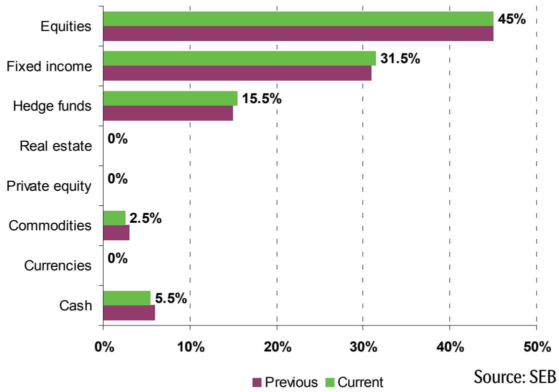


Source: SEB

MODERN AGGRESSIVE

As with Modern Growth we have gradually invested liquidity, in Modern Aggressive spread across all asset classes. Holdings are similar to those of Modern Growth, but asset class allocation is more aggressive, with an exposure to equities of about 45 per cent. Fixed income instruments account for 31 per cent of the overall portfolio (23 per cent high yield and 8 per cent EM debt). Hedge funds account for about 15 per cent, and changes of managers are under way here as well.

In order to achieve its long-term return target, the portfolio has a larger exposure to various risk premiums and thus has a more pro-cyclical nature than Modern Growth, but total risk is currently lower than in the stock market generally.



Source: SEB

Liquidity driving markets and the economy

Stock markets have defied this spring's economic disappointments, climbing largely thanks to central bank stimulus policies that have pumped a large quantity of liquidity into the global economy. Liquidity also benefits economic conditions, and soon the world should be dominated by higher growth.

Last winter there were many signs that both the American and Chinese economies were poised for accelerating growth, while European economic conditions seemed to be approaching stabilisation after an autumn decline. But towards the end of the first quarter, another picture began to emerge, when statistics showed that the downturn in Europe continued early in 2013 and that growth in China as well as the US was instead losing momentum.

These disappointments fuelled speculation that 2013 would also suffer a significant seasonal reversal. The past three years have been characterised by mini-cycles in the global economy and stock market. These cycles have included sagging economic growth coupled with sliding stock markets during the spring and/or summer, followed by economic and stock market upswings in the autumn and part of the winter. This unusual seasonal pattern is explained primarily by the frequent occurrence of especially negative events in the second and third quarters since 2010.

In the spring of 2010 the economic and financial situation of Greece spread a chill in the financial world. In the spring of 2011 a natural disaster occurred in Japan, and that summer the financial problems of European governments (Greece, Spain, Italy) worsened, while the credit rating of the US government was downgraded. The latter occurred due to insufficient federal budget tightening and protracted political negotiations in Washington about raising the federal debt ceiling. In the spring of 2012 Greece again spread uncertainty before its snap election in June, whose outcome posed a risk of Greece withdrawing from the euro zone. This did not happen, and in keeping with the pattern in 2010 and 2011, the latter part of 2012 was a good period both for the economy and stock markets.

The key question now is whether the pattern from 2010-2012 will also prevail in 2013.

Before we give our answer to this question, there is reason to mention first that stock markets in most parts of the world have continued to climb this spring, despite the more downbeat economic signals of recent months. Until quite recently, cyclical sectors also performed far more poorly than defensive sectors in stock markets, an indication that market players have not been expecting improved economic conditions.

In other words, other factors besides expectations of an imminent economic upswing have fuelled the stock market rally since last winter. One factor is that the historically high risk premium on equities has begun to fall, since stock market players now see less risk and uncertainty than before in their economic and political scenario.

Liquidity – a factor behind the stock market upturn

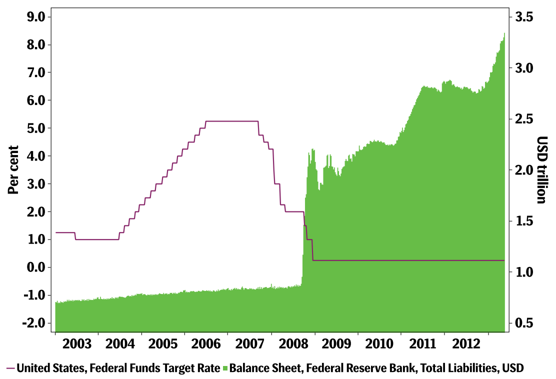
Another, more important factor is the unprecedented quantity of liquidity that is now flowing around in the global economy. Liquidity is of course not an entirely unambiguous concept, but in a macroeconomic context its meaning is often associated with central banks and their actions.

Central bank tools can be divided into conventional and unconventional ones. Central banks have traditionally worked to influence short-term market/money market interest rates and overnight liquidity in the banking system via changes in key (or policy) interest rates and market operations.

Since the outbreak of the 2007/2008 financial and economic crisis, central banks have also resorted to an extraordinary array of monetary policy tools that expand and/or change the structure of their balance sheets (unconventional policies).

Unconventional policies – for example, purchases of government bonds – directly influence long-term market interest rates/bond yields. For this reason, nowadays central bank actions affect the level and steepness of the entire yield curve, short-term and long-term. The most influential central banks

CONTINUED MASSIVE BOND PURCHASES BY THE FED



Source: Macrobond

Aside from lowering its key interest rate nearly to zero, the US Federal Reserve has begun its third round of large-scale bond purchases, which are causing its balance sheet to swell. The Fed now buys a total of USD 85 billion worth of government and mortgage-backed bonds each month, which is likely to continue at least until the end of 2013.

have chosen different tactics, however. The US Federal Reserve (Fed) buys government bonds and mortgage-backed securities. The Bank of England (BoE) focuses on government bonds. The European Central Bank (ECB) has chosen another path, since European companies obtain more than 75 per cent of their funding via banks, while a similar share of funding for American companies occurs in the bond market. In order to lower the borrowing costs of companies, it is thus rational for the Fed to buy bonds in order to keep down interest rates in the bond market, while the ECB in turn has chosen to act via low-cost medium-term loans to the banking system. These loans are now being repaid by the banks at a fairly rapid pace and the ECB's balance sheet is shrinking, unlike that of the Fed, which is growing rapidly.

But the Bank of Japan (BoJ) has the fastest-growing balance sheet, after escalating its asset purchases in April. On an annual basis, these purchases are equivalent to 15 per cent of GDP, compared to the Fed's 7 per cent. The BoJ's asset purchases also span a much broader range; aside from government bonds and mortgage-backed securities, they also include corporate bonds, real estate funds and equities.

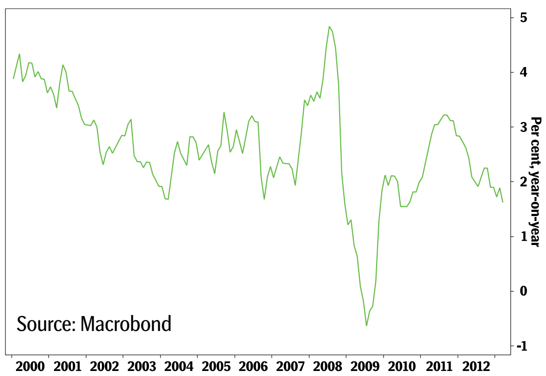
Equities have apparently become an increasingly popular asset class in the central banking world. Today the central banks in Switzerland, Israel and the Czech Republic are also active as buyers in the stock market, and in a recent survey 23 per cent of central banks state that they have either bought or plan to buy equities – which can drive stock markets higher.

The ECB has also chosen to issue conditional pledges to make bond purchases in the market, linked to lending from the European Stability Mechanism, a permanent bail-out fund. Concurrently, lending is under way to Greece, Ireland and Portugal, continuously examined by the Troika (the European Union, ECB and International Monetary Fund) and disbursed mainly via the European Financial Stability Fund, a temporary bail-out fund. In addition, the Spanish banking system has been granted loans.

One consequence of the large-scale unconventional policy commitments of central banks has been that their balance sheets have swollen. This leads to an increase in the "monetary base" (MB). The MB consists of bank notes and coins (a very small share of MB) and liquidity reserves/receivables that banks have deposited with central banks. But an increase in MB does not automatically mean that the money supply/liquidity increases in a national economy. To make this happen, the banks must begin using their liquidity reserves for lending to businesses and households. Only then do central bank policies have a direct impact on the real economy. In the US, this is already about to happen.

The effects of central bank policies and variations in the liquidity supply can be seen directly in financial markets. The policy now being implemented – made possible by very small inflation risks and large idle production capacity – is characterised by a copious flow of liquidity from the central bank spigots and has 1) lowered short-term market interest rates and long-term bond yields in many countries to record lows, 2) narrowed yield spreads between the problem-plagued and core countries of the euro zone, 3) narrowed yield spreads between corporate and government bonds, as well as between mortgage-backed and government bonds and 4) provided plenty of fuel to the stock markets.

FALLING INFLATION OPENS LIQUIDITY SPIGOTS



During the past few years, inflation in the industrialised OECD countries has continued to fall, and according to SEB's forecast it will slow further in the coming year. Along with plenty of idle production resources, this gives central banks room to pursue highly stimulative monetary policies.

The foreign exchange market has also been affected, especially by the Bank of Japan's sharply escalated stimulus policy, which has caused the yen to fall rapidly in value against most other currencies. The commodities market also previously benefited when central banks acted as large asset purchasers, but an increased supply of commodities, a stronger USD and a structural shift in commodities (see the theme article "New driving forces – from investments to consumption") are now pulling strongly in the opposite direction.

Central bank policies that provide cheap money and rapidly growing access to liquidity also – indirectly – affect the economy and growth. One classic example is when lower interest rates make it less attractive to save and more attractive to borrow, which usually increases household consumption and corporate capital spending – thus benefiting growth.

Another interaction between the financial markets and the real economy occurs via wealth effects. When central bank policies – as is now the case – help fuel rising bond, equity and home prices, household and corporate wealth increases. This presumably benefits consumption and capital spending, respectively. Companies also take advantage of the shrinking yield gaps between corporate and government bonds. This makes it cheaper for them to raise funds in the bond market and to restructure their bond borrowing portfolios.

So let us come back to our earlier key question: Will the seasonal pattern from 2010-2012, with a significant economic and stock market reversal in the spring and summer, also characterise 2013?

A repetition of this pattern would seem to require a negative trigger of some kind. Examples of events that have usually sabotaged economies and stock markets – for a few months or a year – are 1) negative government budget events, 2) rapidly rising inflation that has boosted interest rates, which in turn has lowered business investments in fixed capital and inventories, 3) punctured speculative bubbles, for example the dotcom (IT/telecom) bubble in 2000 and sub-prime mortgages in 2007, and 4) the emergence of excessively positive economic expectations compared to what current statistics show/will show.

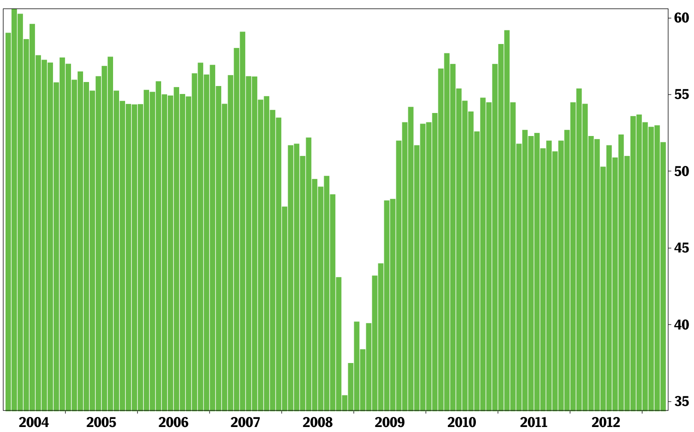
At this writing, there are no indications that any such triggers are hiding around the corner, either in the US or in other influential economies. In addition, of course, economies and markets are being sustained by the unprecedented stimulus policies of central banks, and by the replacement of strict austerity in fiscal policy, especially in European problem countries, by less austere policies. In the future, overall official economic policies will thus provide more fuel to the real economy.

Our assessment is thus that the seasonal pattern of recent years has ended and that a rather mild economic slowdown during the spring will be followed by gradually stronger growth that will continue into 2014. In the macro world, there is support for this scenario in the upswing of recent months in leading OECD indicators. In the micro world, cyclical stock market sectors have recently begun to close the gap separating them from their defensive counterparts. We thus believe that in the near future, there is reason to increase risk-taking in equity portfolios.

Risks associated with current central bank policies

Stimulus policies also entail risks, such as:

- Distorted pricing of credit and market risks when the wave of liquidity boosts prices of riskier assets, which may lead to unsound risk-taking and speculative bubbles.
- Development of "zombie economies", with companies and institutions that would not survive without liquidity support, which prevents "creative destruction" in an economy – a process that usually benefits productivity and growth.
- Higher inflation expectations further ahead when the supply of idle production capacity in terms of labour and real capital decreases.
- Large long-term questions about how the process of shrinking gigantic central bank balance sheets will take place – a journey into previously unknown monetary policy territory.



Source: Macrobond

GENTLE GLOBAL DECELERATION

Although the pulse of the world economy as measured by the J.P. Morgan/Markit global composite purchasing managers' index (manufacturing and services) has recently slowed, this deceleration appears to be gentle. In April the index ended up well above 50, which is the threshold between expansion and downturn.

Theme

New driving forces – from investment to consumption

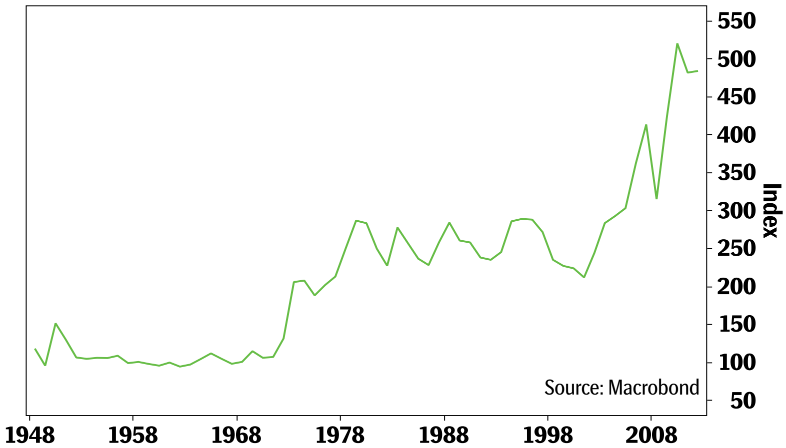
A big topic of conversation in the market nowadays is the shift from bonds to equities. Today's extremely low government bond yields are not attractive and entail a significant risk of a decline in value if the bonds are long-dated. Equities look increasingly attractive for a number of reasons.

There are also other rather interesting shifts to analyse. One is the fact that we are probably facing a cycle not driven by rising commodity prices. It is too early to say with any certainty that we are already in such a phase, but it is interesting to look at the driving forces behind different cycles.

Here we need to focus our attention on one thing. We are talking about periods of 10-20 years, which extend over a number of business cycles. What drives developments forward and what kind of demand does it create? This demand is what subsequently leads to value increases in different assets. Commodities are one example of an asset class whose price fluctuations are created by structural changes in demand over different periods. People talk about commodity price cycles. This, of course, does not prevent us from having shorter tactical cycles in response to temporary changes in demand. For instance, today we can see good potential for rising industrial metal prices and for those precious metals that are used in industrial production, but these are short-term movements. The interesting issue is the long cycles. Considering that investors often tend to look in the rear-view mirror, it is important to get to the bottom of what drives these cycles.

Today commodity prices have not followed share prices upward. We have a clear decoupling between prices of commodities and equities, although both "should" respond positively to a stronger economy. The explanation lies partly in how the stock market has been propelled upward by the search for returns in an environment of low bond yields, but the answer may also have more structural reasons.

The CRB commodity price index reached its peak two years ago and has fallen about 20 per cent since then. Prices rose sharply



CLEAR SHIFTS IN COMMODITY PRICES

Commodity prices, illustrated by the CRB commodity index, show clear shifts in levels. Earlier, we had a long period of fluctuations in line with the general economic trend. Over the past 15 years, prices have trended sharply higher with continued fluctuations. The trend towards increasingly expensive commodities may now have ended.

prior to that, as shown in the chart on the previous page. The question is what pushed prices up so sharply and whether this pattern will be repeated. The most obvious conclusion is to connect these price rises to the rapid industrialisation of emerging markets. There is no doubt that heavy investment in areas such as infrastructure has driven up commodity prices. This rise is clearly correlated, for instance, with developments in China.

China's role for commodities

What is the next step? Current economic data from China indicate that capital spending accounts for a significantly smaller percentage of growth, while consumption remains at a high level. This trend is in line with several different developments.

The Chinese leadership has adopted an explicit policy of shifting to more domestically-driven demand and reducing dependence on capital spending and exports. This is an administrative policy decision in China, but in reality it is also a natural progression.

In an economy with rising GDP per capita, consumption patterns change. There is a decreasing need for capital spending. Demographic patterns change as a consequence of evolving norms and needs. Fewer children are being born, leading to slower population growth. Other items in Maslow's hierarchy of needs have to be met, and consumer demand has become a higher priority – a pattern we have seen in every developing country, most recently in Asia following the rapid economic expansion of the 1970s and 1980s.

One factor to take into account is the current financial situation around the world. During China's expansion phase until 2008 and during the financial crisis of 2008-2009, the economy was driven to some extent by public finances and a sharp expansion in credit, which were used for construction and infrastructure. In the case of China, this has led to a heated discussion about the quality of investments. The question of how to use public funds is an interesting one. There are now clear reasons to shift towards a consumption-driven economy, which in China's case means that public finances will not be used to sustain capital spending to the same extent as before. That driving force is disappearing from the commodities market. Similar patterns are discernible around the world. There is a great need for belt-tightening in public finances and, while the pace of austerity measures has eased, we are a long way from seeing an increase in public investment as a means to bolster the economy. Today the focus instead is on boosting consumption, keeping interest rates low and making credit more readily available to companies. So where will this lead? Other economic sectors should see growth instead.

New patterns create new winners

This will also have considerable direct implications for the Nordic equities market. Companies that were previously big winners because of China's explosive growth can no longer count on the same boost as before if the nature of growth there changes. On the other hand, we may very well have a second generation of winners because of new trends in a number of different industries such as medical devices, safety equipment, consumer packaging, personal hygiene and paper pulp.

Is the heyday of industrial metals over?

The hunger for commodities from the world's emerging markets, and the consequent surge in commodity prices, resulted in very favourable conditions for commodity producers and their sub-contractors during the 2000s. In the Nordic equities market, this led to a boom for mining companies, oil companies and metal producers.

Nowadays China is using more steel per inhabitant than the United States and roughly as much as Germany, despite a per capita GDP less than a quarter as large. Just as the US, Germany and Japan for decades have had an almost nonexistent and at times negative correlation between economic growth and steel consumption, there is thus a clear risk/likelihood that future economic growth in China will not be as commodity-intensive as we have been accustomed to over the past decade.

More private consumption

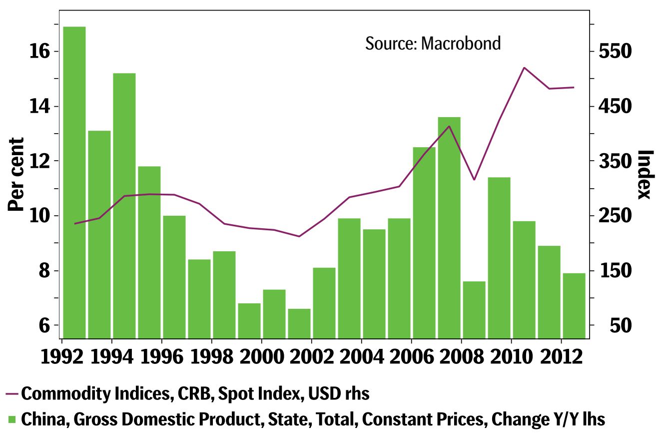
At some point, a sufficiently large number of consumers in the world's emerging markets will already have achieved such a high economic standard that they will no longer primarily demand more cars, but instead will continue to demand higher standards of comfort and safety. The value per vehicle may increase sharply by bringing the standard of safety equipment, such as seatbelts, air bags and electronics, to the levels prevailing in the West. The automobile market may then increase significantly in value without a corresponding rise in consumption of materials.

Other "luxury" goods that may be expected to see a growth in demand in an environment increasingly driven by private consumption and less by capital investment include paper and plastic packaging. Finnish producers of food packaging are already seeing double-digit annual growth in demand in Asia. Swedish manufacturers of separators and other equipment for industrial production of food with high hygiene standards will also benefit from higher sales of semi-finished goods and fast food. A growing share of packaged food and consumption of personal hygiene products and tissue could also make Nordic producers of paper pulp or personal hygiene products relative winners going forward.

Health above everything

While metal consumption often increases dramatically during a relatively early stage of economic growth, then slows and declines, the pattern is almost the reverse for health care expenditures. In the West, the percentage of GDP spent on health care has increased steadily for many decades. There are a number of well-positioned suppliers of advanced medical devices or pharmaceuticals on the Stockholm and Copenhagen stock exchanges that will benefit from the continued rapid growth in health care investment in Asia and Latin America long after commodity consumption per capita has levelled off.

It is crucial to identify driving forces in order to generate returns; there are often very big differences in how various market segments are driven. Values will increase, and so too will opportunities. This time, stronger economic growth need not mean higher commodity prices.



CHINA'S ECONOMIC GROWTH PREVIOUSLY PUSHED UP COMMODITY PRICES

The price trend in the CRB commodity index is strongly correlated with the economic trend in China, shown here as annual percentage change in GDP. In other words, the sharp rise in commodity prices over the past decade is closely linked to industrialisation in China as well as in other emerging markets.

The world is poised for higher growth

- *Global green shoots are now emerging*
- *Stimulative economic policies and lower risks are providing support*
- *The US is a likely explanation if global growth exceeds expectations, the euro zone a probable factor if growth is disappointing*

The world economy is on its way towards recovering thanks to cyclical forces, receding financial risks and forceful economic policies, with central banks setting new stimulus records and fiscal policy becoming less austere. The growth rate will gradually increase over the next few years, but the economic picture will be divergent. This is because many economies are still in recession, and despite numerous positive factors the global upturn is surrounded by a degree of uncertainty.

International price pressures have recently been surprisingly low. A continued ample supply of idle production resources and downward pressure on wages and salaries also indicate that the low-inflation environment will persist. Inflation expectations are also low, and most commodity prices have fallen since last winter. On the whole, this gives central banks room for stimulus measures.

As earlier, the risks to our main scenario (which has a 70 per cent probability of occurring) are symmetric on the upside and downside (15 per cent each). The United States has continued potential for upside growth surprises. The downside risks are mainly found in the euro zone, and to some extent also in China.

Americans are more eager to spend

The US housing market is well on its way to recovery, and household debt has fallen significantly in recent years, laying the groundwork for stronger private consumption. A capital spending rebound is also in the cards for 2014. During the next few quarters, however, growth will be held back by federal fiscal tightening, which will be equivalent to nearly 2 per cent of GDP this year. During 2014 its effect will be almost neutral, enabling the US economic upswing to become far more noticeable. We expect GDP to grow by 2 per cent in 2013 and more than 3 per cent in 2014. Because of short-term restraints on growth together with undesirably high unemployment and low inflation, we expect the Federal Reserve to let its current bond purchasing programme (USD 85 billion per month) continue until the end of 2013, then begin phasing it out. The Fed will not raise its key interest rate from today's 0.25 per cent until the spring of 2015.

Deleveraging is hampering euro zone growth

Crisis-hit euro zone countries have progressed quite far in improving their current account balances and pushing down production costs. Yet these countries – Cyprus, Greece, Ireland, Italy, Portugal and Spain – still face stubborn challenges: falling GDP, high bond yields and political instability. The euro zone economic outlook is noticeably bleak, especially due to the process of adjusting balance sheets. On the plus side, borrowing costs and solvency risks for governments and banks have fallen sharply, with the help of the European Central Bank's loans to banks (LTRO) and bond purchasing programme (OMT) as well as the launch of the European Stability Mechanism (ESM) bail-out fund. We expect euro zone GDP to decline during the first half and begin growing only late this year. GDP will fall by an estimated 0.7 per cent in 2013 and climb by a similar amount in 2014. We predict that the ECB will lower its refi rate once more this year, from 0.50 to 0.25 per cent.

Exports will drive the British recovery

This past winter, the United Kingdom avoided recession. Our assessment is that GDP will grow by 1 per cent this year and 1.5 per cent in 2014. Household consumption is weak and manufacturing shows no signs of imminent upturn, so the economy needs other growth engines. Exports appear capable of taking on this role, thanks to improved competitiveness. Inflation has remained surprisingly high, shutting the door for further monetary stimulus at the moment. This picture is unlikely to change when Mark Carney takes over as governor of the Bank of England this summer, though he has indicated support for expansionary monetary programmes.

Nordic economies a bit divergent

Recent economic signals indicate more divergent trends in the Nordic region. Despite better competitiveness thanks to the weaker EUR, Finland and Denmark (the Danish krone or DKK is pegged to the euro) are characterised by economic stagnation, while domestic demand is in a slump. One bright spot, however, is that rapidly falling inflation will increase household purchasing power. In Sweden and especially in Norway, the domestic economy is performing well. Both countries have a chance to grow faster than the Western European average. In the Nordic region as a whole, we predict that GDP will increase by 1 per cent this year and more than 2 per cent in 2014.

Can Japan's high-stakes political game succeed?

During 2013 and 2014 the stimulus policy known as "Abenomics" (after Prime Minister Shinzo Abe) will provide a positive injection to both the world economy and Japan through higher growth and downward pressure on interest rates. Japanese growth in 2013-2014 will be sustained by a weaker yen, falling real interest rates and rising wealth. Both private and public sector consumption will increase, along with private investments. We expect GDP growth to average more than 1.5 per cent this year and next, but the economic outlook beyond 2014 is very unclear. Can Japan stop deflation and achieve its 2 per cent inflation target? Can government debt be stabilised before surging past 250 per cent of GDP? How will the country manage the consequences of a fast-ageing population? What will happen to financial investors' confidence in Japan? There are many questions, and more can be asked.

Asian emerging economies retain their lead

Growth in Asia's emerging economies slowed early in 2013 but was substantially higher than in the industrialised OECD countries and remained the fastest in the world. Inflation has fallen in the region during the past year, and there are not many signs that price pressures are on their way up. Monetary policy can thus remain expansionary.

In the first the quarter of 2013, GDP growth in China was lower than expected but in line with the official target of 7.5 per cent. Consumption contributed more to GDP than capital spending, which was in line with China's ambition to shift towards consumption-led growth. Our forecast is that GDP will increase by nearly 8 per cent this year and 7.7 per cent in 2014. Continued rapid credit growth despite the economic slowdown will put the economic policies of China's new leadership to the test. The central bank will probably hold off on hiking its key interest rate until late in 2013.

The Indian economy is poised for a slight upswing, and we estimate that GDP will climb by 5.5 per cent in 2013 and 6 per cent in 2014. India's large budget deficit rules out fiscal stimulus, but lower inflation will enable the central bank to make several key interest rate cuts later this year.

Latin American upswing, commodity prices uncertain

After last year's slowdown, with growth of less than 3 per cent, Latin American economies are now gaining strength. We foresee GDP growth of around 3.5 per cent this year and 4 per cent in 2014. On the minus side, the region will see higher inflation rates and current account deficits – whose size will depend a lot on what happens to commodity prices – while fiscal deficits will remain small (only a bit above 2 per cent of GDP). High inflation is plaguing Argentina in particular, but also Brazil, while Chile is showing strong macroeconomic figures except for its current account deficit.

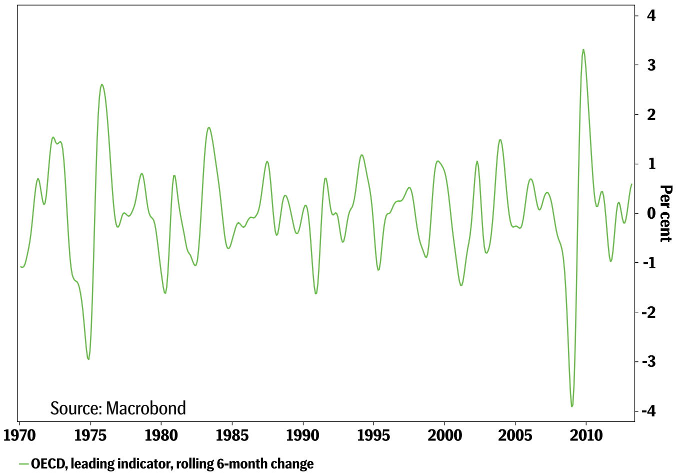
Sluggish in Eastern Europe, but Baltics top EU

Economic growth in Eastern and Central Europe has bottomed out, but the recovery will be sluggish. Growth is being hampered by weak Western European demand, rising unemployment and in southern parts of the region also pressure on banking systems. Meanwhile domestic demand is benefiting from better funding conditions for governments, companies and banks as well as sharp interest rate declines. Lower price pressure and weak growth will also pave the way for economic stimulus measures. But different parts of the region are diverging. Russia and Poland will show decent growth in 2013-2014, while the Czech Republic, Hungary and Ukraine will slowly improve from around zero growth this year. Croatia and Slovenia may move towards another recession year.

For the third straight year, in 2013 we expect the Baltics to be the fastest-growing countries in the European Union, driven by good domestic demand. Exports will chug along despite Western European weakness and Russia's slowdown. This year inflation will remain subdued in Latvia and Lithuania. It will fall in Estonia, yet remain relatively high. Public finances are under control in all three countries, and budget deficits will be small this year. We predict that Latvia will adopt the euro in 2014, while Lithuania may possibly do the same in 2015.

The world is poised for higher growth

After a period of gradually slower momentum in 2010-2012, the world economy is now poised for higher growth. We foresee global GDP growth of more than 3.6 per cent this year and more than 4 per cent in 2014, compared to just over 3 per cent last year. The emerging markets sphere will lead the world, with growth figures of about 5.5 per cent annually in 2013-2014, while the OECD countries will achieve a rate of less than 1.5 per cent this year, but rising to nearly 2.5 per cent in 2014.



POSITIVE ECONOMIC SIGNALS BEING DETECTED

The OECD's leading indicator (see chart) is now once again pointing rather steeply upward after a bumpy ride in the past several years. Judging from the SEB Equities GLEI (Global Leading Economic Indicator) another sharp jump is in store for the OECD indicator this summer, probably followed by accelerating economic growth in the OECD's 34 industrialised member countries.

Better macroeconomic signals are needed

- **Earnings have bottomed out**

  First quarter 2013 reports of listed companies included an unusually large number of earnings disappointments, but we believe that they still provide good reasons for optimism. Industrial companies have gone through a rougher patch than expected, but the worst period is already past and their recovery will be impressive in some cases.

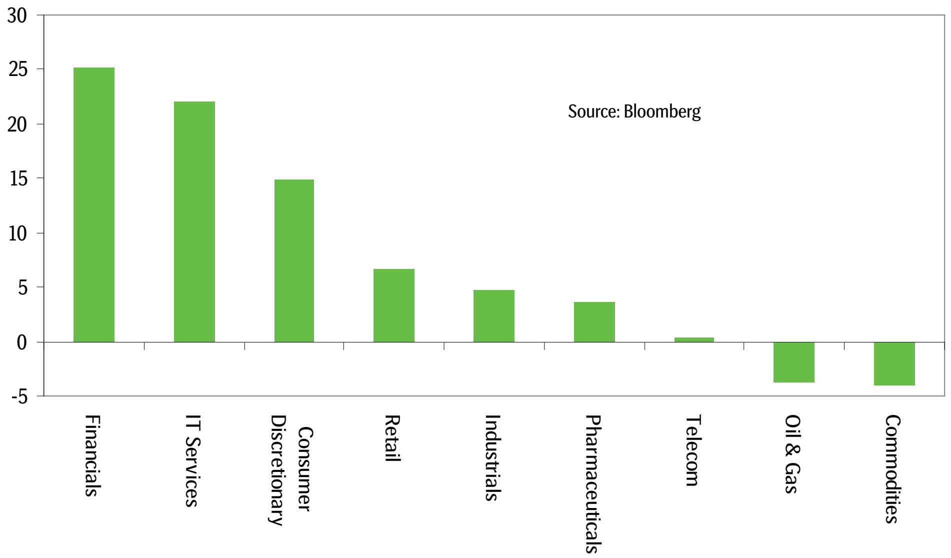
- **Support from news headlines**

  Despite some negative news headlines during the spring, the stock market has climbed. This summer, the pace of economic growth may improve significantly.

- **Revenge for industrials expected**

  If incoming economic indicators improve this summer in line with our forecasts, the index upturn will be driven by cyclical industrial companies that have taken a beating so far this year.

STOCK MARKET PERFORMANCE IN STOCKHOLM SO FAR THIS YEAR



The chart shows stock market performance in per cent so far this year in Stockholm, broken down by sector. Financials (banks and investment companies) and IT (mainly Ericsson) have driven the upturn, while cyclically sensitive sectors such as industrial and commodity companies have lagged behind.

THE STOCK MARKET HAS PERFORMED STRONGLY so far this year, but with wide divergences between sectors. Much of this year's index gain on the OMX Nasdaq Stockholm exchange can actually be explained by five companies: four banks plus Ericsson. Cyclically sensitive sectors such as industrials and commodities have lagged far behind. One important reason is unexpectedly weak economic growth in the countries that had been expected to serve as engines in the recovery: China and the United States.

Meanwhile the stock market has enjoyed support from large-scale monetary stimulus measures and a general easing of concerns that global imbalances in general and euro zone problems in particular will lead to a financial meltdown like the Lehman Brothers crisis. This is one reason why equities have now also begun to be affected by extremely low interest rates. When all other financial assets are historically expensive, equities with historically normal financial ratios appear attractive. Because of the low return requirements on bonds and real assets, investors have now begun to accept lower return requirements, that is, higher valuations on equities as well. Although we will see reversals along the way, this should give the stock market continued support during the rest of the year and possibly for far longer.

Weak reports inspired hope

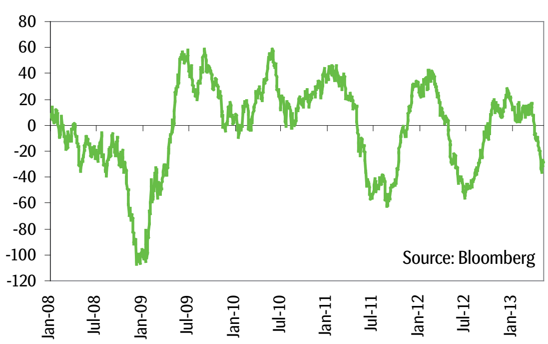
The first quarter 2013 reports of listed companies were weak, in that total earnings decreased and the percentage of companies that did not live up to analysts' forecasts was the highest in several years, but limiting ourselves to these observations provides a highly incomplete picture of this past report period. Banks again delivered solid earnings, a continued improvement after last year's healthy levels. Industrials, which accounted for many of the earnings disappointments also account for the lion's share of the overall year-on-year decrease in earnings. But in many cases, their reports meanwhile showed clearly better than expected order bookings and an upturn compared to the preceding quarter. Weak earnings were often a function of low deliveries during the preceding quarter, which resulted in both lower sales than expected and poorer capacity utilisation at factories, which in turn squeezed margins. When fixed company costs must be allocated among a smaller number of units produced, profitability soon shrinks. In many cases, however, a rapid and significant improvement in order bookings was discernible. Companies like Volvo Trucks and Scania reported a "book to bill" ratio of 1.6 and 1.2, respectively, in the first quarter. This means that order bookings exceeded deliveries by 60 and 20 per cent, respectively. In other words, if order bookings remain at this level for the next few quarters, deliveries will increase accordingly, causing margins to improve dramatically.

To summarise, the first quarter of 2013 and the fourth quarter of 2012 probably marked the low point of this earnings cycle, and our old scenario of an improvement during the remainder of 2013 was strongly supported by the latest quarterly reports. A combination of solid earnings at cyclically insensitive companies and future improvements at cyclical companies indicates good chances of record earnings as early as 2014.

Bad news flow about to turn around

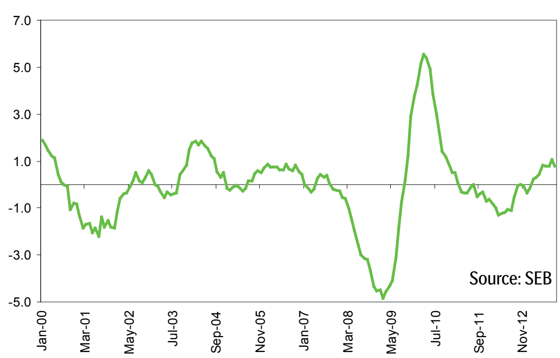
A period of predominantly upside surprises about cyclical trends in the world's major economies early in 2013 was suddenly replaced by noticeable weakness in March and April. A stabilisation is now discernible, however, and this summer we expect a substantial improvement in global economic performance. SEB's early Global Leading Economic Indicator (GLEI) signals that an improvement in leading indicators around the world can be expected by September, and economic performance looks set to strengthen to its best level in several years. We believe that such a favourable flow of macro news will be an upside surprise to many investors and will thus drive the stock market even higher, led by cyclically sensitive sectors.

ECONOMIC SURPRISES



The chart shows how incoming economic statistics from the world's ten largest economies surprised analysts compared to consensus expectations. A rising figure indicates that the percentage of upside surprises was increasing or downside surprises were decreasing. A level above zero means that upside surprises had predominated during the preceding three months, and vice versa.

BETTER CYCLICAL PERFORMANCE EXPECTED THIS SUMMER



The chart shows SEB's Global Leading Economic Indicator. GLEI provides about six months' notice of changes that can be expected in the OECD's leading indicator, which provides an early signal of global GDP growth. A higher level indicates improved economic activity and a lower level indicates deteriorating activity.

Higher earnings and attractive valuations

- **The world's stock markets continue to deliver**

  Global equities have been strong so far this year, but with big differences between countries. Stock markets in Japan, the US and Europe have performed better than elsewhere in Asia and in emerging markets. Greater risk appetite, higher earnings growth and lower valuations provide a golden opportunity to selectively increase EM exposure.

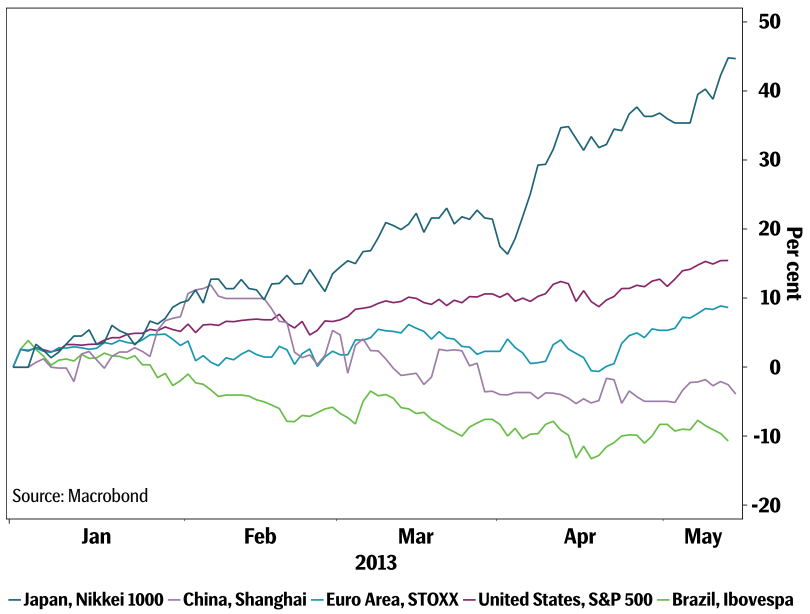
- **EM growth will remain faster**

  Emerging market (EM) stock markets have proved more sensitive to shifting signals from China, and a number of Chinese macro disappointments have probably pulled down their performance, but growth in the EM sphere will still be significantly faster than in developed markets.

- **Greater focus on fundamentals ahead**

  We foresee a greater focus on company fundamentals. Higher earnings and earnings estimates that are adjusted upward in a global recovery will drive stock markets. Asian and EM stock exchanges are likely to set the pace, thanks to lower valuations and better earnings prospects.

STRONG PERFORMANCE IN MAJOR STOCK MARKETS

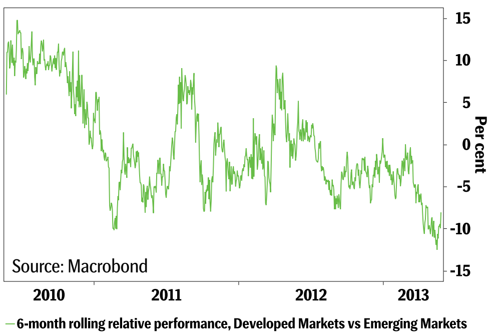


The Japanese stock market has surged so far this year (measured in local currency). However, the yen has weakened, so that in terms of Swedish kronor or US dollars the upturn is not quite as strong. US equities have performed unexpectedly well and share price indices have reached record levels, despite mixed messages from company quarterly reports and macroeconomic statistics. The worst stock market trends have been in Brazil, Russia and parts of Asia.

THE POSITIVE WORLD STOCK MARKET TREND continues. So far this year the MSCI AC World index has risen about 15 per cent in local currencies. The difference between the markets at the top and bottom are dramatic, with the Japanese stock market clearly in first place with an upturn of nearly 48 per cent in local currency. At the bottom are Brazil, Russia and Shanghai, all with negative returns. Against all odds, US equities have gained a full 18 per cent. The only possible reason why the world's most transparent market has reached record levels and second place in the stock market ranking is that investors are uncertain about the global recovery and have sought perceived safer alternatives.

DM performing better than EM exchanges

For some time, stock exchanges in Japan, the US and Europe have outperformed those elsewhere in Asia and in other emerging markets. In the past three months they have even moved in opposite directions – EM exchanges have fallen while Developed Market (DM) exchanges have climbed. Although EM economic growth remains far higher than DM growth, it decelerated during the first quarter of 2013.



For some time, stock markets in Japan, the US and Europe have performed better than those elsewhere in Asia and in other emerging markets. EM stock markets have proved more sensitive to shifting signals from China. A number of Chinese macro disappointments so far this year have probably added to this trend. Investors have sought safer alternatives, mainly the US stock market.

Today many EM economies are working at close to maximum capacity in terms of production resources (labour, machinery and factories). This leaves rather limited room for accelerated economic growth in many places. There are risks of overheating and of negative current account figures in countries whose policies prioritise the domestic market and private consumption rather than exports. Many EM countries are also significant commodity producers, and when commodity prices fall their current account balances are hard hit by decreased exports. But there are huge contrasts between conditions in different countries. Looking ahead, selectivity will be the key to EM investments. DM economies, in contrast, have plenty of idle resources and can grow for quite a long time without risking higher inflation and widening current account deficits.

Quarterly reports have provided mixed messages

First quarter 2013 corporate reports provided mixed signals. Although earnings were satisfactory, sales were generally disappointing. Of US-based companies, nearly three out of four reported results in line with or better than expectations, but their comments and plans for production and exports during the second quarter were somewhat weak and led to downward adjustments in earnings estimates.

Company profits on a global basis are expected to grow by 9 per cent in 2013 and 12 per cent in 2014, with the EM outlook higher at 16 per cent in 2013. US and European earnings estimates are 7 per cent higher, while Japanese corporate earnings are expected to grow by 16 per cent. Korea, Taiwan and Thailand top EM companies. Chinese companies, which recently adjusted their earnings estimates upward, are expecting 12 per cent increases in 2013.

Global equities are trading at an aggregate price/earnings ratio of 14 times forecast earnings for 2013 and 13 times next year's earnings. Japan, the US and Hong Kong are above these averages, while Europe is below. EM equities are trading at P/E ratios of 11 for this year, and Chinese equities at a P/E ratio of 12.

REGION	WEIGHT*	REASONING
Global	1 2 3 4 **5** 6 7	Share valuations are reasonable, provided that earnings forecasts prove correct. Macro data were a bit mixed in the first quarter, but the market has shown resilience and strength. We need to see confirmation of growth to achieve greater stability. Better macro data, stable earnings and inflows to the stock market provide good potential.
Europe	1 2 3 **4** 5 6 7	Positive climate for exporters, but macro signals are still too weak. Great recovery potential, but long-term structural problems; at present we foresee no clear turning point. Choose German and Nordic exporters that benefit from a weaker euro and have a sizeable proportion of their sales in emerging markets.
United States	1 2 3 **4** 5 6 7	Macro data have been relatively stable, which has already resulted in a strong market. Valuations are beginning to be high, which will limit potential.
Asia/EM	1 2 3 4 **5** 6 7	Primary growth investment is Asia, with a focus on less developed countries such as Indonesia, Malaysia and Thailand. Avoid pure commodity exporters. We are tactically a bit cautious; risk appetite must improve.
Japan	1 2 3 **4** 5 6 7	The government's stimulus package has led to a stock market rally and a sharp decline in the currency. These measures will have a positive impact on Asia as a whole. High earnings forecasts, but from low levels.

** "Weight" shows how we currently view each asset category as part of a portfolio. A level of 4 is neutral. These weights change continuously based on our tactical view of the stock market and may thus diverge from our long-term strategic view of the same asset category.*

Selectivity in Asia

In our portfolios, we continue to highlight Asia and emerging markets, but with great selectivity. Higher earnings growth and lower valuations are attractive. Less developed countries such as Malaysia and Thailand have great potential, but developments in China are crucial to the entire region. So far in 2013, many Chinese macro statistics have been weaker than expected, conveying the picture of an economy that is growing more slowly than late in 2012. Yet recent microeconomic signals contradict this picture. Companies in the Nordic countries and the US are citing higher sales and better order bookings in China.

The latest import and retail sales data also indicate somewhat stronger domestic demand in China, while business investments appear to have slowed. Overall, this would be consistent with the ambition of Chinese authorities that growth should be driven by household consumption rather than by capital spending and exports.

The poorer performance of EM stock markets provides a golden buying opportunity, since positive fundamentals combined with faster global economic growth should drive EM equities to higher returns than DM equities during the second half of 2013 as well as next year.

There are also many reasons to consider European equities. When risk appetite resumes, we foresee major potential even though right now there is a lack of sufficiently positive economic data to boost these markets. Well-managed multinational companies in the Nordic countries and Germany will benefit from sales to growing EM countries.

Good potential for strong performance

We are cautiously optimistic about global stock market performance, with good potential for a strong second half and 2014. Macroeconomic data were weak during the first quarter of 2013, but the market has shown good preparedness and resilience. Investors are now foreseeing smaller risks in their economic and political future scenario, which means that the risk premium on equities has begun to fall.

The risk premium has been high as a consequence of uncertainty and low expectations among investors along with low government bond yields. We foresee an increased focus on company fundamentals and attractive valuations. Higher earnings and earnings estimates that are adjusted upward in a global recovery will drive stock markets, with cyclically sensitive companies, Asia and the EM sphere probably leading the way thanks to lower valuations.

The Country Model gives China top marks

The Country Model is one of several analytical tools that we use when allocating global equity holdings to various countries/regions. To obtain a more holistic view, however, we also need to take into account such factors as risk, market mood, flows and macroeconomic data. Right now China, Indonesia and Russia get top quantitative scores while the United States, Germany and Sweden are at the lower end.

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 an 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 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.

Quantitative and qualitative assessment

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 supplemented with qualitative fundamental macro assessments before leading to recommendations or becoming the basis for portfolio allocation decisions.

Countries that stand out right now positively/negatively in the Country Model:

+ China
The Chinese market receives the highest quantitative score because it has low valuations and company earnings estimates have recently been revised upward. Mixed macro signals have held the market back, but the latest figures indicate stronger economic growth.

+ Indonesia
Indonesia receives the highest score for return on equity and earnings growth, but at present we lack an analysed active product/fund for investment in Indonesia.

+ Russia
The Russian stock market is the cheapest in the world and thus comes out well in the model, but the earnings growth outlook is low. Russia is a high-risk market, and at present we are generally tactically cautious. Russia's dependence on oil price developments is very high.

- United States
The American market ends up far down in the Country Model. It has performed well for a long period because investors have been uncertain and sought safe alternatives. Valuations are not attractive, and company earnings are not growing as fast as elsewhere in the world. We are under-weighting the US in our portfolios and believe that its stock market will lag behind the world index once the economic cycle rebounds and risk appetite returns.

- Germany
Germany is also at the bottom of the list. Neither valuations nor earnings revisions look especially attractive right now. Nevertheless, in Europe we prefer well-managed German exporters that will benefit from improved economic activity in Asia. Earnings estimates will then probably be revised upward, and Germany will probably end up with a better ranking in the Country Model.

- Sweden
Like the German stock market, the Swedish market also ends up very low in the quantitative model, since it has already performed well and earnings have been revised downward after first quarter reports. However, we make the qualitative assessment that Swedish companies, like German ones, will hold their own nicely in a global economic recovery and that earnings will then be revised upward.

Central banks throw a party

- **Bargain prices for large sums of money**

  Ever since the unprecedented financial and economic crisis of 2007-2009, central bank policy has been focused on bolstering financial systems and economies. The stimulus measures now being launched should be seen in light of weak growth and low inflation in many countries.

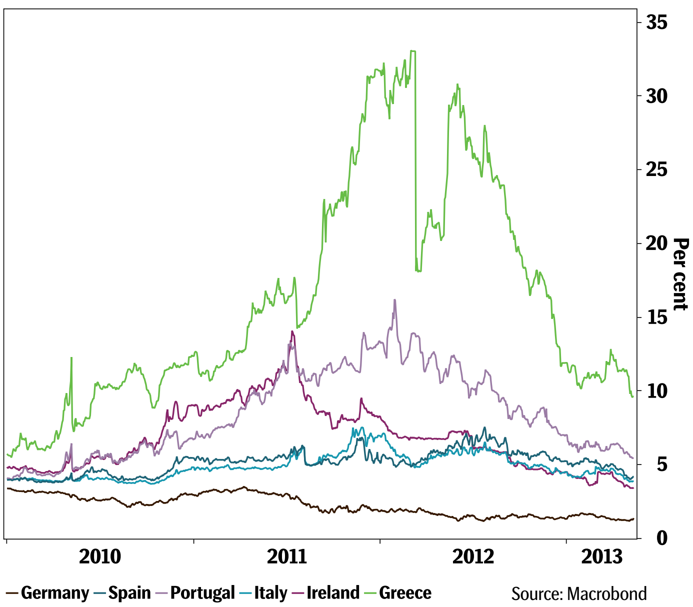
- **National monetary policy with an international impact**

  Because the world's financial markets and economies are now intimately interwoven, the actions of leading central banks reverberate across the globe. The latest example of this is reactions in the global money and currency markets to the Bank of Japan's intensified stimulus policy.

- **Fewer segments of the money market attractive to investors**

  There are increasingly few opportunities for fixed income fund managers to generate high returns, which is why performance expectations for fixed income portfolios need to be lowered. Prospects look brightest for parts of the high yield market and emerging market (EM) debt.

DIMINISHED EURO ZONE RISKS FUEL A BOND RALLY



Source: Macrobond

Sharply rising government bond yields in the GIIPS countries in the wake of repeated government financial crises and political unrest have been succeeded since the summer of 2012 by substantial yield declines/price gains for those countries' bonds (10-year government bond yields in the chart). Among the factors behind this are decreasing financial risks thanks to the European Central Bank's OMT bond purchase programme, progress in these countries' crisis management policies and the Bank of Japan's expanded stimulus measures, which have increased the appetite for high yield bonds around the world.

IN EARLY 2013, YIELDS ON MANY COUNTRIES´ government bonds rose, largely in response to strong signals from various corners of the macroeconomic world, but also due to escalating political risks. However, towards the end of the first quarter, bond yields fell on a broad front – for a number of reasons. Growth data in Europe as well as in the US and China began to weaken. Political risks in the euro zone eased after an agreement on how to manage the economic crisis in Cyprus while Italy swore in a new government led by Enrico Letta after many twists and turns. The Bank of Japan (BoJ) also launched a surprisingly large monetary stimulus package focused on doubling monthly asset purchases.

In early May, a large group of central banks threw a stimulus party featuring interest rate cuts on the menu. The hosts are the European Central Bank (ECB) and the central banks of Denmark, Poland, Australia, India, South Korea and Vietnam. This traditional monetary policy, combined with the US Federal Reserve's continued bond purchases and the BoJ's expanded asset purchases – two examples of unconventional quantitative monetary policy – entail monetary stimulus for the global economy on a scale rarely seen before. This is beneficial to many financial markets as well as the global economy (see also the theme article "Liquidity driving markets and the economy").

The beginning of the second quarter was thus dominated by falling yields on government bonds in the OECD countries, on emerging market bonds and on investment grade (IG) and high yield (HY) corporate bonds. April and early May were thus a very successful period for bond investors.

Among the factors behind the interest this spring in corporate bonds and government bonds in the GIIPS countries (Greece, Ireland, Italy, Portugal and Spain) was the gigantic quantitative easing in the BoJ's monetary policy, which lowered bond yields/raised bond prices considerably in Japan. That in turn caused private Japanese bond investors to start looking for higher bond yields elsewhere in the world. Expectations that this would happen also caused other market players to quickly seek out high yield countries and the corporate bond market, contributing greatly to the yield decreases/price increases in these markets.

By all indications, the period of falling government bond yields in core countries such as the US, the UK, Germany and Sweden is at an end. One reason is that the financial markets, in our view, have been excessively pessimistic about economic prospects. This gloomy mood was reflected in US and German 10-year bond yields, which declined to near record-low levels in early May as well as in defensive stocks, which far outperformed cyclical stocks for quite some time. Given our scenario of a gradual strengthening of the global economy starting this summer, in all likelihood government bond yields will rise/prices will fall for core countries going forward, albeit modestly, thanks to sustained low inflation and central bank measures.

Meanwhile, there is room for even slightly lower yields/higher prices in some segments of the corporate bond market. Those offering such opportunities are the less risky parts of high yield (with a BB or B credit rating). In riskier segments such as CCC, yields have fallen significantly this spring, which is why prices and valuations have become strained. However, running yields that are still relatively high are a positive factor in these segments. At the other end of the market – investment grade – the yield gap to government securities has narrowed so much that there is a higher risk of investors being hit by falling bond prices.

Emerging market (EM) debt remains attractive. For investors based in the OECD countries, there are opportunities for value growth in local currencies as well as growth as a result of appreciating EM currencies. Historically, total value growth in EM bonds has been 40 per cent attributable to return measured in local currencies and about 60 per cent attributable to appreciating currencies.

Nor should it be ruled out that government bonds in the GIIPS countries may generate good returns for a little while longer. However, to a fairly large extent, the positive effects of reduced political and financial risks in the euro zone and the search for returns by Japanese and other investors should have already left their mark in these bond markets.

ASSET CLASS	WEIGHT*	EXPECTED RETURN NEXT 12 MONTHS		RISK
		SEK	EUR	
Treasury bills	1 **2** 3 4 5 6 7	0.8%	0.0%	0.1%
Government bonds	1 **2** 3 4 5 6 7	-1.2%	-1.1%	6.5%
Investment grade corporate bonds	1 2 **3** 4 5 6 7	2.3%	1.3%	3.9%
High yield corporate bonds	1 2 3 4 **5** 6 7	7.3%	6.2%	5.8%
Emerging market debt	1 2 3 4 **5** 6 7	11.0%	14.0%	7.8%

** "Weight" indicates how we currently view the asset class as part of our portfolio. Level 4 is neutral. These weights change continuously depending on our tactical market outlook and may therefore differ from our long-term strategic outlook for the asset class.*

Source: SEB

More stable markets, better opportunities

• In Q1, hedge funds already generated a return in line with full-year 2012

Since the fourth quarter of 2012, the markets have gradually returned to being governed by company and macroeconomic fundamentals, which has been a good climate for hedge fund managers. Hedge funds as a whole have had a good start to the year, generating 3.1 per cent during the first quarter, compared to a full-year return of 3.5 per cent for 2012.

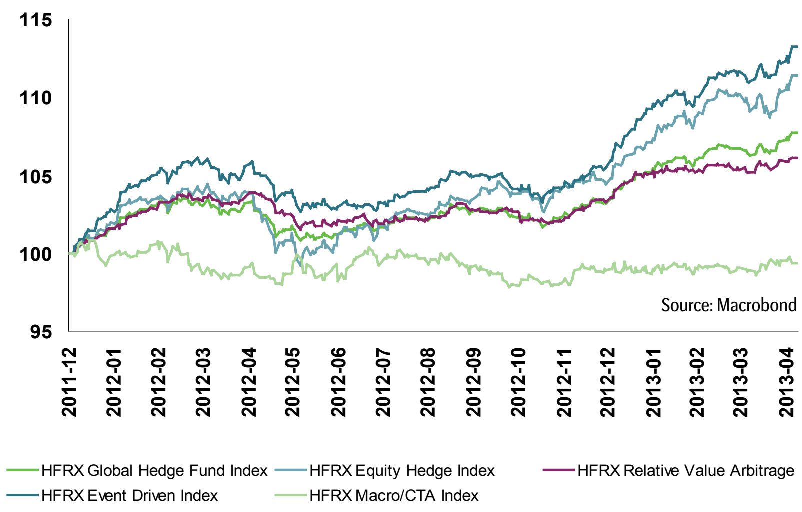
• Variation within and between strategies

Equity Long/Short and Event Driven strategies have benefited most from more "normalised" market conditions, with gains of over 5 per cent this year. Meanwhile, Macro/CTA has stayed just above zero, which is lower than we expected, but there is considerable variation among hedge fund managers.

• Still good potential for every strategy

More sustained trends should favour CTA (strategies based on mathematical models), while large global imbalances create opportunities for both Relative Value and Macro strategies. Market players' growing focus on company fundamentals bode well for Equity L/S, while companies' large cash holdings can be used for acquisitions, which should favour Event Driven and Distressed strategies in particular.

STRONG PERFORMANCE TREND CONTINUES IN 2013



Almost every strategy continued its strong fourth quarter trend, with the exception of Macro/CTA, which hovered around zero. There is still good potential for every strategy, although the rate of return will probably not be as high for the rest of the year.

THE FIRST QUARTER OF 2013 SAW A POSITIVE transition from last year, as the HFRX Event Driven and HFRX Equity Hedge indices led the way with gains of 5.3 and 5.1 per cent, respectively, basically equivalent to the full-year 2012 return for these strategies. HFRX Macro/CTA again had the worst performance this quarter, trending marginally above zero. The broader HFRX Global Hedge Fund Index ended the quarter up 3.1 per cent, and every strategy turned in a positive performance in April.

Equity Long/Short had a very strong first quarter despite some turbulence in the euro zone, with Cyprus and Italy leading the way. Fundamental conditions at the macro level have improved, and fund managers were able to increase their net exposure in their portfolios. One sign that fundamental stock picking has worked is that market-neutral strategies have also delivered in line with expectations. In the last issue of *Investment Outlook* (published March 5, 2013), we argued that 2013 would provide better conditions for this strategy and we are sticking to this. Unfortunately, we have not yet seen the "Great Rotation" from safe government bonds to riskier assets such as equities (although it has begun). Yields have been pushed down further by central bank actions, mainly the Japanese stimulus package that has driven capital out of Japan in search of higher yields and to protect against a falling yen.

After the stock market rally, many hedge fund managers took home profits and adjusted their exposure downward, since there was an increased risk of a temporary correction. They are looking for slightly lower levels to jump back in, and given the major imbalances that still prevail in the world, opportunities are likely to arise. We therefore still have a preference for capital-protection managers but do not mind if they have a more cyclical exposure in their portfolios.

Relative Value had a good first quarter, with a gain of 1.7 per cent. The rather dramatic changes in Japanese monetary policy and closer monitoring of signals that the US Federal Reserve may put an end to its stimulus measures kept fund managers fully occupied. The search for returns continues, with yields on safe government bonds still at extremely low levels historically.

Many managers have been able to develop bigger trading strategies with both short and long positions, which has potential to contribute positively to returns. This was far more difficult last year, due to relatively higher interest costs and higher volatility. We are still positive about this strategy, especially for Fixed Income Relative Value and Credit Long/Short.

Event Driven rose 5.3 per cent during the first quarter of 2013, making it the best-performing strategy (similar to last year's performance). Merger Arbitrage had a rather modest gain of 0.9 per cent. Still, managers focused on special situations, mainly in credits, had better success. Within Distressed strategies, hedge funds have started to build up a slightly larger cash position in order to buy at better prices when there is turbulence, something we saw several times in recent years. In the last issue of *Investment Outlook*, we argued that the conditions for increased activity in corporate acquisitions had improved, which would strongly favour this strategy. The level of activity thus far has been low in terms of major deals. While awaiting activities by major corporations, there seem to be enough smaller-scale transactions and special situations for many managers, who are generating returns in both Distressed and Event Driven strategies. For investors with lower demands for liquidity and longer investment horizons, there should still be good return potential.

Macro and Trading had a weak start to the year. HFRX Macro/CTA rose 0.04 per cent in the first quarter. The HFRX Systematic Diversified CTA Index was even weaker, falling 0.8 per cent during the same period. The global situation is still far from stable. The major economies are still in different stages of recovery, with the US in a situation where stimulus measures may be reined in, whereas Japan has just launched a powerful stimulus package, China is trying to steer its economy towards more consumer-driven growth, and euro zone political leaders are anguishing between budget cuts and growth stimulus. In this environment, currencies, commodities and fixed income instruments should be most affected. That should create good opportunities. Managers who have been forced to focus their trading on risk sentiment in recent years now have greater opportunities to trade based on medium-term fundamental trends although it is still vital to be quick on one's feet. For our CTA funds, we foresee a gradual improvement. Sustained strong trends are still something of a rarity, but lower correlations allow models to build up positions in which trends develop, without quickly reaching the strategy's risk limits. We stand by the positive qualities of the portfolios with this strategy and are pleased with the positive return our selected investments have generated so far this year.

STRATEGY	INDEX	PERFORMANCE % (USD)				
		Q2 2013 TO DATE	Q1 2013	2012	2011	2010
Global Hedge	HFRX Global Hedge Fund	0.9	3.1	3.5	-8.9	5.2
Equity Hedge	HFRX Equity Hedge	1.1	5.1	4.8	-19.1	8.9
Relative Value	HFRX Relative Value Arbitrage	0.7	1.7	3.6	-4.0	7.7
Event Driven	HFRX Event Driven	1.5	5.3	6.0	-4.9	2.0
Macro	HFRX Macro	0.3	0.04	-1.0	-4.9	-1.7

Source: SEB

Increased risk-taking favours secondary markets

- **Higher transaction volume than expected**

  The global increase in volume during the first quarter points to growth of 10-15 per cent for the full-year 2013.

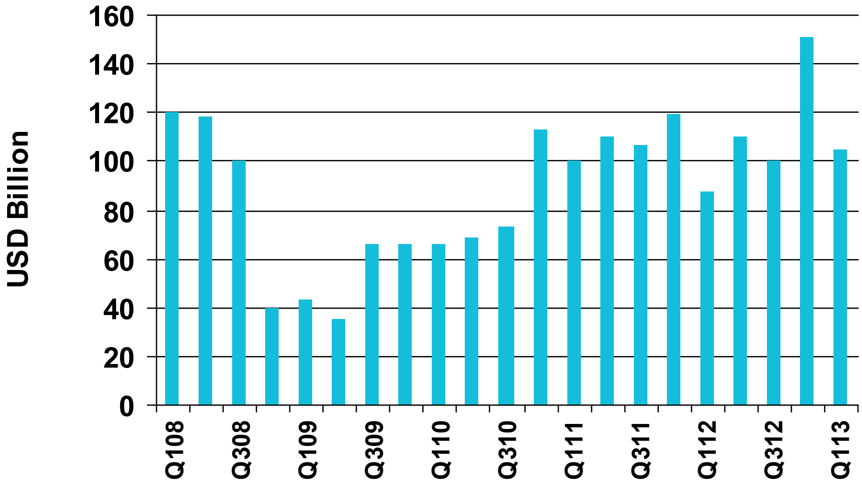
- **High risk appetite and low interest rates bode well for alternative asset classes**

  The markets have great confidence in the world's major central banks, which are promising continued stimulus measures and low interest rates. Real estate, along with other alternative asset classes, will be an increasingly important source of returns.

- **Lower yield levels**

  Pressure in the primary markets has contributed to lower yield levels and signals a continued growing interest in secondary markets.

TRANSACTION VOLUME IS EXPECTED TO INCREASE 10-15 PER CENT THIS YEAR



Source: Macrobond

The first quarter has historically been characterised by lower activity, which is also apparent this year. However, compared to the first quarter of last year, the global transaction volume was up 20 per cent.

IN THE LAST ISSUE OF *INVESTMENT OUTLOOK* (published March 5, 2013), we described how the high transaction volume in the global property market during the fourth quarter of 2012 could indicate a trend shift. The first quarter has historically been characterised by lower activity, which certainly was the case in 2013 as well. The global transaction volume during the first quarter was 31 per cent lower than during the last quarter of 2012, but 20 per cent higher compared to the first quarter of 2012. The total volume for full-year 2013 is now expected to grow 10 to 15 per cent compared to 2012.

Investor sentiment has strengthened despite both political and economic uncertainty factors. Together with higher than expected transaction volume, this has resulted in a sustained strong trend in the global property market. The global REIT index (GPR 250 REIT) is up 19 per cent since the turn of the year and 34 per cent over the past year.

Global GDP growth for 2013 is expected to be below trend, and sharp price movements indicate that the market has low expectations. Despite a number of political and economic challenges, investors seem increasingly eager to move further out on the risk scale in the search for returns. In the real estate market, primary markets with safe but low return potential have long been in demand, but increased activity is now apparent in secondary markets, with far more attractive entry levels and return potential.

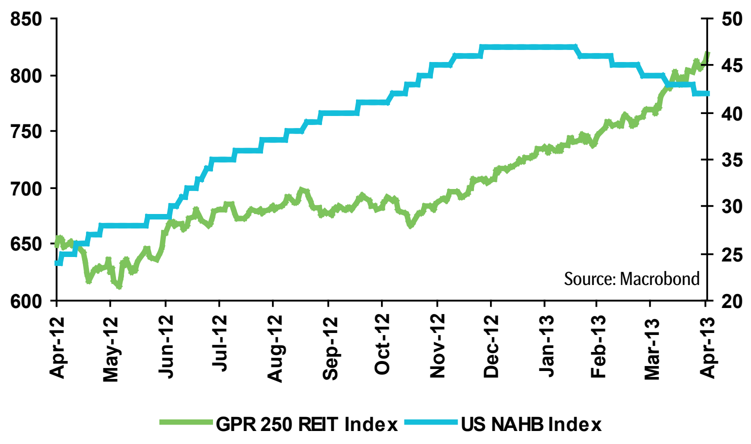
Continued measures by major central banks will benefit the real estate market. Historically low interest rates are expected to hold for a while, and quantitative easing continues to provide the market with liquidity. The lack of risk-free returns continues to attract investors to alternative asset classes that seem increasingly appealing. Institutional investors such as government pension funds have plenty of capital that requires a return, and a clear trend can now be seen toward increased risk tolerance.

Increased pressure in the property market has led to higher prices and thus higher loan-to-value levels, contributing to lower yields in most markets. Sustained interest will probably lead to further value increases while yields should fall slightly. It is then likely that investors will continue to move further out on the risk scale, with a number of secondary markets offering good return potential.

Thus far, the Nordic market has been fairly insulated from the economic and political instability that has dominated the euro zone, for instance. In the Nordic region, the three largest cities in Sweden as well as Oslo, Norway have shown stronger resistance than Helsinki, Finland and Copenhagen, Denmark, where the situation is a bit tougher. In Sweden and Norway, investor focus has been mainly on primary markets. Secondary markets outside the city centres have become less solvent as banks have tightened their lending requirements. However, return levels have stood their ground, which is also a trend that is expected to continue over the next year.

The US housing market is considered by many to be an important indicator of the country's economic recovery. The National Association of Home Builders/Wells Fargo Housing Market Index, a monthly measure of current and future sentiment in the US housing market, has shown that confidence has wavered somewhat since February as a result of rising construction costs and labour supply concerns. However, positive employment figures and announcements from the Federal Reserve about continued stimulus measures point to a recovery. A continued global recovery combined with a sustained low interest rate environment bodes well for a higher transaction volume and increased value generation, mainly in secondary markets.

WAVERING CONFIDENCE IN THE US HOUSING MARKET



This spring, the global REIT index has continued to perform well, but confidence in the US housing market has started to waver a bit after a long period of strength.

Still good potential for listed private equity

- **Low credit costs favour private equity**

  Historically low debt levels and low interest rates contribute to high dividend yields and lower general risk.

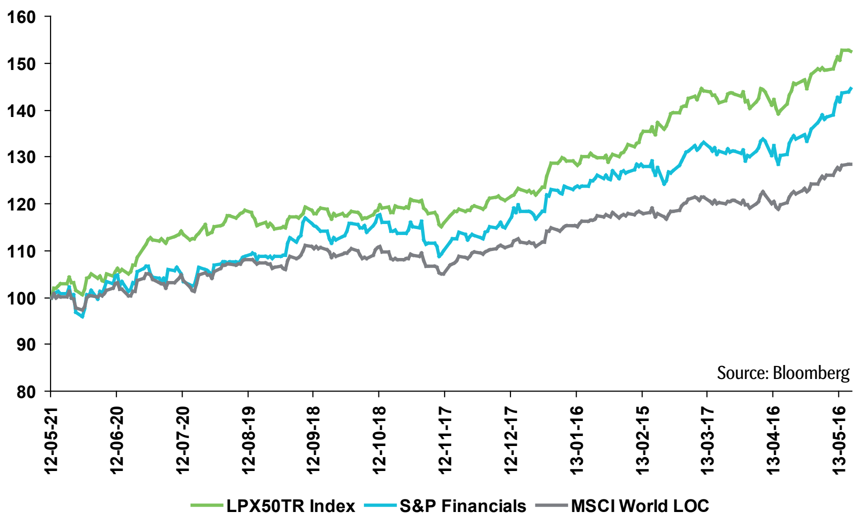
- **Strong risk appetite driving transactions**

  Growing risk appetite has benefited listed private equity through increased transactions, and a functioning exit market is helping provide new opportunities to earn performance fees.

- **Broader portfolio means reduced volatility**

  Large private equity firms today are choosing to broaden their portfolio to include other asset classes in order to continue growing and to increase their diversification.

STRONG, STEADY TREND OVER THE PAST YEAR



Source: Bloomberg

Listed private equity (PE) firms, like many other risk assets, have turned in a strong performance over the past year. In local currencies, the index for listed PE (LPX50 Total Return) is up 52 per cent. The broad index for financial equities (S&P 500 Financial Sector Index) is up 45 per cent and MSCI World is up 28 per cent, all in local currencies.

AFTER RISK APPETITE AMONG MARKET PLAYERS picked up this spring, some fear has crept in that a debt bubble like the one we saw in 2007 is building up. However, prices of listed private equity (PE) companies are still lower than in 2007, and most importantly, company debt ratios are much lower. Combined with low interest costs, lower debt ratios mean roughly 50 per cent lower credit costs for companies. These lower debt ratios also contribute to generally lower risk. The high share of equity relative to high earnings and low credit costs means that we are currently seeing historically high dividend yield levels.

Low credit costs also favour new transactions based on the principle that the currently low risk-free interest rate attracts investors to risk assets. In the last issue of *Investment Outlook* (published March 5, 2013) we described how the increased risk appetite last autumn continued to grow early in 2013. This strong risk appetite has persisted with a few exceptions during the spring, which has also contributed to increased transactions.

Increased activity in the exit market

Reduced uncertainty has made it easier for sellers and buyers to agree on a closing transaction price, which is an essential requirement for PE companies to cash out on or "exit" their investments. The exit market today is strong, and we are seeing a trend towards what is known as dividend recapitalisation, which was especially evident during the final quarter of 2012. Dividend recapitalisation means that a PE company increases its own debt ratio and uses that capital to pay dividends to shareholders, once it has paid down some or all of its debt in a portfolio company. In practice, this entails a shift in risk-taking from the portfolio company to the PE company. The capital flows generated through this procedure are another reason why the exit market has got back on its feet again.

The rise in exit activity has helped enable PE companies to take out performance fees. Many successful investments had been locked in during times of increased uncertainty, without any opportunity for PE companies to charge fees for the value they had generated. Recently, funds with exposure to PE companies have benefited from increased capital flows due to performance fees.

One widespread long-term trend in the stock market is diversifying a company's underlying exposure to Asia through European export companies. Similar trends can be discerned in the PE market, with PE companies able to benefit from growth in the Asian markets by acquiring European export companies. Many PE companies, given their expertise, can also develop these portfolio companies through expansion to new export markets, thereby helping the companies to achieve higher returns.

Lower discounts to NAV

On a number of occasions, we have described how PE companies have taken proactive steps to lower high discounts to net asset value (NAV). In the secondary market, these discounts are still lower than for listed PE, but the gap has narrowed somewhat thanks to the strong performance of listed PE. Increased efforts to reduce discounts to NAV, together with a strengthening of the underlying NAV, have contributed to lower discounts. The average discount for listed PE today is around 25 per cent, compared to about 50 per cent in 2008. Lower discounts to NAV increase the transparency of value generated in the underlying portfolio companies and help improve the investor community's general view of this asset class.

A number of well-known PE companies have chosen to expand their portfolios as their capital grows and invest in a number of different asset classes, such as hedge funds, real estate and various types of debt. Responsibility goes hand in hand with size, and in many cases it may be difficult for large funds to find attractive portfolio companies with the right size to invest in. Expanded portfolio management enables PE companies to continue accepting new capital, while greater diversification in their total capital base helps to reduce volatility.

There is still considerable interest in special situation investments. Special situations involve PE companies identifying vulnerable companies where there is potential to turn around operating profitability and then sell a healthier portfolio company at a higher price. During the spring, this type of investment has continued to be a strong factor contributing to the positive trend we have seen for these types of funds.

With increased risk appetite, the sustained favourable underlying trend and a strong exit market bode well for listed private equity.

Gold's glittering era is over

- **Expectations of economic growth setting the agenda**

  Signs of an improved global economy lifted commodity prices during the second half of 2012. However, this year, mostly since mid-February, prices have slumped. Uncertainty about the direction of the global economy, and China's in particular, has weighed down the market.

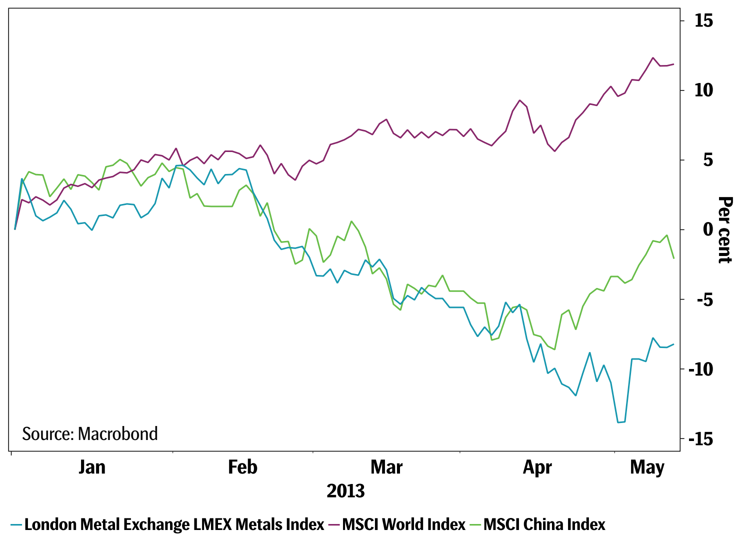
- **Imbalance impacts prices**

  Excess supply in the oil market this spring finally had an impact on prices. The market is now in better balance, and we expect slightly higher prices going forward.

- **Inflation expectations with potential to change the picture**

  Gold's long price run-up ended in April and is most likely over this time around. After price rises of about 600 per cent in the first decade of this century, we expect lower prices going forward unless inflation expectations surge.

METAL PRICES AND EQUITIES IN CHINA GO THEIR SEPARATE WAYS



Cyclically sensitive commodities such as industrial metals and oil have not performed as well as global equities this year. Their correlation with emerging market stock markets has been much stronger, which is logical since these countries consume the bulk of global production. The chart shows how Chinese equities, global equities and metal prices trended together early in 2013 but then went in different directions beginning in mid-February. However, recently we have seen hopeful signs of a rebound.

THE PRICE TREND FOR INDUSTRIAL METALS has been strongly affected by increased economic uncertainty this spring, largely as a result of disappointments from China. The economic situation in China is far more stable than a year ago, but recent statistics indicate slightly weaker performance than expected. This uncertainty is also reflected among global manufacturers, which are maintaining low metal inventories. During the first quarter of this year, the inventory build-up figure was the lowest since 2009.

Combined with continued weak demand from Europe, growth in demand has been more modest than expected while supplies have caught up. Overcapacity and rising inventory levels, with falling prices as a result, have thus dominated the picture for a while. We believe that the global economic recovery will continue and that China's GDP will grow by almost 8 per cent this year. By mid-2013, the focus will also be more on 2014, which should help sustain the market. In our view, prices have now fallen too far, and we expect higher prices a year from now. The London Metals Exchange index is close to its lowest level since 2010, and a number of metals, including nickel and aluminium, are trading at prices well below their marginal production cost.

Excess supply in the spring, but balance now restored

The crude oil market started the year strong, although extensive refinery maintenance work around the world led to weaker demand. The supply from non-OPEC countries also increased faster than expected, partly because production in countries like Sudan and Libya came back on line earlier than forecast. These conditions are usually offset by lower OPEC production, but the organisation made only minor cuts, and supply was about a million barrels per day higher than demand during the first quarter, a situation that should have weighed prices down. However, more positive market sentiment at the start of the year had a greater impact, and the price of oil (Brent) climbed towards USD 120/barrel in mid-February. But reality caught up and oil prices fell relatively quickly, to just under USD 100/barrel at their lowest. Refineries have finished their maintenance, and in our view the oil market is now relatively balanced. We expect oil (Brent) to trade around USD 110/barrel a year from now. Among the factors with potential to change this picture is the rapid rise in North American production (shale oil), which reduces US import needs and is gradually changing global oil flows. Another factor is whether the sizeable oil reserves locked in by various geopolitical conflicts (Yemen, Syria and Iran) will return to the market. However, we do not expect prices much below USD 100/barrel in such a scenario except for short periods, since most OPEC countries need oil to trade at around USD 100/barrel to have a balanced budget.

Normal annual production in investment products

After the extraordinary rise in gold prices since 2000 (+600 per cent) and a flat trend for about two years, gold took an abrupt turn in April, with prices falling sharply. The trigger was most likely the large capital outflows from physical investment products, which were driven partly by more optimistic expectations about returns on other asset classes. Last year, the volume of this type of investment product surpassed 2,600 tonnes, which is equivalent to one year's mining production. In our view, gold prices are still too high unless inflation expectations surge. However, we remain positive about the "hybrid metals" platinum and palladium, since these are used to a large extent in vehicle manufacture. Prices of these metals have trended downward to some extent along with gold prices, which we believe is unreasonable. For instance, for much of the 2000s (until the summer of 2008), platinum traded at about twice the price of gold. Today, the price of platinum is only marginally higher than that of gold. We believe that a return to the previous price relationship is not unlikely.

Absence of drought should lead to cheaper grains

Grain prices have continued to fall from their exceptionally high levels during the summer of 2012. There was a pause in the price drop during the first quarter, with the market waiting to see what the potential is for this year's US harvests. Extremely dry conditions this past winter mean that there is a major risk of disruptions in supply. However, the situation has improved in recent months, and major maize (corn) and soya bean producing regions are no longer affected by drought. There is still uncertainty, but prices should have further downside potential assuming successful US harvests. Grain prices are high and in our view, given normal weather conditions, they should fall further. However, drought could quickly return with the potential to wipe out much of these harvests, resulting in supply disruptions and price hikes.

ASSET CLASS	WEIGHT*	REASONING
Energy	1 2 3 4 **5** 6 7	After excess supply in the oil market this spring, we foresee a more balanced market going forward and slightly higher oil prices.
Industrial metals	1 2 3 4 5 **6** 7	Economic uncertainty, especially about China, has weighed down metal prices for a while. In our view, prices have now fallen too far and we expect higher prices during the second half of 2013.
Precious metals	1 2 **3** 4 5 6 7	After a 600 per cent price climb, gold has now begun its descent. Despite the recent price drop, in our view, gold is still too expensive. However, we believe platinum and palladium are attractive metals since the bulk of production is used in the vehicle industry.
Agricultural products	1 2 **3** 4 5 6 7	Grain prices have fallen since last summer, and we expect they will continue to drop provided that there is no dramatic deterioration in weather conditions in key agricultural regions.

** "Weight" indicates how we currently view the asset class as part of our portfolio. Level 4 is neutral. These weights change continuously depending on our tactical market outlook and may therefore differ from our long-term strategic outlook for the asset class.*

FX market in the hands of central bankers

- **Monetary policy is dominating the foreign exchange (FX) market**
  Historically low interest rates, massive central bank bond purchases and – in some cases – actual currency interventions have shone the spotlight on monetary policy as never before. An assessment of central bank actions is therefore of vital importance in exchange rate forecasts.

- **USD leading the market**
  The most important argument favouring a stronger USD is that the wheels of the American economy have begun spinning faster, with rising home prices and falling unemployment leading the way. A potential tightening in the Federal Reserve's quantitative easing policy in 2014 would also help strengthen the USD.

- **Japanese betting everything on one card**
  The Japanese government and central bank are determined to smoke out deflation and reverse the slow deterioration in the country's economy. But time is running out. One of the most important steps by far has been to try to bring down the value of the JPY. Further yen depreciation is likely.

CENTRAL BANKS TAKING DIFFERENT APPROACHES ON CURRENCIES

CENTRAL BANK ATTITUDE		FOCUSING ON	CURRENCY	VALUATION
FED	Relaxed	Unemployment	USD	Undervalued
ECB	Relaxed	CPI	EUR	Fair
BOJ	Aggressive	CPI	JPY	Fair
BOE	Relaxed	CPI	GBP	Fair
SNB	Aggressive	EUR/CHF 1.20	CHF	Overvalued
RBA	Concerned	ToT/CPI	AUD	Overvalued
RBNZ	Concerned	Trade balance	NZD	Overvalued
PBOC	Concerned	Exports to US	CNY	Overvalued
RIX	Concerned	Imported CPI	SEK	Fair
NB	Aggressive	Imported CPI	NOK	Fair

Source: SEB

Economic policymakers in the US are taking a rather wait-and-see approach to the US dollar's performance since exports are of little importance to the American economy. According to SEB's currency analysts, the USD is undervalued. The Federal Reserve is focusing mainly on labour market developments. In contrast, the Bank of Japan is pursuing a very active, aggressive currency policy, primarily aimed at leaving deflation behind for good and achieving inflation of 2 per cent.

SO FAR THIS YEAR, THE FOREIGN EXCHANGE MARKET has been characterised by a strengthening of currencies in peripheral countries, such as commodity exporters Australia and New Zealand and the Scandinavian countries, at the expense of the major currencies, which previously offered safety and liquidity.

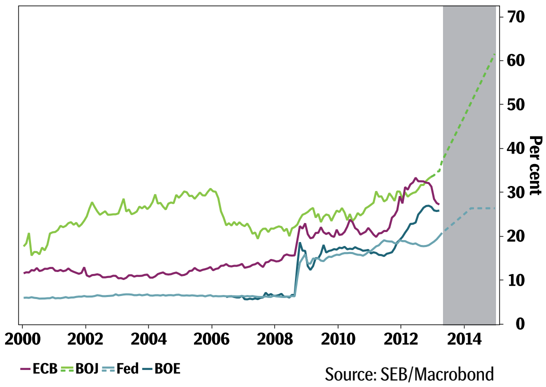
Quantitative easing by the Japanese and US central banks totalling some USD 150 billion a month is making its way into well-managed smaller economies, whose currencies are appreciating as a result. Such flows have led exporters in those countries to start complaining, putting pressure on their central banks to implement or consider interest rate cuts. But even the larger central banks see such a need, as illustrated by the European Central Bank cutting its main refi rate by 0.25 percentage points in early May, with accompanying signals that there could be further reductions. In Sweden, the Riksbank hinted by lowering its interest rate forecast in April that its key repo rate could be cut at the next monetary policy meeting in early July. However, we believe the Norwegian central bank will maintain its benchmark interest rate at the current level until the summer of 2014. In our view, the effects of these measures could mitigate the upward trends for the EUR and SEK, while the NOK could strengthen since the interest rate spread to other currencies is increasing.

This is the sixth straight year of loose monetary policy in large parts of the world. The Bank of Japan (BoJ) is the latest and most forceful player on the stage. Prime Minister Shinzo Abe has established three policy focus areas to tackle the country's considerable economic problems: 1) forceful fiscal stimulus measures, 2) a highly aggressive monetary policy under the BoJ's new governor, Haruhiko Kuroda, whose task is to reverse more than a decade of deflation and meet a 2 per cent inflation target within two years, largely by means of a doubling of the BoJ's monetary base, and 3) a thorough restructuring of the economy, which should nevertheless take a fairly long time. Nonetheless, Japan has launched negotiations, for instance in the agricultural sector, to get restructuring measures and economic reforms under way.

The effects of Japan's policy we have seen in the market so far are lower market interest rates in peripheral countries such as Australia, New Zealand and Canada as well as in Scandinavia. Japanese financial institutions have left the domestic market to seek higher returns on fixed income investments abroad. This has also affected the JPY, which has weakened considerably since late 2012.

According to SEB forecasts, the JPY will weaken against the USD, reaching nearly 120 yen to the dollar in the long term. However this is not new or unfamiliar territory for the USD/JPY exchange rate. The currency pair traded at or above that level most recently in 1998, 2001 and 2007. The effects of Japan's explicit monetary policy have not been long in coming. The Nikkei share price index has risen almost 48 per cent so far this year calculated in local currency, which shows that expectations are very high that Abe's policies will succeed.

CENTRAL BANKS PUMPING UP THEIR BALANCE SHEETS



Source: SEB/Macrobond

The Bank of Japan's balance sheet was already large as a percentage of GDP before the central bank launched very aggressive monetary policies during the spring. In relative terms, its balance sheet would even be more than twice the size of the Federal Reserve's balance sheet if SEB forecasts for 2014 prove correct.

Europe continues to wrestle with the spectre of recession. Leading indicators are currently still weaker than forecast, and the euro zone economy will remain fragile this summer and early autumn. No recovery trend is expected until towards the fourth quarter of this year.

Despite major economic difficulties the EUR has fared well in foreign exchange markets recently, thanks to current account surpluses and improved confidence in official economic policy measures to manage the crisis. This is perhaps most apparent in the weakening of the CHF, a trend that is expected to continue. The Swiss National Bank also serves as guarantor that the CHF will not appreciate above 1.20 against the EUR.

In the emerging market countries, SEB is taking a wait-and-see approach to the Russian rouble, RUB. Among other factors, the Russian economy is been squeezed by falling commodity prices, and the Ministry for Economic Development recently lowered its forecast for Russia's GDP growth in 2013 from 3.6 to 2.4 per cent.

The enormous liquidity flows coming from Japan and the US have to some extent found their way to Turkey, a country that offers high returns and an economy on the rise. Turkey has a very active central bank, which lowered its benchmark interest rate by 0.50 percentage points a few weeks ago. The objective was to prevent the country's currency, the lira (TRY), from appreciating too quickly. However, our forecast is that the currency will still undergo relatively strong appreciation, given high fixed income returns in the country, stable economic growth, a credible central bank and prospects of a general increase in risk appetite. We expect continued upward adjustments in the country's credit rating, which will help raise the value of the TRY.