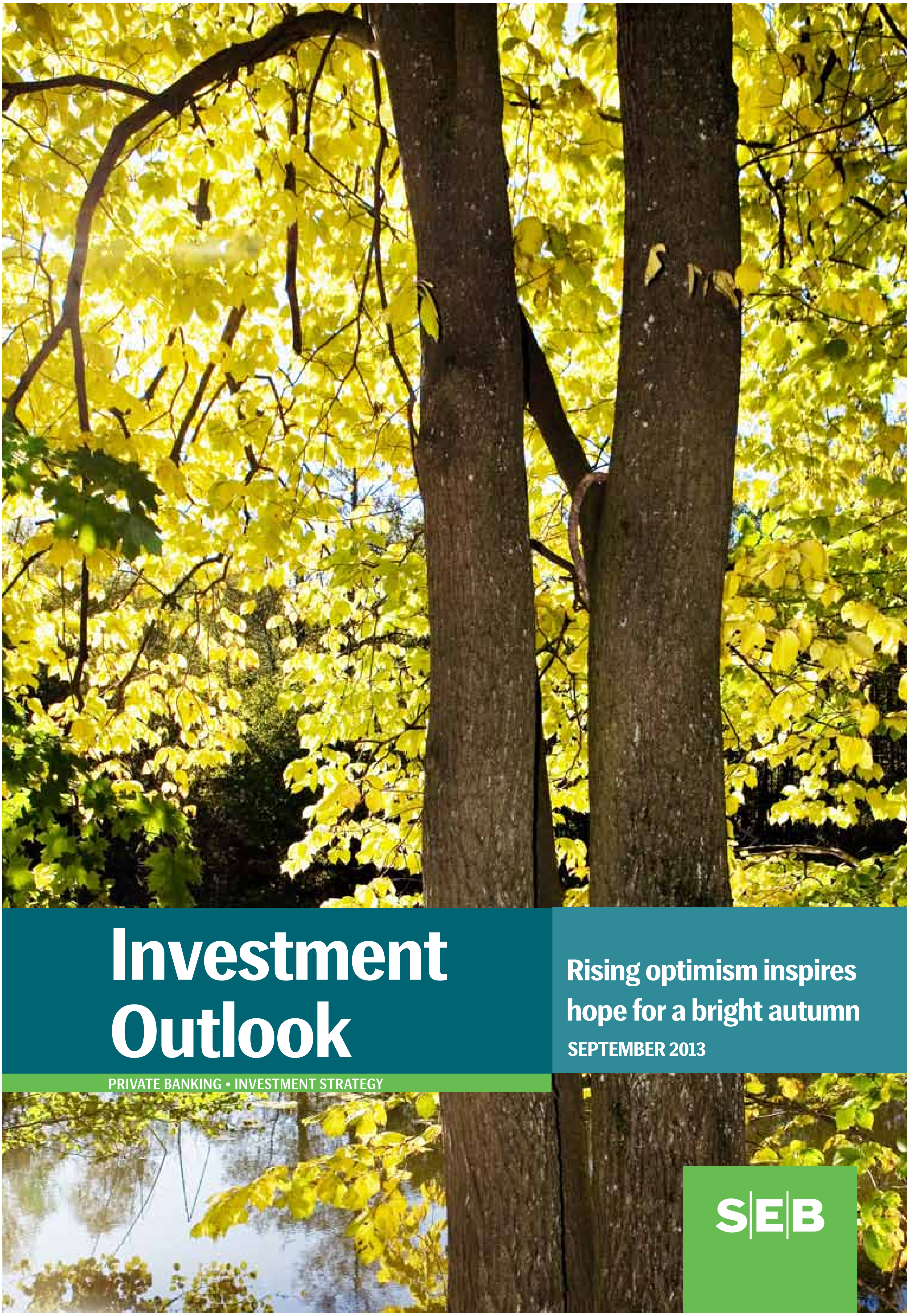

Investment Outlook

PRIVATE BANKING • INVESTMENT STRATEGY

Rising optimism inspires hope for a bright autumn

SEPTEMBER 2013

SEB

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Rising optimism inspires hope for a bright autumn

We are heading into a very interesting period. The three economically biggest regions in the world – the US, Japan and Europe – are approaching stabilisation and probably higher growth.

To some extent, the economy is organic. It is about people, their faith in the future, hope and courage. In recent weeks, we have seen signs that optimism is beginning to grow. We have seen an increased number of corporate merger and acquisition transactions both in the Nordic countries and elsewhere in the world. The Microsoft-Nokia deal is among the larger transactions, and Sweden's SKF is acquiring a US-based supplier. For a long time, the Japanese economy has been characterised by deflation, which has stifled consumer confidence and capital spending. Recently we have seen home prices and lending gain momentum, and the Japanese are also acting more optimistically. All this is positive and indicates that we are heading into a more normalised period than previously. One example is that the US Federal Reserve (Fed) is beginning to talk about reducing its support to the economy in various ways. The concept of "tapering" has become the term that describes the American central bank's planned reduction in its current bond purchases, which it has employed in order to provide liquidity to the market. Removing such support is normal, and in itself a good sign, but once this happens it will have an impact on markets. There are two reasons why the market reacts. One is that investors are worried that the economy will slow without such support. The other is that the capital supply and short-term interest rates are the basis for the entire global financial system. The withdrawal of a source of liquidity is thus another cause for concern.

The amount of liquidity and the level of interest rates affect bond yields, which have recently shown relatively sharp increases. When this happens in the US, it has a major impact on global capital flows. This time was no exception, and emerging markets have seen large outflows. Key interest rates will remain unchanged for a long time to come. The Fed says until 2015, market prices point to 2014 and the future will show which of these is correct.

Overall, this has led to new price levels, among other things for emerging market (EM) currencies, equities and bonds – an interesting situation. The differential between prices of EM equities and global equities is the widest in a very long time. This may be partly justified, since during a transitional phase the growth rate in emerging markets has gone from very high to "only" high. Prices move up or down, depending on whether there is a shift towards more positive growth levels or, as in this case, more negative ones. We are also seeing clear price differentials between European and American equities, as well as between cyclical and defensive shares. These differentials will create some of the biggest investment opportunities this autumn.

This issue of *Investment Outlook* includes a theme article on Europe, a region with genuine potential to be a good investment this autumn. The European Central Bank still emphasises that the euro zone economy needs support, but all indications are that the recession there has ended.

We have also written about Japan, a somewhat forgotten giant, which in our view needs to be re-examined for various reasons. Shinzo Abe, the new prime minister, is laying a new economic foundation. If Japanese demand can regain its momentum, this will provide an important economic stimulus for the whole world.

Building good portfolios and keeping track of risks and opportunities are vitally important. We are in a special phase in equity markets, in the sense that bond yields will be on their way up for a rather long time. This implies that bonds, a natural component of investment portfolios, risk generating negative returns in terms of their market value. As a result, we must be careful about maturities and look at other ways to diversify our portfolios.

Recoveries after financial crises are lengthy. During the autumn, the building blocks of normalisation will continue to be put in place. During this time-consuming process the markets will be volatile, but it will also create opportunities.

HANS PETERSON
Global Head of Asset Allocation

Federal Reserve sets short-term agenda

Since May, when the US Federal Reserve announced that during the autumn it intends to reduce its support to the economy by means of recurring bond purchases, we have entered a volatile period in capital markets. The main consequence was rising bond yields in the United States, which changed global capital flows and caused relatively sharp declines in emerging market currencies and some other asset prices. One outcome is that differences in valuations of various assets have become relatively large. Even earlier last spring, the valuation gap between defensive and more cyclically sensitive assets widened; now it is even wider. This is true of equities in terms of regions and currencies, and thus also to some extent of bonds. These changes will provide some of this autumn's better investment opportunities, once the conditions are in place.

In the long term, we have a positive growth scenario that will provide favourable potential for returns. Many of the assets now priced at low levels will regain value. In the short term, however, the issue of how the US central bank will act is shaping our investment conditions. At this writing, we thus have a relatively diversified strategy, but one that will gradually be adjusted as the economy stabilises.

MAJOR DIFFFERENCES BETWEEN STOCK MARKETS

Source: Macrobond

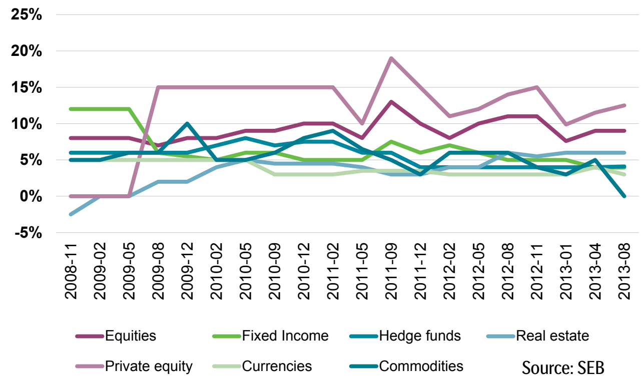
Equities in emerging markets, especially China, have performed weakly in the past year. Meanwhile Japan, driven by stimulus measures launched by Prime Minister Shinzo Abe ("Abenomics"), has experienced a volatile but strong share price rally. Looking ahead, we believe that European equities have the greatest potential.

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 21). 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.

In order to improve transparency, last spring we chose 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 where it is more relevant. Since the last issue of *Investment Outlook* (dated May 28, 2013), it is worth noting that the highly diverse commodities asset class has an expected return of zero, but that within this asset class there are opportunities for returns, for example industrial metals and energy.

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



Source: SEB

CHANGES IN OUR RETURN EXPECTATIONS

Since the last issue of Investment Outlook *(dated May 28, 2013), we have made adjustments mainly in the commodities asset class, where expected return is now zero. The potential decline (risk) in the private equity asset class has increased due to sharp upturns.*

ASSET CLASS	EXPECTATIONS NEXT 12 MONTHS		REASONING
	RETURN	RISK	
Equities	8.5%	17%	Expectations of better news headlines that will boost risk appetite may benefit equities. Valuations compared to bonds remain attractive. Major differences between various regions and sectors; those that have lagged behind will recover.
Fixed income	4%	6%	Stable spreads for corporate bonds. Best risk/reward ratio in high yield bonds, but potential returns have decreased somewhat. Focus on the maturities issue; choose shorter durations in a climate of rising yields. Sovereign bonds are less attractive.
Hedge funds	4%	4%	Market neutral strategies are our first choice, although the market climate is generally better for hedge funds. The trend of returns has stabilised.
Real estate	6%	13%	The market has matured, but transparency remains low. Investors are tending to move further out on the risk scale, especially since the search for "safe havens" has pushed down returns in primary markets.
Private equity	10.5%	25%	Good growth and reasonable valuations will benefit this asset class, provided that risk appetite among investors increases. In case of high market volatility, private equity is often severely affected.
Commodities	0%	20%	Weak trend, since worries about future demand have hurt this asset class. Economic growth in China will be the key issue, but risk is high and expected return is very low. Major differences among commodity categories, however. Industrial metals and energy may provide upside surprises, but it still feels early to "jump in".
Currencies	3%	4%	Emerging market currencies are being pushed down. Reversing this trend will require better export data from Asia. EUR and USD markets are moving in a channel, but overall FX market performance is controlled primarily by monetary policies.

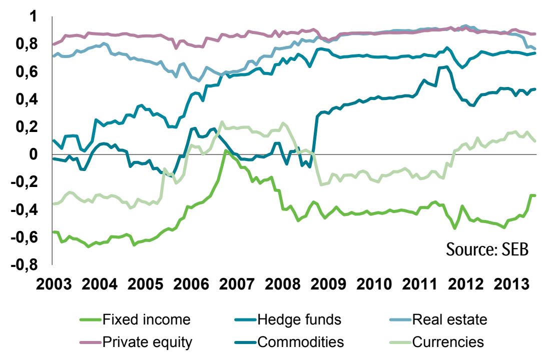
Source: SEB

HISTORICAL CORRELATION (AUG 31, 2003 TO JUL 31, 2013)

	Equities	Fixed income	Hedge funds	Real estate	Private equity	Commodities	Currencies
Equities	1.00						
Fixed income	-0.36	1.00					
Hedge funds	0.69	-0.34	1.00				
Real estate	0.83	-0.11	0.57	1.00			
Private equity	0.86	-0.31	0.70	0.87	1.00		
Commodities	0.37	-0.22	0.68	0.32	0.43	1.00	
Currencies	0.02	0.05	0.15	-0.02	0.02	0.02	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

- **We are in a stock market-friendly phase**
  The pace of the equity market upturn varies greatly in different parts of the world. Weaker economic activity in emerging markets has become a new element in the calculation, but the main trend will be driven by stronger demand, with equities assuming the role of the most important source of returns.

- **Emerging markets are cheap in terms of valuations**
  Uncertainty associated with the economic slowdown in EM countries has created very large pricing differentials. Today the gap in price-earnings ratios between EM and other countries is the widest for many years, creating investment opportunities.

- **A maturing economic cycle will drive cyclical assets**
  The defensive trend that has dominated stock markets will come to an end. Sectors and regions characterised by more cyclical sensitivity will be in the spotlight.

- **Europe will contribute to future returns**
  The European economic recovery is under way, leaving the recessionary phase behind. This will contribute positively to perceptions of Europe as an investment. There are significant growth opportunities, with potential for higher earnings.

- **Bond yields are in an upward trend, but not in a hurry**
  Bond yields have risen and will continue to climb gradually, though slowly. From a portfolio standpoint, however, it is important to understand the significant risk that investments tied to bonds may contribute negatively to returns; short maturities are important.

- **Because of rising bond yields, hedge funds and free fixed income investment mandates will be important**
  One of our foremost objectives is to control risk in a given asset class and not become overly dependent on a single asset class. Managing cyclical and equity risk in our portfolios requires a focus on assets that are not market-dependent.

ASSET CLASS	WEIGHT*	REASONING
Equities	1 2 3 4 **5** 6 7	Over the next 12 months, stock markets will benefit from steadily improving economic activity. The focus of our portfolio management is on Europe and Asia, which have lagged behind and have lower share valuations than global equities. These regions are cyclically sensitive and their share prices will be boosted by economic growth in 2014.
Fixed income	1 2 **3** 4 5 6 7	We have a cautious approach to long fixed income maturities, since bond yields are gradually rising. We will maintain our focus on various types of corporate bonds, primarily high yield with short maturities.
Hedge funds	1 2 3 **4** 5 6 7	A stable, lower-risk market usually benefits hedge funds. We prefer market neutral strategies that will offset equity portfolios in terms of risk. We have also gradually increased credit hedge funds as a proportion of our holdings.
Real estate	1 2 3 **4** 5 6 7	We have a fundamentally positive view of this asset class, but right now we prefer to be a bit wary about including it in our portfolios, partly due to the shortage of good investment properties.
Private equity	1 2 **3** 4 5 6 7	The climate for private equity is improving. The number of corporate deals is increasing. It is easier for PE companies to carry out transactions. The performance of this asset class is often connected to the US financial services sector, where we would like to see a stabilisation before adopting a more favourable view.
Commodities	1 **2** 3 4 5 6 7	Selectively attractive. Industrial commodities have very good potential. Energy is also in a positive trend but will be dependent on political developments. Commodities that are more affected by weather and harvest volumes are in surplus, with falling prices as a result.
Currencies	1 2 **3** 4 5 6 7	The foreign exchange (FX) market has been volatile this year. Emerging market and commodity-dependent currencies have been severely affected. Looking ahead, exchange rate movements will probably be relatively dependent on economic cycles.

** "Weight" shows how we currently view the asset class as 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 tailored to individual needs.*

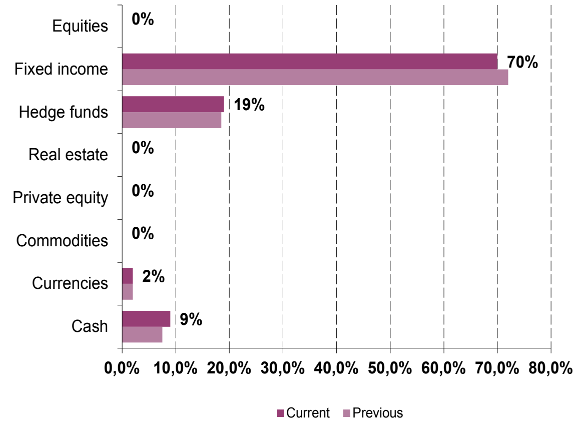
Source: SEB

MODERN INVESTMENT PROGRAMMES

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

MODERN PROTECTION

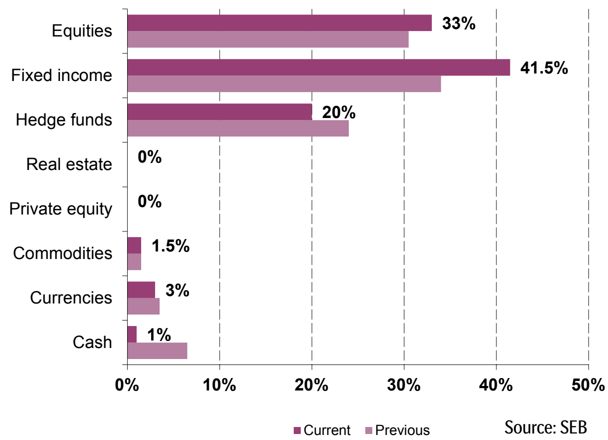
Given the continued risk of rising interest rates, the focus is still on interest rate neutral investments. We have made no major changes. About 35 per cent of the portfolio is allocated to Absolute Return fixed income managers, who have free mandates and full flexibility to take advantage of changes in the yield curve, thereby retaining interest rate risk neutral exposure. The high yield allocation, which consists mainly of short duration high yield bonds and leveraged loans, is about 13 per cent. In the hedge fund sub-portfolio (about 19 per cent) 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 currencies is nearly 2 per cent.



Source: SEB

MODERN GROWTH

Because of the market's focus on the Federal Reserve and worries about decreased stimulus measures, in June we saw continued risk of outflows from emerging market assets. In Modern Growth, we thus halved our exposure to EM equities to 1.3 per cent during the summer. Meanwhile we have gradually increased European equities from 3 per cent to 8 per cent. In fixed income, we have decreased the portfolio's sensitivity to rising interest rates by reducing "normal" high yield from 15 to 10 per cent and increasing short duration high yield and leveraged loans. We have also increased convertible instruments by 2 percentage points and reduced cash holdings from about 11 to 4 per cent. There is room to further increase cyclical exposure this autumn, but right now we are tactically cautious.

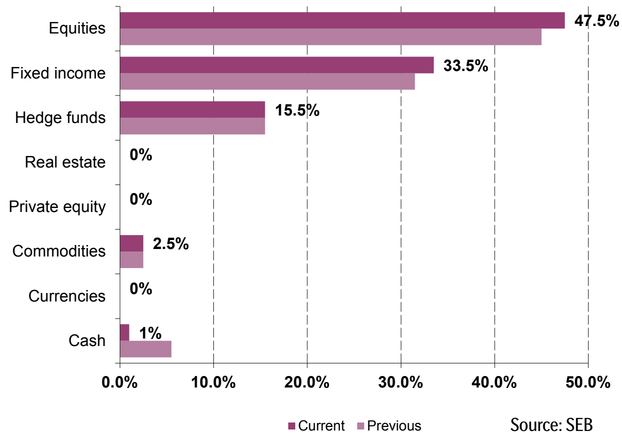


Source: SEB

MODERN AGGRESSIVE

The US economic recovery should continue to support the global recovery, and the European economy seems to be approaching a turning point. As with Modern Growth, we have shifted some of our emerging market exposure (both equities and bonds) to Europe, and we have marginally increased the portfolio's equity exposure. In fixed income, we have invested surplus liquidity in leveraged loans (both globally and in Europe) as well as short duration high yield bonds.

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

Theme

Time for a positive view of Europe

The euro zone still has bigger fundamental problems than many other regions in the global economy, so recovery will be marked by some imbalances, risks and uncertainty. Nevertheless, there are signs of brighter prospects and reasons to adopt a more positive view of the region.

In the second quarter of this year, the six-quarter-long recession in the euro zone economy came to an end, as GDP grew once again. Meanwhile, the competitiveness of the euro zone countries strengthened and their current account balances improved, while the policies and actions of the European Central Bank (ECB) have stabilised financial markets, significantly reducing the risk of the euro project collapsing.

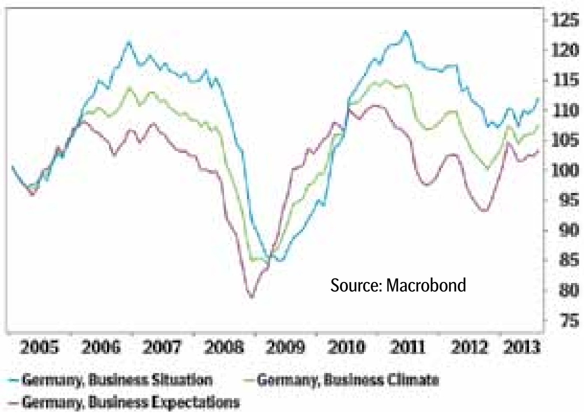
Recently, various forward-looking economic indicators in the euro zone have risen more than expected, in particular the purchasing managers' indices for manufacturing and services. Going forward, the euro zone economy will also get increasing support from accelerating US growth.

As economic conditions and fiscal policies in the euro zone stabilise, investment opportunities are also being created. Granted, the old problems are still fresh in people's minds, and there are worrisome structural issues. Hopes for financial stability are pinned largely on Germany, which accounts for almost 30 per cent of the entire euro zone economy.

Germany's strong dependence on exports, about 50 per cent of its GDP, means that the country will benefit substantially from a strengthening of the global economy in 2014-2015. Higher exports also pave the way for an upswing in German capital spending activity, and private consumption has good potential to increase further. The outlook has gradually started to brighten, especially since less focus is being placed on belt-tightening. Instead, growth is increasingly seen as the way to move forward. Moreover, unemployment in Germany has remained at a historically low level of less than 5.5 per cent since the summer of 2012, and there are no signs that the rate will rise; rather, it should fall. The IFO business climate index has clearly signalled that the country's economy is now picking up, with the indicator showing a surprisingly large climb since the spring.

While Germany remains the engine that will be driving growth, the political situation in the country nevertheless calls for close monitoring. One key event in the near future is the German federal election on September 22.

INCREASE IN GERMAN BUSINESS ACTIVITY



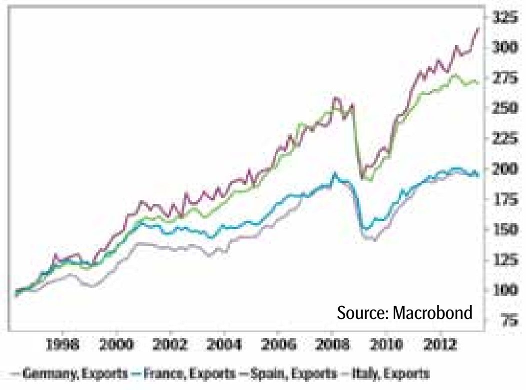
Since the spring downswing, the IFO business indices in Germany have risen significantly. Companies have grown more confident about the current business situation and about the future. The IFO figures weigh heavily in the assessment of German economic trends, and positive signals in recent months are in agreement with other promising macroeconomic indicators in the country.

Some euro zone countries bolstered by the global economy

Germany is not the only country getting an economic boost from other countries around the world. Exports are now also on the rise in a number of the GIIPS countries (Greece, Ireland, Italy, Portugal and Spain). In many euro zone countries, competitiveness has increased dramatically. The best example is Spain, where exports of consumer and capital goods were up 9 per cent in the first five months of this year. The number of tourists in the country has also increased. Lower wages and higher productivity in the GIIPS countries have helped narrow the differences in competitiveness vis-à-vis Germany and other countries outside the euro zone. However, Italy and France are still losing competitiveness against other euro zone countries.

What is interesting here is that the competitiveness of many former low-cost countries has deteriorated globally and the outsourcing trend has been reversed to some extent, with production shifting to Europe. That gives many small and medium-sized enterprises with links to their domestic market a chance to recover.

EXPORT SECTORS WITH VERY DIFFERENT GROWTH



Since the turn of the millennium, Germany and Spain have achieved far more export success than France and Italy, and the differences have been accentuated in recent years. In reality, German companies have long been competitive in the global market – French and Italian companies have not – while Spain's export success has lately depended to a large extent on reduced labour costs.

Some questions still remain. Budget cuts continue to restrain growth in the GIIPS countries, but austerity measures will be less harsh over the next two years compared to this year and last. Yet the macroeconomic situation in France is still generally poor and is dominated by a weak labour market, rising taxes and uncertainty among companies, which is hampering capital spending.

The UK is OK

The British economy has entered a sustained recovery, reflected in this summer's sharp rise in purchasing managers' indices for manufacturing, services and construction. In the short term, exports will be the main engine driving United Kingdom economic growth, thanks to a cheap pound and given that a significant share of exports is aimed at the increasingly vigorous US economy. Since SEB predicts that the Bank of England (BoE) will keep its key interest rate at a low 0.50 per cent for about another 18 months, by all indications the pound will remain weak for some time to come.

Lower inflation combined with fairly moderate acceleration in UK growth is paving the way for a continuation of the BoE's highly stimulative monetary policy.

Household consumption has started to accelerate and was the strongest driver of GDP growth during the second quarter this year. The investment climate here – as in the euro zone – has been hampered by significant excess capacity in many British companies. However, over the next year, capital spending activity could pick up speed, with the construction sector leading the way.

In the final analysis, SEB's view is that GDP growth in the UK will accelerate to almost 2.5 per cent next year from 1.5 per cent this year and exceeding 2.5 per cent in 2015.

Time to focus on investments aimed at Europe

To sum up, there are several factors that will gradually change the outlook for Europe and that favour focusing on Europe as an investment.

First, the economy is stabilising, as noted above, and prospects are good that the recession will end in 2013. One important effect of this is that economic growth is spreading to more sectors. There are substantial needs here that have basically been neglected following the economic downturn in 2008 and subsequent austerity measures.

A clear example is domestic consumer demand, but also capital spending in manufacturing. Domestic demand in the euro zone is still modest. Low capacity utilisation in companies is hampering capital spending activity, and a lot of the good profitability that companies have shown in the past few years has been a result of cost controls rather than new ideas and investments. However, as growth accelerates, investment needs will increase, and we foresee a phase rather soon in which companies increasingly begin to invest in the future.

Household demand, especially in southern Europe, is being restrained by budget austerity, very weak labour markets and general uncertainty about what will happen economically and politically. Nevertheless, the euro zone domestic economy should gradually improve going forward. Furthermore, consumer sentiment picked up a little over the summer.

Accelerating capital spending in manufacturing will benefit the relatively manufacturing-centred, cyclical euro zone. Once the general economy picks up speed in Europe, it will affect corporate profitability. The leverage on earnings per share could be as high as 20-30 per cent. Even today, earnings forecasts are high for Europe compared to other regions. However, in many cases, this is not reflected in share valuations. Instead, it is a question of how the market interprets risks generally in connection with questions today about US monetary policy and other factors that curb risk appetite.

MARKET PLAYERS GIVE BANKS A LOW VALUATION

The chart shows the very low valuation of European banks in terms of their price to book ratio. The European banking sector is valued lower, for instance, than Swedish banks and also lower than US banks.

Financially, the picture has improved considerably in Europe. A stronger economy is generating more tax revenue; countries are healing on their own. The European Central Bank (ECB) eliminated many of the risks when it extended its protection to euro zone banks. The ECB has also been clear in its actions and guidance, providing transparency and generating confidence. It also has room to launch further stimulus measures to bolster the euro zone economy and financial markets as well as reduce the risk of deflation if necessary.

SEB predicts that the ECB will lower its refi rate from 0.50 to 0.25 per cent in December 2013 and then keep it there for all of 2014 and 2015. The ECB is also expected to provide new long-term liquidity (through its Long-Term Refinancing Operation, LTRO), since the banks' current repayments of previous LTRO loans are rapidly reducing the amount of excess liquidity in the financial euro system, with the risk that short-term market interest rates will be pushed up.

That means the entire financial sector will be put into a different light, with the rebound in share prices being more a question of how much rather than whether it will materialise or not. Valuation differentials between euro zone banks and Swedish banks, for instance, are dramatic. The same is true if we compare them to US banks. The difference depends on how banks are valued. Many factors point towards an ongoing upward revaluation of euro zone banks.

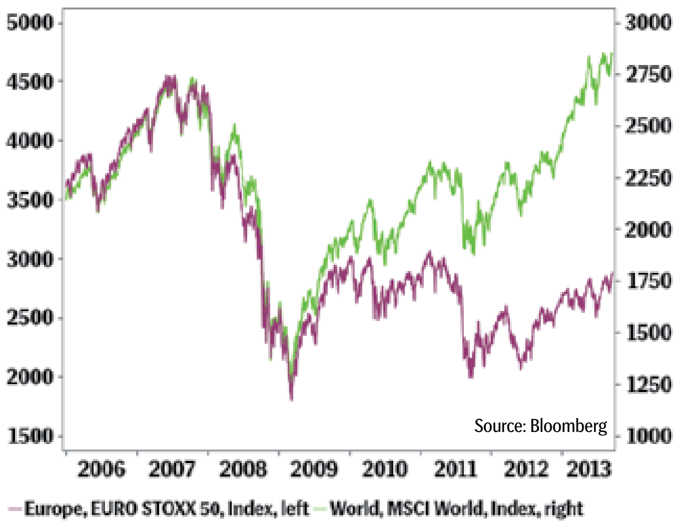
The euro zone is growing again

SEB's forecast for euro zone GDP is a 0.5 per cent decline this year, followed by growth of 0.8 per cent in 2014 and 1.7 per cent in 2015. It should be noted that the improvement of 1.3 percentage points from 2013 to 2014 should be one of the biggest accelerations in the global economy during this period.

Inflation falling, but low risk of deflation

In recent months, consumer price inflation in the euro zone has fluctuated between 1 and 1.5 per cent, but a slowing trend is now anticipated on the order of 1 per cent or slightly less in 2014-2015. In some countries, there is even a risk of deflation, or generally falling prices. However, the euro zone as a whole is not expected to encounter any threat of deflation.

There are many reasons to look at Europe as an investment in the near future. Historically, the third quarter is usually a weak period for stock markets, but then as the economy gradually improves there is hope of better performance. One factor in this equation is that the shift from bonds to equities that we have seen in the US as bond yields have risen has not yet taken place in Europe. Obviously, we need a more sustained flow of positive news to further lift confidence, but that should come.



EUROPEAN STOCK EXCHANGES LAGGING BEHIND

The chart shows the performance of European stock markets (purple line) and global stock markets (green line). There is a considerable lag, and this is where we believe some of the autumn's best investment opportunities lie.

Japan - a forgotten giant

- **A large economy, a key trading partner and a major stock market**
  Japan is important, and major changes there have global implications. Many investors have more or less ignored Japan for a long time. Despite the size of its economy and stock market, the changes there have been too small or negative to be important, but today the situation is different.

- **Breaking out of the deflation and recession trap?**
  Japan's new prime minister, Shinzo Abe, has kindled hopes that after two lost decades, the country's economy will break out of its deflation and recession trap

- **Expect large movements on the Tokyo Stock Exchange**
  Share prices on the TSE have surged and analysts are counting on sharply higher earnings, but many observers are sceptical. Will earnings forecasts and the Exchange index fizzle, or will record-low valuations drive the index further upward?

Japan is the world's third largest economy and the fourth largest trading nation. Its GDP is as large as those of the three smallest BRIC economies (Russia, India and Brazil) put together, and the country accounts for nearly 6 per cent of global imports and exports, excluding trade within the European Union. The Tokyo Stock Exchange is one of the world's largest, with a market capitalisation 20 per cent smaller than London but four times bigger than Stockholm, and with a weight of 8 per cent in world indices. Yet the country has suffered from very weak growth and repeated recessions over the past two decades, and for 15 years the economy has been stuck in a deflationary spiral. However, financial markets are often most interested in change and the pace of change. Because the growth of the Japanese economy has been close to zero in nominal terms during the past decade, it has essentially been possible to pay no attention to impulses from there. Except for some brief periods, global equity investors with Japan as part of their investment universe have done well to ignore the existence of the Tokyo Stock Exchange since 1989. Since then, the TSE has racked up 12 years of share price performance substantially worse than the rest of the world, followed by 12 years of equivalent price performance but far lower dividend yields.

THE TOKYO STOCK EXCHANGE HAS BEEN WEAK SINCE 1989

The chart shows the Nikkei 225 Index since 1980. The Tokyo Stock Market was an international outcast for 12 years after Japan's financial bubble burst in 1989 and has fluctuated sideways since then. Does the past year's rally signify a reversal of this trend, or do optimists risk yet another disappointment?

The bull market in Tokyo so far this year probably represents the beginning of a period of significantly larger share price movements. It will thus be important to pay attention to developments in Japan during the next few months – perhaps more important than at any time in 20 years. Tokyo is one of the world's best-performing stock exchanges in 2013, even adjusted for the weaker yen (about +39 per cent in local currency and some 20 per cent in SEK). The current market rally reflects expectations of a 60 per cent corporate earnings upturn in 2013 and a 12 per cent increase in 2014, as well as hopes that the country's deflationary epoch is now over, but there are still many sceptics.

If optimistic earnings forecasts prove correct, there is remaining potential. If upward revisions to these forecasts continue, this potential is significant, but there is also an obvious risk that such growth will not materialise and that the forecasts will prove overly optimistic. The future direction of Japanese stock exchange indices is uncertain, but during the coming 12 months their movements are likely to be sizeable.

The scourge of deflation

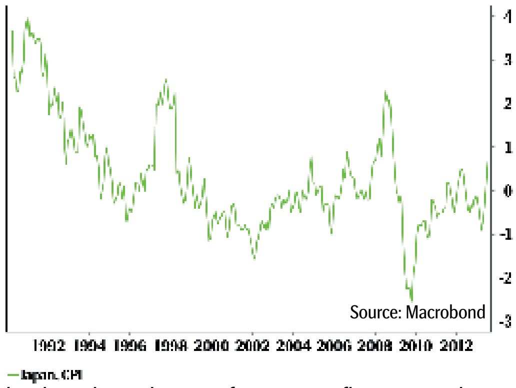
In itself, deflation is very troublesome for an economy, since it persuades both households and businesses to postpone those purchases and capital expenditures that can be postponed – on grounds they will be cheaper in the future. Furthermore, deflation causes real interest rates on loans to be uncomfortably high; conversely, interest rates on savings are comparatively good, even when nominal interest rates are extremely low. The whole society thus prioritises saving instead of consumption, while capital spending is minimised and postponed. Entrepreneurs who nevertheless choose to borrow in order to make business investments must count on a combination of high real interest costs and weak demand for their goods or services. Meanwhile the most passive and safe investment options, government bonds, may provide relatively attractive real interest rates.

Deflation hampers risk-taking and future-oriented investments by households and businesses. This, in turn, inhibits economic growth. Low growth contributes to low capacity utilisation in the economy, which keeps prices low and helps generate a downward spiral of deflation and slow growth.

Can Shinzo Abe liberate Japan from deflation?

As a result of the December 16, 2012 election, Shinzo Abe became prime minister of Japan. He has promised to eradicate deflation and boost GDP growth. Abe's economic reforms have been aggressively marketed to Japan's somewhat sceptical population and have become popularly known as "Abenomics". Abe has also formulated his economic objectives as the 2-2-2 plan, in which political leaders and the central bank are expected to help increase inflation to 2 per cent by doubling the monetary base and by pursuing an expansionary fiscal policy equivalent to 2 per cent of GDP. The aim of this is to help lift economic growth to 2 per cent in real terms. This is equivalent to nominal growth of 4 per cent, a level not seen in Japan for more than 20 years.

TIME TO SLAY THE DEFLATION MONSTER



The chart shows the rate of Japanese inflation according to the Consumer Price Index since 1990. Except for some brief interruptions in 2006-2008, when higher prices of imported commodities pushed up inflation, Japan has been stuck in its deflation trap for nearly 15 years.

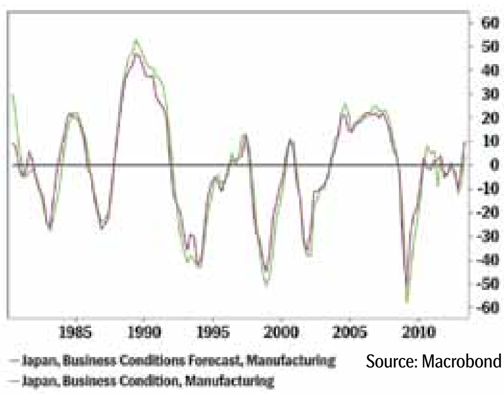
Dawning optimism

Abenomics is described as combining three "arrows" of change – analogous to a Japanese folk tale about a ruler whose three sons were individually incapable of breaking a bundle of three arrows, yet easily able to break one arrow each. The first arrow consists of a substantial easing of monetary policy, the second a fiscal stimulus and the third a set of structural reforms to boost long-term growth prospects.

Abe has rightly declared that international confidence in these policy objectives will be crucial to their success. Rooting out deflation will require that households, businesses and the financial sector stop believing in falling prices. One key to this is the unprecedentedly expansionary monetary policies being pursued by the Bank of Japan, which intends to continue such policies for the next few years.

It must therefore be regarded as an important partial victory that financial market inflationary expectations have doubled since November 2012, although at 1.5 per cent they remain far below the government's 2 per cent target. Meanwhile the stock market has surged, and surveys show that both households and businesses have become more optimistic about Japan's economic future than for many years.

BUSINESSES FORESEE A BRIGHTER FUTURE



The chart shows the Bank of Japan's quarterly Tankan index of how major manufacturing companies view the current economic situation, as well as their future expectations. During the second quarter of 2013, these expectations reached their highest level since 2007.

Unfortunately, fiscal policy and structural reform successes are still conspicuously absent. Expansionary fiscal policy is hardly a novelty in Japan. On the contrary, the country already has the largest gross government debt of all the developed economies in the world. It is approaching 245 per cent of GDP. However, this entire debt is domestically funded and the government meanwhile possesses large financial assets, for example in state-owned companies, making its net debt more manageable. The next step will, in fact, be fiscal tightening – by raising the consumption tax from 5 per cent to 8 per cent in April 2014. Whether this tax hike will actually be implemented, or will be adjusted or postponed, is nevertheless still an open question. Yet there is obviously far more limited potential for dramatic changes on the fiscal front than through monetary pollicy, and public confidence in this "second arrow" is thus significantly lower than confidence in the "first arrow".

The stock market rally has taken a break since May, and although the initial correction at that time can be explained as a reaction to comments by Ben Bernanke, chairman of the US Federal Reserve, combined with a technically extremely overbought market, many observers would like to factor in a mistrust of the structural growth reform programme unveiled by the Abe government in June.

The success of Abe's Liberal Democratic Party in the upper house election in late July nevertheless indicates that voters are convinced. The LDP's stronger position also means that Abe now has a mandate to push through the reforms he wants. An additional update in the planned structural reforms is expected in September. This may be crucial in ensuring that Abenomics will not rely solely on the "first arrow" (monetary policy).

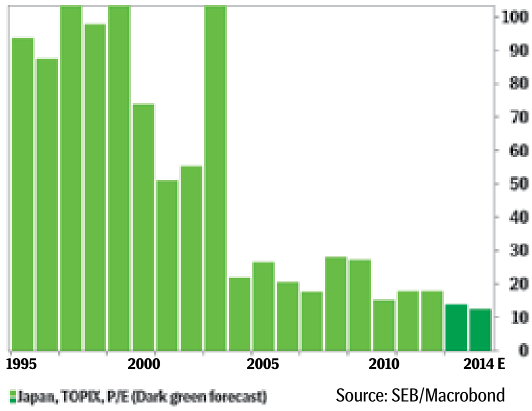
Has Tokyo's economic thaw only begun?

In retrospect, the abysmal performance of the Nikkei 225 Index between 1989 and 2003 is hardly surprising, in light of the astronomical valuations once regarded as "normal" in Tokyo. Yet the 1980s bubble has long been consigned to history, and today's valuations are relatively normal or attractive in an international comparison. In the days when Japanese equities were still valued at highly inflated multiples, there were investors and analysts who justified high price-equity (P/E) ratios by citing Japan's high corporate tax, combined with accounting principles that allowed generous depreciation, resulting in an underestimation of the earnings generated by Japanese companies in international comparisons. This view is partially supported by statistics on the ratio between cash flows and reported earnings. In this context, it is very interesting that Abe is expected to reform corporate taxation and lower the corporate profit tax. It is also possible to argue that due to the country's long period of deflation, Japanese corporate earnings are even more depressed than those of American and northern European companies.

Overall, share valuations appear to support forecasts of continued positive performance by the Tokyo Stock Exchange, but can we rely on these forecasts?

Over the past eight years, Japanese equities have continued to lag behind American ones, but this has been driven entirely by changes in relative values. Japanese corporate earnings have grown faster than American (and European) earnings, but relative earnings multiples for US equities have increased compared to Japanese equities. Today America's S&P 500 companies have a P/E ratio of 13.4 based on forecasts for 2014, while Japanese companies (TOPIX) are valued at a P/E ratio of 12.6.

JAPANESE EQUITIES CHEAPER THAN EVER, IF FORECASTS ARE CORRECT



The chart shows price-equity ratios for companies in the Tokyo Stock Price Index (TOPIX) based on historical earnings plus forecasts for 2013 and 2014. Years with negative P/E ratios have been omitted, and P/E ratios above 100 are shown as 100. If the consensus forecasts for 2013 are correct, valuations are unusually attractive, but analysts have repeatedly been forced to drastically lower their forecasts in recent years.

JAPANESE CORPORATE EARNINGS ARE RISING

The chart shows indexed earnings trend in US dollars for the largest publicly traded companies in the US (S&P 500), Japan (Nikkei 225) and Europe (MSCI Pan-Europe) since 2005. Japanese companies have greater volatility in their earnings, but show first-rate growth.

During the past year, stock markets in all the old industrialised countries have gained in value, driven by a decrease in risk aversion and lower return requirements on equities, which until last year had not yet been noticeably affected by low international interest rates.

Compared to Europe and the US, however, this year's Japanese stock market rally has – to a significantly greater extent – been a function of higher earnings expectations. For the coming 12 months, these expectations are 23 per cent higher in Japan than at year-end 2012, while in the US they are 5 per cent higher and in Europe slightly lower than at year-end.

Japanese export companies are benefiting from the weaker yen, and foreign earnings of multinational companies are worth more in depreciated home currency, but even in terms of US dollars, the increase in Japan is stronger than in the US and Europe. Higher earnings forecasts for the next 12 months in Japan are driven both by upwardly revised forecasts for 2013 as a whole and expected earnings growth in 2014. In the US, the increase is explained entirely by expected earnings growth in 2014, while calendar year 2013 and 2014 forecasts have actually been revised marginally downward.

The revisions of forecasts that we have seen so far this year and expected earnings growth reflect a continued relatively positive view of Japanese equities, but it remains uncertain whether companies can live up to these expectations. In recent years, it has repeatedly looked as if Japanese equities were as cheap as today, but analysts have then been forced to lower their expectations , with companies delivering significantly worse earnings than expected at the beginning of the year. There is thus considerable uncertainty, and revisions of forecasts over the coming months will be very interesting to follow. So far, no weaknesses are apparent.

Major rotation potential

International investors are not alone in ignoring Japanese equities over the past decade. Deflation does not reward risking-taking and investments; it rewards saving and caution. Japanese investors have learned that government bonds provide relatively good real returns despite low nominal interest rates, while for the past 24 years it has been just as well to avoid the domestic stock market.

Today we are hoping that stock markets in the Nordic countries and the rest of the world will be energised as households gradually find their way back into equity investments (after having favoured bonds for a long time), just as many institutions have already done during the past year. There are few markets where such capital rotation could have a bigger impact than in Japan. For natural reasons, in Japan the proportion of household savings invested in equities is substantially lower than in Europe and the US, while higher inflation expectations will make bonds appear less attractive than for many years. There are also indications that during 2013, Japanese investors have found their way back to the Tokyo Stock Exchange.

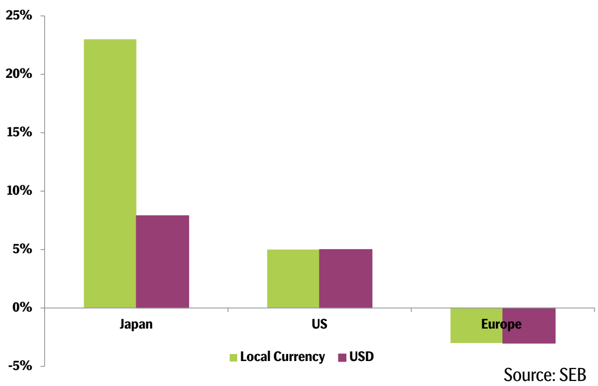
If the Japanese continue to rotate capital into the stock market, international investors who are "habitually" under-weighted in Japanese equities will have to carry out a more proactive evaluation of their positions. We suspect that many may then increase their exposure to a neutral index weighting, which might mean significant positive capital flows. In other words, if Abenomics is successful, there is major capital rotation potential for the Tokyo Stock Exchange.

Current economic assessment

Japan's economic recovery is continuing. Business and – especially – household optimism has strengthened so far this year. Capital spending has consequently stopped falling and private consumption has shown greater stability. The improved mood is mainly due to rising share prices, a weaker yen and a surge in public investments due to Abenomics.

To ensure sustainable economic growth and rising inflation, economic policy makers must continue to deliver. Launching stimulus programmes via the government budget, using new money printed by the Bank of Japan and thereby weakening the yen, is the easy part of Abenomics, whereas restructuring policy (the "third arrow") will pose far greater social and political challenges. Japan's economic prospects thus appear uncertain. This is reflected in SEB's forecasts that GDP growth will be about 2 per cent this year, followed by less than 1.5 per cent in 2014 and only 1 per cent in 2015. We also expect the yen to continue weakening over time, due to Japan's very loose monetary policies.

To ensure that prices in Japan continue to rise, wages and salaries must increase and push underlying inflation upward. Without higher pay, it will be difficult both to meet the 2 per cent inflation target – SEB forecasts 2.5 per cent inflation in 2014 but only 1.5 per cent in 2015 – and to raise the consumption tax. One or more consumption tax hikes were Japan's "promise" to other major Group of 20 (G20) industrialised countries aimed at stabilising public sector debt. Assuming that the tax is raised, this debt can level out at about 245 per cent of GDP late in 2015, the highest level ever recorded for an industrialised country. After that, Japan will need a long-term plan to tackle its government debt problem. Absent such a plan, Japanese interest rates risk climbing steeply in the future.



Source: SEB

MAJOR UPWARD REVISIONS IN JAPANESE EARNINGS FORECASTS

The chart shows the change in earnings forecasts for the next rolling 12-month period in Japan, the United States and Europe in local currencies and US dollars, respectively. By a wide margin, earnings forecasts have increased the most in Japan, partly as a function of the weaker yen. But even in USD terms, Japanese companies come out best.

Risk of disappointments

SEB is among the sceptics of Abenomics. It will probably be challenging for Japanese listed companies to report the earnings that analysts are now anticipating, given the economic scenario that we expect. Since the March 2011 Fukushima nuclear accident, the country also has a particularly challenging energy situation. Most nuclear reactors in Japan remain closed, and there are no simple solutions to this problem.

In the long term, aside from entrenched deflation, energy challenges and a gigantic government debt, Japan also faces an enormous demographic challenge in the form of a narrowing population pyramid. This means that in the future, fewer and fewer workers will be supporting more and more pensioners.

Conclusion

Shinzo Abe has promised to slay the Japanese deflation monster. If he succeeds, investors who dare to put their money into Japanese equities will be richly rewarded, but there is meanwhile a great risk of new disappointments. The only thing we dare to promise is that it will be exciting to follow developments in Japan and the Tokyo Stock Market during the coming year. Price movements are likely to be sizeable.

Increased correlations are creating challenges

After a long period of liquidity stimulus measures, there is widespread concern about the Federal Reserve's plans to phase out ("taper") its quantitative easing. Because of this shift from full central bank support to a restored market, driven more by economic fundamentals, we are in an environment that is not fully conducive to risk-taking. Correlations have increased and risks are tending to move in the same direction, thereby apparently reducing the added value of portfolio diversification.

If we look at last year, the performance of corporate bonds was exceptional. Their strong performance showed both very low volatility and low correlation with the broad stock market. This provided great potential for constructing an efficient portfolio. A strong but more volatile stock market, along with corporate bonds, contributed to good risk-adjusted returns. The combination of equities and high yield bonds, in particular, was a prevalent theme that benefited many asset managers, including ourselves.

Narrower credit spreads have contributed to somewhat lower potential returns, and overall sensitivity to interest rates has given us a higher correlation with the broad stock market. Looking ahead, there will still be attractive return levels, but expected increases in long-term yields will probably shift our focus to bonds with shorter durations and the use of more asset classes.

Navigating a heavily-stimulated market

"There ain't no such thing as a free lunch" is a saying that can be traced back to the 1930s. "Free lunch" referred to a nineteenth century practice in which bars treated their guests to a salty lunch in order to entice them to buy drinks. Since then, the expression has been widely used in financial theory to mean that there is no return without risk. Modern portfolio theory, largely based on the work of Harry Markowitz, certainly creates no free lunches but is a tool for demonstrating how a combination of asset classes with different return patterns may result in a lower risk, given a certain expected return.

Choosing the right asset class exposure at any given time requires access to a lot of information, not only data about the macroeconomic situation and valuations but also data about how different factors affect each other and ultimately affect the overall portfolio. Questions that must be answered are how to construct an efficient portfolio – in other words what asset structure will result in the lowest possible risk – given a certain expected return.

If we look back at the past four years, global capital markets have been coloured by new elements in the form of large-scale central bank stimulus measures. Added liquidity and unnaturally low key interest rates have pushed up risk appetite while contributing to a greater decoupling and reduced correlation between equities and corporate bonds, for example. Depressed short-term interest rates have contributed to a gradual narrowing of credit spreads, while strong confidence in central banks has driven up the value of risk assets. Historically low correlations and standard deviations have led to low co-variations, creating a good environment for portfolio diversification.

Fundamental portfolio allocation

In its simplest form, standard deviation assumes that return outcomes are normally distributed. This implies that upside risk is as large as downside risk, which unfortunately seldom coincides with reality. Aside from the statistical tools that are available, fundamental factors are at least equally important. With the aid of our models, we can generate information to use in up-weighting or down-weighting an asset class, but we must add information on the prevailing trends and cycles that is not always possible to reflect in our forecasts.

High valuations in the US are currently limiting the upside in the global stock market, but they are meanwhile providing opportunities in regions with cheaper equities such as Europe. Worries about reduced central bank stimulus measures, along with slower growth in a number of emerging market countries, have contributed to large declines for both risk assets and currencies. A number of regions face structural reforms in order to maintain stable growth in the future, and prices in various emerging markets have dropped to attractive levels. A clarification of central bank policies together with higher risk appetite could thus be regarded as a trigger for increased exposure in emerging markets.

Risk calculation in theory

Risk is uncertainty about the future and can be quantified and visualised in a number of different ways. Historical data can give us an indication of an asset's statistical characteristics but rarely reflect what is in front of us. In order to quantify risk, we usually employ the statistical measure known as standard deviation. Standard deviation is calculated as the square root of variance, which is the squared deviation from a mean that, in our world, is the expected return.

Standard deviation: $\sigma = \sqrt{\sum[r(s) - E(r)]^2}$

This helps us to understand the static basic characteristics of a given asset class. If we return to the efficient portfolio, the characteristics of each asset in the form of expected return and risk are obviously important, but an even more important component is how these assets co-vary with each other. We measure this by means of the statistical measure known as correlation, which varies within the interval -1 and 1 where 1 indicates a perfect co-variation and vice versa. Co-variation also takes into account the risk of each asset class, measured as standard deviation and calculated as the product of the standard deviation and correlation of each asset class pair.

Co-variation: $Cov(r_1, r_2) = \rho_{1,2}\,\sigma_1\,\sigma_2$

In constructing an efficient portfolio, co-variation will thus account for a significant contribution to overall portfolio risk. Given assumptions concerning expected risk and historical correlation, we can calculate portfolio risk.

A new credit climate

Concurrently with cyclical shifts in the stock market, this summer's stimulus-driven worries also demonstrated the sensitivity of the bond market. Expectations of diminishing stimulus measures contributed to higher long-term yields, which in turn lowered corporate bond values. Returns on bonds have reached higher levels and are expected to be adjusted slightly downward in the short term, and spreads between government bonds and corporate bonds are expected to remain stable. Greater volatility was also accompanied by rising correlations with the stock market, causing increased co-variations even for a seemingly well-diversified portfolio. One important portfolio tool in this type of environment is so-called market neutral strategies. As the name implies, a market neutral strategy is a management technique aimed at achieving a low correlation to stock market risk. In our asset management, today we are primarily using managers with flexible exposure and are generally positive towards market neutral strategies, mainly because of their diversification characteristics.

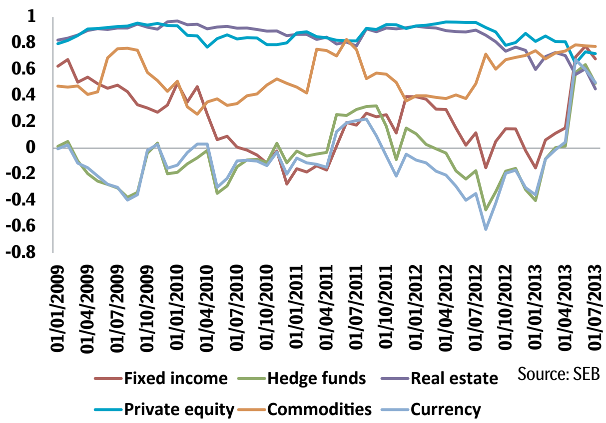
Looking ahead, one important feature of credit portfolios will probably be diversification in terms of maturities and returns. Even if long-term yields increase, it is possible to enjoy a high return if bond holdings are allowed to reach maturity. By combining different maturities, we reduce interest rate risk and duration in the portfolio, whose performance will become less sensitive to interest rate movements. Within the fixed income asset class, it is also possible to fund other attractive return opportunities with lower correlations to the broad credit market. Loan funds invest in bank lending and generate returns based on the flow of interest payments. Other sources of returns with low correlations to the market are investments in various types of royalties. Unfortunately, the common denominator for this type of instrument is its relative inaccessibility to investors, but above all a steady stream of payments not directly connected to general market sentiment.

Correlations affect the decision making process

Five years of successive crises have resulted in a central bank-focused investment climate. What we have historically regarded as natural correlation patterns have, in many cases, apparently vanished completely, and we are probably heading into a tactically more complex phase. The transition from largely liquidity-driven correlations to a market that is driven more by fundamentals will require heightened observance. A fundamental evaluation of each asset class and its underlying markets and sectors has become increasingly important. Over a lengthier time horizon, both long-term average values and our forecasts still support the theory of a well-diversified portfolio.

Various stock markets have historically had a high correlation with each other, but arguments about such phenomena as decoupling have occasionally been heard. Despite the financial problems of governments in developed countries, a number of emerging market areas have shown strong growth for a long time. Yet capital has been more mobile, which in times of turmoil has resulted in large outflows from regions which are perceived as more risky.

CORRELATIONS HAVE INCREASED NOTICEABLY

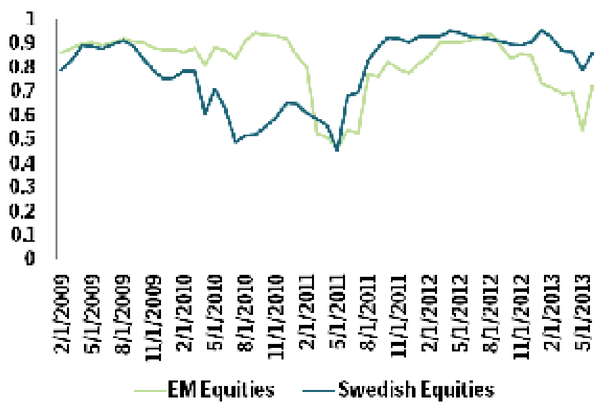


Rolling 12-month correlations clearly demonstrate how correlations between corporate bonds within the fixed income asset class and global equities have risen sharply this year. This trend also applies to other asset classes such as commodities, market neutral hedge funds and currencies. Historical values are based on the following indices: MSCI AC World LOC; fixed income = 50% iBoxx Liquid Investment Grade Index USD, 50% iBoxx Liquid High Yield Index USD; HFRX Market Neutral Hedge Fund USD; EPRA Index EUR, LPX50TR Index EUR; DJ UBS Commodities TR EUR; BarclayHedge Currency Trader USD.

Asset class	Expected return	Expected risk	Correlation*	Co-variation**	Reasoning
Equities	8.5%	17.0%	1.00	289	Valuations have risen but equities remain attractive compared to bonds.
Fixed income	4.0%	6.0%	0.68	69	Sovereign bonds are gradually rising, and credit spreads are expected to be stable. Best risk-adjusted returns from high-yield bonds with short durations.
Hedge funds	4.0%	4.0%	0.49	33	Better climate for hedge funds. Continued focus on market neutral strategies.
Real estate	6.0%	13.0%	0.45	99	Depressed return levels in primary markets have led to greater risk-taking.
Private equity	10.5%	25.0%	0.72	306	Given growing risk appetite, there is good potential for PE, though strong performance during the year has increased potential losses.
Commodities	0.0%	20.0%	0.77	262	Continued weak trend, but industrial commodities and energy may become attractive.
Currencies	3.0%	4.0%	0.50	34	Downward pressure on EM currencies with weak current account balances. An improved trend will open up opportunities further ahead.

** Rolling 12-month correlations*
*** The product of the asset class's expected risk, expected equity risk and the asset class's 12-month correlation with equities*

According to the table, hedge funds and currencies appear to be especially attractive building blocks, measured in terms of co-variation with global equities. "Currencies" here refers to a well-diversified currency basket. A single currency pair may result in significantly higher risk. The table shows that the historical correlation with the broad stock market is relatively high for the fixed income asset class. The co-variation between fixed income and equities was as low as -10 around year-end 2012 but has gradually risen. A combination of asset classes – hedge funds, measured as market neutral strategies, or currencies – provides the lowest co-variation with equities.



Source: SEB

FLIGHT FROM EM SPHERE HAS LOWERED CORRELATIONS

The risk-on/risk-off tendencies in Western countries are clearly visible in the correlation between emerging markets and the global stock market. This correlation has clearly diminished as economic growth has slowed and stock market performance has weakened during the past year.

Strategy today and tomorrow

Statistical tools and the theoretical basis for our efforts to develop efficient portfolio allocation will always provide a good indication of market direction, but at times like these it is clear that a focus on fundamental aspects is more necessary than ever. Given higher correlations and co-variations, especially between such traditional types of assets as corporate bonds and equities, we need to lift our gaze further. Employing more asset classes will become increasingly important, but especially working to identify the right exposures within each asset class. Looking at equities, for example, despite attractive assumptions emerging markets appear tactically volatile until we see fundamental improvements that strengthen these positive assumptions further. Partly because of Europe's strong fundamentals along with relatively low valuations, we have increased our exposure to the region, with a focus on small and medium-sized companies. Judging from our co-variations, market neutral strategies are an important element in constructing an efficient portfolio. There are discernible trends in this type of assets, but the most important factor is the choice of managers, which de facto applies not only to hedge funds. Considering the long period of falling yields, short-term correlations are of greater relevance given the future outlook for sovereign bonds. Over a longer time horizon, however, the theory of efficient, well-diversified portfolio allocation will always be relevant. We are not being treated to any free lunches, but we feel confident in the methods that are available for generating and preserving value over time.

World economy ready to take off

- *Prospects for higher global growth better today than for a long time*
- *US economy may provide main upside surprises; difficulties in implementing monetary policy exits are biggest risk*
- *Growth gap between EM and DM spheres shrinking significantly*

The world economic outlook is improving. Leading indicators in the household and business sectors point to accelerating global growth, risk appetite is increasing, headwinds from fiscal austerity measures will diminish and monetary policy will continue to support growth and financial markets. The United States in particular has the potential to experience an economic take-off in 2014-2015.

World inflation will be persistently low thanks to plenty of spare capacity in the 34-country Organisation for Economic Cooperation and Development (developed markets, DM). This will keep wage and salary costs in check, while slower growth in Asia will create downward pressure on commodity and energy prices. Central banks will thus have manoeuvring room to delay key interest rate hikes, which will also facilitate the task of implementing restructuring measures and fiscal consolidation.

The US is poised for an economic surge

This year, US growth is hampered by very tight fiscal policy due to tax hikes in January and automatic expenditure cuts (the "sequester"), which began to have an impact in the second quarter. Yet prospects for faster growth seem to be improving. Driving forces will be the housing market, now in a clear upturn phase, sounder household finances that will benefit private consumption, an impending acceleration in manufacturing activity and a substantial reduction in fiscal headwinds starting in 2014. We expect GDP growth of 1.6 per cent this year, 3.3 per cent in 2014 and 3.7 per cent in 2015. We assume that in September, the Federal Reserve (Fed) will announce a "tapering" of its monthly bond purchases, ending them next summer, while indications are that its key interest rate will remain at 0.25 per cent until autumn 2015.

The euro zone economy has started growing again

In the second quarter of 2013, the euro zone emerged from its longest recession to date. Important factors behind this improvement are that several countries have strengthened their competitiveness, while current account balances and public finances have improved. European Central Bank (ECB) policies and actions have also stabilised financial markets, reducing the risk of a euro collapse. Euro zone economies are now being helped by the international upswing, though domestic demand for capital spending and consumption remains modest. But as growth accelerates, there will be a greater need for capital spending. Low inflation will benefit household purchasing power. We expect GDP to fall by 0.5 per cent this year but grow by 0.8 per cent in 2014 and 1.7 per cent in 2015. The ECB has room to launch further stimulus measures. We expect it to cut the refi rate from 0.50 to 0.25 per cent in December and supply new liquidity to banks through its Long Term Refinancing Operation (LTRO).

Clear signals of a British upturn

The British economy has begun a sustainable upturn. In particular, this summer purchasing managers' indices in manufacturing, services and construction rose far more than expected. In the short term, exports will be the main growth engine thanks to the cheap currency and because a sizeable share of exports goes to the US. Lower inflation along with rather modest British growth will enable the Bank of England to keep its key interest rate at 0.50 per cent for about a year and a half more. We forecast GDP growth of 1.5 per cent in 2013, close to 2.3 per cent in 2014 and above 2.5 per cent in 2015.

International upturn will benefit Nordics

The export-oriented Nordic economies will benefit from higher global growth, but domestic markets will also strengthen in some of these countries. In Sweden this will be due to higher household spending, in Denmark due to lower inflation and more stable home prices. In Norway, higher purchasing power will lead to stronger private consumption, partly offsetting weaker capital spending in 2014. But in Finland, the domestic market will remain weak because of factors such as high unemployment and tight fiscal policy. Total Nordic GDP will grow by 0.8 per cent this year and around 2.5 per cent in both 2014 and 2015.

The difficult phase of Abenomics remains

Japan's economy is on a growth track thanks to greater business and consumer optimism, causing capital spending to stop falling and private consumption to show more stability. The improved mood is due to rising share prices, a weaker yen and increased public investments because of "Abenomics" policies. To achieve continued economic growth and sustainably meet the official 2 per cent inflation target, policy makers must continue to deliver. Launching government stimulus programmes financed by new money printed by the Bank of Japan – thus weakening the yen – is the easy part, while restructuring will entail far greater social and political challenges. Japan's economic prospects are thus uncertain. We predict GDP growth of about 2 per cent this year, less than 1.5 per cent in 2014 and only 1 per cent in 2015.

Asian emerging economies still growth leaders

Despite slower growth so far this year, Asia's emerging market (EM) economies remain the fastest-growing in the world. Weak demand from Europe and China has hampered exports, but looking ahead, prospects will brighten – especially as US demand rises. The region's GDP growth will be about 6 per cent in 2013 and 2014, a bit higher in 2015. The biggest economies – China and India – will grow in 2013 by 7.5 and 5.0 per cent, respectively; 7.5 and 5.5 per cent in 2014; and 7.0 and 6.0 per cent in 2015. Inflation pressure will remain low in the region, allowing unchanged or lower key interest rates in a majority of these countries.

Most of these countries' currencies – though not China's – weakened this summer due to worries about the Fed's tapering of bond purchases and decelerating growth in the region. Meanwhile, depreciating currencies benefit export-dependent economies, which have suffered from weak external demand. Except for India – which is grappling with sizeable macroeconomic problems – the situation stabilised in July and August. Due to floating exchange rates, large currency reserves and solid government finances, many of these economies are more resilient to financial turbulence than during the 1997 Asian crisis.

Latin America has been hurt in various ways

Latin American economies were hard hit by last spring's global slowdown, lower commodity prices and unsteady financial markets in the summer. Brazil has dominated the spotlight and is now plagued by worsening financial imbalances, weaker competitiveness and higher inflation. To stem inflation and stabilise its currency, Brazil has hiked the key interest rate several times this year, most recently to 9 per cent. The region's second-largest economy – Mexico – is showing more stability, while Argentina (No. 3) has major structural problems as well as a shaky economic upturn. We expect overall Latin American GDP to grow about 3 per cent this year and some 3.5 per cent in 2014 and 2015, while inflation weakens.

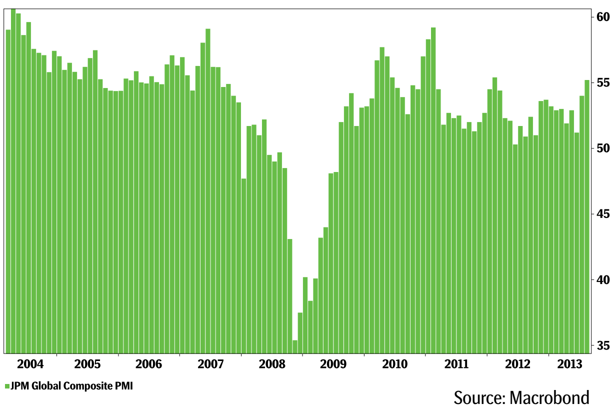
Cautious recovery after Eastern European slump

The economies of Eastern (including Central) Europe lost momentum in 2012 and early 2013, but there are now hints of improvement. A faster-paced German economy will provide help, while low interest rates and good purchasing power will benefit household consumption. Capital spending is now depressed but may regain strength in 2014 and 2015. The Russian economic outlook is anaemic due to such factors as a poorly functioning labour market and low industrial capacity utilisation, but household optimism is high in Russia. An infrastructure programme and likely key interest rate cuts this autumn may help Russia achieve somewhat higher growth in 2014. Backed by a series of rate cuts since late 2012, Poland will now see better growth momentum.

The Baltic countries, the fastest-growing economies in the European Union for some years, will show continued successful growth in 2013-2015, except for a slump in Estonia this year. The main economic engine today is rising private consumption, soon to be accompanied by stronger capital spending. Exports will also perform relatively well, helped especially by good competitiveness. Latvia will convert to the euro in 2014, while Lithuania has a chance to do so in 2015 – unless inflation gets in the way.

World economy will speed up

The world economy is poised for acceleration. We foresee global growth of above 3 per cent this year, 4 per cent in 2014 and above 4 per cent in 2015. The EM sphere will remain the fastest-growing at nearly 5.5 per cent in 2014-2015. Yet the growth gap between EM and DM countries will narrow significantly, with the latter showing a GDP increase of about 2.5 per cent next year and nearly 3 per cent in 2015.



Source: Macrobond

WORLD ECONOMIC GROWTH IS ACCELERATING

Judging from purchasing managers' indices in the global business community (manufacturing and services), the growth rate in the world today is the highest in 2½ years. Rapidly rising order bookings and higher employment in August point to a stronger economic upturn ahead.

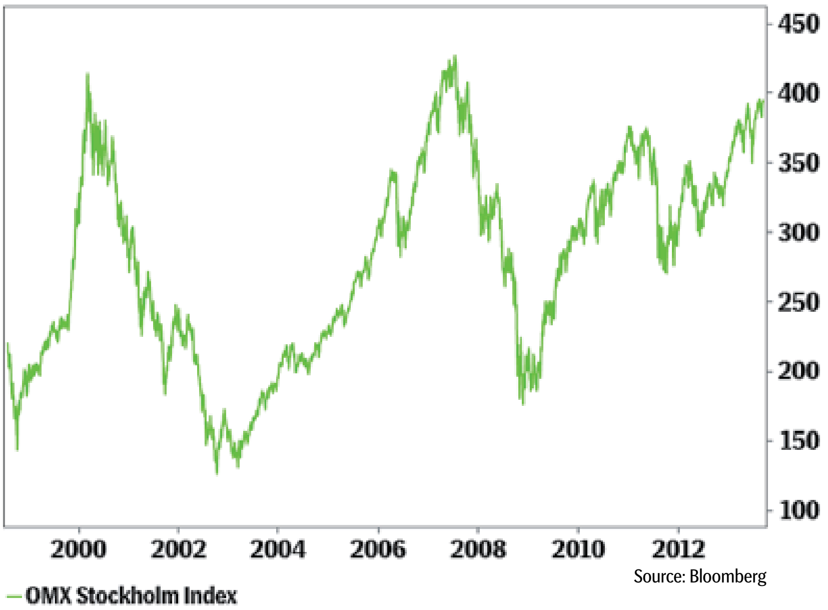
Equities moving towards record levels in 2014

- **Nordic equities have turned in a strong performance this year, but their old fuel is running out**
  This year's stock market return has been driven solely by higher valuations; earnings forecasts have been adjusted downwards. Fleet-footed institutions, which have driven up share prices, unfortunately already have full exposure to equities. Banks have been the engine driving stock markets this year, but they have recently lost momentum.

- **New driving forces are taking over and will lift equities in Stockholm to new records in 2014**
  Brighter economic prospects will probably make cyclically sensitive manufacturers and retail/wholesale companies stock market winners over the next six months. There are good prospects for the major growth in earnings we are forecasting next year to materialise, making valuations once again attractive. Capital flows to Nordic equities may remain positive, with old investor categories finding their way back into stock markets.

- **Many Nordic winners when the European economy rebounds**
  Most small- and mid-cap companies and many large-cap companies in the Nordic region still have the bulk of their sales in Europe, despite rapid expansion in Asia over the past decade. Many small- and mid-cap companies on the Stockholm exchange will be winners as private consumption picks up in Sweden.

HIGHER VALUATIONS THIS YEAR PUSHING EQUITIES TOWARDS OLD RECORDS



Source: Bloomberg

The chart shows the performance of the Nasdaq OMX Stockholm exchange (OMXS Index) since 1998. The index is currently about ten per cent below its record levels in July 2007.

THIS YEAR'S STOCK MARKET GAINS are entirely a function of higher valuations. The price-earnings (P/E) ratio for 2013 has risen by more than three points to its highest level in ten years, if we exclude 2009, an extreme year when earnings were squeezed by recession and major credit losses in the Baltic countries. Valuations are still not terribly high, but the potential for upward movements from this level must nonetheless be considered fairly limited.

Growing investor appetite for equities this year can largely be explained by their relative valuation compared to fixed income instruments, combined with easing concerns about various imbalances in the global economy, especially in the euro zone. Capital rotation in favour of equities should pick up energy from the recent upturn in bond yields, which has reminded investors that even so-called risk-free assets, such as Swedish sovereign bonds, can fall in value when yields rise. The OMRX index, which reflects the value of a typical portfolio of Swedish sovereign bonds, has slumped 4.5 per cent this year. In relative terms, this naturally means that the equity risk that has been feared by so many for so long may now be somewhat less frightening. Although the risk premium has fallen significantly as a result of higher share valuations and higher interest rates, relative valuations are still attractive in a long-term perspective, with a risk premium on Nordic equities compared to German sovereign bonds of 5.8 per cent (versus a ten-year historical average of 5.1 per cent and a 20-year average of 2.9 per cent). Nordic equities are also attractive compared to the stock market globally, with a record gap in dividend yields in favour of the Nordic market.

Will households return to the stock market?

However, not every investor category has a rekindled infatuation with equities. For instance, Swedish mutual fund investors have not been net purchasers of Swedish equity funds since March this year, although some surveys indicate that international funds are now increasing their exposure to equities at near-record levels.

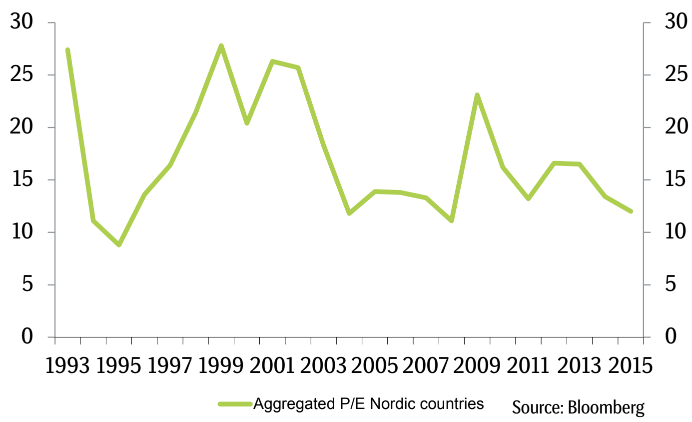
What is positive about this is that the most fleet-footed institutions may very well be passing the baton to households and other investor categories in terms of rotating capital into the stock market, especially with economies elsewhere in Europe once again on the mend. As a result, the general public will probably dare look to the future with somewhat more confidence.

Strong earnings growth in 2014

Second-quarter earnings reports generally lacked any major drama, although overall earnings were somewhat below expectations for this quarter as well. At the same time, we should note that our relatively positive outlook for 2014, after a gradual improvement in 2013, fortunately looks like it will materialise. We find support above all in this summer's batch of economic statistics. Leading indicators show a clear improvement, especially in Europe. So we are increasingly convinced that our current forecasts – earnings growth of 11 per cent in Sweden in 2014 and 2015 as well as 20 per cent for the Nordic region as a whole in 2014 and 11 per cent in 2015 – will prove correct.

This healthy earnings growth means that valuations will once again look more attractive. Cyclically sensitive companies in the manufacturing and commodity sectors, which have not kept up with stock market gains so far this year, will benefit most – showing the fastest earnings growth over the next few years – and are thus well positioned to take over as stock market engines this autumn and in 2014.

It is particularly positive for Nordic listed companies that the biggest economic turnaround is now visible in the euro zone. While rapid growth in Asia has been the biggest growth factor over the past decade and has long been the most important theme of change, many companies still have the bulk of their sales in Europe. In many cases, Europe is also where companies enjoy their highest marginals. Of the 271 largest Nordic companies we follow, 70 per cent earn half their revenues or more in Europe including the Nordic countries, and 48 have half their sales or more in Europe excluding the Nordic countries. Improved demand in this region, after a number of difficult years, should have a significantly positive effect on the earnings of Nordic listed companies. We expect record earnings next year. We have also identified a number of winners among smaller listed companies that will benefit from increased private consumption in Sweden, which we expect to dominate the market during the coming year.



VALUATIONS ARE STILL ATTRACTIVE

The chart shows the historical P/E ratio for listed companies in the Nordic region as well as P/E forecasts for 2013-2015. Based on the 2013 forecast, valuations no longer look particularly attractive, but 2014 and 2015 valuations are still low.

Swedish retailers in the winner's circle

After seven difficult years, with negative sales growth for Swedish fashion retailers, we have seen a slight upswing in the past few months. The same pattern is visible in car sales to households, which started rising again last month for the first time since 2011. We believe that small signs of improvement in these widely disparate consumer sectors over the past few months are the start of an upswing that will make 2014 the best year for consumer durables since 2007.

This is based on a number of inter-related factors:

1. Government fiscal stimulus, aimed largely at boosting household disposable income. We expect SEK 20 billion in fiscal stimulus measures (earned income tax credits, lower income tax rates on pensions, increased social benefits and an increase in the threshold at which national income taxation begins to take effect).

2. A clear easing of worries about unemployment among the general population and an already significant drop in the number of lay-off notices.

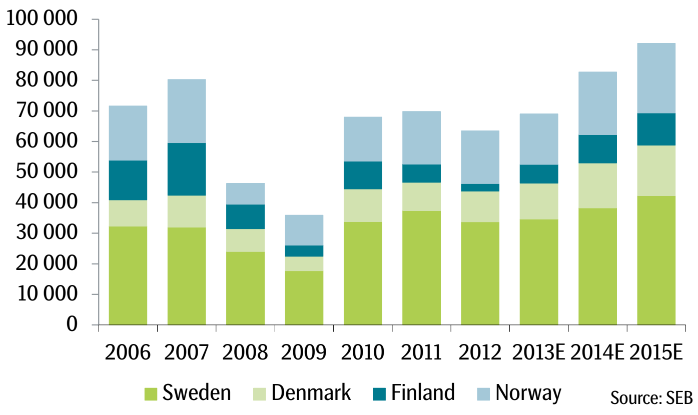
3. Nominal wage hikes and low inflation, resulting in real wage growth of 2.8-2.9 per cent in 2013 and 2014.

4. Higher home prices, which make consumers feel better off and thus save less.

The economic recovery is also coming after a long period of difficult conditions for many companies in the retail sector; for instance, the earnings of clothing retailers (excluding H&M) fell by 50 per cent just since 2010. Because earnings are so depressed today, consumer durable companies do not look particularly cheap in terms of earnings multiples, but they are attractively valued historically in terms of less volatile sales multiples. A recovery to the historical average would correspond to an upward valuation of the entire sector by more than 25 per cent.

Summary

We are cautiously optimistic about equities going forward, although the fuel that has been driving the gains so far this year is running out. We believe investors should be positioned for a stock market rally and be over-weighted in Nordic equities relative to the rest of the world and over-weighted in cyclically sensitive sectors, but under-weighted in interest-rate sensitive and defensive sectors. As for equity sectors, we are positive towards commodities, industrials, consumer goods, oil & oil services and shipping & transport.



VISIONS OF NEW RECORD EARNINGS NEXT YEAR

The chart shows aggregate net earnings of Nordic listed companies in millions of euros by country. After a weak performance in 2012, new record earnings are again expected as early as 2014.

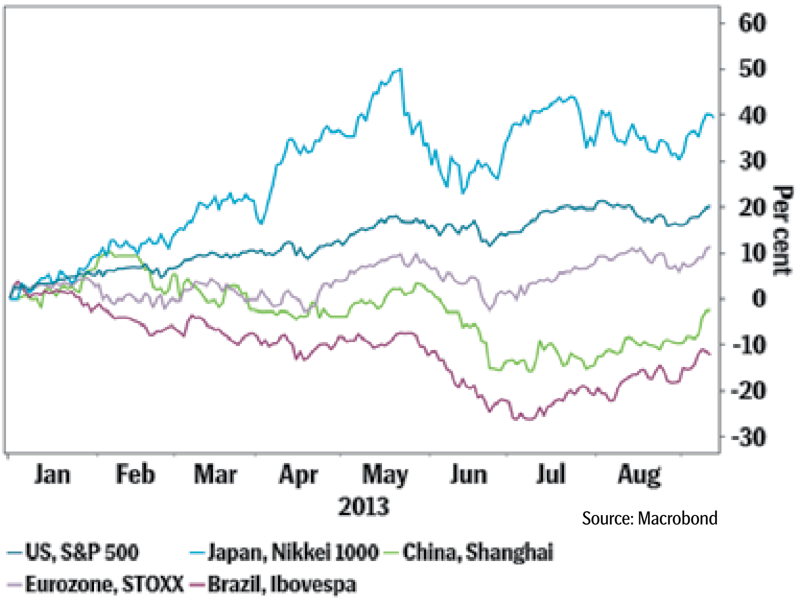
World equities in holding pattern

- **Global stock market investors showing some hesitation**
  During the past three months, share prices have been on a roller coaster ride. Risk assets fell sharply in June and then bounced back in July. August was characterised by modest declines. Investors mainly want a clearer picture of how the American central bank will act this autumn before wishing to increase their risk.

- **Big differences in returns between stock exchanges**
  The differences in performance between various markets in 2013 are amazing. From January 1 to August 31, the Japanese stock market was at the top, with an upturn of 29 per cent in local currency. Meanwhile Brazil lost a full 18 per cent in local currency. American equities have performed surprisingly well, especially those on the Nasdaq exchange, which is up 19 per cent so far this year.

- **Greater focus on countries/sectors that have lagged behind**
  In the next upturn phase, we regard cyclical sectors (industrials, financials and information technology) and selected countries in Europe, Asia and emerging markets that have lagged behind as the most attractive for investments. Low valuations and high earnings growth will pave the way for better returns.

BIG DIFFERENCES IN RETURNS BETWEEN STOCK EXCHANGES



Source: Macrobond

In local currency, the Japanese stock market has surged so far this year, but because of the depreciation in the yen, the upturn is not as strong in terms of for instance Swedish kronor, for example. US equities have performed unexpectedly well and are trading at record levels. We have seen the worst stock market performance in Brazil, Russia and parts of Asia.

THERE IS AGAIN SOME HESITATION IN THE WORLD'S stock markets after June's share price drop and July's rebound. So far this year, the MSCI All Country World Index has risen 10 per cent in local currencies and 9 per cent in Swedish kronor, which must be regarded as very good after its 10 per cent increase in 2012. The past three months, however, have occasionally been characterised by risk aversion; the World Index has lost nearly 2 per cent in local currencies and 1 per cent in kronor. The downturn in August was mainly due to increasing concerns about how the US Federal Reserve will act in the future and about the drama unfolding in Syria.

Regions have moved in different directions

There are striking divergences in the performance of different regions during the year. Since January 1, the Japanese stock market has topped the charts with a 29 per cent rally (local currency), while Brazil has lost 18 per cent. US shares have done surprisingly well, especially the technology-dominated Nasdaq exchange, which is up 19 per cent. Among the reasons why the world's most transparent market keeps chugging along, reaching record levels, is investor uncertainty regarding Chinese growth and the pace of global economic recovery. In times of turmoil, investors seek out "safer" alternatives for their money and avoid higher-risk markets such as the EM sphere. Aside from Brazil, countries at the bottom this year in terms of stock market performance are Chile, Peru and the Czech Republic. The EM sphere as a whole has lost 14 per cent. Latin America is the biggest loser with a downturn of 20 per cent, but Eastern European stock markets have also declined sharply. Asia has fared a bit better, with Chinese share prices losing 7 per cent. Overall, developed markets are up 11 per cent this year while emerging markets have fallen 14 per cent – an astounding difference.

Defensive equities becoming expensive

As for sectors, defensive equities have continued to perform well. Pharmaceuticals and durable goods are at the top, with upturns of nearly 20 per cent. Meanwhile commodities, which are strongly correlated with global economic trends, have lost 11 per cent. Cyclical sectors (commodities, industrials and information technology) have the highest expected growth in 2014. Pharmaceuticals in emerging markets are also expected to show better than average growth. Defensive companies (durable goods, consumer staples and pharmaceuticals) are highly valued, with P/E ratios of 15 to 16 after their upturn. Energy, commodity, financial service and information technology companies are valued lower, however. IT and other cyclical sectors thus appear to be more attractive investment alternatives, with low valuations and high expected growth, and are currently preferable to defensive sectors with high valuations.

On a global basis, corporate earnings are expected to grow by 8 per cent in 2013 and 11 per cent in 2014, with the EM outlook a bit higher at 10 per cent for this year and 12 per cent in 2014. We have thus adjusted estimated earnings in the emerging market (EM) sphere downward since last spring, bringing them closer to developed market (DM) earnings. European earnings estimates have recently been revised upward to 14 per cent for next year, while US corporate earnings will grow more slowly. This is one argument for investing in Europe rather than the US. In Japan, estimates have been revised sharply higher and now stand at a full 64 per cent in expected earnings growth during 2013. Japanese companies in consumer-related sectors such as energy and financial services stand out, with the largest upside earnings estimate revisions for this year. In the EM sphere, Korea and Taiwan will show the best earnings growth. Chinese corporate earnings are predicted to increase by 10 per cent this year and in 2014, while Russia company profits are hardly expected to grow at all.

REGION	WEIGHT*	REASONING
Global	1 2 3 4 **5** 6 7	The stock market is in a period of flat, cautious consolidation. To enter the next upturn phase, we will need more favourable macro data and news headlines. Earnings estimates will then be revised upward, and risk appetite among investors will increase. Share valuations have risen but are reasonable, provided earnings estimates prove correct.
Europe	1 2 3 **4** 5 6 7	The European economic picture is improving continuously. Valuations are low compared to US and global equities. The European Central Bank (ECB) and fiscal stimulus measures will provide positive support, and macro data will stabilise. Choose German and Nordic exporters that benefit from having a sizeable proportion of their sales in Asia and 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 starting to be high, which will limit potential.
Asia/Emerging markets	1 2 3 4 **5** 6 7	Asia remains our primary growth investment, but the picture is mixed. Due to unstable macro forecasts, we are tactically down-weighting the region a bit in our portfolio. Choose less developed Asian countries with continued high growth potential. Avoid pure commodity exporters.
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. Government policies are starting to impact macro data. High earnings forecasts and upward adjustments in earnings (but from low levels). These measures will have positive effects on Asia as a whole.

** "Weight" shows how we currently view the asset class as 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.*

Japanese valuations more in line with other markets

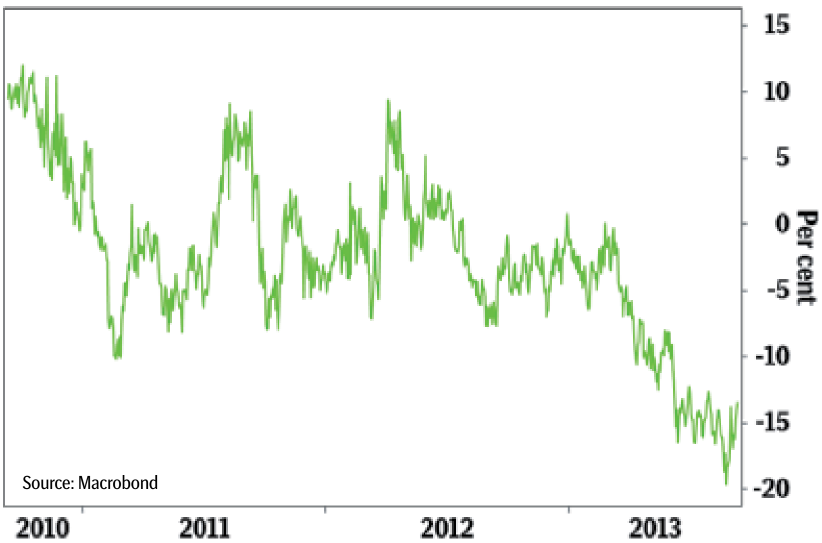
Global equities are trading at an aggregate P/E ratio of 15 times expected 2013 earnings and 13 times 2014 earnings, which can be described as consistent with historical levels. It is notable that the Japanese stock market, which has historically traded at multiples above 20, has now ended up at a P/E ratio of 14 times earnings for next year, thanks to positive revisions in profits. This is the same P/E ratio as the US, while Europe is somewhat lower. The EM sphere has an overall P/E ratio of 10 for 2014, with equities in China and Korea appearing to be attractively valued.

Looking ahead, there are many indications that world stock markets will perform positively, but at present a “risk-off” climate is predominant among investors. This has led to a slight downward correction in stock markets, which may last for another while. In the short term, the actions of the US central bank regarding its bond purchases will be a major influence on the markets. We also need assurances that Prime Minister Shinzo Abe’s stimulus programmes in Japan are sustainable and about what will happen in the Syrian conflict. On the plus side, the European economy seems to have bottomed out. Expectations of Chinese growth are now more realistic, and the risk of disappointments has diminished, though a lack of political flexibility is still creating some uncertainty.

Focus on sectors and countries that have lagged

The economic picture in China is gradually improving; signs of improved growth and stabilisation seem likely to eventually fuel markets. Those regions and sectors that have lagged behind in stock market performance appear attractive. We foresee an increased focus on company fundamentals and low valuations in the next upturn phase. Cyclical sectors and selected countries in Europe, Asia and the EM sphere meet the criteria for this and will thus attract investments. When synchronised global growth picks up, with higher corporate earnings and resulting upward adjustments in earnings forecasts, this will drive stock markets and persuade investors to increase the risks in their portfolios.

EM EQUITIES HAVE PERFORMED FAR WORSE THAN DM ONES



The chart shows 6-month rolling relative returns between developed markets and emerging markets.

In local currency, the Japanese stock market has surged so far this year, but because of the depreciation in the yen, the upturn is not as strong in terms of Swedish kronor. US equities have performed unexpectedly well and are trading at record levels. We have seen the worst stock market performance in Brazil, Russia and parts of Asia.

The Country Model

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.

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:

+ Turkey
The Turkish market receives the highest quantitative score, with valuations that stand out as a direct consequence of the sharp stock market decline during the past three months. Turkey is a high-risk market and at present we are tactically cautious about taking high risks.

+ Denmark
Denmark occupies second place in the Country Model. The main reason is that the stock market analyst corps has adjusted its estimated earnings forecasts upward. Expected earnings growth in the next 12 months is also among the highest.

+ China
Like last spring, China earns a high ranking in the model, now reaching third place. Valuations are attractive and dividend returns are good. The latest macro signals indicate stronger economic growth.

+ Germany
Several European countries besides Denmark made it into the top half of the table this time, among them Norway, Germany, Spain and the United Kingdom. Valuations look good in Germany. This fits nicely with our view highlighting Europe as an attractive investment alternative with many well-managed exporters that will benefit from improved economic activity in Asia.

+/- Sweden
The Swedish stock market ends up in the middle in the quantitative model. What pulls it down is valuations, but dividend returns are good. 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.

+/- United States
The American market is just below the middle of the table. Investors who have been unwilling to take high risks have sought this comparatively safe alternative for a long time, and share prices have reached record levels. Valuations are becoming high, and company earnings are growing more slowly than in other regions of the world.

- Japan
Japan ends up in second to last place. Return on equity is the parameter that pulls down its score the most. In our assessment, the massive stimulus measures implemented by the government will have an impact on the economy over time.

Gradual normalisation of monetary policy

- **Central banks are still in the driver's seat, but heading in different directions**

  Japan is buying back bonds on a large scale, which is providing a capital injection. The European Central Bank will continue its stimulus policy, while the US Federal Reserve will gradually reduce liquidity through a tapering process.

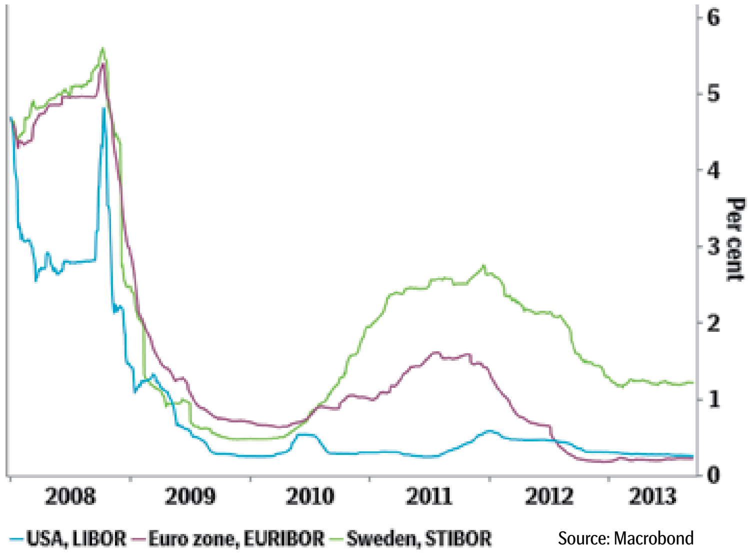
- **The price of money is still low**

  We expect a gradual, very prolonged movement towards a normalisation in the price of money

- **Low bankruptcy rate favours high yield bonds**

  Investors are looking for yields in an environment with a low corporate bankruptcy rate and stable valuation growth. However, spreads between high yield bonds and government bonds as well as mortgage-backed securities have narrowed, which reduces the potential somewhat.

KEY INTEREST RATES APPEAR TO HAVE HIT BOTTOM



Source: Macrobond

SEB believes the European Central Bank (ECB) will lower its key interest rate once more by 25 basis points during the second half of 2013.

The chart shows three-month interest rates, which are crucial for floating rate loans and investments. Expected hikes in key interest rates have been postponed, in the case of the US for a couple of years.

THE MAJOR CENTRAL BANKS have recently acted a little differently from each other in terms of the monetary signals they are sending. The US Federal Reserve (Fed) gave world financial markets the jitters in May when it started talking out loud about "tapering", a plan to reduce its USD 85 billion monthly purchases of government bonds and mortgage-backed securities. At this writing, the question still remains as to the timing and size of this tapering. These questions will probably be answered by the Federal Open Market Committee meeting on September 17-18. Tapering can be seen from two perspectives – economic growth is considered so strong that stimulus measures are no longer needed to the same extent, or people are worried that the Fed will withdraw this stimulus too much and/or too quickly. The market has had a relatively long time to prepare for this and will probably calm down once the Fed's plan has been presented...

As for the benchmark federal funds rate, our forecast is that the Fed will not raise it until late 2015. Our forecast for 10-year US Treasury notes is around 3.15 per cent at the end of 2014 and about 3.70 per cent at the end of 2015, levels we consider relatively attractive, provided inflation remains under control. Compared to the current rate, this means an upturn of around 90 basis points over a period of about two years.

The US central bank has thus taken the initiative and acted forcefully. Political leaders there still need to agree on raising the federal debt ceiling. Debates and decisions should take place in late October or early November.

In the euro zone, the European Central Bank (ECB) has been actively providing capital to a weak banking sector. SEB predicts that the ECB will lower its refi rate from 0.5 per cent to 0.25 per cent late in 2013 to help intensify the bright spots now visible in the euro zone economy. The Bank of England (BoE) will also maintain a stimulative policy for the next two years, keeping its key interest rate low. The BoE has already reached its quota for bond purchases (GBP 375 billion) – a cap that will probably not be raised. The countries that are first in line to raise their key interest rates are Norway and Sweden. Norway is expected to go first, raising its rate by half a percentage point during the second half of 2014, followed by another 75 basis point increase in 2015 to 2.75 per cent. Sweden's Riksbank will first raise its repo rate in late 2014 and then hike it to 1.75 per cent by late 2015.

High yield is still our first choice

High yield bonds and funds are still attracting investors. In the banking sector, there is a gradual shift from issuing perpetual bonds to contingent convertible bonds (CoCos). The function of CoCos – reinforcing the banks' capital base – is the same as for perpetual bonds issued earlier, but the characteristics of the bonds differ slightly.

If a bank's percentage of shareholders' equity falls below a predetermined level, three different events could occur (depending on the bank's minimal capital requirement):

- The value of the bond is written down to zero.
- The bond pays no coupon during the crisis period.
- The bond is converted into shares.

No Swedish bank has issued this kind of securities yet, but that is very likely to happen before the end of the year. Banks such as Rabobank, Société Générale and Barclays have recently issued such bonds.

The popularity of high yield bonds is obviously due to their generating a high sustained return with relatively low volatility. This asset sub-class, which is our number one choice in fixed income, is doubtless here to stay. Moreover, the low-yield environment, the improving economy and good access to liquidity have resulted in a very low bankruptcy rate among issuers, which also favours high yield investments.

So far this year, 24 high yield bond issuers in North America, 13 in Europe and six in Latin America have suspended payment (Source: Moody's). Companies have become more cautious about new capital spending, so the risk profile has generally become lower. Sectoral restructuring and corporate acquisition activity has been low for several years. Since we do not foresee any drastic interest rate increases over the next couple of years and since access to liquidity is still good, the climate for investments in high yield products should remain favourable.

For more cautious investors, covered bonds (debt instruments secured by mortgage loans) with an AAA rating offer an attractive return. The return is almost 3 per cent for maturities of about five years. However, investors should be on their guard if interest rates start to rise, since higher rates would result in falling bond market values.

ASSET CLASS	WEIGHT*	EXPECTED RETURN NEXT 12 MONTHS		RISK
		SEK	EUR	
Treasury bills	1 **2** 3 4 5 6 7	0.9%	0.1%	0.2%
Government bonds	1 **2** 3 4 5 6 7	2.1%	2.0%	4.5%
Investment grade corporate bonds	1 2 **3** 4 5 6 7	2.7%	1.7%	2.8%
High yield corporate bonds	1 2 3 4 **5** 6 7	5.9%	4.9%	9.3%
Emerging market debt	1 2 **3** 4 5 6 7	7.1%	7.1%	10.6%

Source: SEB

** "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.*

Hedge funds

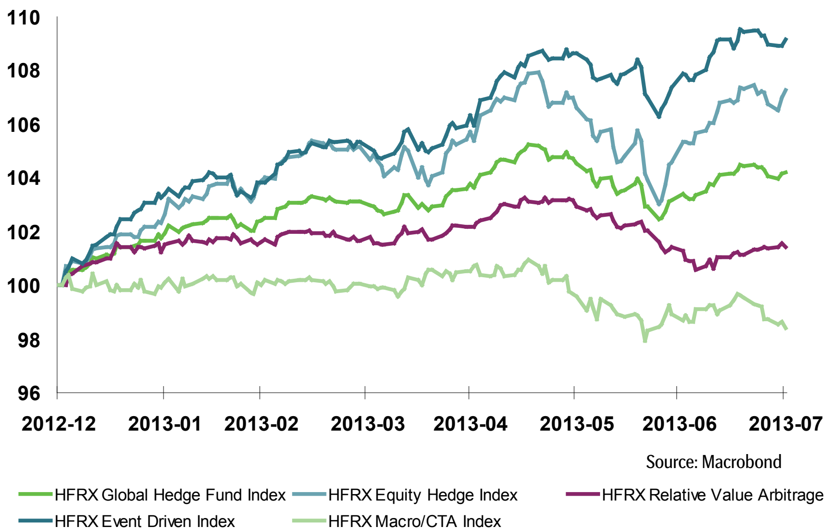
Outlook still good, but more cautious approach

- **Hedge funds still advancing, though at a slower pace than in the first quarter**
  Hedge funds collectively rose 1.1 per cent from April to July, which means a gain for the year until July 31 of 4.15 per cent. However, the US Federal Reserve's comments on reducing bond purchases led to considerable volatility over a fairly long period, which many managers found difficult to handle. Strategies that benefited from sharp gains in mature stock markets fared better.

- **Higher volatility means both opportunities and risks**
  We remain positive towards all our strategies but are taking a somewhat more cautious approach in the immediate future, since generally higher volatility has pulled up correlations and diminished the usefulness of fundamental analysis. Meanwhile, opportunities are being created through price differentials between various geographic regions. Substantial variations in corporate earnings provide opportunities for higher absolute return for managers with flexible strategies, so we believe holdings in Market Neutral strategies could be increased.

- **Strong stock markets and a bond market that still favours companies bode well for Event Driven strategies**
  Event Driven strategies are flexible both in terms of region and asset class. For Credit Long/Short and Macro/CTA, we expect continuing slightly higher volatility, but these strategies still serve as good diversifiers in the portfolio.

LOWER RATE OF RETURN AFTER STRONG START TO THE YEAR



Hedge funds have generally continued their positive trend, although at a slower pace than in the first quarter. However, there is considerable variation between strategies, with Event Driven and Macro/CTA at opposite ends of the spectrum. Higher volatility and correlations have proved difficult for most managers to navigate, but this will produce mispricings later on, which they can take advantage of.

SINCE OUR REPORT in the last issue of *Investment Outlook*, risk assets turned in a less stable but generally positive performance. Hedge funds generally advanced, although at a slower pace than during the first quarter. The broad HFRX Global Hedge Fund Index rose another 1.1 per cent, resulting in a gain for the year to July 31 of 4.15 per cent in EUR. Event Driven led the advance, up 3.7 per cent during the period, and has now posted a positive return of a full 9.2 per cent so far this year. In contrast, the HFRX Macro/CTA index lost 2-3 per cent (some managers lost significantly more) when the systematic and discretionary models were caught out by the market reversals in May-June.

We continue to see good potential in all the main strategies but are adopting a more cautious approach over the near future. The macroeconomic picture is a little more divided regionally. The US continues to improve, emerging markets are showing a weaker performance, and Europe is somewhere in the middle, with some potential for upside surprises. The crisis in Syria has also escalated, resulting in higher volatility and higher correlations in the markets. All in all, this means both opportunities and risks – opportunities since regions in different phases could create price differentials that stock pickers can take advantage of, and risks since downward movements could be sharp, which would in turn pull up correlations and reduce the usefulness of fundamental analysis.

Equity Long/Short continued to perform well during the period, with an upturn of 1.8 per cent for HFRX Equity Hedge, driven mostly by strong equities in mature markets. Risk has been brought down recently, driven by profit-taking. But exposure remains focused on advancing markets, and we believe the next high will be reached in conjunction with the next reporting period. We prefer managers with flexible exposure and believe that holdings in Market Neutral strategies could be increased, since substantial variations in corporate earnings provide opportunities for higher absolute return.

Relative Value Fixed Income strategies had a difficult time in May-June but recovered for the most part in July, ending 1.5 per cent higher for the period January-July. The Fed's comments on reducing its bond purchases led to considerable volatility for a fairly long time, which many managers had a hard time handling. Among credit strategies, high net exposure fared best while those with a more negative approach certainly saw spreads widen, but since they narrowed fairly quickly, these managers were unable to generate any excess return. In the uncertain low-return environment we are now in, fundamentals will determine performance to a greater extent in the corporate bond market, especially in segments below investment grade. Overall, given great uncertainty about central bank actions, volatility will be somewhat high, so we prefer Credit Long/Short with an emphasis on high yield.

Event Driven managers did not see much of an increase in corporate activity either during this period. Still, money could be made on special situations in equities and corporate bonds. Strong stock markets and a bond market that continues to favour companies suggest that corporate activity should increase going forward. There is probably some caution in boardrooms, bearing in mind the Fed's actions, but at the same time we should not forget that the US economic recovery has shown clear stability, while Europe and Asia have actually shown signs of strengthening. Should these trends meet or even exceed expectations, there is likely to be greater optimism and courage to act. Strategies that are flexible both in terms of region and asset class (equities, bonds, convertibles etc.) are preferable in the present situation.

Macro and Trading generated significant losses in general. One shared cause was the sharp increase in yields on the long side of the yield curve. Most had/have large positions in contracts of up to a year, which were considered safe since central banks and other players have long maintained they would keep their key interest rates low for an extended period. Unfortunately, the Fed's "tapering" announcement created uncertainty, which in turn led to considerable losses. In addition, long positions in risk assets such as equities and emerging market (EM) currencies generated losses due to the resulting risk sell-off. The different types of positions such as short-term fixed income, EM currencies and equities were expected to diversify their portfolios but correlated far too closely for a short period. Some managers were hit especially hard, because they had higher risk budgets and more diversified signal models, which were successful in 2012 but at a disadvantage in 2013 since models that follow a trend have worked better than models based on fundamentals. Despite their recent performance, we still believe Macro/CTA strategies deserve a place in the portfolio as diversifiers but also feel the near future could be challenging for these strategies. It will be important not to let the total risk of the holdings relative to the rest of the portfolio increase going forward, at the same time as we believe the prevailing imbalances could create trends that managers can take advantage of.

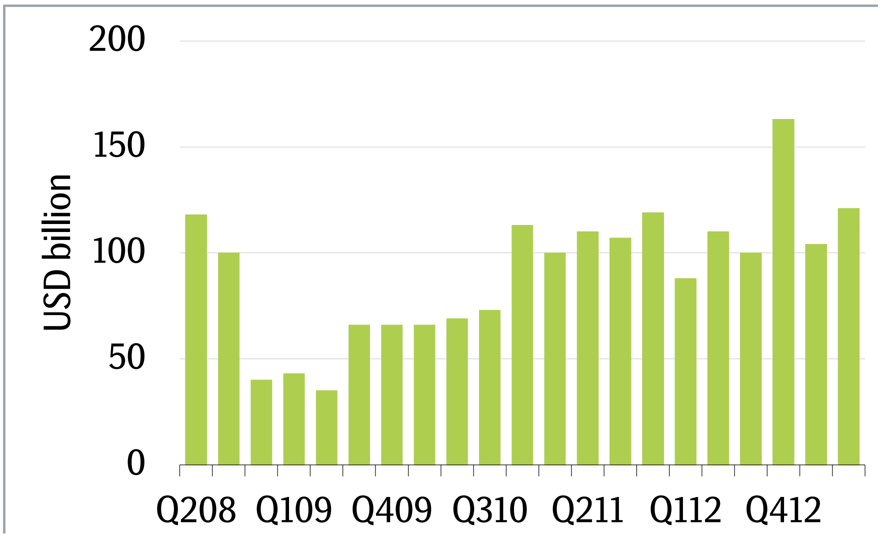
STRATEGY	INDEX	PERFORMANCE % (USD)				
		Apr-Jul 2013	Q1 2013	2012	2011	2010
Global Hedge	HFRX Global Hedge Fund	1.1	3.1	3.5	-8.9	5.2
Equity Hedge	HFRX Equity Hedge	1.8	5.1	4.8	-19.1	8.9
Relative Value	HFRX Relative Value Arbitrage	-0.2	1.7	3.6	-4.0	7.7
Event Driven	HFRX Event Driven	3.7	5.3	6.0	-4.9	2.0
Macro	HFRX Macro	-1.6	0.04	-1.0	-4.9	-1.7

Source: SEB

Search for returns further out on risk scale

- **Increased risk-taking in the search for returns**
  Still limited return potential in primary markets, which is driving investors further out on the risk scale.
- **Increased volatility linked to large flows from institutional investors**
  Growing institutional investor interest, as well as assets in exchange-traded funds (ETFs), have helped make the property market at least as volatile as the stock market.
- **Despite generally low loan-to-value ratios, there is reason for caution before the Federal Reserve announces its stimulus tapering**
  The asset class's close link to mortgage loan financing means it closely follows developments in the credit market. Along with high volatility, there is thus reason to wait for further central bank clarifications.

CONTINUED GROWTH IN GLOBAL TRANSACTION VOLUME



Source: SEB

Historically, the first quarter has been characterised by lower activity, which can also be seen this year. Transaction volume grew by 16 per cent during the second quarter and by 10 per cent year-on-year.

IN PREVIOUS ISSUES of *Investment Outlook*, we reported increased transaction volume and growing investor interest in secondary markets with higher return potential. The prevailing low-yield environment has also helped force investors to seek out alternative investments, with real estate being an increasingly important asset class in the search for sources of uncorrelated returns.

While general sentiment in the latest quarter shifted to stronger confidence in a fundamentally driven recovery in the industrialised world, the financial markets have been dominated by reflections about central bank plans to taper current stimulus measures. Despite occasional turbulence, transaction volume in the global property market has continued to rise and is nearing its fourth straight year of uninterrupted growth.

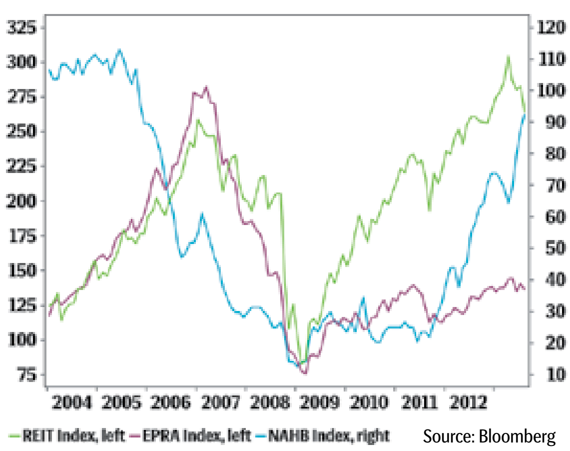
Sustained high pressure in safe primary markets has resulted in a continued decline in return levels and an ever clearer outward shift on the risk scale. Investors are increasingly turning to secondary markets, with a focus on quality properties in the US and Europe, where more attractive return levels can be found. Safety will probably be a continuing theme for some time to come, but it is likely that growing numbers of investors will gradually overcome their risk aversion as the market once again regains confidence and momentum.

In the US, the Federal Reserve's stimulus tapering is expected to contribute to a period of somewhat higher volatility and longer lead times for sales, but this period will probably be followed by a rebound in the fourth quarter. For 2013 as a whole, the volume increase in the US is expected to be 10-15 per cent. Rising US home prices are one of several factors contributing to a recovery in consumption, which is an important driver of economic growth.

The US housing market has changed from solely providing a roof over the head of the owner to becoming an increasingly popular asset class for investors. Large inflows from institutional investors and growing assets in ETFs have contributed to volatility in the US housing market comparable to that in the stock market. Among the places this can be seen is in the index of new home sales, which fell 13 per cent from June to July this year, while the index for existing home sales rose. Despite generally lower loan-to-value ratios, rising mortgage interest rates and tighter credit availability have contributed to increased volatility, but it is mainly outflows from institutional investors that have had a negative impact on this asset class.

A continuing increase in transaction volume still bodes well for the fundamental driving forces in this asset class. An increasingly clear recovery in Europe and the US will continue to favour real estate. However, taking into account high volatility, mainly connected to the market's "risk on-risk off" tendencies, there is reason for caution in the immediate future, since the Fed's tapering could further shake up the markets.

FLUCTUATING TREND IN THE US HOUSING MARKET



Source: Bloomberg

The National Association of Home Builders Market/Wells Fargo (NAHB) Index measures current sentiment and expectations in the US housing market for single-family homes. In the past two years, the NAHB Index has turned in a strong performance; the same is true of the US REIT Index, which follows the market for real estate investment trusts. However, increased anxiety associated with the Fed's tapering and higher interest rates have contributed to a weaker performance for the REIT Index beginning in May this year. The European property market had a weak start to the year but has risen sharply since late April, given signals of a stronger economic recovery.

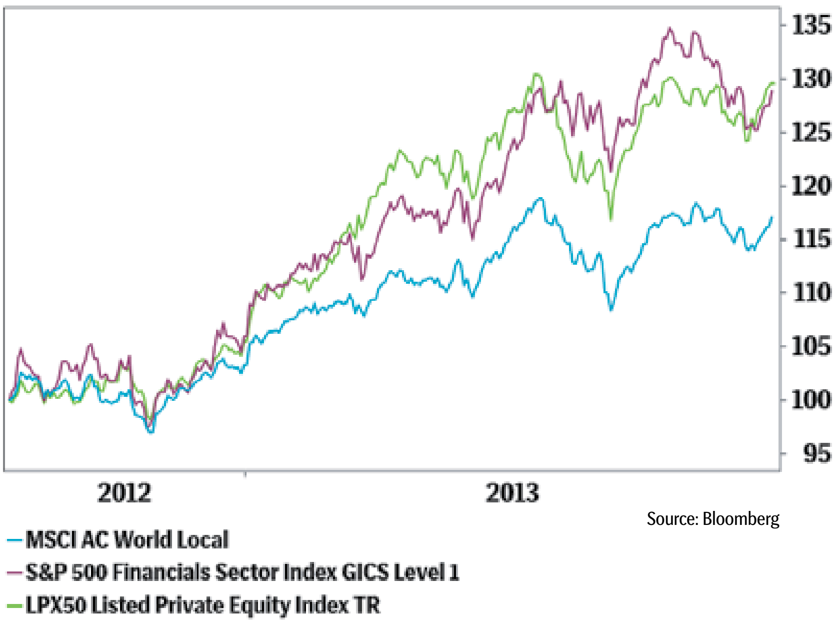
Greater risk appetite benefits transaction market

- **Greater risk appetite benefits transaction market**
  The low interest rate situation, combined with low leverage, continues to generate high dividend yields for Private equity (PE) companies.

- **Intensifying activity in the exit market**
  The good risk climate has helped provide PE companies with opportunities to cash out of mature investments.

- **Low discounts to net asset value (NAV) allow increased transparency**
  Discounts to NAV are down to levels similar to those before 2008 and are helping make it easier for PE companies to communicate the value they generate.

STRONG PERFORMANCE OVER THE PAST YEAR



Source: Bloomberg

Over the past year, the index for listed PE companies (LPX50TR) has turned in a strong performance with a historically low standard deviation. Considering that private equity is among the riskiest asset classes based on historical trends, falling risk appetite in June resulted in a relatively small decline.

THE FIRST SIX MONTHS OF 2013 were dominated by growing risk appetite, which drove the upturn in risk asset prices, especially in the index for listed private equity companies. In the last issue of *Investment Outlook* (published in May 2013), we described how increased risk appetite has contributed to a better functioning exit market and higher transaction volumes. We also noted how the low interest rate situation, combined with low leverage, has favoured private equity companies in the form of historically high dividend yields. Increased volatility could be triggered by a tapering of stimulus measures, but over a longer investment horizon there is still good potential in this asset class.

The trends that could be discerned during the spring have largely continued to drive the performance of listed private equity. The persistent low interest rate situation has directed capital streams towards risk assets and at the same time resulted in a stronger credit market, especially for high yield bonds, with the volume of bonds issued so far this year exceeding the level last year.

Sustained higher risk appetite has opened up opportunities to cash in on mature investments, and many private equity companies today are choosing to sell rather than invest. The ratio of exits to investments is therefore unusually high, which is obviously not a sustainable trend in the long run since an optimal private equity portfolio should be diversified through investments with different maturities. A high percentage of the exits carried out today are therefore being achieved through initial public offerings (IPOs) or recapitalisations.

The increase in risk asset prices, together with fears of costlier borrowing in the future, has driven another trend described in previous issues of *Investment Outlook*. A higher level of shareholder dividends, so-called dividend recapitalisation, is being funded through increased borrowing in the portfolio company. The way this works is that PE companies, after paying down some or all of the debt in a portfolio company, increase its debt leveraging and use the capital for shareholder dividends. There is also greater interest in private investments in listed companies, since private equity companies thereby have the chance to raise new capital by increasing their leveraging.

The sharp price rise, combined with profit taking, has helped push discounts on net asset value (NAV) to their lowest levels since 2008, according to the Association of Investment Companies. The average discount was as low as 14 per cent in February, but was around 18 per cent in late June (compared to about 60 per cent in February 2009). The lower discounts are a clear sign that PE companies have been more successful in communicating the value generated in their portfolio companies. Lower discounts in the secondary market for existing PE investments have also helped to increase interest among listed PE companies in partnership investments with larger PE companies in the primary market.

This year, investment banks around the world have sharply increased the revenue they have generated from PE transactions. Figures from late August 2013 indicate that such revenues reached their highest year-to-date levels since 2007. According to Financial News, the strong performance of the US private equity market has helped to boost fee-related revenue by 34 per cent compared to the same period last year. In Europe, total volume only amounts to a fifth of the US market, but revenues from PE transactions for European investment banks were up almost 50 per cent compared to the same period last year.

In Europe, prices are still at good levels but, despite higher volume, still appear to be less attractive given the relatively low transaction level. The best potential now is in Asia, where there is great interest in what are called special situations. Special situations entail PE companies identifying companies with development potential, with the aim of turning around operations and increasing the value of the portfolio company.

In the long term, there is good reason to include listed private equity in a well diversified portfolio, but tactically there is reason for a somewhat more cautious approach. The greatest factor of uncertainty for this asset class going forward is how the markets will react to rising interest rates. We have already seen repercussions in both the equity and fixed income markets, and improved economic growth driven by fundamentals has to take over from movements focused on central banks.

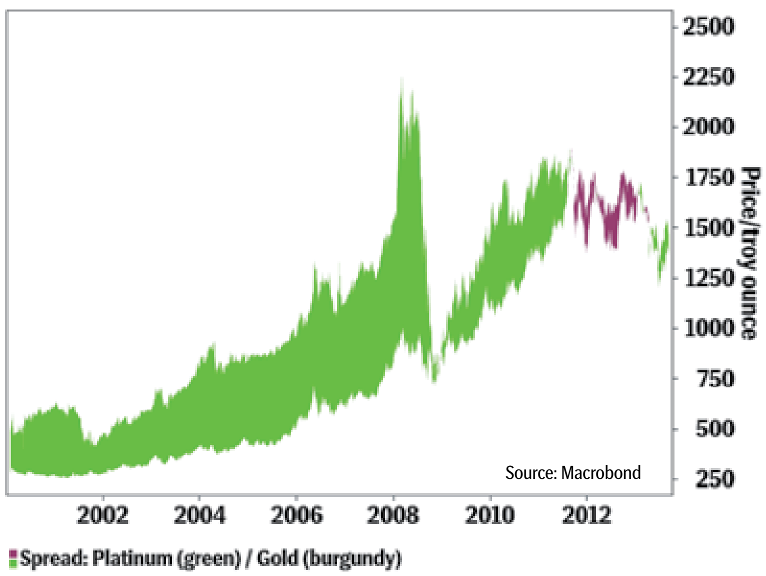
Industrial commodities show upside potential

- **Situation in Syria causing volatile oil prices in the short term**
  The recent turmoil in Syria has reminded us how sensitive oil prices are to this type of events. Assuming that geopolitical tensions do not worsen, we believe oil prices will be somewhat lower a year from now.

- **Platinum will benefit from an improving European economy**
  A glimmer of light in the tunnel that is the euro zone economy, combined with a strong concentration of supply, makes platinum our favourite precious metal. The metal is attractive even relative to the price of gold.

- **China is the key to the performance of industrial metals**
  After a spring full of disappointing statistics from China, recent economic indicators from that country have been positive, which is reflected in a rebound for metal prices. A continuing economic recovery provides support to our forecast of rising prices for industrial metals.

RELATIVE PRICING OF PLATINUM AND GOLD IS NORMALISING



Historically, platinum (green) has traded for extended periods at twice the price of gold (burgundy). Periods when gold was more expensive were an exception and included September 2011 to January 2013. In our view, the platinum/gold ratio should eventually return to its historical pattern.

SEASONALLY WEAKER demand (for the period between the heating and driving seasons), combined with the fact that OPEC – mainly Saudi Arabia – did not reduce production enough, resulted in excess supply and falling prices during the spring. Brent crude oil was trading at under USD 100 per barrel on several occasions, but with the market in better balance the price later fluctuated between USD 100 and 105 per barrel. At this writing, the turmoil in Syria has lifted prices by about USD 10. We expect oil prices to be around USD 105 per barrel in a year, assuming geopolitical tensions are not further exacerbated. Saudi Arabia has the capacity to increase its daily production by about 3 million barrels, if the need arises. At the same time, we consider the probability of sharply falling prices to be low, at least over extended periods, and we expect that OPEC will adjust its production.

The price differential (spread) between West Texas Intermediate crude (North America) and Brent (North Sea) oil fluctuated between USD -1 and 4 per barrel from 2008 to 2011. Infrastructure problems in the US then caused the spread to widen, at its peak, to over USD 15 per barrel in February this year (WTI being cheaper). The situation has now improved, and we expect a spread of USD 5-10 going forward. One reason why some price differential is still expected to persist is US shale oil, which is a factor to reckon with even though it has not yet had such a large impact. One report on estimated total global oil reserves indicates that shale oil constitutes 10 per cent of them. Today shale oil accounts for about 3 per cent of total production. We can be fairly certain these figures will be adjusted going forward, since we are still at the beginning of this trend. So far only the US is producing shale oil, and since there is a ban on oil exports from that country, this will mainly affect the price of WTI crude.

South African concentration a supply risk for platinum

The price of gold climbed from about USD 800 USD/ounce (oz) in early 2008 to around USD 1,800/oz late last year in the wake of quantitative easing (QE) and the flight to safety. The speculative element gradually increased and, at their peak, investments in physical products were equivalent to one year of gold production. This year, the price has fallen by about 15 per cent. We do not expect gold to trade at USD 800 USD/oz again, but production cost inflation of around 10 per cent a year leads to our forecast of a reasonable price of USD 1,300/oz, assuming no dramatic increase in inflation expectations.
Our favourite precious metal, platinum, is used mostly in the automotive industry for catalytic converters for petrol-powered cars, which are most common in Europe. Since the economic trend in Europe now looks a little brighter, this should bolster the metal. Supply is concentrated in South Africa, where over 70 per cent of global production takes place, and while newspaper headlines about violence at South African mines have faded, the two sides are still a long way from reaching agreement. Mine workers are demanding wage hikes of 100-200 per cent and the current counteroffer is 5 per cent, so there is still a risk that the situation could significantly disrupt the supply.

No dramatic change in agri prices if weather holds

After an exceptional price upturn in agricultural products of about 90 per cent from June 2010 to March 2011 in the wake of the La Niña and El Niño weather phenomena, prices have slumped and are now on par with 2009 levels. We consider today's levels reasonable and expect prices overall to be around today's levels a year from now. However, there is always a risk of drought or flooding, with potential to completely alter this forecast.

China's economic trend still the most important

This year has been dominated by falling industrial metal prices, even though prices for many metals are below their marginal production cost. This decline is connected to concerns about the economic trend in China, since a majority of the country's statistics this spring and summer were disappointing. Recently, however, figures from China have in many cases exceeded forecasts, with metal prices rising as a result. In our view, industrial metals are the commodity sub-category with the greatest potential for gains over the next year, but that will require continued economic improvement and a stable China, which is also our forecast. Among industrial metals, copper and nickel are the most attractive. These metals are highly cyclical, and there are limited opportunities to rapidly expand supply. Aluminium is priced low, but global stocks are currently at record levels. From an investment perspective, it is also important to take into account the forward curve, which is now in contango, which means that the market is already discounting some price upturn.

ASSET CLASS	WEIGHT*	REASONING
Energy	1 2 3 **4** 5 6 7	Provided geopolitical turmoil does not escalate any further, we believe oil prices will be somewhat lower a year from now.
Industrial metals	1 2 3 4 5 **6** 7	Industrial metals are the commodity sub-group with the greatest potential for rising prices. However, that requires continuing economic improvement and, above all, stable growth in China.
Precious metals	1 2 **3** 4 5 6 7	We expect gold prices to continue falling unless inflation expectations rise sharply. We consider platinum the most attractive precious metal, driven in part by an improving European economy.
Agricultural products	1 2 3 **4** 5 6 7	The price trend for agricultural products should be relatively unchanged at an aggregate level a year from now.

* *"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.*

JPY depreciation to continue

- **Monetary policy continues to play a critical role in foreign exchange (FX) market trends**
  Key interest rates will remain at low levels. We expect the ECB to lower its rate before the end of the year, with Norway and Sweden making small rate hikes in 2014.

- **The Federal Reserve's signal about "tapering" – phasing out its bond purchases – came as a surprise**
  This led to sharp depreciations in EM currencies, with the Indian rupee falling the hardest – 25 per cent at its worst – against the USD during the summer. The tapering debate led to a strengthening of "safe haven" currencies.

- **Falling emerging market currencies have pulled down bond prices as well**
  The weakening of EM currencies has caused the central banks of Brazil, Turkey and other countries to respond by raising their benchmark interest rates in order to strengthen their currencies. This reaction is probably excessive, since the Federal Reserve will most likely be cautious with its tapering.

JPY DEPRECIATES WHILE EURO STRENGTHENS

Source: Macrobond

The chart shows the major impact the change of Japanese prime minister had on the JPY. Since then, the currency has consolidated and its decline has halted. One consequence of the Federal Reserve's tapering talk was that investors fled emerging market currencies, ending up as usual in times of anxiety in safe haven, liquid currencies.

THE US ECONOMIC RECOVERY has shown continued vigour: long-term yields have risen, driven by economic growth and the Fed's hints of reduced purchases of US government bonds and mortgage-backed securities. SEB predicts this tapering will start in September (the current level of purchases is USD 85 billion a month). The economic trend in Europe has begun to show signs of less pessimism.

That means earlier forecasts have been slightly revised. Although the USD is still trending stronger, the bright spots visible in Europe have attracted purchases of EUR assets. Our forecast implies a delayed appreciation in the USD, with a EUR/USD exchange rate of 1.33 at year-end (that is, no major change from the current level). By year-end 2015, we expect the EUR/USD to have fallen to 1.20.

The Japanese yen (JPY) has already depreciated, underscored by an explicit stimulus programme, in which accommodative monetary policy is a cornerstone. This weakening started almost a year ago, when Shinzo Abe took over as prime minister. During the summer, we saw a consolidation of the JPY, probably mainly as a reaction to its weakening in late 2012 and early 2013.

However, these three currencies (USD, EUR and JPY) could appreciate if we have a turbulent autumn, with great turmoil in Syria, Egypt or nearby countries. The main reason for their strengthening is that they are "safe havens" in times of trouble. They offer high liquidity, which is a priority for investors around the world. Nevertheless, a weaker JPY trend is likely.

The British pound (GBP) has weakened since 2008 (GBP/USD 2.05) to levels of around 1.55 against the USD. Since the financial crisis, the UK economy has shown weak performance, but the signs of recovery seen this summer are encouraging. We believe the country's stimulative monetary policy will continue and that the GBP will remain weak for the next year and a half. Expected levels in December 2015 are GBP/USD 1.48, EUR/GBP 0.81 and GBP/SEK about 10.12.

The Norwegian krone (NOK) is still considered undervalued, given the country's strong fundamentals. At the same time, the Norwegian central bank is trying to prevent too rapid an appreciation. Increased economic activity and rising inflation will most likely force Norges Bank to start raising its key interest rate in June 2014. SEB predicts the EUR/NOK will be at 7.70 at the end of 2014, with another marginal strengthening in 2015, bringing it to 7.65.

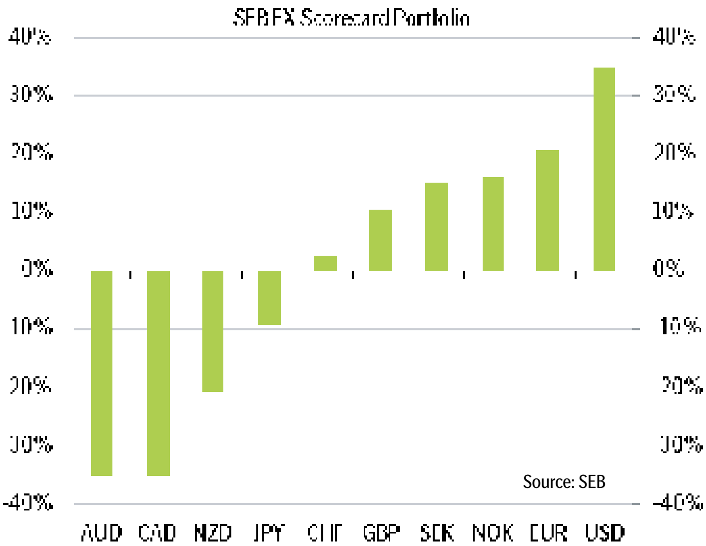
Turbulence in emerging market currencies

Tapering talk in the US has weakened emerging market currencies significantly. The Indian rupee lost about 25 per cent in value against the USD during the summer. Stimulus policy has reached the end of the road in emerging markets and should be replaced by economic reforms aimed at generating faster growth. Some countries are wrestling with large current account deficits. As for China, political leaders are trying to bring about a transition from export- and investment-driven growth to an economy based on domestic consumption. They have a good chance of succeeding, since the country has a large current account surplus.

SEB FX Scorecard

The SEB FX Scorecard Index is a so-called total return index and measures the return on a currency strategy/portfolio which buys or sells 10 of the most widely traded currencies around the world. The currencies included in the strategy are the USD, EUR, JPY, GBP, AUD, NZD, SEK, NOK, CHF and CAD. Each currency is rated based on ten different factors that SEB's currency analysis team considers important.

The results of the ratings determine which currencies are to be bought and sold. The relative strength of the rating then determines the size of each position. It is worth mentioning that exposure takes into account the volatility of each currency pair, so that those with lower volatility are given somewhat greater exposure. The SEB FX Scorecard index is based on the Swedish krona. That means gains and losses resulting from changes in value are defined in SEK. The model portfolio is normally adjusted once a month when the FX Scorecard index is updated.



FX SCORECARD

The chart shows the SEB FX Scorecard after the latest rebalancing made by SEB's currency analysis team in September. After the change, the single largest positions are purchases of the USD and divestments of the AUD and CAD. After initial concerns during the spring and summer, the negative position in the JPY has been reduced somewhat.