Investment Outlook

Markets waiting for earnings confirmation

MARCH 2014

PRIVATE BANKING • INVESTMENT STRATEGY

SEB

Table of contents

This report was published on March 4, 2014.
The contents of the report are based on information and analysis available before February 26, 2014.

Ann Grevelius
Chief Investment Officer &
Global Head of Investment Strategy
+ 46 8 763 63 04
ann.grevelius@seb.se

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

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

Victor de Oliveira
Head of Investment Strategy Luxembourg,
SEB Asset Management
+ 352 26 23 62 37
victor.deoliveira@sebgroup.lu

Lars-Henrik Røren
Head of Investment Strategy Norway
+47 9822 8506
lars.henrik.roren@seb.no

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

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

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

Reine Kase
Economist,
SEB Asset Management
+352 26 23 63 50
reine.kase@sebgroup.lu

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

Stefan Lukacs
Economist
+46 8 763 69 37
stefan.lukacs@seb.se

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

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

Markets waiting for earnings confirmation

The economy is continuing to stabilise and our world view is painted in bright colours. Interest rates are low, risk appetite is good, the stock market has performed well and now corporate acquisitions are also gaining momentum. Can we expect these trends to continue, or is the next step a pause?

A year ago (in the March 2013 issue of *Investment Outlook*), we wrote that it was "Springtime for equities" – which turned out to be quite correct. The question is where we stand today. The world's macroeconomic experts increasingly concur that global economic prospects are looking better and better. But does higher GDP growth automatically fuel continued stock market rallies? Both yes and no. The stock market is a leading indicator. In other words, it climbs on hopes of a brighter future – and once we look closely at the evidence and note that growth is actually taking off, the stock market has often already celebrated some of this victory in advance. Meanwhile, greater optimism obviously provides opportunities for higher earnings, which are the most efficient stock market fuel. Last year, shares rose mainly on hopes of higher earnings. Now it is time to show the evidence. We will need to see accelerating earnings growth if the stock market is to reach even greater heights.

The global economy, led by the United States, continues to perform well. Interest rates remain low, while stock market valuations have risen. Or to put it more correctly, valuations have risen in the stock markets of more developed countries. Emerging markets are still lagging behind, burdened by structural challenges and lower growth rates. How should we view emerging markets? Conditions vary greatly in different regions and countries. In this issue of *Investment Outlook*, we have chosen to look more closely at Africa – a region that many observers consider exciting, with great potential. As in our last issue (published in December 2013), where we carried out an in-depth analysis of the BRIC countries, we note that conditions in individual countries are very different. And it is not always possible to equate attractive economies with attractive investment opportunities.

As the global economy slowly recovers, so far without showing traces of widespread inflation, many people wonder whether we are moving into a dangerous period of deflation. Price pressures are very low, while we have had a long period of huge economic stimulus. Shouldn't we be seeing slightly more "normal" inflation in this environment? Should we worry about a deflation scenario in other countries besides Japan, where we have seen it for a long time? We address these issues in our theme article "Are deflation and inflation worries justified?".

On the commodities front, the world's energy map is being redrawn significantly. The emergence of shale oil and shale gas, mainly in the US, is keeping oil prices in check, but it will also entail major changes for both the oil industry and the global political scene. We have conducted an in-depth examination of what is happening in this exciting field and have looked closely at potential consequences.

From a portfolio strategy standpoint, the allocation challenge is to strike a balance between relatively highly valued stock markets in the developed world, lower valuations – but more instability – in emerging markets and, on the other hand, a fixed income market that will continue to provide low nominal returns. Our decision is to maintain a balanced level of risk. We continue to prefer a lower-valued European stock market to a higher-valued American one. We are choosing to have our emerging market exposure in Asia and are continuing to maintain relatively high risk in our fixed income portfolios, with a focus on corporate bonds in the high yield segment.

ANN GREVELIUS
Global Head of Investment Strategy

Equity-friendly, while prepared for volatility

By their nature, stock markets are "forward-looking". They precede actual developments and discount the future. From a historical perspective, stock markets are at relatively high valuations, thus presuming a favourable economic trend and good corporate earnings. The probability that this will occur within a 12-month period is relatively high, but given a shorter horizon the picture is more uncertain. For the past month or so, the US has delivered a series of weaker macroeconomic data, which may test both the patience of investors and the belief that the earnings trend will live up to expectations. Yet in our opinion, we are in an equity-friendly phase. Looking at 2014 as a whole, equities are the asset class with the best potential. Still, it is important to be prepared for a degree of volatility, as valuations have risen.

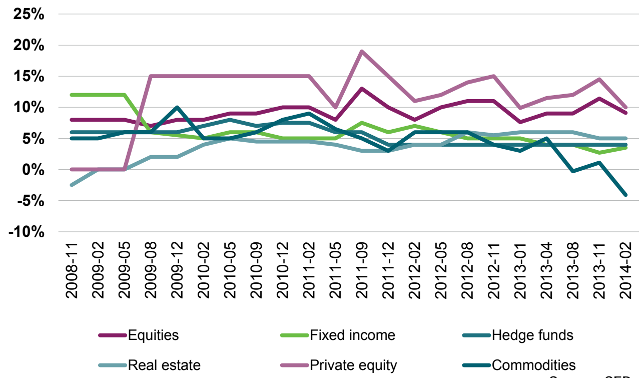
The fixed income and bond markets are currently driven by low inflation. In a 12-month perspective, yields are on their way up. Central banks will continue to maintain stimulative policies, although the US Federal Reserve will gradually reduce its bond purchases. Current bond markets are at levels that are partly determined by short-term interest rates and partly a consequence of earlier slow growth and low inflation expectations. We see no potential for price gains ahead, but instead continue to have a cautious maturity strategy (that is, short durations). Corporate bonds of various kinds nevertheless remain attractive, especially European ones.

We continue to have a humble attitude towards the power of the economic recovery, the problems found in emerging markets and the slightly too cautious momentum we notice in stock markets, where defensive sectors are performing better than cyclical ones. As a result, we are limiting the proportion of our investments that are dependent on high risk appetite.

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 20). These expectations cover the next 12 months.

ASSET CLASS	EXPECTATIONS NEXT 12 MONTHS		COMMENT
	RETURN	RISK	
EQUITIES	9%	13%	Expected risk and total return for global equities, measured using the MSCI All Country World Index in local currencies.
FIXED INCOME Bonds Cash	 2.8% 0.8%	 5.0% 0.1%	The forecast refers to an average duration of 5.5 years (T-bonds 7 years and high yield 4 years). In this case, cash equals assets with risk-free returns, for example T-bills.
HEDGE FUNDS	4%	4%	The risk and return forecast is based on the HFRX Market Neutral Index.
REAL ESTATE	5%	12%	The risk and return forecast is based on the EPRA Index.
PRIVATE EQUITY	10%	16%	A beta adjustment of global equities, measured as the performance of the LPX Total Return and MSCI AC World LOC indices over the past seven years.
COMMODITIES	-4%	15%	Expected risk and total returns for the Dow Jones UBS Commodity Index with weightings as follows: energy 33%, industrial metals 19%, agriculture 36%, precious metals 13%.
CURRENCIES	N/A	N/A	Used as a source of returns in our asset management. Our forecasts (12 months ahead) for the most central currency pairs are: EUR/USD 1.28 (-6.6%), EUR/SEK 8.50 (-5.5%) and USD/SEK 6.64 (+1.2%).



Source: SEB

CHANGES IN OUR EXPECTED RETURNS

Since the last issue of Investment Outlook *(published December 3, 2013) we have made the assessment that commodities will contribute negatively to returns in the coming 12 months. We have also slightly lowered our estimates of risk-adjusted returns for equities and private equity.*

Source: Macrobond

NEGATIVE START TO 2014 AFTER STRONG 2013

After last year's rally, stock markets lost ground in January. The world's broad indices showed generally negative figures, with the Japanese stock market falling the most after last year's strong performance.

MAIN STRATEGIES IN OUR PORTFOLIO MANAGEMENT

- **Equities focus – industrialised countries remain predominant, with Europe the most attractive**
  We are in an equities phase that primarily favours industrialised countries, where the economic recovery is the strongest and risks are decreasing. We continue to view Europe as an important area to invest in. The euro zone will benefit from strengthening domestic economies, there are still revaluation effects in crisis-hit countries and the euro currency has proved unexpectedly stable.

- **The economy will be sustained by consumers and private investments**
  Businesses and consumers are under-invested after a long period of weak growth, austerity and belt-tightening. These portions of the economy will provide the basis for growth ahead, and sectors that benefit from increased private consumption or corporate capital spending are the focus of our investments.

- **Corporate bond investments remain attractive**
  Europe is in a phase where credit markets are changing. More and more borrowing occurs via corporate bond issues, generating opportunities for both individual bond holders and for hedge fund managers with free fixed income market mandates. This will remain a focus area for us.

- **Hedge funds benefit from a stable climate**
  In a market climate driven by stable economic growth, hedge funds are often paid better for their strategies than in more volatile periods. For us, hedge funds are a way of identifying opportunities for returns other than those based on pure market movements (that is, "alpha" rather than "beta" returns).

ASSET CLASS	WEIGHT*	REASONING
EQUITIES	1 2 3 **4** 5 6 7	We are sticking to our positive strategic view of equities. The global economic recovery will support it, but valuations have reached levels that are causing us to adopt a cautious short-term stance. Earnings estimates continue to be revised downward and despite relatively good signals from purchasing managers, corporate earnings will take time to materialise. Europe is our first choice among equity markets, with Asia a close second. Continued market gains will require better earnings, and year-end financial statements did not give us the desired results.
FIXED INCOME	1 2 **3** 4 5 6 7	Corporate bonds in the high yield segment still seem to be the most attractive assets in the fixed income market, thanks to such factors as good corporate health, central bank stimulus policies and the prospect of higher risk appetite. Rising yields on government bonds in developed markets, with adverse effects on bond prices, make these unattractive for fixed income investors. High effective yields and chances for some price gains in a number of places are found instead in the emerging market sphere.
HEDGE FUNDS	1 2 3 **4** 5 6 7	During 2013, markets continued to "normalise", with decreased impact from the actions of politicians and more focus on company fundamentals. Both Equity Long/Short and Relative Value managers with a fundamental approach have had good returns over the past 12 months, and we expect that they will continue to deliver. The climate for Event Driven strategies also remains favourable.
REAL ESTATE	1 2 **3** 4 5 6 7	Expansionary monetary policies and signs of improved economic growth in Europe and the US should benefit real estate, but the shortage of investment alternatives and greater sensitivity to interest rates are still reasons to be cautious about this asset class.
PRIVATE EQUITY	1 2 **3** 4 5 6 7	The outlook for the private equity asset class will be positive over the next few years. Continued improvements in economic fundamentals – especially in Europe and the US – along with the continuing search for alternative sources of returns, will provide further potential. The growing number of exits is a good sign that the market has recovered after a few years of restraint.
COMMODITIES	1 **2** 3 4 5 6 7	The risks have increased and we are not expecting any returns in the next 12 months. The industrial metals market is balanced, oil prices are expected to be about the same a year from now and we expect gold prices to continue falling. For agricultural commodities generally, we expect rising inventories and falling prices for another while. Weather phenomena such as La Niña and El Niño obviously have the potential to change this picture.
CURRENCIES	1 2 **3** 4 5 6 7	In 2013, economic growth improved in the US and UK, while the euro zone left its recession behind. This benefited the USD, GBP and EUR. The only major currency to drop significantly in value last year was the JPY, which was weighed down by extremely stimulative economic policy in Japan (Abenomics). We predict that the Swedish krona will appreciate against the euro but weaken against the US dollar during 2014.

** "Weight" shows how we currently view the asset class as part of a portfolio. Level 4 is a neutral stance. 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 the customer level, portfolios are tailored to individual needs.*

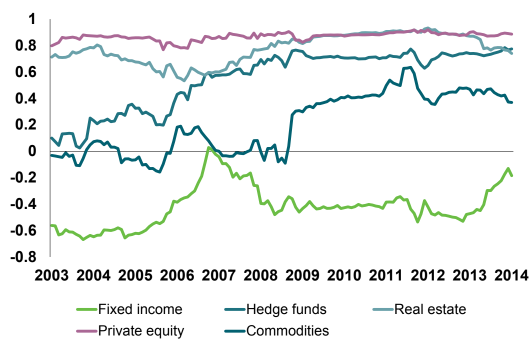
Source: SEB

HISTORICAL CORRELATION (FEB 28, 2004 TO JAN 31, 2014)

	Equities	Fixed income	Hedge funds	Real estate	Private equity	Commodities
Equities	1.00					
Fixed income	-0.32	1.00				
Hedge funds	0.71	-0.34	1.00			
Real estate	0.83	-0.08	0.57	1.00		
Private equity	0.87	-0.29	0.70	0.87	1.00	
Commodities	0.35	-0.23	0.66	0.30	0.41	1.00

Source: SEB

ROLLING 36-MONTH CORRELATION VS. MSCI WORLD



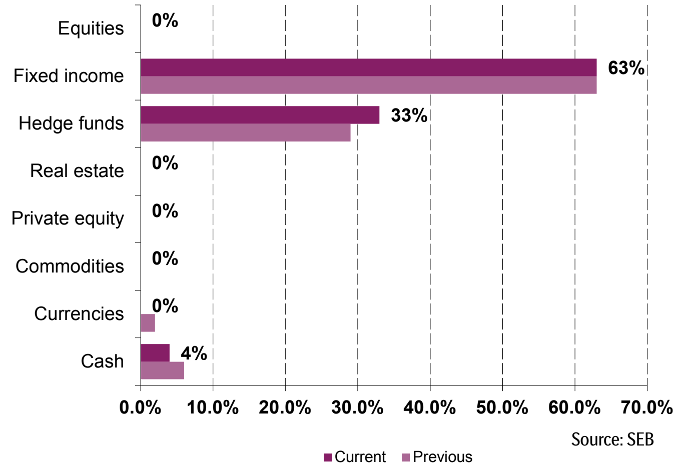
Historical values are based on the following indices: Equities = MSCI AC World EUR; fixed income = JP Morgan Global GBI EUR; hedge funds = HFRX Global Hedge Fund USD; real estate = SEB PB Real Estate EUR; private equity = LPX50 EUR; commodities = DJ UBS Commodities TR EUR.

MODERN INVESTMENT PROGRAMMES

– ALLOCATION OF CAPITAL ACROSS ASSET CLASSES AT THREE RISK LEVELS

MODERN PROTECTION

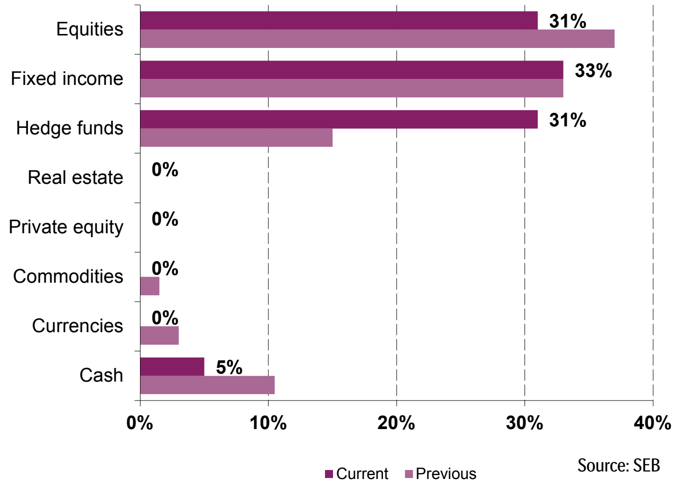
Modern Protection is still focusing on interest rate neutral strategies. Since October we have gradually increased hedge fund holdings as a proportion of the portfolio, mainly through Credit Long/Short strategies. This has yielded results – more than half of the portfolio's returns over the past three months have come from our Credit L/S and Market Neutral managers. We have made no changes in the fixed income sub-portfolio and senior loans/high yield remain at 11.5 percent, while Absolute Return accounts for 26 percent of the portfolio. Our managers continue to deliver in line with our expectations and the various asset classes complement each other well. We anticipate continued stable returns ahead.



Source: SEB

MODERN GROWTH

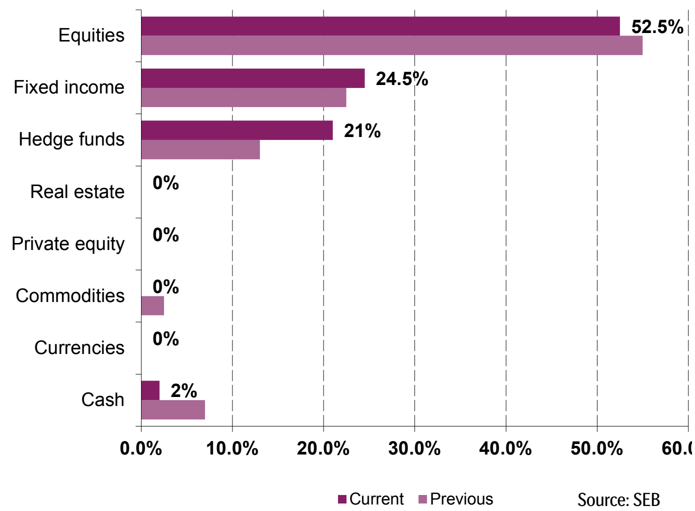
We still have a long-term constructive view of equities. Towards the end of January, however, we saw a significant risk of a major correction in light of weaker macro data and lower corporate earnings. We therefore decided on a short-term reduction in equity exposure from 39 to 31 percent to reduce the portfolio's downside risk. At this writing, markets have rebounded while earnings estimates continue to be revised downward. The risk of market turbulence persists and we have thus invested in Equity Long/Short, Event Driven and convertible bonds to obtain an equities-like exposure, but with better downside protection.



Source: SEB

MODERN AGGRESSIVE

Early in 2014 Modern Aggressive was positioned for a continued strong equity market, with 62 per cent equities, but as in Modern Growth we have tactically reduced downside risk by reallocating from equities to convertible bonds, Equity Long / Short and Event Driven holdings. We have also invested a small percentage of the portfolio in Contingent Convertibles or CoCos – a new and growing type of hybrid capital mainly issued by banks to meet their capital requirements. Our equity exposure is still tilted towards Europe and Asia – the regions we believe have the best potential for future growth. About 13 per cent of the portfolio is in ETFs (exchange-traded funds), so that we can quickly adjust the risk profile if the market outlook changes.



Source: SEB

Sub-Saharan Africa offers opportunities

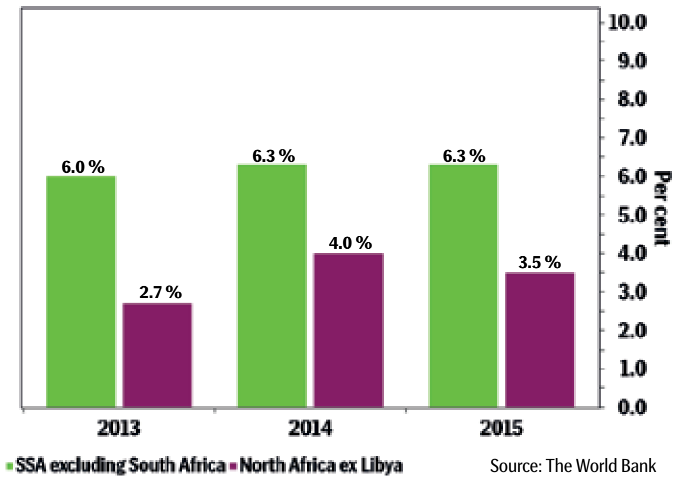
While countries in Asia, Latin America and Eastern Europe have achieved considerable economic progress, Africa's successes have been small. The continent's share of world GDP today is not even 3 per cent. Conditions and prospects – both in macroeconomic and stock market terms – are significantly better south of the Sahara desert than to the north, but for an equity investor it is difficult to achieve the most attractive exposure.

Industrialism was born in the United Kingdom in the mid-18th century and spread during the 19th century to the rest of Western Europe, North America and Japan. It was followed by massive investments in infrastructure development in the form of roads, railways and waterborne transport systems. Concurrently with the spread of industrialism, the role of agriculture for employment and the economy diminished and material prosperity rose.

The spread of industrialism in the northern hemisphere, especially during the 19th century and the first half of the 20th century, was accompanied by a growing need for commodities. Eyes turned towards Africa. Colonialisation followed. This meant that transport and communications improved to some extent on the African continent. But above all, natural resources were exploited. One consequence of colonialism – which lives on to this day – was that countries focused on producing and exporting a few commodities such as agricultural and food products, metals and oil. African economies thus remain highly sensitive to fluctuations in commodity prices.

During the post-war period, Africa has undergone a number of economic phases. First, attempts to boost industrialisation – often with foreign assistance. The aim was to reduce these countries' dependence on agriculture, but the results were less than satisfactory, among other things due to a less than successful policy of replacing imports with domestic production. After that came the launch of economic restructuring programmes (deregulation of markets and removal of trade barriers and subsidies) letting African countries benefit from financial assistance from the International Monetary Fund (IMF) and the World Bank. However, this had undesirable consequences, such as increased corruption and poverty.

In a somewhat new economic phase, a number of emerging economies have shown great interest in Africa's natural resources. This includes countries like China, India and Brazil that need commodities such as oil, natural gas, cobalt, nickel,



Source: The World Bank

FASTER GROWTH IN SSA THAN THE NORTH

In many respects, Sub-Saharan Africa (SSA) is macroeconomically stronger than North Africa, and both socially and politically the risk picture in North Africa also appears more serious. In this GDP forecast, Libya has been excluded from North Africa since its GDP has fluctuated wildly in recent years, while South Africa has been excluded from the Sub-Saharan figure since the region's growth dynamic is more clearly apparent if this large slow-growth economy is left out.

aluminium and platinum. In exchange for favourable long-term trade agreements and investments in African infrastructure, these countries are seeking new markets for their exports, reliable commodity supplies from Africa and access to farm land.

As to the outcome of this kind of "neo-colonialism" in Africa, the jury is still out. On the one hand, Africa undoubtedly has a great need of investment capital for infrastructure as well as telecoms, tourism and financial services. On the other hand, there is a danger that a rather high proportion of foreign capital will be channelled into "old-fashioned" commodity-based activities. This would impede the emergence of a more diversified African business community

Africa's place on the world map today

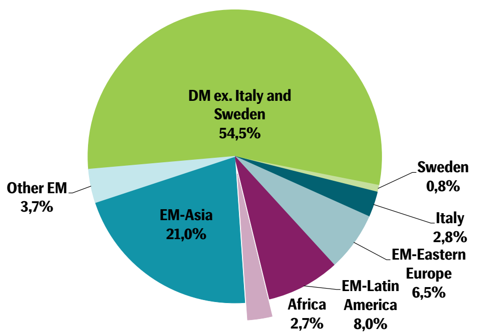
The three main emerging market regions (Asia excluding Japan, Latin America and Eastern Europe) have achieved economic progress in recent decades. According to IMF statistics for 2013 (in nominal terms and in USD), Asia excluding Japan accounts for almost 18 per cent of world gross domestic product (GDP), Latin America's 8 per cent and Eastern Europe's 6.5 percent. Meanwhile the success of Africa has been very small.

Today Africa consists of 55 countries. Five of these are in North Africa (Algeria, Egypt, Libya, Morocco and Tunisia), and the remainder are classified as south of the Sahara desert (Sub-Saharan Africa, SSA). Africa's population is about 1 billion people – one seventh of the world total – while Africa's GDP in 2013 was only USD 2.017 trillion (IMF statistics, nominal).

While every seventh person on earth thus lives in Africa, the continent accounts for less than 3 percent of world GDP. This means that GDP per capita (person) – a measure of economic prosperity – is extremely low (about USD 2,000, compared to USD 55,000 in Sweden).

Africa's GDP is comparable to Italy's (USD 2.068 trillion in 2013), larger than India's and a little less than that of Russia or Brazil. Last year, China's GDP totalled about USD 9 trillion,

AFRICA – A SMALL PERCENTAGE OF THE WORLD ECONOMY



Source: IMF

Although a billion people live in Africa and the continent possesses large reserves of commodities, Africa accounts for less than 3 per cent of world gross domestic product (GDP). Africa's economy is roughly comparable to that of Italy and less than four times larger than that of Sweden.

while Sweden's reached USD 552 billion. The African economy is thus less than four times larger than Sweden's.

The countries of North Africa account for over 35 per cent of the entire GDP of Africa, and the SSA countries account for less than 65 per cent. The wide gaps between countries are particularly striking. Last year, six African countries had a GDP of over USD 100 billion: South Africa, Nigeria, Egypt, Algeria, Angola and Morocco. Among the countries with the smallest GDP (under USD 1 billion) were Gambia and Guinea-Bissau.

Continued heavy dependence on a few products

The macroeconomic size of African countries varies greatly, but their dependence on a few export products is a common factor. These exports are generally not highly processed (manufacturing represents a very small share of the African economy), and consist mainly of commodities and foods. For some 15 countries, oil is the main source of export earnings. For five countries, it is coffee. Other products dominating Africa's exports are aluminium, platinum, copper, phosphorus, cobalt, diamonds, cocoa, tobacco, cashew nuts and tuna.

This export pattern – with more than 2/3 of exports consisting of commodities – closely reflects the economic structure of Africa. A full 50 per cent of Africans are employed in agriculture, followed by retailing, tourism and the public sector. Industrial jobs account for less than 10 per cent of the total.

Today this "obsolete" business structure is detrimental to Africa's economic well-being and vitality. There are also many other problems. For example 20 percent of Africans have to walk more than 2 kilometres to fetch water, only 30 per cent of people in the SSA countries have access to electricity and in some countries more than half of people aged over 15 years are illiterate.

Good potential for reforms and economic take-off

At the same time, these difficulties may serve as a breeding ground and a catalyst for the implementation of structural economic reforms – improvements in the functioning of markets, greater rule of law and infrastructure investments in key areas as well as political changes: democratisation, reduced corruption and reduced ethnic and social tensions. Together these would mean significant positive opportunities.

The emergence of an economic middle class in Africa may eventually become an increasingly strong growth engine in domestic markets. More than 40 per cent of the SSA population is under age 14. In itself this offers amazing opportunities – considering the problems caused by the shrinking proportion of working-age people in countries such as Russia, China and Japan – but it also poses a major challenge to generate job opportunities for this huge labour resource.

Far-reaching economic, political and social changes take time, in Africa's case probably a long time. The outlook for the next couple of years also shows major differences between the various countries in the region.

The African economic outlook in 2014-2015

World Bank forecasts (January 2014) for 2014-2015 clearly indicate very divergent outlooks in North Africa and Sub-Saharan Africa (SSA).

North Africa

Since the beginning of the "Arab Spring" just over three years ago, North Africa has witnessed great political, social and economic drama, with significant elements of violence. Uncertainty and the risk of political and social destabilisation are still weighing down the mood among households and businesses, especially in Egypt. Growth has consequently slowed, while government budgets and current account balances have weakened.

One important source of income – foreign tourists – has largely dried up, and the same is true of foreign direct investment inflows, especially to Egypt and Tunisia, but North Africans working elsewhere in the world still continue to remit large amounts of money to their relatives and friends.

For years, the region has suffered major structural problems, including high youth unemployment – a breeding ground for social upheaval – and significant inequality of economic opportunity for businesses and households.

Slow implementation of already democratically agreed political reforms (Egypt, Tunisia), persistent social unrest and the danger of further violence are holding back necessary structural reforms and also affecting growth, as well as oil production in Algeria and Libya.

Government finances and current account balances in these oil-producing countries will also deteriorate if oil prices fall further than those now prevailing. Meanwhile Egypt, Morocco and Tunisia – which are not major oil exporting countries and have relatively large current account deficits – will benefit from falling oil prices. The highest inflation rates in North Africa are found in Egypt and Libya.

After last year's North African GDP growth of less than 2 per cent, the World Bank predicts growth of nearly 5 per cent this year and 4 per cent in 2015. Excluding Libya – which is expected to undergo a significant rebound in growth – the 2014 and 2015 figures would end up at around 4 and 3.5 per cent, respectively.

Sub-Saharan Africa (SSA)

The region south of the Sahara has been one of the world's fastest growing regions since the mid-1990s, with annual GDP increases averaging nearly 5 per cent. In the future, the outlook for SSA is considerably better than for North Africa. The largest SSA economies are South Africa, Nigeria and Angola. As for South Africa, the country's relatively slow rate of growth in recent years – for reasons that include structural problems and labour unrest in the mining sector – has played a major role in holding back economic growth throughout the region.

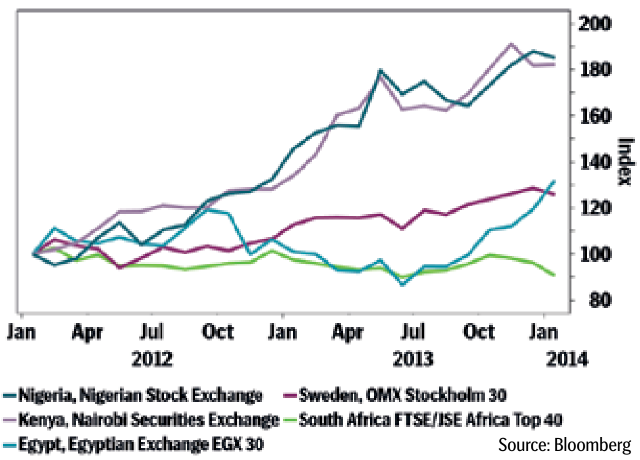
Growth in SSA is very broad-based. Private consumption – equivalent to about 60 per cent of GDP – as well as government consumption, capital spending and exports are now growing at a rate of 5-6 per cent. Despite widespread poverty and high unemployment, domestic demand is strong in low-income countries such as Kenya, thanks to greater household purchasing power. Although these countries may not receive much help from exports, because they have few international financial links, they also avoid major disruptions during global financial crises.

There were large inflows of foreign direct investment to SSA in 2013. This capital went mainly to the commodities sector, but also to telecoms, financial services, retailing and transport. Foreign corporate investments are also expected to remain an important growth engine in the coming years.

Inflation in SSA reached nearly 10 percent in late 2012, but slowed to around 6.5 percent by late 2013. Even lower inflation is now in the cards. This is partly due to the prospect of lower prices for some commodities – in itself a challenge for the region.

Another challenge is deteriorating government finances, although deficit levels are still not particularly alarming. In SSA, the overall budget deficit reached almost 3 per cent of GDP in 2013, while in low-income countries it was 4.5 per cent. Average government debt in SSA is 34 per cent of GDP – a low level, which many Western European countries, the US and Japan surely envy.

If future oil prices are lower than expected, this will hurt the oil producer Nigeria, which also has a rather small government



Source: Bloomberg

HOT STOCK EXCHANGES NEAR THE EQUATOR

The chart shows indexed share price performance in terms of Swedish kronor at four of the largest African stock exchanges: South Africa, Egypt, Kenya and Nigeria – plus the Nasdaq OMX Stockholm for comparative purposes – since January 2012. The markets in Nigeria and Kenya have performed very strongly, and after a slow start the Egyptian stock market has gained more than 50 per cent since September 2013. South African equities have performed weakly throughout the period, however. In local currency terms, South African shares also showed a clear price increase, but investors in other currencies could have lost this entire upturn due to the declining rand.

financial buffer. Sensitivity to mood changes among global investors is also a clear risk, as well as an opportunity, for countries like Nigeria (which has a military conflict under way in its northern regions), Kenya and South Africa.

According to the World Bank's current forecasts, GDP in Sub-Saharan Africa will increase by about 5.5 per cent in both 2014 and 2015, after last year's growth of more than 4.5 per cent. Excluding South Africa, the numbers for both this year and next will instead be close to 6.5 per cent.

Challenges for equity investors interested in Africa

For investors who intend to buy shares directly in individual African companies, or indirectly through a fund or structured product, it is important to be aware that the investment opportunities available outside South Africa today are limited.

For those who are primarily interested in Africa's vast natural resources, there are many alternatives and plenty of investment opportunities in African stock markets, but also on exchanges elsewhere in the world. The Nasdaq OMX Stockholm offer companies that focus on exploiting oil reserves in Africa, and one of the exchange's two biggest mining companies has its largest reserves in Congo-Kinshasa. Internationally, there are numerous resource companies that focus wholly or partially on African resources, especially on the Johannesburg Stock Exchange.

South Africa – the continent's biggest economy – also has by far its largest stock market. Capitalisation is equivalent to SEK 5,340 billion, or somewhat more than the Nasdaq OMX Stockholm. Mining and energy companies are important components, but there are also financial services, media, telecoms, retailers and consumer goods companies. In many cases, at an early stage South African companies identified growth opportunities elsewhere in Africa and established operations across much of the continent. However, the domestic market and markets outside Africa are still the most important to these companies. Since South Africa's macroeconomic situation is different from that of North Africa, and in several respects diverges negatively from that of many other SSA countries, it is not self-evident that investors seeking exposure to Africa/SSA want to have especially many South African shares in their portfolios. Africa funds nevertheless usually have their largest exposure in South Africa

Global commodities or local economic sectors

The success of equity investments in the commodities sector usually depends on global price trends for each respective mineral. Although progress on the African continent in terms of reduced corruption and improved infrastructure may have a major impact on the profitability of mineral extraction there, a successful investment in African mining or oil companies is probably more dependent on strong industrial growth in the West and China than on the progress being made in Africa.

Those who are seeking equity investments that benefit from Africa's unique demographic situation and the rapid economic growth in most SSA countries should instead focus on sectors that are more dependent on domestic economic growth. Examples are financial services, retail trade, building materials and food.

South Africa, North Africa and Nigeria

Unfortunately it is difficult to find investments that meet all criteria. The largest stock markets in Africa – after South Africa – are in Nigeria and Egypt, but for cultural, economic and political reasons, equity investors should regard North Africa and SSA as two completely separate regions.

For good reasons, many investors find SSA, excluding South Africa and the commodities sector, the most attractive. Unfortunately in this category there are only 14 listed companies with a market capitalisation of more than SEK 2.5 billion and daily trading volume of more than SEK 2.5 million. The list is dominated completely by Nigeria, with ten companies, followed by Kenya with three and one company based in Senegal.

The Nigerian Stock Exchange is by far the most important after South Africa, and is dominated by a few companies. The three largest – a cement manufacturer, a brewer and a food producer – together account for nearly half of total market capitalisation. Exposure to them is sought after by many investors, so their shares are valued at P/E ratios of between 20 and 37 based on 2013 earnings. According to Transparency International, Nigeria is one of the world's most corrupt countries, but this does not seem to have resulted in any discount in its stock market.

Sub-Saharan Africa is exciting, but difficult

To summarise, economic developments in Africa are very exciting. But for equity investors it is difficult to gain direct exposure to the most interesting region, SSA. Those investors who are attracted by the possibility of investing in Africa funds must therefore accept a relatively large element of both commodity companies and South Africa, and must also be aware that Nigeria will weigh heavily in the portfolio.

COUNTRY	STOCK MARKET CAPITALISATION, SEK BN	LISTED COMPANIES WITH MARKET CAP ABOVE SEK 1 BN
South Africa	5,340	164
Nigeria	486	45
Egypt	320	31
Ghana	177	10
Kenya	144	26
Morocco	81	34
Western CFA region	72	15
Tanzania	39	5
Botswana	33	15
Tunisia	16	18
Sweden	*4,890*	*190*

Source: Bloomberg and SEB

Are deflation and inflation worries justified?

Simultaneous worries about deflation and inflation have recently arisen. Inflation is often more short-lived and dramatic, whereas deflation can be a long drawn-out curse. There now seems to be a greater risk of deflation, but the chances of avoiding general deflation are good.

Expectations about deflation and inflation around the world have shifted dramatically in the past 5-6 years. Since mid-2011, a new trend has dominated the global economy – disinflation (a slowing of the inflation rate). Many people are worried that disinflation will turn into deflation before long, while others are concerned that inflation will soon return. Which group has the greater cause for concern?

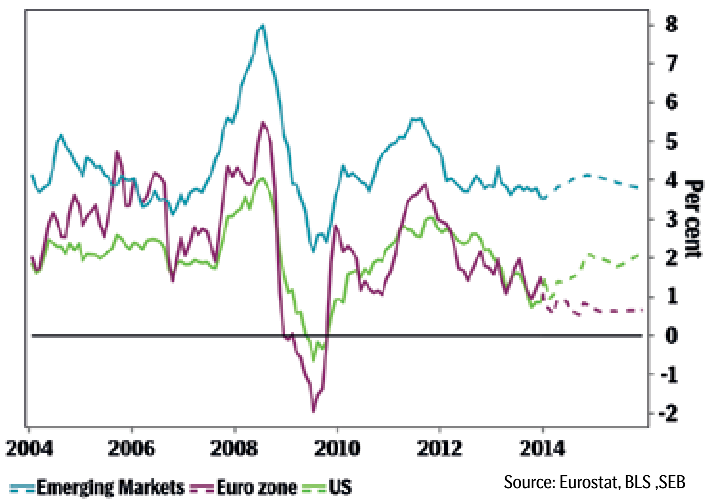
Consequences of deflation and inflation

Deflation – a fall in the general price level – is the opposite of inflation, which is a rise in the general price level. In other words, if prices of individual goods and services fall, that is not deflation. Instead, what is needed is a period of decline in a broader price index, such as the gross domestic product (GDP) deflator or consumer price index.

Deflation has essentially the opposite effects of inflation, benefiting savers while hurting those in debt. It also redistributes wealth "randomly". Both inflation and deflation create uncertainty about the future, which among other things makes it difficult for companies to obtain a solid basis for investment calculations. Of course deflation, if combined with falling real economic activity, is also devastating for corporate earnings.

In a society with inflation, there is incentive to consume quickly, preferably with borrowed funds. In a deflationary society, the reverse applies. It is rational to postpone consumption since goods/services will be cheaper later on, and postponing consumption means increased saving.

Once deflation has got a grip on an economy, there is a clear risk of a vicious circle. Expectations of falling prices bring high saving/low consumption, which – due to excess supply – makes prices fall more. That further weakens consumer demand, which leads to even greater downward price pressure and so on. This vicious circle is also fed by a growing number of bankruptcies and, in their wake, growing credit losses in the banking system.



Source: Eurostat, BLS ,SEB

OUR CRYSTAL BALL SHOWS A MIXED GLOBAL PRICE PICTURE

For a decade, there has been considerable variation in price change rates around the world. Inflation increases in 2008 and 2011 were mostly due to commodity price hikes, whereas the sharp downturn between those years was the result of the economic and financial crisis. For two and a half years, disinflation has been prevalent, while SEB's crystal ball predicts a mixed price trend, with the greatest deflation risk in Europe.

Inflation expectations can also give rise to a vicious circle. In that case, demand and debt accelerate, higher costs push up prices, market interest rates rise sharply, and central bankers and finance ministers implement economic policy tightening measures, so that after a while the economy plunges into recession.

An inflationary spiral is usually of much shorter duration than one driven by deflation and is also less difficult to get out of. In the choice between cholera and the plague, the macroeconomic disease of inflation is preferable, although there is far greater drama involved as it runs its course.

Drivers of deflation

Financial crises with asset deflation, where prices of financial assets and real estate fall, have typically resulted in disinflation for goods and services. Globally during the 1930s and in Japan during the 1990s, deflation spread to the real economy, where it lingered for a long time as a result of economic policy mistakes/passivity. The decline in prices of goods and services occurred because falling values of financial assets caused households and businesses to reduce their demand, with depression/recession and lower prices as a consequence.

There was also a general fall in prices in conjunction with the financial and economic crisis of 2008-2009, but that did not last long (a quarter or so in Europe, just under a year in the US). This was followed by a trend of accelerating price increases for a couple of years.

One important reason why deflation in asset markets did not spread to the real economy – the markets for goods and services – at that time was active economic policymaking. First, there were emergency fiscal and monetary measures to "save the financial and banking system", followed by monetary stimulus on an unprecedented scale, with central banks pursuing a zero interest rate policy and in some cases massive quantitative easing (securities purchases). Their motto has been that it is better to overshoot than to do too little too late.

Yet even though this unparalleled monetary policy is still being pursued with full force, and even though the current economic upturn has been under way for almost five years, disinflation has still characterised the last two and a half years or so. Some likely explanations for this are:

- An apparent reversal in the commodities trend, towards falling prices.
- A significant gap between actual and potential production in developed markets caused by the latest financial crisis, so that there is now an unusually plentiful supply of labour and spare production capacity, resulting in downward pressure on wages and costs.
- The length of time needed for financial crises to work their way through the financial system and the real economy when governments, companies and households focus on strengthening their balance sheets, which impedes growth.
- Technological advances, especially in information technology, which have contributed to higher productivity and downward price pressure.
- Deregulation in domestic markets and between countries, leading to increased domestic and international competition, which is why companies have ended up in a situation where they have no real pricing power.

So the lesson that can be learnt is that deflation generally benefits fixed income investors. Share prices can also do well when there is deflation – provided this is combined with economic growth. However, the combination of deflation and recession is devastating for equities.

Another important conclusion is that deflation is dangerous for borrowers. Deflation means that the real interest rate rises and the real value of debt increases accordingly. What economists call "debt deflation" – an indebted economy and indebted households are forced to use a growing share of their income to pay their debt burden – could drive a country into deep recession.

Drivers of inflation

In the post-war period, the inflation phenomenon has been completely dominant compared to the deflation phenomenon. A general rise in prices is often attributable to demand in the economy growing faster than supply, or to rising costs for companies, which causes them to raise their prices. Such price hikes usually characterise the final phases of a traditional business cycle.

Another cause of inflation could be substantial increases in commodity prices. Finally, there is a connection between inflation and the rapid expansion of an economy's money supply. Put simply, if the amount of money grows more than the new production of goods and services over an extended period of time, the result will be a growing excess supply of money. The value of money will fall and, over time, demand in the real economy will probably exceed supply, with the consequence being inflation.

At this writing, there is little apparent risk of demand- and cost-driven inflation in the developed market (DM) sphere, given high levels of available production resources and historically low interest rates. Recent statistics in the US also indicate that unit labour costs – a factor strongly correlated with the price trend – are now falling by about 1.5 per cent annually. In contrast, in the emerging market (EM) sphere, there are now indications of accelerating pressure on costs and prices in some countries in the wake of insufficient production resources and falling currencies. For that reason, EM sphere inflation should accelerate in 2014, but once recently implemented economic policy measures have been in effect for a while, price increases in these countries should ease in 2015.

Nor are there any flashing lights warning of inflation in the commodity markets. Instead, the trend there is for stable or falling prices, due in part to the decelerating growth rate in

China and several other leading EM countries, favourable climate/weather conditions and commodity-specific factors, such as potential excess supply in the petroleum market.

The circumstances outlined above thus do not signal any inflation threat. So those who believe the spectre of inflation will soon make an appearance are most likely worried about the consequences of the massive central bank stimulus provided by the US Federal Reserve (Fed), the Bank of Japan and – to some extent – the Bank of England, which the European Central Bank may add to during the spring.

But first, it is quite a long step for instance between the swelling of the Fed's balance sheet/monetary base and a rapidly growing money supply in the US. The link between the monetary base and the money supply is determined by the credit multiplier – a measure of how active banks are in their borrowing/lending. In the US, the multiplier is currently 3, compared to a normal figure of 10. Second, in order for a growing money supply to result in higher inflation, rising loan-financed demand from households and companies must be so great that it largely absorbs the excess capacity in the US economy, and that appears to be many years in the future.

Deflation a greater concern in developed markets

As a result, the spectre of deflation currently seems more frightening than the spectre of inflation in the developed markets, whereas inflation is a greater short-term problem in many emerging markets. However, there are important links between these two main global economic spheres.

In themselves, market reactions to the macroeconomic imbalances that have long been developing in many EM countries could give rise to deflationary tendencies in the DM countries. One way is through falling share prices and government bond yields as well as rising currencies (which reduce import prices) in DM countries, illustrated most recently by events in early 2014. Another route is through reduced demand from EM countries, which has a negative impact on growth in DM countries. In this context, there is reason to recall that it was the Asian financial crisis of 1997 that caused Japan to plunge into deflation.

But current price trends in the developed markets diverge. Particularly in the euro zone, there is clearly a high risk of deflation, but if the ECB launches new monetary stimulus measures – our main scenario – then general deflation can probably be avoided.

In the US, the rate of price increases has been fairly stable for some time, and there is far less deflation risk than in Europe – especially since the economy looks set to strengthen going forward, and some economic sectors are actually seeing wage hikes. Our fundamental outlook for the US is slightly higher – but by no means frightening – inflation later this year and in 2015.

In Japan the government's economic strategy, known as Abenomics, has stemmed the fall in consumer prices, which have now started to rise. Whether Japan has actually pulled itself out of the swamp of deflation depends in part on whether structural measures will trigger a sustained upward trend in wages and salaries.

When prices are aggregated in a consumer price index for all the developed markets (the OECD countries), SEB's current forecast shows an increase of 1.4 per cent in 2014 and 1.7 per cent in 2015, after a rise of 1.6 per cent last year – implying neither deflation nor inflation.

To sum up, there is no deflation in sight over the next two years, but keep in mind that deflation/inflation ghosts may be unpredictable...

World energy map being redrawn

In the space of only a few years, new extraction methods have made it possible to access enormous oil and gas deposits that were previously commercially unreachable. The world energy map is being redrawn, and this will affect many areas.

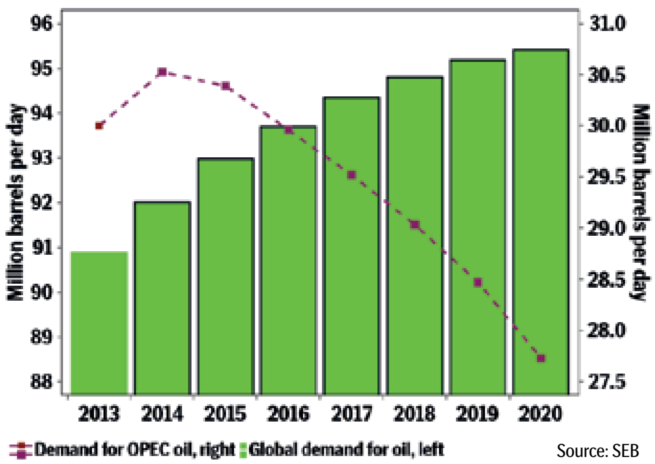
Well over 90 percent of world oil production today takes place from conventional resources/reserves. This refers to oil and gas extracted from a geological formation where the subsurface reservoir and its flow properties allow oil and gas to easily flow into the borehole.

It has long been argued that we are approaching "peak oil" – that we are running out of oil resources and that production will decline, while demand rises. We are now arguing that both of these claims should be strongly qualified or are in fact erroneous.

New extraction methods that combine "fracking" (hydraulic fracturing) and horizontal drilling have freed up enormous resources and made the extraction of unconventional reserves in recent years possible. North American shale oil, Canadian oil sands and a number of heavy oil projects in Venezuela are examples of unconventional reserves. Production growth from these resources has been very strong – so strong that the decline in oil production that had been under way in the United States for about 20 years has reversed over the past five years. In principle this means that the growth in output during this five-year period has been four times larger than the average annual decline in the previous two decades.

Combined with the transition to alternative fuels and continuous improvements in energy efficiency, today we can instead define "peak oil" as the time when the demand for oil peaked – with completely different consequences for the world economy than if it had been supply that peaked.

The market has generally viewed USD 110 per barrel of Brent crude as a kind of floor for future oil prices, but our assessment is that this figure may instead become a ceiling. The potential of unconventional resources is very large. Technically, we can speak of almost unlimited deposits.



Source: SEB

WILL OPEC LOSE SOME OF ITS CLOUT?

In our assessment, total demand for oil will continue to increase. As a consequence of this, we foresee challenges for OPEC. Our conclusion is that OPEC will play a weaker role in the next few years, since the demand for OPEC oil will decrease.

In the Bakken Formation in North Dakota alone, it is estimated there could be around 900 billion barrels of oil (known as "oil in place"). This would be equivalent to 30 years of global consumption. At present, about four percent of this volume can be regarded as economically recoverable reserves. Even this is a sizeable quantity, and the percentage is also increasing rapidly as technological advances occur.

The Bakken Formation is one of several similar areas. Deposits of shale oil and gas that are now rapidly becoming profitable to extract are scattered around the world. In Australia, South America, Russia, South Africa, China and Europe, both technical and political developments are under way that will allow the profitable extraction of unconventional resources. Far from all areas are commercially viable today, but the future looks bright. With rapid advances in technology and strong demand, extraction in these areas is likely to become profitable in the near future. In many cases, what today may seem unthinkable will be tried and tested tools in just a few years – the question is not whether it will happen, but how soon. In our opinion, this means that an ever-larger share of global unconventional resources will be politically, technically and economically extractible during the current decade.

Greater US self-sufficiency will reduce import needs

The United States accounts for more than one fifth of world oil consumption, since the country consumes around 19.5 million barrels per day. US production steadily declined for some four decades, while demand increased. Domestic production peaked in 1971 at 10 million barrels per day. In 2008 production stood at around five million barrels per day, with demand still rising steadily. The increased demand gap resulted in a greater need to import oil, particularly from the Middle East – which in itself was not entirely free of problems.

In just the past three or four years, the US has increased its oil production by about 60 per cent, equivalent to three million barrels per day. Our assessment is that this growth will continue for at least another three or four years, although the rate may vary from year to year. This growth is entirely due to new, unconventional extraction methods that make it profitable to pump oil and gas from previously inaccessible formations. The trend is driven by strong market forces and by public authorities that see the value of boosting the country's self-sufficiency level. Ten years ago, sparsely populated North Dakota (home of the Bakken Formation) was one of America's poorest states. Today its economy is booming and everything is growing rapidly, thanks to the expansion of oil production. North Dakota is now America's second largest oil-producing state after Texas.

Positive environmental effects

New methods for extracting unconventional resources are not just about oil. A large part of the story is natural gas, which will increasingly replace coal in the power generation industry and also gradually replace consumption of diesel fuel in the transport sector. This will lead to significant reductions in emissions. The combination of more efficient engines and more gas propulsion will make it easier to achieve climate goals. We are not saying that the climate issue can be solved by using the new extraction methods, but we will see positive effects.

Environmental criticism of the new extraction methods focuses on the extraction of oil sands. This extraction occurs either from open-pit mines or by using an on-site heating process, in which steam is injected to separate the bitumen (heavy viscous crude oil) and pump it out. Both these processes are energy-intensive and the latter method also consumes large quantities of water. The open-pit process has a major, highly visible impact, since large areas of land are excavated and the processing plants are sizeable. Oil sands also contain higher levels of sulphur than ordinary crude oil, and turning the bitumen into refined products is a far more demanding process.

In our opinion, the environmental criticism is justified, but we should also point out that any extraction that takes place on land is vastly more efficient and less damaging to the environment than current offshore drilling projects. Working on oil rigs at sea requires huge amounts of energy, and there are major environmental risks.

Will OPEC's role become weaker?

We believe that worldwide energy supply is in a state of flux. The supply side is increasing in terms of oil, while demand for oil will ease somewhat due to increased use of gas. Meanwhile, extraction methods will become more efficient, and production costs will fall. We anticipate that total oil demand will continue to increase, though at a much slower pace towards the end of this decade than today. As a consequence of this we foresee challenges for the Organisation of the Petroleum Exporting Countries (OPEC). Our conclusion is that OPEC will play a smaller role in the coming years, since the demand for OPEC oil will decline.

What economic consequences will the new oil and gas deposits have? It is a little too early to predict exactly what the consequences will be, but we are convinced of one thing: this is just the beginning of a very big change. In 10 years, perhaps the US will get by almost without oil imports. With access to cheap energy and increasing production that generates more jobs, this may signify America's revenge as an economic superpower, with a major impact on the US economy and current account balance. We can assume that increased independence will also lead to a reduced US interest in the Middle East (with opportunities to cut back the military budget) as OPEC's influence possibly declines.

Low prices and stable energy supplies should have positive consequences for consumers and for growth in most parts of the world. Energy-intensive companies in particular will benefit.

The biggest changes will occur within the oil service industry, especially in exploration and production (E&P). This will be of great significance for the global transport sector, the power industry and the petrochemical industry. Companies directly/indirectly involved need to keep track of this theme.

Our main message is that the energy map is being redrawn and that this will affect many areas. Our advice is to take these changes seriously. In other words: “When the facts change, we have to change our mindset.” Those who are able to respond proactively to future developments and are aware of the changes that are taking place will be more successful than those who are passively watching (and perhaps even denying what is happening). The rapid development of global unconventional oil and gas extraction will bring major changes, whether we like it or not.

Actually the oil and gas industry has been evolving continuously for more than 150 years. What has happened in the past decade, however, represents a significantly faster change. Both supply and demand are now changing. This means that the consequences will be far more extensive and will be important well outside the industry itself. This is absolutely not a transitory phenomenon, but one whose consequences will attract growing attention in the future. We also expect new unconventional forms of energy to appear. In this context, it may be worth mentioning methane hydrate (natural gas in frozen ice crystal form). This probably lies further ahead in time, however, but if/when scientists solve the technical and economic challenges, we are talking about an energy resource that is larger than all of today’s oil, gas and coal deposits combined...

Markets and asset classes

Macro summary

World economy steadily improving

- *An increasingly stable global economic upturn*
- *Brighter DM outlook, lingering worries in parts of the EM sphere*
- *US expansion may surpass high expectations but Fed "tapering" may hurt EM growth*

The international economic upturn appears increasingly stable. The industrialised, mainly affluent OECD countries (developed markets, or the DM sphere) have scored various macroeconomic successes this winter, supported by continued ultra-loose monetary policies and fading fiscal policy headwinds. Meanwhile the emerging market (EM) sphere has suffered from clear problems. EM countries with a combination of high inflation, large current account deficits and political instability are especially hard hit. But assuming that the global economic upturn continues, the risks of an EM financial crisis on par with the Asian one in 1997 seem small. If US growth is higher than in our main scenario, the world economy may expand unusually fast (20 per cent probability), while weaker-than-expected global growth (20 per cent probability) is likely to be due to possible adverse effects on EM countries from the US Federal Reserve's ongoing phase-out – or "tapering" – of its stimulative bond purchases.

Pieces of US growth puzzle falling into place

Growing household wealth thanks to rising home and share prices, along with a gradually improving labour market, signals higher US consumption ahead. Meanwhile businesses increasingly need to invest, and the contractive effect of fiscal policy will ease from more than 1.5 per cent of GDP in 2013 to only 0.2 per cent in 2014. We thus expect American GDP growth to accelerate from less than 2 per cent last year to nearly 3.5 per cent this year and more than 3.5 per cent in 2015. Inflation will remain low but tend to creep higher. The labour market will gradually heat up – unemployment may drop to 6 per cent as early as this year – causing business payroll costs to rise a bit faster. This indicates that the Federal Reserve (Fed) will continue to taper its monthly bond purchases at the current pace of USD 10 billion per policy meeting and that the first key interest rate hike will occur in the summer of 2015.

Euro zone bright spots, but also worries

The euro zone has climbed out of its recession. After falling by nearly 0.5 per cent last year, we predict that GDP will grow by 1 per cent this year and more than 1.5 per cent in 2015. Overall fiscal policy will be largely growth-neutral in 2014-2015. The actions of the European Central Bank (ECB), along with narrowing fiscal imbalances and improved competitiveness, have greatly lowered sovereign bond yields in countries like Ireland, Spain and Portugal, but southern Europe has not left the crisis entirely behind, so there is some remaining risk of market disappointments. Notable among euro zone worries are record-high unemployment and a banking system that is not yet working normally. The latter, together with worries about deflation (generally falling prices), indicates that the ECB will soon offer banks another round of long-term LTRO loans and will launch a bond purchasing programme. Meanwhile the ECB's key interest rate will remain at 0.25 per cent for a very long period.

British economy a big upside surprise

The United Kingdom has been one of the biggest upside economic surprises this past autumn and winter. Growth has ramped up, thanks to better competitiveness, less harsh fiscal policies and higher home prices, while UK banks have reached firmer ground. GDP rose less than 2 per cent in 2013, but we forecast nearly a 3 per cent increase this year and only a bit slower in 2015. Inflation has fallen with unexpected speed, and even more slowly rising prices ahead will allow the Bank of England to stick to its current stimulus policies, but ever-lower unemployment will make an initial rate hike from today's 0.50 per cent likely by the summer of 2015.

Varying Nordic possibilities and problems

The Nordic countries will follow different paths. In Denmark the housing market is recovering, laying the groundwork for higher private consumption. The Finnish economy faces many difficulties – poorer competitiveness, unfavourable price trends in foreign trade and structural problems in export sectors – and will thus lag behind the other Nordics. Last year, Swedish exports hit a bad patch while the domestic market performed well, but expansion is now broadening again and exports will accelerate. The greatest risk in Sweden is falling home prices. The Norwegian economy benefits from oil and world-class public finances, but a high cost situation, indebted households and falling home prices are a drag on growth. We predict Nordic GDP growth of more than 2 per cent this year and nearly 2.5 per cent in 2015, compared to just over 0.5 per cent last year.

Uncertainty about Japan will increase

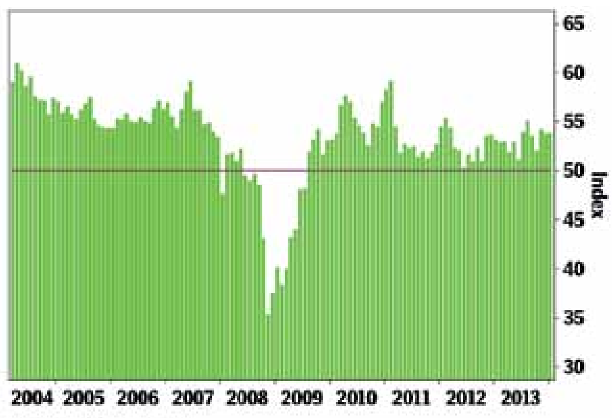
Because of unusually stimulative economic policies, Japan's economy and stock market strengthened greatly in 2013, but now fiscal policy will tighten (including a consumption tax hike), challenging economic growth. After growing by more than 1.5 per cent last year, we believe GDP will increase by less than 1.5 per cent this year and next, while tax hikes and the Bank of Japan's expansionary policies will push up inflation, especially this year.

In the long term, structural reforms (the "third arrow" of Abenomics) will pave the way to better growth and pay hikes will help keep inflation at about 2 per cent. But there is a risk that structural reforms will fail and that companies will remain reluctant to give their employees higher pay.

Faster growth ahead in emerging Asia

Growth in Asian EM countries will accelerate in 2014 and 2015, partly because of exports to the US and Europe, but intra-regional trade is also taking off. Export-led growth will mainly benefit small open economies such as Singapore and Taiwan, while the situation of commodity-exporting economies like Indonesia and Malaysia will be less positive. Financial market turbulence in 2013 caused by the Fed's talk about eventual "tapering" hit India and Indonesia especially hard. But although EM worries persisted early in 2014, they are likely to diminish.

In China, growth will decelerate cautiously in 2014-2015, mainly due to reform efforts including a tightening of credit expansion. This will adversely affect capital spending. We predict GDP growth of less than 7.5 per cent this year and 7 per cent in 2015, after more than 7.5 per cent last year. India's economic slowdown appears to have bottomed out, but there are no clear signs of vigorous recovery. There is also little room for either monetary or fiscal stimulus. The government budget deficit is large and the central bank has expressed a strong desire to lower inflation. Last year GDP increased by about 4.5 per cent. In 2014 we expect growth of 5 per cent and in 2015 nearly 5.5 per cent.



Source: Macrobond

Economic trouble spots in Latin America

Argentina and Brazil have experienced especially great economic and financial turbulence in the past six months. Argentina's central bank recently gave up defending the peso. The major depreciation that followed will add further to already high inflation pressure. In Brazil, the weak real along with rapid price increases have persuaded the central bank to continue its relentless rate hiking policy. In both countries, the economic outlook appears dim, at least in the short term. Another major economy in the region characterised by far better macroeconomic figures is Mexico. We forecast overall Latin American GDP growth of more than 2.5 per cent this year (the same pace as in 2013) and more than 3 per cent in 2015. Price increases will accelerate in 2014 and then slow next year.

Germany giving Eastern Europe a helping hand

Except for Russia and Ukraine, most countries in Eastern (including Central) Europe began an economic recovery last autumn and winter. Improvements are clearest in the central region, helped by German demand and the stabilisation of the euro zone economy and financial system. Countries now rebounding economically are Poland, the Czech Republic and Hungary. In many parts of Eastern Europe, private consumption will soon rise faster, as low inflation helps boost purchasing power, but capital spending looks set to remain weak, except for various large infrastructure projects. Economic expansion in the Baltic countries will strengthen and become more broad-based as exports revive this year, on top of a long-stable upturn in private consumption. Latvia and Lithuania will remain the fastest-growing EU economies, while Estonia is bouncing back after last year's abrupt deceleration. Latvia joined the euro zone on January 1 this year, which will hardly affect the economy in the short term. It is now very likely that in 2015, Lithuania will become the last Baltic country to join the euro zone.

Steady global improvement

The world economy is accelerating. We expect global GDP growth of nearly 4 per cent this year and 4 per cent in 2015, after just over 3 per cent in 2013. The EM sphere will grow the fastest, by about 5 per cent annually in 2014-2015, but the growth gap to the DM sphere will narrow, with developed market GDP set to rise by nearly 2.5 per cent in 2014 and over 2.5 per cent in 2015, compared to only 1.3 per cent in 2013.

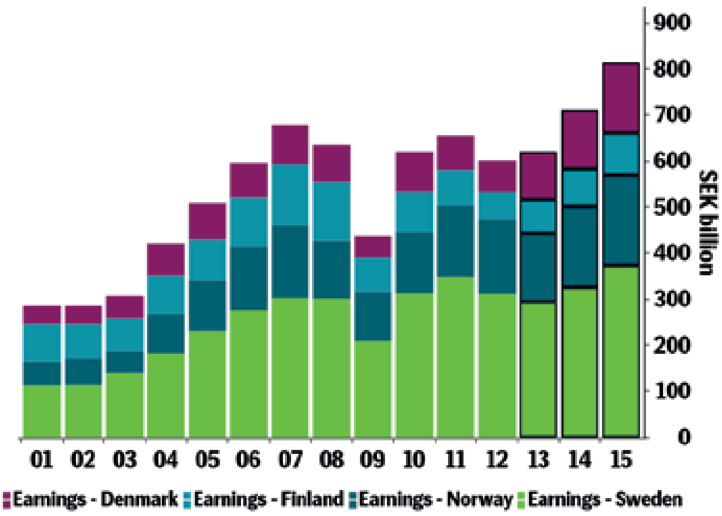
WORLD ECONOMY UNDERGOING STABLE EXPANSION

During the past three months, the composite global purchasing managers' index (PMI) for manufacturing and services has stood at around 54, signalling good world economic growth. Above 50 means growth; below 50 means contraction. In January 2014, the outlook in the global service sector shifted into higher gear while global manufacturing slowed a bit. Sub-indices predict continued good economic strength in the world this spring.

Earnings growth or not – that is the question

- **Disappointments dominated 2013 year-end reports, as earnings forecast are again adjusted downward**
  After three years of constantly recurring downward adjustments in earnings forecasts, a turnaround would have been more than welcome early in 2014. Instead, the year began with an unusually large proportion of disappointments as 2013 financial statements were unveiled.
- **Better manufacturing performance crucial if earnings are to rebound**
  Profitability is depressed at engineering and basic industrial companies, which are expected to deliver sharp earnings improvements both in 2014 and 2015, but only an upswing in manufacturing will make such a trend reasonable.
- **Earnings growth vital for a continued stock market upturn**
  After two years of strong stock market gains while company earnings have decreased, we believe an improvement in the earnings trend is critical to continued positive stock market performance.

RECORD EARNINGS AS EARLY AS THIS YEAR?

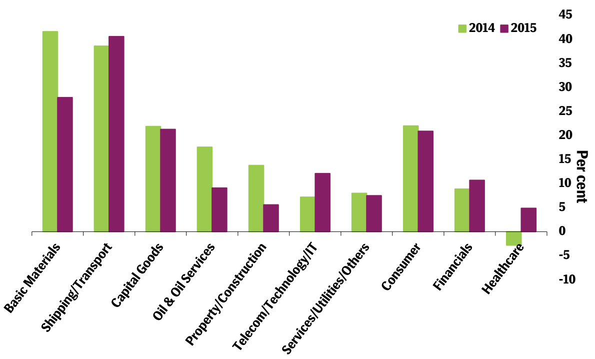


Source: SEB

The chart shows the aggregate earnings of Nordic listed companies in billions of Swedish kronor, allocated by country. The companies on the Nasdaq OMX Stockholm exchange generated record earnings in 2011, but then earnings shrank two years in a row. Our forecasts indicate new record earnings in Sweden in 2015. In the Nordics as a whole, earnings have not yet reverted to their 2007 record, but according to our forecasts a new record can be expected to be set as early as this year.

The Nasdaq OMX Stockholm exchange recently set new record highs, and interest in equities among the general public has greatly increased. Unfortunately the upturn has been driven entirely by downward adjustments in return requirements; in other words, the stock market has benefited from the effects of low interest rates. The corporate earnings trend has provided no support. On the contrary, earnings decreased by 5-10 per cent both in 2012 and 2013.

HIGH EXPECTATIONS FOR CYCLICAL COMPANIES



Source: SEB

The chart shows our forecasts for 2014 and 2015 earnings growth in per cent for companies on the Nasdaq OMX Stockholm, allocated by sector. We expect earnings improvements especially in such cyclical sectors as basic materials, capital goods and transport, but the consumer sector (H&M) is also expected to help boost earnings in 2014 and 2015.

A similar picture prevails in the Nordic region as a whole, although Denmark diverges since companies there generated record earnings in 2013. In Finland, earnings rose by more than 20 per cent in 2013, but this improvement occurred from a very low level and combined earnings are still only somewhat above half what they were during the record year 2007.

In 2014, analysts expect substantial earnings improvements in the Nordic region, 14 per cent, while in Sweden they anticipate that earnings will climb by 10 per cent. If these expectations prove correct, this will mean record earnings in the Nordic region for the first time since 2007, but Swedish corporate earnings will still be somewhat worse than during the record year of 2011.

Can companies live up to expectations?

Many investors are worried that companies will not be able to live up to analysts' expectations. If we look more closely at the forecasts for companies listed in Stockholm, it is apparent that cyclically sensitive sectors are expected to account for the bulk of earnings improvements. The projected trend thus also requires improved conditions in the manufacturing sector, not only in the United States and Germany, but globally.

Such an earnings trend would also make valuations, measured as price/earnings (P/E) ratios, look less stretched. The largest percentage earnings improvements are expected in such cyclical sectors as forest products, steel and nonferrous metals, as well as transport and engineering companies (capital goods). Sectors that are not as dependent on economic cycles, especially health care, financials and telecom operators, are expected to contribute significantly less to earnings growth. In absolute terms, capital goods above all must deliver according to expectations if overall earnings are to grow as planned. The capital goods sector is expected to contribute 45 per cent of this year's total earnings upturn on the Stockholm exchange.

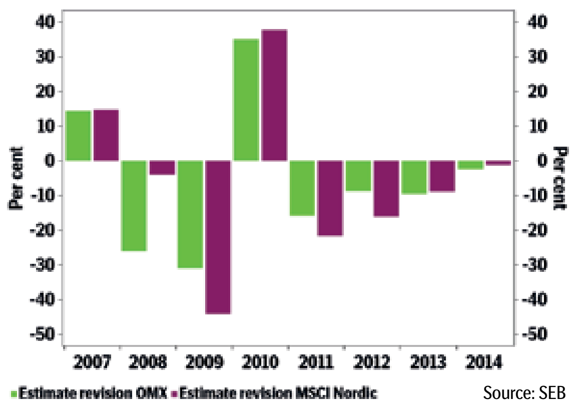
Weak start worrisome

Over a three-year period, earnings forecasts have been in a constantly falling trend. Final overall earnings of Swedish listed companies in 2013 and 2012 were about 10 per cent below expectations at the beginning of each respective year. Elsewhere in the Nordic region, company performance was even worse.

We currently foresee 10 per cent earnings growth in Sweden this year, but if the revision trend of recent years does not reverse or at least slow, investors will not dare to rely on the final figure being anywhere near that good.

There were many disappointments when 2013 financial statements were unveiled, and unfortunately it is not possible to see any improvement in the revisions trend; seven weeks into the year, earnings forecasts for 2014 have already been adjusted downward by more than 2 per cent.

FOURTH YEAR OF DOWNWARD ADJUSTMENTS IN FORECASTS?



Source: SEB

The chart shows our earnings forecast adjustments in per cent for Nordic and Swedish listed companies, respectively, from January 1 of each year until their year-end reports had been published about 14 months later. We have now been forced to adjust our earnings forecasts downward continuously for more than three years. Earnings in 2013 were about 10 per cent worse than we had anticipated on January 1, 2013. Unfortunately 2014 has also begun with continued downward revisions, creating concerns that companies will not be able to live up to expectations of 10-14 per cent earnings growth this year.

Do forecasts matter?

If analysts' year-ahead forecasts have been so seriously inaccurate in recent years, does it matter how they revise these forecasts? Is there any reason at all to look at these forecasts?

Yes, in our opinion the aggregate analyst forecasts at any given time still provide the best possible picture of the earnings outlook for the current year, given the information that is available at the moment. A stabilisation of forecasts would reflect the fact that news flows and statistics are no longer forcing analysts to lower their forecasts. A stabilisation will thus be one of the first signs that companies appear likely to live up to the expectations being attached to them.

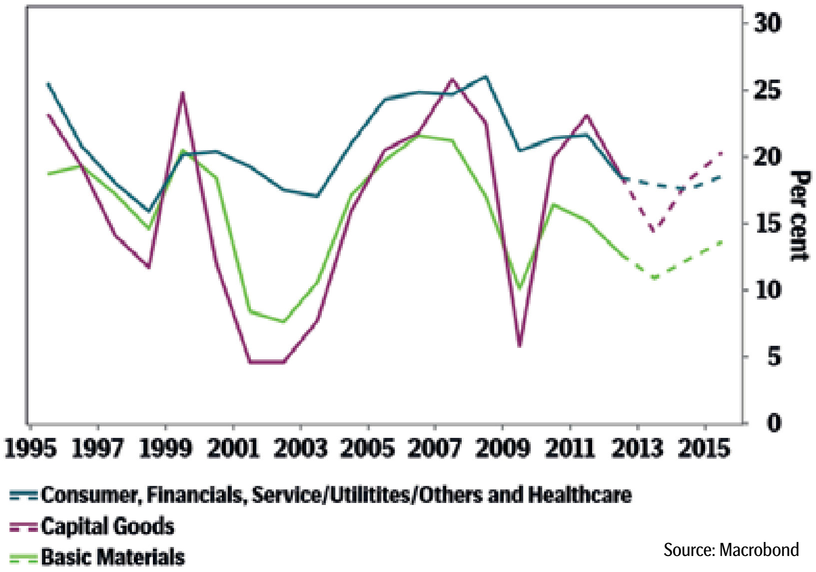
Significant improvement potential

Although analysts today are counting on companies to deliver major improvements during the coming year, it is from depressed levels. Apart from the extreme recession year 2009, return on equity for Swedish listed companies in 2013 represented a 10-year low.

Basic industries (forest products, steel and nonferrous metals) have not had as poor profitability as last year since 1993, and return on equity in the engineering industry deteriorated by nearly 40 per cent in two years. Fluctuations in profitability have often been significant and rapid. In fact, once turnarounds materialise they are often surprisingly large. The speed of the 2010 recovery was vastly underestimated once it began.

In other words, expectations of sizeable earnings upturns in 2014 are not at all unreasonable, viewed in a historical perspective. The question instead is: Will the turnaround materialise now? If it doesn't, explanations of the "it's different this time" type will not be long in coming. Many people may then be expected to be worried that there are structural changes behind the deterioration in profitability and that the good times will not come back.

BETTER PROFITABILITY EXPECTED IN THE CAPITAL GOODS INDUSTRY



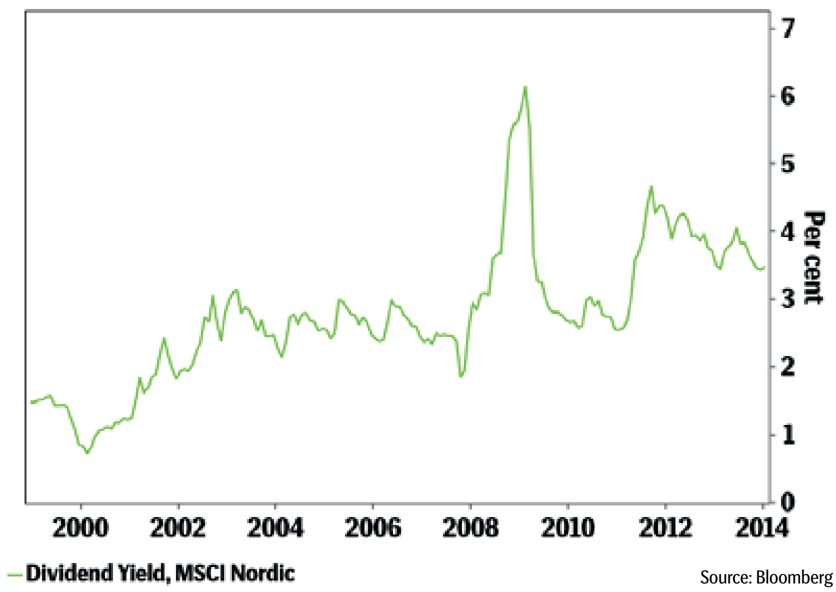
Source: Macrobond

The chart shows return on equity for engineering companies (capital goods) and basic industries, respectively, and the average for more stable sectors: consumer goods, financials, services and health care. Today profitability is depressed in basic industries and at its lowest level for more than a decade in other groups (except for engineering in 2009). In absolute figures, however, profitability is quite good compared to prevailing interest rates. We expect an improvement during the next couple of years for both engineering and basic industries.

Equities, the least bad alternative

We believe that better earnings growth is vital to give the stock market the energy to climb further from current levels, and that the upturn that has already occurred will turn out to be based on economic fundamentals. Meanwhile it is important to remember that the upturn of recent years has not been driven by earnings but by positive capital flows that, in turn, were generated by investors seeking better return alternatives than the extremely depressed yields on government securities and high-quality bonds. This situation persists even today. With a dividend yield of 3.5 per cent in 2013 and 3.8 percent in 2014 in Sweden and the Nordic countries as a whole (higher in Finland and Norway, but lower in Denmark), equities stand out as a relatively attractive alternative, even though the long-awaited surge in earnings will take time to materialise. Low interest rates and yields on other investments will help sustain the stock market this year as well, but it would be nice if we received more support from companies' own earnings.

ATTRACTIVE DIVIDEND YIELD



Source: Bloomberg

The chart shows dividend yield in the Nordic stock market in per cent, calculated using dividends during the previous 12-month period (moving). Even though stock market valuations have already climbed significantly, to many people a 3.5 per cent dividend yield looks attractive compared to other investment alternatives.

News-sensitive markets supported by growth

- **The year begins in a hesitant mood**
  After last year's gains in world stock markets, 2014 began with hesitant investors and falling share prices. The biggest stock market declines occurred in Japan, Brazil and Hong Kong. Uncertainty about emerging market growth and policies topped the agenda after weak macroeconomic statistics out of China.

- **Brighter macro and micro outlook in Europe**
  Supportive structural measures by euro zone governments, combined with the successful efforts by companies themselves to become cost-effective and competitive are providing positive signals. Global growth and increased consumption in Asia should benefit European companies.

- **Economic growth will provide support to global equities**
  The market is sensitive to negative news. In the long term, equities are clearly preferable to other asset classes, and share prices will be supported by continued global economic growth, but we are holding back on raising the risk in our own portfolios until we see clear signs of better corporate earnings.

A DIP IN WORLD STOCK MARKET CURVES DURING JANUARY

Source: SEB

After last year's price gains, stock markets lost ground in January. Broad global indices showed negative numbers in general, with the Japanese stock exchange showing the worst performance after last year's strong increase. Chinese purchasing managers' indices for manufacturing fell more than expected, leading to declines for emerging market equities.

LAST YEAR GAVE US EXCELLENT SHARE PRICE INCREASES. The world index rose a full 26 per cent in local currencies, but the gap between regions in stock market performance were astoundingly wide. Japan, the US and Europe performed significantly better than emerging market (EM) exchanges and the rest of Asia. Concerns about the Fed's actions led investors to seek out safer alternatives in the form of developed market (DM) shares. The Japanese stock market rose over 50 percent in local currency followed by the US-based Nasdaq, which was up 38 per cent. The worst performer was Brazil, where the index fell 15 per cent, but Russian and Chinese equities also fell. The strongest performers among EM countries were Taiwan and India.

A dip in the curve during January

This year started on a negative note, with the broad equity indices showing overall red numbers in January. Share prices fell sharply in Japan, Brazil and Hong Kong. Concerns about the EM sphere erupted after credit-tightening measures in China. Chinese purchasing managers' indices for the manufacturing sector fell more than expected and emerging market currencies weakened significantly. This year's decline has been broad. Pharmaceutical and utility companies are exhibiting marginally positive returns, while other sectors have lost value. Telecom operators, energy and consumer-related sectors are the global losers. Last year's winners, consumer durable companies, have fallen this year.

Continued decent earnings growth

Looking ahead, companies in the commodity, engineering and IT sectors are showing the highest earnings growth in 2014, while telecom operators and utilities are growing at a slow pace. Financials and commodities are attractively valued, while consumer-related companies and pharmaceuticals are more expensive than average. The IT sector no longer looks as attractive after strong gains last year. High earnings growth and low valuations are found mainly in commodities, but companies in this sector are also the most dependent on the economy genuinely taking off and earnings forecasts materialising.

Overall corporate earnings are expected to grow by 10 per cent in 2014, where the outlook for EM-based companies is higher at nearly 14 percent. We foresee the best earnings growth in Japan and India, while earnings will fall in Russia. We predict that European corporate earnings will grow by 12 per cent this year, and the picture is becoming brighter and brighter. Responsible governments in the euro zone have undertaken significant reforms, and slimmed-down companies are now competing effectively against Asian newcomers from traditionally low-cost countries. With nearly half the sales of European companies going to other parts of the world, these companies benefit significantly from increased global growth, consumption in Asia and new trends in technology. We are finding attractive investment alternatives among well-run small and mid-cap companies as well as in the consolidating financial sector.

Valuations on the high side

The global stock market is valued at a price/earnings ratio of 14.5 for 2014, or slightly higher than the historical average. EM shares are cheaper with a P/E ratio of 10, while Eastern Europe has the lowest valuation (P/E ratio of 8). On closer scrutiny, Eastern European shares look less attractive earnings are not rising. American companies are valued higher than average, and European and Japanese companies somewhat lower. In the long term, we continue to focus on Asia as an attractive alternative, with its P/E ratio of 10.5 and earnings growth of 12.5 per cent. At present, the Chinese market is undervalued (P/E ratio of 8) and earnings will grow by 10 per cent.

The stock market is sensitive to negative news, and we need to see better earnings growth to justify rising P/E ratios (and thus higher share prices). Ambiguous macro data are currently a challenge, since valuations are not as attractive anymore. In the long term, equities are clearly preferable to other asset classes and the market will eventually be supported by continued global growth. In the short term, however, we are cautious and will hold off on increasing risk in our portfolios until we see clear signs of better corporate earnings.

REGION	WEIGHT*	COMMENT
Globally	1 2 3 4 **5** 6 7	In the slightly longer term, global equities will enjoy continued support from global economic growth. Achieving higher P/E ratios and share prices will require upward revisions in earnings forecasts and a better earnings trend. Share valuations are higher than the historical average and the market is thus more sensitive to negative news.
Europe	1 2 3 4 **5** 6 7	Europe is overweighted in our portfolios, since macro data are continuously improving and valuations and earnings growth look attractive compared to the US and emerging markets. The European Central Bank and fiscal policies are supportive, while companies are cost-effective and competitive.
US	1 2 **3** 4 5 6 7	Relatively stable macro data as well as better earnings growth and company reports have already led to a strong market that is trading at record levels. Valuations are stretched, which limits potential.
Asia/EM	1 2 3 **4** 5 6 7	Asia continues to be a growth investment for the long term, with some caution at this stage. Unstable forecasts mean that we are tactically reducing the weighting somewhat in our portfolios. Choose less developed countries in Asia with continued high growth potential. Avoid pure commodity exporters.
Japan	1 2 3 **4** 5 6 7	The government's stimulus package has triggered a stock market rally and a fall in the currency. The impact of new policies is now beginning to show up in macro data. High earnings forecasts and earnings have been revised upward, but from low levels. Stimulus measures are having a positive effect on Asia as a whole.

** "Weight" shows how we currently view a region. Level 4 is a neutral stance. These weights are changed continuously based on our tactical market view and may thus diverge from our long-term strategic view of a region.*

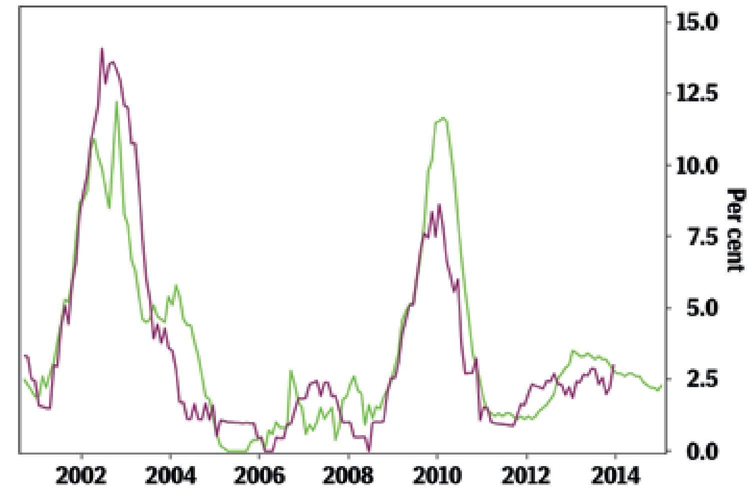
Investors focus increasingly on high yield

- **Zero interest rate policies and securities purchases continue**
  Very low inflation, continued concern about the financial system and an economic upswing will allow leading central banks to maintain their unprecedented stimulus policies for a good while longer.

- **Probably the start of a long period of rising government bond yields**
  In the short term, central bank policies themselves will keep government bond yields down, but the argument for rising yields is gaining strength. By all indications, the summer of 2012 marked the bottom of the latest 30-year interest rate cycle, which means there are great challenges for fixed income investors now and going forward.

- **High yield better than low yield**
  Corporate bonds in the high yield (HY) segment still seem the most attractive investment in the fixed income market, thanks in part to good corporate health, central bank stimulus policies and the prospects of investors willing to take risks to achieve better returns. These happy days should continue for at least a year, but then the risks of a deteriorating HY climate will increase.

CENTRAL BANKS AND IMPROVED ECONOMIC CONDITIONS
WILL MEAN FEW CORPORATE BANKRUPTCIES



Source: S&P and SEB

The return on high yield bond investments depends mainly on their running yield, on whether bond prices fall (yields rise) or rise (yields fall) and on whether the companies that issued the bonds go bankrupt or not. Based on SEB's forecast for Europe, the risk of bankruptcy will be at a historical low during the coming year.

ONE TREND THAT THERE IS EVERY REASON to keep in mind is the 30-year interest rate cycle, which has existed for almost a century. The last period with a rising government bond yield trend lasted from the early 1950s to the early 1980s. After that, government bond yields tended to fall for about 30 years. These falling yields were mainly due to lower and lower inflation (the deflation risk is now greater than the inflation risk – read more in our theme article), largely the result of central banks' strong focus on fighting inflation.

In recent years, zero interest rate policies and very active unconventional monetary policies (mostly government bond purchases) by leading central banks have helped push government bond yields even lower. But the question is whether the bottom of this 30-year interest rate cycle was reached in the summer of 2012, with government bond yields now heading north for a very long time to come.

Clearly, the zero interest rate policy pursued by the US Federal Reserve (Fed), the Bank of England (BoE), the European Central Bank (ECB) and the Bank of Japan (BoJ) will continue for a good while. We predict that the first interest rate hikes (by the Fed and BoE) will not occur until the summer of 2015. Meanwhile the balance sheets of those two central banks will grow via securities purchases totalling more than USD 1,100 billion in 2014, although the Fed will gradually slow its purchasing pace. We also expect the ECB to start buying bonds during the spring.

Nevertheless, our main scenario is that government bond yields will gradually rise, starting in 2014 and 2015. Arguments for this include a strengthening global economy, good risk appetite (which should limit the demand for government bonds), initially quite low real interest rates (nominal interest rates minus price changes), and every indication that the Fed and BoE along with a number of smaller central banks – such as their Norwegian and Swedish counterparts – will introduce policy rate increases in 2015. Higher growth and inflation in the US compared to large parts of Europe, combined with monetary policy considerations (see above), should cause US government bond yields to rise far more than yields on many European government bonds over the next couple of years.

Rising government bond yields in developed market (DM) countries, with accompanying negative effects on bond prices, make these instruments unattractive for fixed income investors. Instead, high bond yields (running yields) and the possibility of price gains here and there can be found in emerging markets (EM) and in DM corporate bond markets.

Bonds issued by emerging markets were hit hard after the Fed signalled in the second quarter of 2013 that it would slow its bond purchasing pace. The general anxiety about the EM sphere that dominated early 2014 then further reduced EM bond prices, especially measured in DM currencies. One could therefore argue that EM bonds might be worth buying, but the uncertainty that will most likely dominate the EM sphere for a while longer calls for great caution at present.

Fixed income investors are therefore focusing increasingly on the corporate bond market in general and the high yield segment (HY) in particular. Granted, yields have fallen to historically rather low levels, and the yield gap to government bonds has narrowed. But the combination of a stronger global economy, which improves corporate earnings/balance sheets, continuing exceptionally accommodative monetary policies and the prospects of good risk appetite/rising share prices are economic conditions that favour HY to a high degree.

The great interest in HY among fixed income investors continues and is reflected in the large inflows to HY funds, signs of excess demand for HY bond issues (issuing activity, especially in Europe, continued to be robust in January 2014), and the fact that the HY market successfully withstood the wave of risk flight in financial markets that dominated the start of the year.

But these happy times will not last forever, and as the Fed's first interest rate hike – towards the spring of 2015 – approaches, that could trigger a less favourable HY climate.

ASSET CLASS	WEIGHT*	EXPECTED RETURN NEXT 12 MONTHS		RISK	
		SEK	EUR	SEK	EUR
Treasury bills	1 **2** 3 4 5 6 7	0.7%	0.1%	0.1%	0.3%
Government bonds	1 **2** 3 4 5 6 7	-0.7%	0.3%	4.8%	4.9%
Investment grade corporate bonds	1 **2** 3 4 5 6 7	1.7%	1.1%	2.5%	2.5%
High yield corporate bonds	1 2 3 4 **5** 6 7	5.2%	4.6%	5.2%	5.2%
Emerging market debt	**1** 2 3 4 5 6 7	7.0%	7.0%	9.4%	9.4%

Source: SEB

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

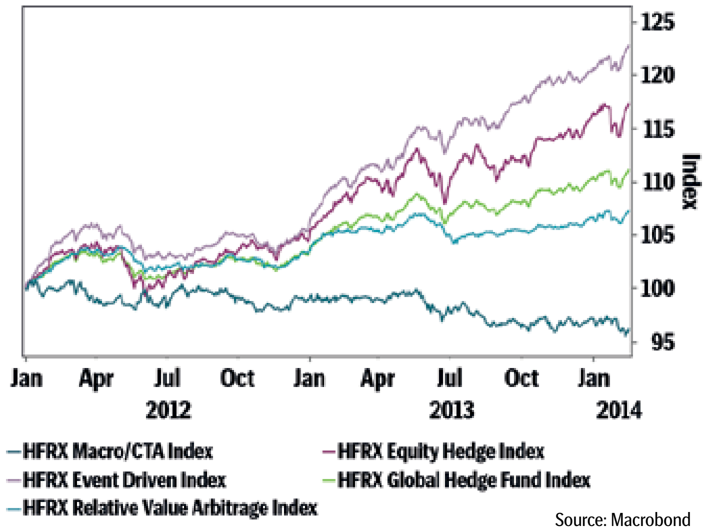
Hedge funds headed for another bright spring

- **Strategies with a fundamental valuation approach continue to generate returns**
  The markets continued to "normalise" in 2013, with the diminishing effects of political manoeuvring and more focus on company fundamentals. Equity Long/Short (Equity L/S) and Relative Value fund managers with a fundamental approach both generated good returns over the past 12 months, and we expect they will continue to deliver.

- **Event Driven strategies benefit from corporate deals**
  Companies are having difficulty growing organically and should opt for spin-offs and acquisitions, which benefit Event Driven strategies. Continued restructuring of European banks also creates opportunities for these fund managers.

- **We are beginning to see the dawn for trend-following strategies**
  Trend-following strategies had a rough year, with a small number of events generating most returns. Less "risk-on/risk-off" behaviour is good for CTA, but trends are still shifting rapidly, which means we remain cautious about Macro/CTA strategies.

"NORMALISATION" OF MARKETS BENEFITS HEDGE FUNDS



Source: Macrobond

Last year was a good year for many hedge fund strategies. The best performers were Equity Long/Short and Event Driven. Times were tougher for trend-following strategies such as CTA, to which we still have a cautious approach.

HEDGE FUNDS HAD A GOOD 2013 overall. The HFRX Global Hedge Fund Index closed the year up 6.7 per cent (in EUR). The last quarter of 2013 started slowly, given the problems surrounding the US federal debt ceiling, which however were resolved at the last minute. Nonetheless, investors remained focused on macroeconomic statistics and the bond market actions to be taken by the new Federal Reserve chair, Janet Yellen. Equity Long/Short fund managers were able to continue generating added value in a more fundamentally driven market despite brief troubles and had one of the winning strategies, with the HFRX Equity Hedge Index gaining a full 11.1 per cent (in EUR) for 2013.

The Fed's announcement in May about its future plans to reduce monthly stimulative bond purchases caused significant turmoil during the summer. When the tapering was finally announced in December, the message was accompanied by forward rate guidance assuring investors that interest rates would remain low for a long time, which gave them new confidence. Upward-adjusted gross domestic product (GDP) forecasts for the US and Britain also helped to buoy spirits. In Japan, the yen (JPY) fell to a five-year low against the US dollar, which benefited the country's key export sector and thus its deflation-plagued economy. In contrast, Europe showed further signs of a slow economic recovery, and the ECB lowered its key interest rate in view of low inflation and high unemployment. Still, unfavourable news from Europe did not sour the mood in mature markets. However, the picture was somewhat mixed for emerging markets.

Equity Long/Short

Most factors point towards this strategy continuing to perform well – sustained low interest rates, a stable US economic recovery and lower correlation between individual equities. Fundamental factors should prevail and "smart" money could look to undervalued equities, while fund managers could also short-sell overvalued equities.

Of course, there are always uncertainties that could cause turbulence. January is a good example, with a decline driven by worries about emerging markets and their currencies. There are concerns about China's credit market and the country's move towards a more free economy, which could have a global but especially a regional impact. Talented, knowledgeable fund managers can take advantage of these concerns by analysing the region's impact on individual companies and taking positions accordingly. Equity market neutral and long/short strategies in mature markets have good potential to perform well. Still, pure emerging market Equity L/S strategies should probably be avoided for the next few quarters, since there is a great risk of higher correlations.

Relative Value Arbitrage

This strategy ended the year up almost 3 per cent. During the final quarter of 2013, credit spreads almost without exception had a narrowing trend, which mostly benefited Credit L/S fund managers with a long bias, who were able to deliver returns in the low double digits. Although long-term sovereign yields rose mainly in the US in the final months of last year, the underlying market was strong. Key interest rates in the West are expected to remain at low levels for a long time, whereas there are clearly concerns about emerging market bonds, which leave investors few alternatives in their search for higher yields. This strategy remains one of our absolute favourites.

Event Driven

Not only was this a winning strategy in 2013, with a gain of 13.9 per cent; it had its best year since 2009. Companies involved in acquisitions were richly rewarded last year. Limited opportunities to grow organically or cut costs increased willingness to create spin-offs in order to increase shareholder value. In 2013, divestments totalling USD 1.3 trillion were made, the highest level since 2007. Companies unwilling to change corporate structure were targeted by activist investors, who launched 65 per cent more campaigns than in 2012. Forecasts are trending higher for this year, given companies' bank balances and a continuing need for consolidation in sectors such as pharmaceuticals, technology and commodities. In Europe, a capitalisation and restructuring process for banks is still under way, which will create further opportunities. Prospects are bright for this strategy.

Macro /CTA

This strategy ended the year down 1.79 per cent. Mature stock markets were the driving force behind a 1 per cent gain in the final quarter of 2013, but many systematic models had trouble handling the difficult conditions in the fixed income and commodity markets. Concerning fixed income, fund managers were affected by talk about the US Federal Reserve's "tapering", which led to increased focus on statistics and the Fed's FOMC meetings. The more focus is placed on individual events, the more difficult it is to take positions with any conviction. Commodities made a negative contribution for many fund managers, with the fall in gold prices in particular playing a key role. Compared to 2013, there should be fewer interventions by central banks, thus reducing risk-on/risk-off behaviour. Nonetheless, there is still the risk of disappointment over unemployment in the West and the financial health of Chinese lenders, which could once again focus investor attention on central bank actions and make life difficult for trend-following strategies. All else being equal, 2014 should offer better potential, but we are not fully convinced – although we appreciate the value of diversification from a portfolio standpoint.

STRATEGY	INDEX	PERFORMANCE % (USD)					
		YTD (Jan 31, 2014)	Q4 2013	2013	2012	2011	2010
Global Hedge	HFRX Global Hedge Fund	-0.2	2.3	6.7	3.5	-8.9	5.2
Equity Hedge	HFRX Equity Hedge	-1.0	4.2	11.1	4.8	-19.1	8.9
Relative Value	HFRX Relative Value Arbitrage	-0.2	1.2	3.0	3.6	-4.0	7.7
Event Driven	HFRX Event Driven	0.4	2.7	13.9	6.0	-4.9	2.0
Macro	HFRX Macro	-0.1	0.9	-1.8	-1.0	-4.9	-1.7

Source: Bloomberg

Real estate

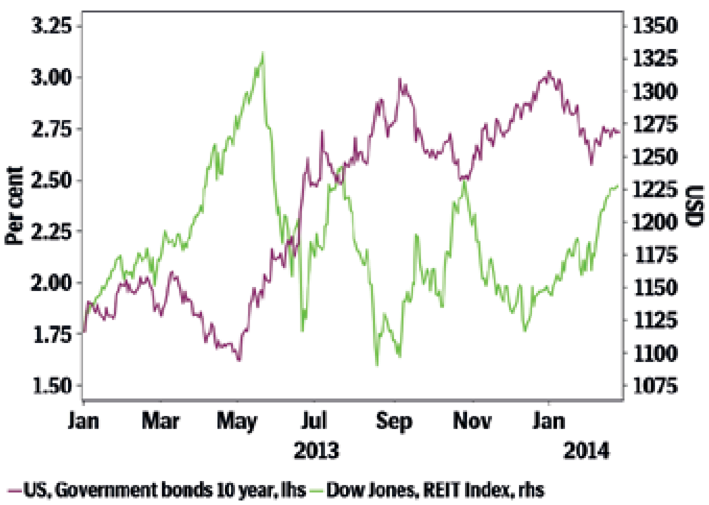
Low interest rates benefit the real estate market

- **Increasingly clear economic recovery is bolstering the real estate market**
  Accommodative monetary policy and stronger growth have benefited the credit and equities markets, creating good potential for the general investment climate.

- **Rising long-term yields have had a temporary impact on the REIT market**
  Rising long-term yields in the wake of growing concerns about interest rate hikes have caused a negative reaction in the real estate investment trust (REIT) market, especially in the US. Lower long-term yields in Europe have contributed to a better performance for European REITs.

- **The climate in the US housing market is driving consumer confidence**
  According to the National Association of Home Builders (NAHB) Index, the US housing market climate – historically a leading indicator of US consumer confidence – has improved significantly.

WEAKER TREND IN THE US REIT MARKET



Source: Bloomberg

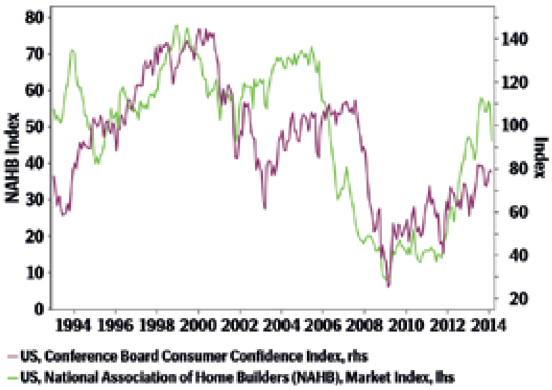
From its low point in March 2009 until February of this year, the US REIT index generated a total return of 163 per cent in SEK terms. However, the trend was not as pronounced last year.
Following US Federal Reserve Chairman Ben Bernanke's announcement in May of Fed plans to reduce quantitative easing, there were growing concerns about rising yields and interest rates. The REIT index for the second half of 2013 showed a volatile trend, with the asset class up 1.5 per cent in SEK.

VIEWED OVER A TEN-YEAR PERIOD, 2013 was one of the better years for risk assets, with the broad MSCI All Country World Index for equities up 23 per cent in local currencies. However, this year had a more turbulent start. The US Federal Reserve (Fed) continues its “tapering” of bond purchases, which began in December last year. Combined with structural problems in a number of emerging markets, this has contributed to substantial movements in foreign exchange (FX) markets and growing concerns. With the exception of some negative effects from a cold winter, most signs indicate a continued economic recovery in the US. Stronger US growth gives us reason to believe the Fed will complete its tapering in 2014. Key interest rates are expected to remain low for quite some time in both the euro zone and the US, but long-term bond yields have risen sharply since May 2013.

As a rule, an economic recovery is positive for the real estate market. Improved demand and rising occupancy rates drive up rents and returns. In this phase, there is growth potential even though new construction will generally pick up speed only in a more mature phase of the economy. However, in the long term, rising yields and interest rates will limit return potential, with higher borrowing costs and lower return on equity. The interest rate situation is thus critical to the real estate market trend, which was also the case last year. A look at Standard & Poor’s broad REIT index together with the yield on 10-year US Treasury notes shows that there is a clear negative correlation.

Persistent structural problems and deflation risks in parts of the euro zone meant that long-term European yields did not rise as much as those in the US. Given that short-term interest rates are more relevant to the real estate market, this was probably one factor contributing to a better end to 2013 for the European REIT market, as measured by the EPRA Index, which closed the year up 10.3 per cent.

Asia was the first region where transaction volume passed its 2007 peak. Investment activity benefited from a recovery in both credit and stock markets as well as from increased liquidity. Last year, transaction volume in Japan doubled in local currency, while China, Australia and Singapore also posted record volumes. More multi-asset managers are allocating increasing capital to the real estate asset class, and this investment activity looks set to continue in 2014. Nonetheless, worries about the impact of the Fed’s tapering of bond purchases contributed to a 2.8 per cent fall in the Asian REIT market last year, measured by the Bloomberg Asia REIT Index.



Source: Macrobond

Still, over a longer period, the connection between yields and interest rates and the real estate market trend is different. The negative influences have been far greater during periods of recession and decreasing supply than in periods with rising yields and interest rates. However, in periods of changing yields and interest rates, there is great sensitivity between different types of real estate investments. Just as in the bond market, the choice of contract duration is an important factor. The shorter the duration, the greater the flexibility and the less sensitivity there is to interest rate movements. Nevertheless, interest rate sensitivity has an inverse relationship to changes in the economy. For instance, the hotel sector, with one-day contracts for its rooms, has low sensitivity to interest rate changes but is naturally more vulnerable to economic disruptions affecting demand.

The National Association of Home Builders (NAHB) takes monthly readings of the climate in the US housing market. Survey respondents assess the current climate for new home sales as well as what they think the climate will be during the next six months. There has generally been uninterrupted improvement in sentiment since September 2011, but the level fell from 57 to 56 in January this year. However, a figure above 50 indicates a positive climate, so even though the direction was negative, the current level still signals continued optimism. In the US, low interest rates have contributed to rising home prices, which in turn have increased banks’ willingness to issue new loans. This is a key factor for a rebound in consumption.

This year looks like it could be a good year for the real estate market. Fundamental improvements both in Europe and the US point towards a better climate for companies and increased capital spending. Stronger credit markets, especially in the US, have supported the real estate transaction market. The issuance of commercial mortgage-backed securities (CMBS) in the US rose 87 per cent in 2013 and is expected to rise further in 2014. The credit market in Europe has not seen the same strength, but shows signs of continued improvement. Better funding opportunities point towards continued inflows into the real estate market, with limited return potential in primary markets causing investors to continue looking farther out on the risk scale – with southern Europe, for example, looking increasingly attractive.

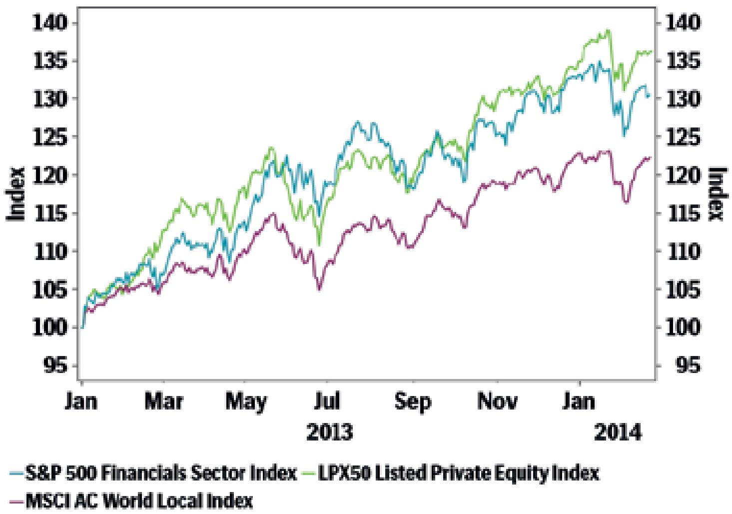
THE US HOUSING MARKET IS DRIVING CONSUMER CONFIDENCE

The chart shows the trends for the US Conference Board Consumer Confidence Index and the NAHB Index over the past 20 years. The trends clearly show that the mood in the housing market affects consumer confidence.

Low volatility creates opportunities

- **Historically low volatility has favoured risk assets**
  Last year's low volatility was very much a product of continued accommodative monetary policy. This low volatility has contributed to relatively stable price multiples in the private equity market, which in turn has benefited the exit market.
- **Increased volume but decreased number of funds**
  Inflows to private equity investments were up sharply last year, but the number of funds was down, which can be seen as a sign of increased consolidation.
- **Expensive, but there is still good potential**
  After a year of price rises, valuations are high, but fundamental improvements in the more traditional markets in Europe and North America point towards continued potential.

PRIVATE EQUITY A STRONGER PERFORMER THAN THE FINANCIAL SECTOR IN 2013



Source: Bloomberg

In SEK terms, the LPX50 Total Return Index for private equity generated a far better return than the broad S&P 500 stock market index. On several occasions, volatility was also lower for the broad private equity index.

FUNDAMENTAL ECONOMIC IMPROVEMENTS, combined with continued accommodative monetary policy in both Europe and the US, contributed to growing investor risk appetite and low volatility in the market last year. Higher valuations are to some extent a result of these improvements, but multiple expansion has also been a key factor, driven by strong risk appetite and a lack of attractive return alternatives.

Despite higher valuations in the private equity (PE) market, returns have been good, mostly because of access to cheap credit. Low interest rates have stimulated borrowing, which is now back at the high level seen in 2006. Last year we also noted that many PE firms were selling holdings to an increasing extent, rather than investing in new ones. That can be explained by the larger number of mature investments ready to be sold after a lengthy period of general uncertainty in the capital markets. The high percentage of sales has benefited the income streams of asset management companies, whose discounts to net asset value have fallen as a result of sharp price rises, but levels are still historically high.

Listed private equity was among the winners last year. The LPX50 Total Return Index for listed private equity ended the year with a return of about 39 per cent in SEK terms. That can be compared to the return for the broad MSCI All Country World equities index in local currencies, which ended the year up 23 per cent. This strong performance was also achieved with historically low volatility. Measured as standard deviation, the index for listed private equity had a risk of 13 per cent, compared to 9 per cent for the broad equities index. If this is compared with volatility over the past ten years, the average is 31.4 and 15.4 per cent, respectively. Volatility last year was thus exceptionally low compared to historical levels.

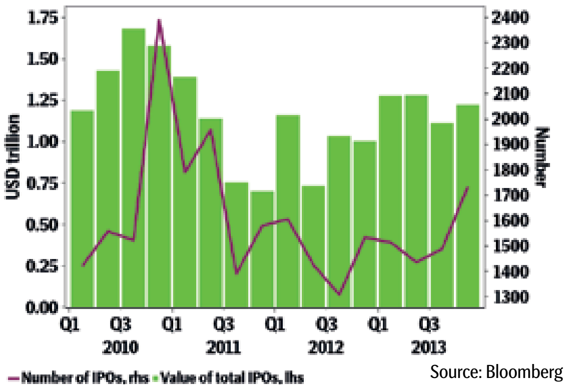
Transaction volume for leveraged buyouts in Europe and the US increased from a total of USD 324 billion in 2012 to USD 504 billion last year. In comparison, volume in 2009 was USD 42 billion.

Equity financing has gradually decreased as borrowing has become cheaper. The credit market has continued to strengthen, especially in the US. The value of high yield bonds issued in Europe and the US increased from USD 393 billion in 2012 to USD 420 billion in 2013, while spreads to government bonds narrowed to below their historical average both in Europe and the US.

After an extended period of uncertainty, many private equity firms have amassed large quantities of investable capital. The number of initial public offerings (IPOs) benefited from fundamental improvements and growing risk appetite in the market. Large flows from realised gains have fuelled the "recapitalisation dividend" trend, in which PE companies – after paying down some or all of their liabilities in a portfolio company – increase their borrowing and use the proceeds to pay dividends to their shareholders.

The aggregate value of money moving into new PE investments has gradually increased since bottoming out in 2010, but the number of funds has fallen. In 2012, there were 1,046 funds, compared to 932 in 2013. This may be a sign of greater consolidation, with the best known PE firms attracting increasing volumes. That makes clear the importance of a good track record. Investors are selective in their choice of PE firms and require a good historical performance.

EXPANDING MARKET FOR INITIAL PUBLIC OFFERINGS



Measured in both number and volume, the global market for initial public offerings (IPOs) grew in 2013.

The liquidity premium for closed private equity investments over a ten-year period turns out to be significant compared to the trend for the stock market. Until mid-2013, the average annual return on PE investments was about 22 per cent, compared to a return of 7.5 per cent on European equities (measured by the MSCI Europe Index), 14 per cent for EM equities (MSCI Emerging Markets Index) and 7 per cent for US equities (S&P 500), measured in local currencies (source: Preqin Private Equity Spotlight, February 2014).

The strategy that has by far the highest historical returns is buyouts, where private equity companies buy up a company's equity and debt. Over the past decade, this type of investment generated an average annual return of 26 per cent (source: Preqin Private Equity Spotlight, February 2014). It has also been the PE strategy that has attracted the most investors. In January this year, the largest buyout fund since 2008 was launched. The fund is managed by Apollo and drew a total of USD 17.5 billion. This is clearly a positive sign for the broad PE market, but is also a good example of how hard it is to gain access to this market. Long lock-in periods often require high minimum initial investments, which is why smaller investors usually have to look to the secondary market or fund-of-funds solutions.

Geographically, many investors have been more sceptical recently about investments in emerging markets, where concerns about growth and volatile currencies have helped limit exit opportunities. Stronger signals of better growth in the more traditional markets such as Europe and North America have instead attracted increasing capital.

Prospects are bright for the private equity asset class over the next few years. Continued fundamental economic improvements, especially in Europe and the US – combined with the continued search for alternative sources of returns – will provide further potential. The rising number of exits is a good sign that the market has recovered after a few rather difficult years. Growing volume in new funds also bodes well for potential value creation going forward.

Commodity markets in balance

- **Weak currencies have a moderating effect on prices**
  Weakened currencies in the emerging markets allow for lower commodity prices (in USD terms) since commodity-producing countries have their costs in local currencies while production is priced in dollars. However, in our view, an improved global economy will keep falling prices in check.
- **Oil supply to grow more than demand in 2014**
  Global oil demand will increase during the year, but supply will grow even more. An anticipated surplus of about 500,000 barrels per day should not entail any adjustment problems for the Organisation of the Petroleum Exporting Countries (OPEC), since member countries are currently producing more than they have in a very long time.
- **A lack of factors pushing gold prices higher will mean a continued price decline**
  Despite anaemic economic growth in 2013, gold prices have continued to slump. The outstanding volume of exchange-traded funds (ETFs) with gold as their underlying physical asset is still about 6-7,000 tonnes above normal volume. Furthermore, there are few inflation expectations or reasons for investors to flee to safe havens.

STRONG CORRELATION BETWEEN ETF VOLUME AND GOLD PRICE TREND

Source: Bloomberg

Investors' flight to safety was one reason why gold prices climbed to about USD 1,600/oz. The outstanding volume of ETFs with gold as their underlying physical asset increased in line with gold prices, reaching 2,600 tonnes in January 2013. With better economic conditions and no inflation in sight, 2013 volume fell to about 1,700 tonnes. A reasonable volume is about 1,000 tonnes, which allows room for additional sales.

AN IMPROVED US ECONOMY signals increased oil consumption. The International Energy Agency (IEA) has revised its forecast for demand in the country upwards to over 20 million barrels per day for the first time since 2008. Global oil demand is expected to increase in 2014 by 1.3 million barrels per day while non-OPEC supply is expected to increase by around 1.7 million barrels per day. OPEC should therefore reduce its production to achieve market balance. The most important OPEC countries – Saudi Arabia, Kuwait and the United Arab Emirates – have produced 12-16 million barrels per day since the early 2000s and have offset supply disruptions elsewhere in the world. Last year, Saudi Arabia accounted for 10 million barrels per day (a 30-year high), so adjusting the supply should not be a problem.

Operational disruptions are reducing the global oil supply by about 3 million barrels per day, with Libya and Iran accounting for about two thirds of this loss. We do not expect full production from these countries in the near future, but there is potential for another 1.5-2.3 million barrels per day. Shale oil added about a million barrels per day in 2013; another million will probably be added in 2014. Saudi Arabia argues that without shale oil, it would have been difficult to maintain market balance last year. We believe OPEC will adjust production and that oil prices will be trading at today's levels towards the end of the year as well.

Copper supply has also caught up with demand

The industrial metals market is relatively balanced. During the year, the aluminium market will shift from excess supply to balance or to a marginal shortage. However, high inventories will keep price rises in check. The nickel market has also been characterised by excess supply and large inventories, but because Indonesia (with 20 per cent of global production) decided to introduce an export ban on the metal a while ago, the market will be more in balance. In our view, nickel is the industrial metal with the greatest potential for higher prices during the year.

The lead-time for copper mines is about ten years, yet some 1.2 million tonnes will be added to the market in 2014 and another 1.4 million in 2015. However, there will also be a decline in other production so the net increase in supply will be about 800-900,000 tonnes per year.

Since 2004, global copper demand has risen by 3 per cent yearly, and we expect that pace to be sustained, which means about 600,000 tonnes in increased demand in 2014, or potential excess supply of 200-300,000 tonnes. Annual demand for copper outside China has fallen by 2 million tonnes since 2008, which allows room for China's growing demand. Demand from the OECD countries today is 11 million tonnes. This means that an increase of about 2 per cent will be enough to maintain balance, which sounds reasonable. Should the OECD countries return to previous demand levels, all else being equal, there would be a shortage of copper in the market

Still a lot of gold to sell

After the gold price rally during the first decade of the millennium, 2013 was a very weak year. The sale of gold ETFs partly explains this, and this will continue to weigh down prices. Combined with very low inflation expectations, a better economy and the beginning of "tapering" by the US Federal Reserve, our conclusion is that prices will continue to fall, with the price ending up around USD 1,100/oz by year-end. The decline will be larger for short periods, since a price of USD 8-900 is sufficient for existing production to cover costs (which was also the price level before the financial crisis).

High inventories are holding down platinum prices

Ongoing strikes in South Africa's platinum mines (which account for 70 per cent of global production) have led to major production disruptions. However, platinum prices expressed in USD have not risen to any great extent, partly because of large inventories. South Africa's weakened currency, the rand (ZAR), has held down prices to some extent, while inflation on the other hand has been almost 10 per cent a year.

The mine strikes and a better European economy should lift platinum prices (catalytic converters for diesel engines, which are most common in Europe, consume half of global production). Platinum will eventually trade at its previous level of about twice the price of gold.

Agricultural products should become cheaper

For agricultural products in general, we expect rising inventories and falling prices for some time to come. Weather phenomena like La Niña and El Niño obviously have the potential to change this situation.

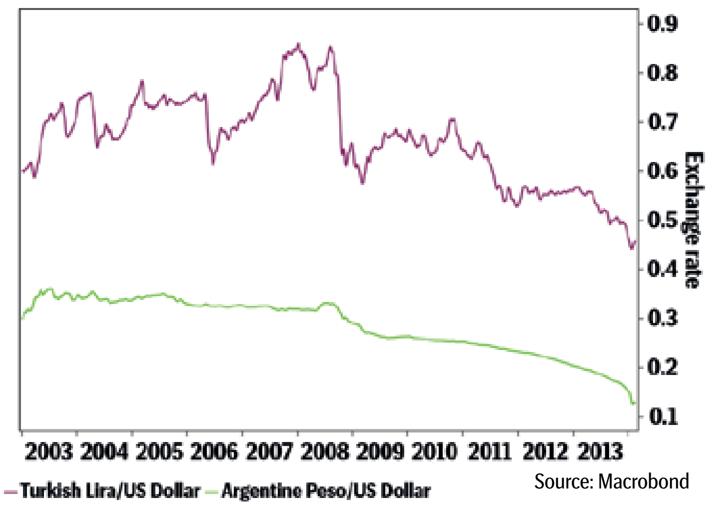
ASSET CLASS	WEIGHT*	REASONING
Energy	1 2 **3** 4 5 6 7	Oil supply is expected to increase more than demand. We expect OPEC to adjust its supply for market balance. Oil prices will be around today's levels a year from now.
Industrial metals	1 2 3 **4** 5 6 7	We expect a balanced market for industrial metals during the year. We see the greatest upside potential for nickel as a result of Indonesia's export ban on the metal.
Precious metals	1 **2** 3 4 5 6 7	Because of a better economic situation and the absence of inflation expectations, we expect a continued sell-off of gold and a price around USD 1,100/oz by year-end. However, better economic conditions in Europe will bolster platinum prices.
Agricultural products	1 **2** 3 4 5 6 7	Provided no weather phenomena (La Niña, El Niño) disrupt the situation, we believe agricultural prices will continue to fall.

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

Monetary policy and growth differences critical

- **Growing arguments for a stronger US dollar**
  The USD encountered headwinds in 2013 as the Federal Reserve's bond purchases continued at an unchanged pace and political bickering prevailed in Washington. This year, the Fed is tapering its asset purchases, US political leaders have reached some key agreements and the American economy is growing significantly faster than that of the euro zone. Expect a stronger USD in 2014.
- **Only one way for the Japanese yen – down**
  Japan's economic strategy (Abenomics) relies on a stronger economy and a weaker JPY to establish inflation in the country. However, there is a risk that growth will be hit by a consumption tax hike this spring, which would make a weaker JPY even more essential in order to reach the 2 per cent inflation target.
- **Swedish krona and Norwegian krone headed toward parity**
  In the past year, Sweden's Riksbank and Norges Bank introduced or announced dovish monetary policy measures, at the expense of their currencies. Early in 2014, prospects are slightly brighter for the Swedish economy than for the Norwegian economy, which is why the currencies are moving towards parity.

ESCALATING MACROECONOMIC IMBALANCES WEAKEN EM CURRENCIES



Source: Macrobond

Economic and financial tensions and imbalances have been building for a long time in a number of emerging markets, including Argentina and Turkey. Once the US Federal Reserve began tapering its bond purchases this winter and a series of events highlighted major economic and political problems in the EM sphere, currencies predictably tumbled.

IN 2013, THE CURRENCIES OF SMALL countries with strong economic fundamentals (good government finances, current account surpluses and low inflation) had a hard time holding their own. Among the factors behind this were relatively high valuations and central banks that either lowered their key interest rates – such as in Australia and Sweden – or issued statements that weakened their currency, as in the case of Norges Bank. The Swedish and Norwegian economies were also weaker during the year than expected, while the commodity-based Australian dollar (AUD) was hit by declining commodity prices.

Meanwhile economic growth in major countries such as the US and Britain strengthened in 2013, while the euro zone came out of recession and the risk premium on crisis-hit euro zone countries gradually declined. This benefited the USD, GBP and EUR. The only major currency that instead significantly depreciated (fell in value) last year was the JPY, which was weighed down by the powerful economic stimulus package introduced in Japan (nicknamed Abenomics, after Prime Minister Shinzo Abe). This kind of pattern is also expected to characterise the foreign exchange (FX) markets at least during the first half of 2014. The most important drivers will be expectations about central bank moves and growth prospects.

The arguments are building for an appreciation of the USD against the EUR in 2014. In our view, the Federal Reserve will continue to gradually reduce (taper) its bond purchases, while the European Central Bank (ECB) will launch a bond purchasing programme during the spring. Our crystal ball also shows that US growth will be substantially higher in 2014-2015 than both consensus forecasts and euro zone growth. Moreover, the political risk in the US eased significantly this winter after Congress reached a budget agreement and raised the federal debt ceiling with no conditions attached.

Abenomics will probably weigh down the JPY in 2014 as well, especially if suspicions grow that the Japanese government's measures to improve the economy's long-term growth and introduce structural reforms ("the third arrow") are insufficient and if this spring's consumption tax increase has an unexpectedly negative impact on growth.

This tax hike could jeopardise the Japanese government's target of sustained 2 per cent inflation. In that case, expectations could take hold in the FX markets that the Bank of Japan will be forced to expand its securities purchases compared to its current objective (to raise the monetary base to JPY 270 trillion), which would weaken the JPY. If Japanese bond investors then abandon negative domestic real interest rates on a larger scale and look for higher yields abroad, that would be another straw on the inflation camel's back.

The GBP has had the wind in its sails for a while, largely due to the many upside British economic surprises since last summer. The continued decline in unemployment has caused the FX market to push forward its expectations that the Bank of England (BoE) will introduce its first interest rate hike late this year or early next year. However, inflation in Britain has meanwhile plummeted below the BoE's 2 per cent target and should remain there for quite some time. In our view, the market is too aggressive in its interest rate outlook and the BoE will not raise its key rate until the summer of 2015. In that case, the GBP should not appreciate any further next year and could at times even lose value.

While the Swedish economy disappointed expectations and Sweden's Riksbank lowered its key interest rate in 2013, another scenario for 2014 is taking shape. By all indications, growth in Sweden is poised to accelerate, underlying inflation is about to bottom out, and the Riksbank is done with rate cuts (we predict the first rate hike will occur in April 2015). Meanwhile, if growth in the euro zone is very modest and the ECB launches a bond purchasing programme, there is reason to predict a stronger SEK against the EUR in 2014, mainly during the second half of the year. However, the SEK should weaken somewhat against the USD in 2014.

The NOK did not do well last year, as expectations about Norwegian economic growth were dashed. Norges Bank announced that it would postpone any rate hike. Although the NOK has plummeted in value since early 2013 – also against the SEK – it is still not cheap in light of the rapid rise in Norwegian unit labour costs. Another decline in the NOK is thus likely, and we predict that parity with the SEK will be reached by late 2014; 1 euro would then cost SEK 8.50 or NOK 8.50.