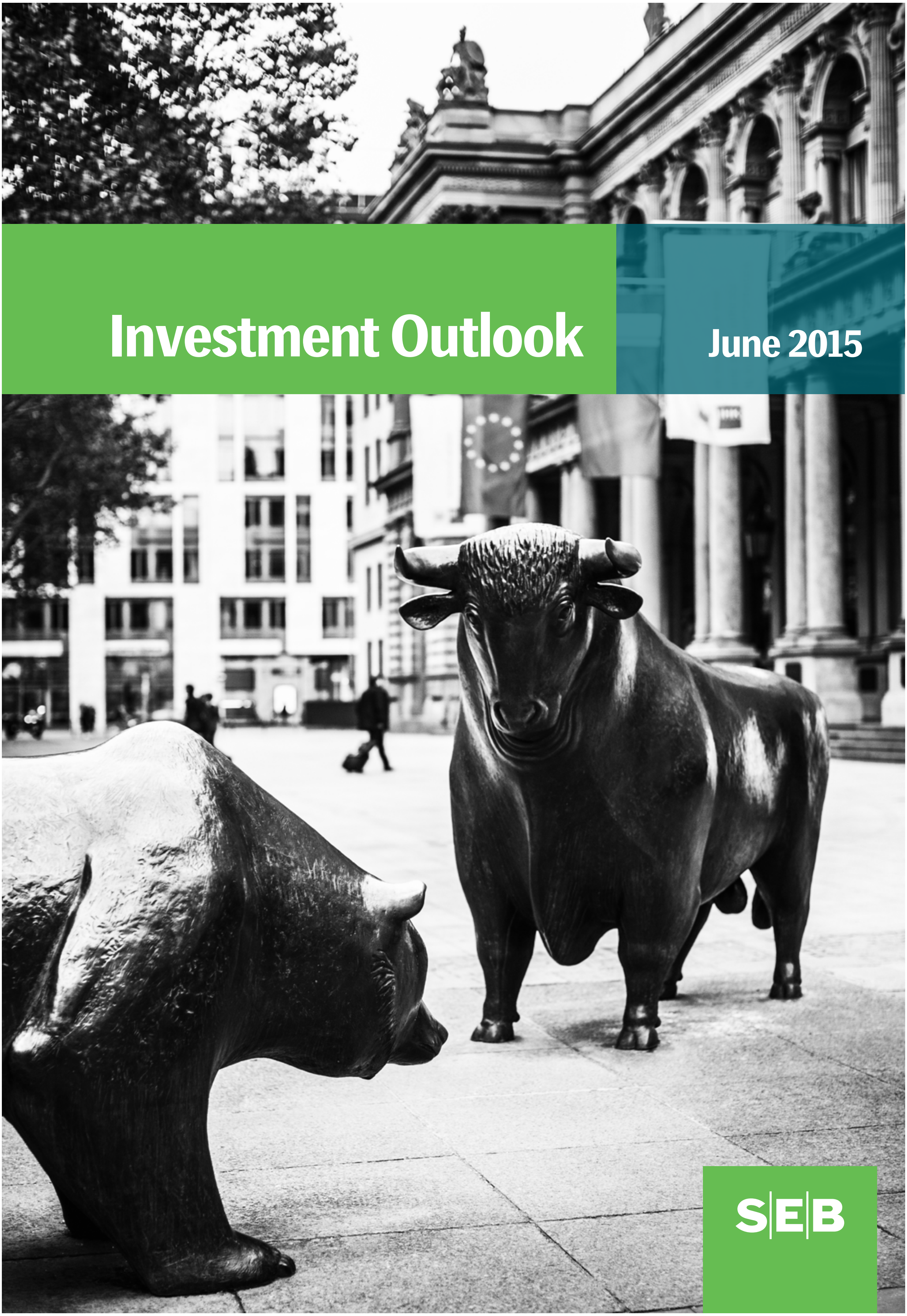
Investment Outlook

June 2015



SEB

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Economic cycles, financial markets and risks

AFTER A FEW YEARS OF UNREMARKABLE global expansion, there are now rising expectations of an accelerating growth rate this year and in 2016. However, early 2015 showed a modest and uneven trend. In the United States, economic activity was low, due to another severe winter. The euro zone showed clear signs of improvement, helped by a currency with a favourable exchange rate as well as massive stimulus by the European Central Bank (ECB). A more detailed analysis of the various driving forces and the regional structure of growth is presented in our "Macro" section.

As a rule, stronger growth results in rising corporate profits and greater inflationary and interest rate pressures. How does this impact our view of the companies listed on the Nordic stock exchanges? Do they have better prospects of boosting their earnings during 2015 than in prior years? This has a major bearing on our assessment of the local stock market. Can interest rates and bond yields be kept at record-low levels, or is it time for them to rise? How do we allocate risk in a portfolio containing several asset classes? As usual, these questions and many more are addressed in this issue of *Investment Outlook*, where we analyse asset classes individually as well as from a portfolio perspective.

This issue also includes an in-depth analysis of the situation in the euro zone: "How is the euro zone doing?" SEB has adjusted its euro zone growth forecast upward. We recommend euro zone stock markets, which have responded with strong upturns recently. We also take a close look at Japan, updating the situation nearly two and a half years after Prime Minister Shinzo Abe launched "Abenomics". Both these theme articles detail the prevailing situation in places where the previous somewhat lopsided dependence on the US economy has now eased, as the rest of the world looks set to bounce back.

During the past year, global growth has been mediocre. This has made it harder for the corporate sector to generate earnings. On the other hand, central banks have been very active and stock markets have continued to climb, while interest rates and bond yields have been squeezed to unprecedentedly low levels. Consequently we think it is time to re-examine valuations in financial markets. We also review what risks we believe exist in the markets, how probable it is that they will materialise and how big an impact they may have in that case.

Wishing you enjoyable reading,

FREDRIK ÖBERG
Chief Investment Officer, Private Banking

Market view
Summary

- Accelerating and more robust growth.
- Continued central bank stimulus measures.
- Equities and credits still preferable, despite high valuations.
- Euro zone and Asian equities preferable to US ones.

WE STILL EXPECT EQUITIES to generate the highest returns. Next come corporate credit instruments and alternative investments (hedge funds). Bringing up the rear are government bonds. This reflects a world that is expected to deliver successively stronger economic growth and a continued low underlying inflation rate. The world's central banks will stimulate and support continued growth via record-low key interest rates and large-scale stimulus packages in the form of direct purchases of financial assets.

If our growth forecast is correct, corporate earnings should rise, justifying stock market valuations to a greater degree. We expect global earnings growth in the range of 5-10 per cent annually during the coming two years. In addition, the dividend level should end up around 2-3 per cent in the same period. Yet this does not make it a foregone conclusion that stock markets will climb to the same extent, especially since they have already performed well and share valuations are fairly high in a historical perspective. Our forecast for global stock markets is thus somewhat lower than expected earnings growth plus dividend level.

For fixed income investments, the situation looks different. Some parts of the government bond segment are more or less disqualified due to extremely low yields. By including a varying degree of corporate credit risk in their portfolios, investors receive yield compensation. Depending on the degree of credit exposure and maturity, expected returns in the fixed income world range from 0 to 6 per cent during the coming 12 months.

Equities and corporate bonds are both dependent on the economic cycle and the ability of companies to deliver earnings. To ensure that not all the risk in customer portfolios will be dependent on the same factors, we supplement them with various types of hedge funds. Our aim is to identify funds with a limited connection to the stock and bond markets. Our expected returns on this asset class are 2-4 per cent in the coming 12 months.

To summarise, we continue to have a positive attitude towards financial markets, except for government bonds in Europe including Sweden.

MAIN STRATEGIES IN OUR PORTFOLIO MANAGEMENT

A POSITIVE VIEW OF THE ECONOMIC CYCLE AND HELPFUL CENTRAL BANKS

One of our fundamental assumptions is a clear improvement in the economic situation during the coming two years. The US economy looks robust, while the rest of the world will be helped by competitive exchange rates and central bank stimulus measures. Global interest rates are low, and further stimulus is being provided by far lower commodity prices. Taken together, this suggests a broader and more stable economic upturn in which more regions than previously can deliver positive growth figures.

ASSET CLASSES HAVE THE SAME RANKING AS BEFORE

We prefer equities to credits and alternative investments. We are avoiding government bonds in Europe and Japan, but are more positive towards the same asset type in the US and in emerging markets. Among global equities, we prefer Europe and Asia to the US and to other emerging markets. We are more positive towards global equities than to specifically Swedish ones; although the expected returns are similar, the risk is higher in the Swedish stock market.

RISKS AND VALUATIONS

Among risks we are now following are potential cyclical downturns, geopolitical turmoil, Greece, Chinese debt problems, possible negative effects from the US Federal Reserve's expected key interest rate hikes and any bubbles in asset markets.

REDUCED RISK, BUT CONTINUED EQUITY OVERWEIGHTING

This year we have gradually reduced the risk in our portfolios, but remain overweighted in equities and credits. The main reason for our risk reduction was the sharp stock market upturn. Our portfolios are still dominated by equities. Compared to our benchmark indices we are overweighted in Europe and Asia, but in absolute terms our largest exposure is to US and Swedish equities. We are underweighted in fixed income investments. In this asset class, we are overweighted in corporate credits and underweighted in treasury bills and government bonds. Among alternative investments, we maintain broad exposure with limited correlation to equities and corporate bonds.

ASSET	WEIGHT	TACTICAL EXPECTATION (12-MONTH)		REASONING
		RETURN	RISK	
EQUITIES				
Global	1 2 3 4 5 **6** 7	8.2%	12.1%	Stronger economic growth and continued stimulus measures will provide potential for higher earnings. A broader upturn will improve opportunities for cyclical industries. Valuations have climbed, yet equities offer better value for money than fixed income investments. From a Swedish perspective (krona as base currency), this asset type will benefit from a stronger US dollar.
Emerging markets	1 2 3 **4** 5 6 7	9.0%	14.3%	Stronger economic conditions and increased trade flows, as well as historically low valuations compared to global equities, make emerging markets attractive. Heavy dependence on commodities, the negative effects of a strong US dollar and rising US interest rates are disadvantages. We prefer the Asian part of the emerging market segment.
Swedish	1 2 3 4 **5** 6 7	13.6%	13.6%	The weak krona and a stable domestic situation will provide strength. In international terms, dividend yields are high but valuations have climbed in recent years. First quarter 2015 earnings were helped by favourable exchange rates. Further ahead, there are clear risks connected to the real estate market and future higher interest rates in Sweden.
FIXED INCOME				
Government bonds	**1** 2 3 4 5 6 7	0.3%	4.2%	Because of very low government bond yields, portions of the bond market are unattractive. Stronger economic conditions may lead to gradually rising yields over the next few years, with a risk of negative returns.
Corporate bonds, investment grade (IG)	1 **2** 3 4 5 6 7	1.4%	2.4%	Low yields provide limited potential, but this asset type may work well as a stabiliser in a portfolio that includes other higher-risk assets.
Corporate bonds, high yield (HY)	1 2 3 **4** 5 6 7	3.7%	3.6%	Yields of around 3-4 per cent stand out in the fixed income world, but as a consequence there is also clearly higher risk than with IG bonds, for example. HY bonds will benefit from rising growth and market liquidity, which boost risk appetite. Yield spreads to government bonds should thus narrow or remain the same as today.
Emerging market (EM) debt	1 2 3 **4** 5 6 7	6.5%	9.4%	Yields of around 6 per cent provide reasonable compensation for the risks connected to this asset type.
ALTERNATIVE INVESTMENTS				
Hedge funds	1 2 3 **4** 5 6 7	N/A	N/A	Clear trends combined with lower correlations between and within asset classes suggest investing in hedge funds.
Commodities	1 2 **3** 4 5 6 7	N/A	N/A	Gradually lower demand from China and elsewhere, combined with increases in production capacity, has resulted in sharply falling commodity prices. The price picture clearly stabilised early in 2015. In a longer-term perspective, this asset class is attractive if inflation rises along with commodity prices.
CURRENCIES				
CURRENCY PAIRS	**MAY 20, 2015**	**Q2 2015**	**Q3 2015**	**REASONING**
EUR/USD	1.11	1.05	1.00	This spring's weakening of the USD against the EUR is expected to be only a temporary dip in a rising dollar curve, as indicated by rising US economic growth and the Fed's imminent key rate hikes.
EUR/SEK	9.30	9.30	9.15	In the short term, the krona will remain weak against the euro, but later this year the SEK will appreciate, one reason being that the Riksbank's stimulus measures are expected to be less far-reaching than the ECB's.
USD/SEK	8.35	8.86	9.15	Provided that the USD resumes its general appreciation, it will also climb significantly in value against the SEK during the coming year or so.

"Weight" shows how we currently view the asset type as part of a portfolio. These weights are changed continuously, based on our tactical market view, and may thus diverge from our long-term strategic view. Tactical expected return is based on the SEB House View as of May 20, 2015. Currency rate forecasts are as of May 12, 2015. Index/basis for calculation: Global equities – MSCI All Country World Index in local currencies. Emerging markets – MSCI EM TR in local currencies. Swedish equities – SIX Portfolio Return Index in SEK. Government bonds – OMRX T-bonds in SEK. Corporate bonds, investment grade (IG) – IBOXX Investment Grade Index in USD; high yield (HY) – IBOXX High Yield Index in USD. EM debt – JP Morgan Emerging Markets Bond Index in local currencies. Hedge funds – HFRX Global Hedge Fund Index in USD.

Market view

Macro - Central banks driving growth

Monetary policies are having a clear impact on the world economy. The belief that the Federal Reserve (Fed) will begin raising its key interest rate during 2015 has caused the US dollar to appreciate. Combined with extreme winter weather and port labour disputes, this caused US growth to dip temporarily. In the euro zone, European Central Bank (ECB) stimulus policies have rapidly affected growth as well as inflation expectations, and the euro has fallen in value. The Bank of Japan's stimulus programme has benefited growth and caused the yen to fall. These currency movements and cheaper oil are now helping to boost growth in developed market (DM) countries, while economic expansion in the emerging market (EM) sphere will accelerate only in 2016.

US – Temporary growth slump

For many years, the US economy has grown significantly more slowly in the first quarter than in other quarters, a pattern repeated this year when GDP climbed only 0.2 per cent. We believe earlier patterns will repeat themselves this year and that the economy will soon gain strength. This will mainly be thanks to more eager household spending due to a stronger labour market and increased purchasing power, as well as a greater desire for capital spending by companies, with low productivity among the factors providing an incentive for investment.

Stable prices during 2015

Although USD appreciation since the summer of 2014 has hampered exports, this is more or less entirely offset by the stimulative effect of the simultaneous oil price decline. Because of a stronger currency and cheaper oil and petrol, this year the US will experience more or less stable consumer prices on average.

Euro zone – Good economic outlook

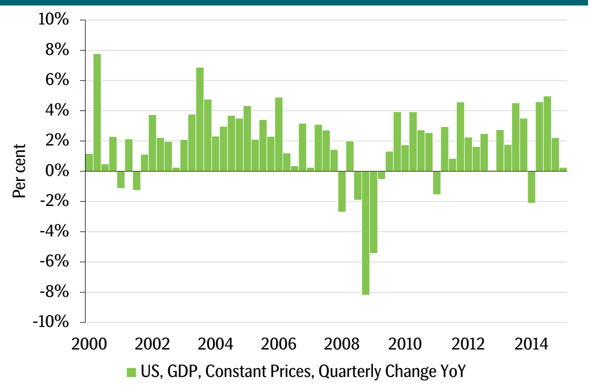
The oil price decline, the weaker euro and ECB stimulus policies have strengthened the euro zone economy since late 2014. Improved competitiveness is benefiting exports, and rising employment – along with better purchasing power – has spurred stronger retail sales. The recovery is now proceeding unexpectedly fast and is spreading to more sectors.

Big crisis-driven austerity is now past, and euro zone fiscal policy will be neutral in the next couple of years. Economic growth remains fragile, however, with underlying problems such as high debt levels and political uncertainty. Greece in particular is once again a source of great concern.

Reasons for optimism about the British economy

After last year's high growth, the British economy began 2015 on a weaker note. Yet there are reasons to be optimistic about the economic outlook. Among positive factors are the oil price decline, lower unemployment and political stability after the Tories (Conservatives) won the May 7 election and formed their own government.

US ECONOMY FACED FIRST QUARTER HEADWINDS



Source: Macrobond

During the past five years, GDP growth in the US has been substantially slower in the first quarter than during other quarters. One important reason is that severe winter weather has hampered activities such as construction. According to current estimates, GDP rose a modest 0.2% during Q1 2015, a reading that is nevertheless likely to be revised downward.

IMPROVING BUSINESS SENTIMENT IN GERMANY

Source: Macrobond

Since late 2014, Germany's Ifo Business Climate Index (blue) has climbed as companies' views of the current situation (green) and the future (purple) have trended higher. This improvement in economic sentiment has caused many forecasters to revise their GDP estimates upward for Germany, and the outlook for the entire euro zone has brightened at the same time.

Asia/China – Faster growth in Asia despite China's deceleration

Most Asian economies will accelerate cautiously, driven by higher domestic demand due to strong labour markets, good wage increases and expansionary monetary policies as well as larger demand from the US and the euro zone. The Fed's approaching rate hikes are a source of uncertainty, though, since all indications are that Fed policies will cause the US dollar to rise further in value. In recent years, many companies and countries in Asia have greatly increased their USD-denominated borrowing. Continued dollar appreciation would boost their debts and loan servicing costs in local currencies.

India speeding up, China slowing down

Falling inflation and improved central government finances will allow India room to stimulate its economy by using both monetary and fiscal policy tools. Although major economic reforms remain conspicuously absent, the Narendra Modi government's latest budget is growth-friendly. We believe that GDP will accelerate this year and in 2016. But in China, cyclical deceleration continues – mainly due to a weakened housing market. Since policy-makers can stimulate the Chinese economy via economic policy measures, a gentle slowdown in growth is likely.

Japan – Doing better but not really well

Since last autumn, the Japanese economy has offered many disappointments. The consumption tax hike in April 2014 is still hurting consumer demand. Major industrial companies have become less optimistic, despite improved international competitiveness due to the weaker yen. But helped by the oil price decline, gradually stronger global economic conditions, the Bank of Japan (BoJ)'s expansionary monetary policy and an improved Japanese labour market, the momentum of economic growth is likely to speed up a bit.

Too early to give up on Abenomics

We expect the BoJ to expand its asset purchases further this summer, but more important in the future will be the degree of reforms aimed at boosting the labour supply and productivity growth, known as the "third arrow" of Prime Minister Shinzo Abe's Abenomics strategy. To date, no far-reaching reforms have been launched, but this strategy should not yet be written off. Read more in our Japan analysis on pages 29-30.

Latin America – Macroeconomic imbalances

Latin American GDP will more or less stagnate this year. Inflation will persist, and large current account deficits will lead to increasing foreign debt. The economies in the region are thus significantly out of balance.

Brazilian economy will shrink during 2015

In Brazil, the economy has slowed dramatically and GDP looks set to fall significantly this year. The corruption scandal surrounding the state-owned oil company Petrobras is further slowing the pace of capital spending, and turmoil in the political sphere is making reform efforts more difficult. Meanwhile the need for structural reforms is increasingly apparent.

GDP – YEAR-ON-YEAR PERCENTAGE CHANGE	2013	2014	2015	2016
United States	2.2	2.4	2.7	3.2
Japan	1.6	0.0	1.1	1.3
Germany	0.1	1.6	2.2	2.3
China	7.7	7.4	6.8	6.5
United Kingdom	1.7	2.8	2.5	2.4
Euro zone	-0.4	0.9	1.7	2.1
Nordic countries	0.3	1.6	1.8	2.1
Baltic countries	3.2	2.6	2.5	3.1
OECD	1.4	1.9	2.3	2.7
Emerging markets	4.8	4.7	4.3	4.9
The world (PPP)*	3.2	3.4	3.4	3.9

* PPP= Purchasing power parities: economies have been adjusted to account for price differences between them.

Source: SEB Economic Research, analysis dated May 2015.

The world economy is moving ahead this year in the same gear as in 2014, with the 34 mainly affluent countries of the Organisation for Economic Cooperation and Development (OECD) gaining momentum as emerging market economies slow down. During 2016, world economic growth will pick up due to acceleration in both these types of economies.

Eastern Europe – Resilient to the Russian crisis

Central and south-eastern portions of Eastern Europe are resilient to the Russia-Ukraine conflict as well as to Russia's food sanctions and recession. Among underlying factors are rising real incomes, falling unemployment and low interest rates, which together benefit household consumption. Other factors are the more positive outlook for exports to Germany along with fiscal easing in most countries after a long period of austerity measures. Poland is showing strength in its underlying economy and banking system; it is now the fastest-growing economy in Central and Eastern Europe. In contrast, Russia will experience a deep recession in 2015. The oil price decline has weakened the rouble, leading to accelerating inflation and large capital outflows, but this spring's oil price rebound and signs that the ceasefire in eastern Ukraine is holding have led to a recovery for the Russian currency.

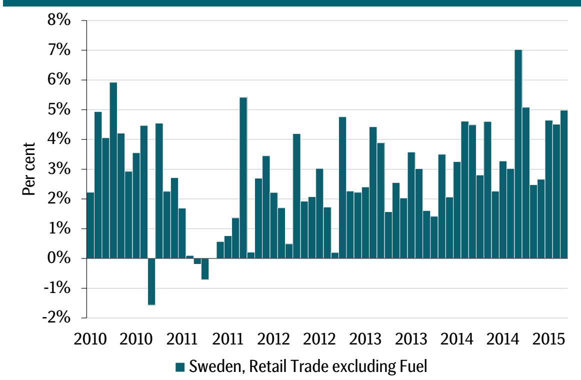
Household demand driving Baltic economies

The three Baltic economies are showing decent growth, largely thanks to rising real incomes that are enabling a continued healthy rate of increase in private consumption. Exports will gradually be helped by improving economic conditions in Western Europe, while capital spending will remain weak in the Baltics.

Nordic countries – Divergent economic trends

Economic forces in the Nordic economies are pulling in different directions. In Norway, growth is being hampered by an investment decline in the oil sector, which will also have negative consequences in many other sectors. Norwegian growth will thus be slow, mainly this year but also in 2016. Denmark has now left its earlier housing market crisis behind, as reflected in rising home prices, and today both household consumption demand and business investments are increasing.

SWEDISH HOUSEHOLDS ARE SPENDING MORE



Source: Macrobond

Over the past few months, retail sales in Sweden have increased far more rapidly than in the preceding period. Households have been especially eager to buy durable goods, which is usually a good economic sign. Factors underlying this rise in consumer demand include higher employment, very low interest rates and fairly cheerful sentiment among Swedish consumers.

Although the Finnish economy is benefiting from the weaker euro and greater demand elsewhere in the euro zone, business sector indicators are currently not signalling any economic rebound, but are instead pointing to a very slow recovery from Finland's protracted recession.

A dualistic Swedish economy

The positive driving forces in the Swedish economy are rising residential construction and increased private consumption. But the upturn in manufacturing activity seems unusually sluggish, even though Western European growth is gaining momentum and Swedish merchandise exports can thus recover. By all indications, underlying uncertainties about the global economy and domestic economic policy conditions are hampering activity to some extent.

Conclusions from our macro analysis that we take into account in our asset management

- We believe that the US growth slump is temporary and that currency rates and central banks will speed the recovery in Europe.
- Asian growth will accelerate in spite of China, and Japan will gain in strength from low levels.
- Stronger expected economic growth with a broader geographic dispersion will generate improved earnings opportunities after several weak years.
- Due to the actions of central banks and continued low inflation, interest rates and bond yields should rise at a slow pace.
- Economic signals are expected to be positive, thus benefiting equities and corporate credits more than government bonds.
- Europe and Asia will narrow the lead of the United States, and investments in these regions thus remain attractive compared to investments in the US.

Global equities

Healthy correction in the world's stock markets

Despite a downturn in May, the world equities index has climbed 10 per cent in SEK this year. The market dip must be regarded as healthy, since after good returns over a short period, investors chose to take some profits. Global equity valuations are high in a historical perspective and pose a risk, but our main scenario is that the wheels of the economy will begin to speed up somewhat, resulting in growth and good corporate earnings while setting the stage for further share price upturns. We choose to have a large proportion of our portfolios invested in equities, in which we recommend an overweighting in Europe spiced with Asia – read more about that region's fast-growing markets below.

- The world equities index has risen 10 per cent in SEK and 6 per cent in local currencies this year.
- The Shanghai and Hong Kong stock exchanges are at the top, while US exchanges have performed worse.
- Company reports for the first quarter of 2015 were favourable overall, especially in Europe and Japan.
- Global equities are valued at a price/earnings (P/E) ratio of 17 for this year and 15 for 2016 earnings, which is somewhat higher than in prior years.
- We are seeing good signals from European-based firms and prefer investing in Europe to investing in the US. Valuations are lower and growth is taking off.
- Stronger growth in the West along with stimulus measures in China and Japan also suggest investing in Asia.

EARLY 2015 OFFERED fine share price gains in the world's stock markets. The MSCI All Country World Index in local currencies peaked late in April, but fell during May. After having received good returns in a relatively short period, investors chose to take profits in equities as well as fixed income investments and currencies. Lower risk appetite can be explained by weaker macroeconomic statistics in the US and continued worries about events in Greece. It can also be viewed as a market consolidation after a very strong period. Despite the downturn, the world index has gained 10 per cent in SEK and 6 per cent in local currencies since the beginning of 2015. The stock exchanges in Shanghai and Hong Kong topped the list along with Russia (measured in local currencies), while the US stock market had a tougher time. Emerging market (EM) economies, led by Asia, have gained momentum and moved ahead of the rest of the world after having performed worse than developed market (DM) economies for some years. Defensive sectors such as pharmaceuticals and consumer goods are at the top so far, while financials and utilities have performed the worst. The information technology (IT) sector in China stands out with an upturn of no less than 45 per cent in local currency since the turn of the year.

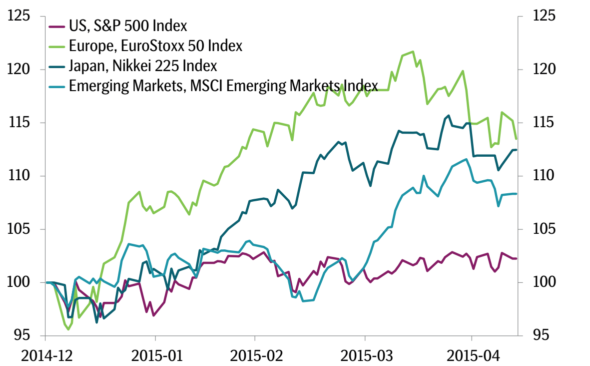
Earnings are continuing to grow

First quarter company reports have recently dominated economic news headlines. In the US, a large percentage of companies showed better-than-expected earnings, but unusually few managed to deliver upside surprises in terms of sales growth, which was a bit of a sour note. In addition, macroeconomic statistics have been on the weak side. The strong US stock market upturn over a long period and high valuations compared to other countries also made this market sensitive to profit-taking. In Europe, too, companies pleased the market with good quarterly reports. Unlike US firms, more than 70 per cent showed stronger sales than expected (partly helped by weak currencies). Fresh statistics indicate clear regional differences, with earnings being adjusted upward in Europe and Japan and the majority of downward adjustments in the US and in emerging markets.

Potential limited by high valuations

Overall company earnings are expected to grow by just below 3 per cent this year and nearly 13 per cent in 2016. Expectations for 2015 have thus fallen from 7 per cent in the previous issue of *Investment Outlook* (March 2015). Global equities are valued at a P/E ratio of 17 for this year's and 15 for next year's earnings, which is high in a historical perspective. Combined with downward adjustments in this year's expected earnings, this may pose a risk and a limitation in the potential for higher share prices. US and

EUROPE TOPS STOCK MARKETS DUE TO ECB AND CURRENCIES



Source: Macrobond

The chart shows 2015 performance in local currencies for key stock markets. Europe (green) tops the chart, very much due to powerful ECB actions and weaker currencies. The US stock market has had a slightly tougher time, after a long period of good returns. High valuations and mixed macroeconomic statistics have pulled down market performance.

Japanese company shares are being traded at above-average valuations, while listed companies in Europe are valued in line with the rest of the world. Emerging markets have an overall P/E ratio of 11.5 for 2016 earnings, which is attractive. Our conclusion is that we foresee a more synchronised growth rate around the world. Among emerging markets, we continue to prefer Asian equities due to low valuations and the region's long-term structural growth.

Continued growth is our main scenario

American macro statistics will probably recover. Combined with liquidity supplied by the European Central Bank and the Bank of Japan, this continues to favour investing in equities as an asset class. We are therefore choosing to have a large proportion of equities in our portfolios. Market valuations indeed appear high, and lasting share price increases will require a global economic take-off and better company earnings. At present, high share valuations can be justified by record-low interest rates and bond yields, but the risk will increase as the US central bank begins its key interest rate hikes this autumn. Our main scenario is that the economy will speed up and corporate earnings will be adjusted upward. When the world's industrial companies enjoy a tailwind from higher demand and show solid earnings growth, we will probably see a shift in investors' portfolios from defensive to more cyclical equities.

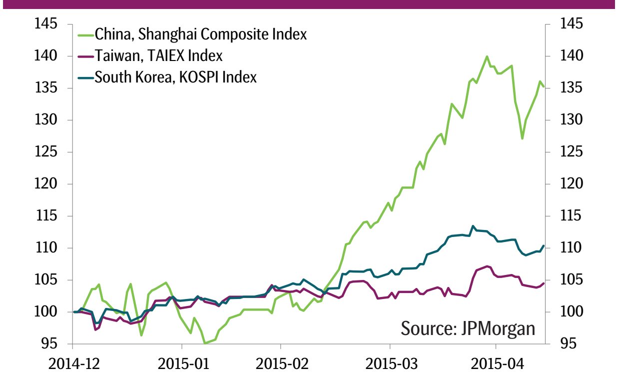
Europe is well-positioned

We are noting favourable signals from companies in Europe. Since they have great potential for improvement and upside surprises, we prefer to invest there rather than in the US. European-based listed companies are becoming increasingly cost-effective and are benefiting from having a large proportion of their sales in EM countries and the US. European earnings are being adjusted upward, and valuations make the region attractive for equity investments. A higher growth rate is probably not entirely discounted by the market yet either.

Rapid growth and low valuations in Asia

Stronger growth in Western countries along with stimulus measures in China and Japan also make Asia attractive.

CHINA'S IT SECTOR LEADS STOCK MARKET PERFORMANCE



The chart shows 2015 performance in local currencies for selected Asian stock exchanges. Overall, listed equities in emerging Asia have climbed 12 per cent, but this is mainly being driven by Chinese companies, which have gained 26 per cent. The IT sector in China shows a stock market return of no less than 45 per cent. Other markets in Asia have lagged behind.

The robust stock market upturn in EM countries this year has mainly been due to the performance of Chinese equities. Other attractive markets with rapid structural growth and low valuations – such as South Korea, Taiwan and Indonesia – have not performed as well. The Asian economies are strongly correlated to global economic conditions, and provided that our forecast of continued positive economic growth in the world as a whole proves correct, Asia should benefit from this.

The back yard of the electronics sector

Taiwanese companies benefit greatly when Western consumers spend more money on tablet computers, laptops and smart mobile phones. They supply components to the world's electronics giants, and the technology sector accounts for as much as half of stock market capitalisation in Taiwan. Some of Apple's best-selling products are manufactured and assembled there. The Taiwanese stock market is valued at an attractive price/earnings (P/E) ratio of 12 for 2016 earnings. South Korea, whose stock market is dominated by companies like Samsung and SK Hynix (a leader in semiconductors and electronic components), has expected earnings growth of 36 per cent this year with a P/E ratio of 10. Korean companies are generally importers of commodities and benefit from low commodity prices.

India admittedly does not offer equally low share valuations, but earnings are expected to grow by 13 per cent this year and 19 per cent next year. With its growing middle class, India's enormous population along with that of China will eventually account for a large percentage of the world's consumption. India also has Asia's second lowest production costs (after Indonesia) and thus attracts foreign companies that create jobs and increased prosperity.

To summarise, looking ahead we are confident about global equities. The correction now under way in the stock market is necessary and healthy. It will pave the way for new upturns as growth gains momentum and corporate earnings are adjusted upward. We recommend overweighting European equities, spiced with selected Asian countries.

COUNTRY/ REGION	P/E RATIO 2016	EARNINGS GROWTH 2015	EARNINGS GROWTH 2016
US	16.4	0.6%	13.2%
Europe	15.2	2.7%	13.0%
Japan	15.5	7.3%	14.9%
EM Asia	11.6	14.3%	10.1%
China	11.4	2.0%	12.7%
Taiwan	12.4	14.2%	60%
South Korea	9.6	34.0%	6.8%

Source: JPMorgan

Stock markets in emerging Asia show an overall P/E ratio of 11.5 on projected 2016 earnings, which must be viewed as attractive. South Korea looks like one of the cheapest markets in Asia at 9.6. Earnings growth in the region is estimated at 14 per cent in 2015 and 10 per cent in 2016. Chinese earnings are predicted to grow hardly at all this year, but by 12 per cent in 2016.

Nordic equities

Normalised risk premium makes equities attractive

Earnings forecasts have stabilised over the past six months, lending credibility to our forecast of 16 per cent earnings growth in Sweden this year. Good growth is also expected in Finland and Denmark, while Norway is still weighed down by lower oil prices. Higher earnings and the recent stock market correction have pushed down the price/earnings ratio from earlier peak levels, and the risk premium on Swedish equities is now in line with the average for the past 10 years. Even after its latest decline, the P/E ratio is still high in a recent historical perspective. We favour growth companies, whose earnings can be expected to catch up with the prevailing valuations and offset any upward adjustment in return requirements in a longer perspective.

- Highest earnings growth in five years.
- Quarterly reports confirm good start to the year.
- Stable forecasts are reducing risks.
- Correction provides buying opportunities.
- More attractive valuations again.
- Profitable growth the most attractive.
- Normalised risk premium.

IN THE PAST YEAR THE OMX STOCKHOLM exchange has climbed 18 per cent. Even though significant new monetary stimulus measures were announced in Europe during this period, the upturn is a function of higher valuations only to a small extent. If we separate the forces behind the improvement into two factors, "higher valuations" and "higher earnings forecasts", valuations or rising price/earnings (P/E) ratios account for only about 3 percentage points of the upturn while higher earnings explain about 15 percentage points (the 12-month forward earnings forecast is 15 per cent higher today than a year ago). Meanwhile, interest rates and bond yields have fallen (even after the rebound of recent weeks), which means that the risk premium investors receive for buying Swedish equities has increased by more than one percentage point from the lows of just over a year ago.

The recent stabilisation in earnings forecasts, after substantial downward revisions between 2011 and autumn 2014, gives credibility to our forecast of 16 per cent earnings growth in Sweden this year and 13 percent in the Nordic region overall, despite negative earnings growth in Norway (-3 per cent in NOK). In Denmark and Finland, we expect earnings growth of 16 per cent and 17 per cent, respectively, in euros and in DKK (which is pegged to the EUR).

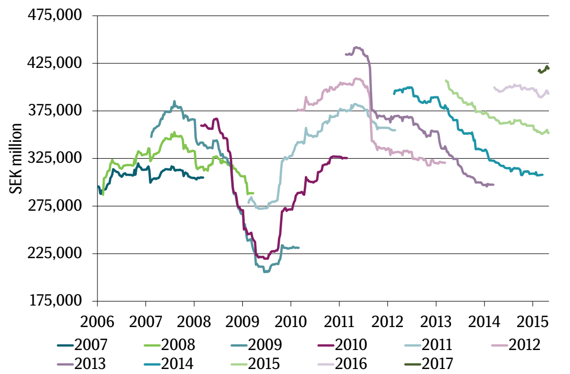
We believe that improved earnings growth will give the stock market rally of recent years a more solid foundation, than merely lower return requirements driven by monetary stimulus measures, as was previously the case.

Correction creates buying opportunities

After six months of uninterrupted gains, the stock exchanges in Stockholm, Helsinki and Copenhagen began May with a sharp correction. This downturn can be explained by three interacting factors: profit-taking after a sizeable upturn, a decline in the US dollar after the powerful appreciation of the past year and a significant upturn in risk-free bond yields all across Europe. We see the downturn as a temporary correction that has created good buying opportunities, and we expect higher share prices by year-end.

Corrections driven by profit-taking are a natural element of the stock market cycle, and the longer they are delayed, the more powerful they risk being, since the quantity of corporate earnings is increasing, and some investors thus find it psychologically easier to accept selling at price levels even further below record highs. SEB also believes that the downturn in the dollar and the upturn in long-term yields are only temporary.

HIGHER EARNINGS EXPECTED – ACCORDING TO MORE STABLE FORECASTS



Source: SEB Equity Research

The chart shows aggregate earnings forecasts for companies listed on the OMX Stockholm in millions of SEK for each year since 2006. During 2011-2014, repeated disappointments regarding company earnings resulted in continuous downward revisions in earnings forecasts. Since late 2014 these forecasts have stabilised, and analysts have boosted their earnings forecasts for 2016, though marginally.

Earnings growth and the report period

The first quarter 2015 company report period can now be summarised. We can state that our earnings forecasts are holding up and that earnings growth will accelerate from 9 per cent last year to 16 per cent this year, in SEK terms. Earnings have surpassed analysts' estimates in both Sweden and the other Nordics. Adjusted operating earnings improved by 9 per cent compared to the previous year in Sweden and by 17 per cent in the Nordic region if we exclude Statoil. The report period has not led analysts to make any significant forecast adjustments in Sweden, while their forecasts for the Nordics as a whole have been revised downward for 2015, but left virtually unchanged for 2016.

The percentage of upside surprises in quarterly reports significantly exceeded the percentage of downside surprises; for every disappointment, 1.5 reports were better than expected. In spite of this, aggregate earnings forecasts for 2015 have been adjusted downward, due to major disappointments in three companies. Earnings forecasts have been revised upward in seven out of 10 sectors, while one has been left unchanged (industrials) and two have been adjusted downwards (telecoms and shipping).

If we adopt a slightly longer perspective, so far this year we note small upward revisions in earnings estimates in Denmark and Finland (0.3-2.1 per cent) and small downward adjustments in Sweden (1-2 per cent), but downward revisions of more than 20 per cent in Norway as a result of the oil price decline. Since oil prices have recovered much of their winter slide in recent months, however, there should also be good potential for a stabilisation in Norway as well. We view the stabilisation of earnings estimates as positive for the stock market, since the recurrent downward revisions of recent years meant that share valuations repeatedly proved higher than previously estimated. More reliable forecasts should, all things being equal, lead to a lower risk premium.

Normalised risk premium

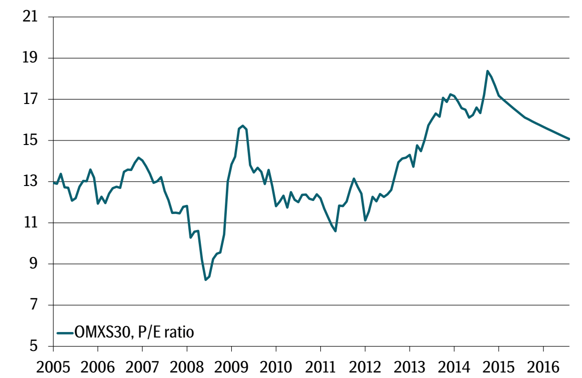
We see nothing unnatural in the lower return requirements of recent years in the stock market. On the contrary, it is completely reasonable that lower interest rates and bond yields will lead to lower return requirements on equities as well, both as a direct effect of the downward adjustment in risk-free yields but also because it may be reasonable for risk premium to also be adjusted downward when risk-free yields fall. If a risk premium of 5 per cent was justified when the risk-free yield also amounted to 5 per cent, some form of reduction should also be justified now that the risk-free yield is less than 1 per cent. Asking today for a return more than 6 times higher on equities than on government bonds when a return twice as high was considered acceptable a couple of years ago would seem strange.

The combination of higher earnings and the recent stock market correction has pushed down the P/E ratio again, however. We note that the risk premium is now back at its average level for the past 10 years. In other words, the stock market-friendly factors of the past year, such as the launch of the ECB's quantitative easing, have not resulted in lower risk premiums.

Profitable growth can protect against high valuations

Although the risk premium on equities is not in any way extreme today – we would even consider a slight downward adjustment from the current level to be reasonable

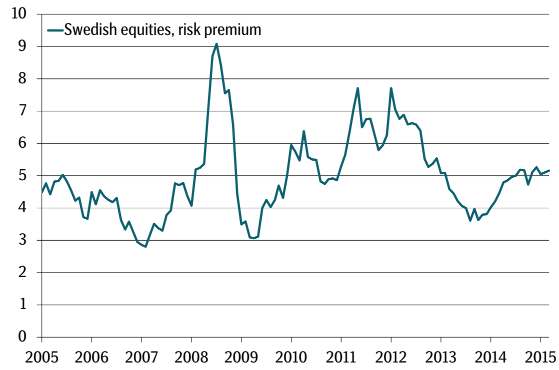
VALUATIONS HAVE FALLEN



Source: SEB Equity Research

The chart shows the price/earnings ratio for the OMX Stockholm exchange, based on forecasts for the next 12 months (today from the second quarter of 2015 to the end of the first quarter of 2016). After more than two years of an entirely valuation-driven stock market rally (autumn 2011 to spring 2014), the stock market gains of the past year can be explained primarily by rising earnings.

RISK PREMIUM BACK AT AVERAGE FOR PAST 10 YEARS



Source: SEB Equity Research

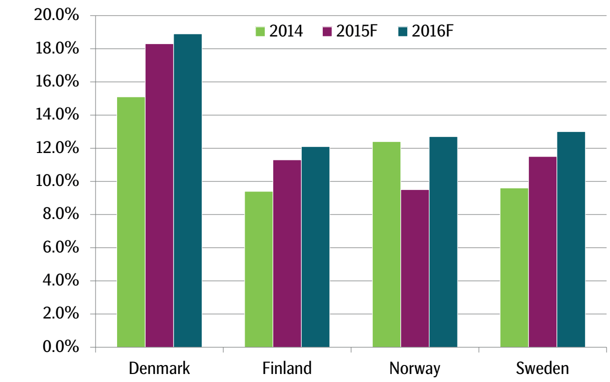
The chart shows the implied risk premium on Swedish shares (the difference between "earnings yield" based on projected earnings for the next 12 months and the risk-free yield on 10-year Swedish government bonds). The stock market rally in 2012, 2013 and early 2014 was driven by lower return requirements, which were largely due to a downward adjustment in the risk premium on equities. Better earnings growth and the recent stock market correction have lifted the risk premium back to its average level for the past ten years, despite a recent rebound in the risk-free yield.

– overall return requirements are low and the P/E ratio is high in a 10-year perspective. This is a direct result of low yields and the consequent downward adjustment in the risk-free yield component when calculating the return requirement on equities as well. One way that investors can protect themselves against a possible decline in P/E ratios again within 3-10 years is to invest in companies whose earnings growth can be expected to be good and whose P/E ratio recovery to historically more normal levels can occur by means of higher earnings (E) instead of lower share prices (P). This strategy seems especially attractive when we can observe that many of the historically most reliable growth engines in the Nordic countries are valued today at significantly lower premiums compared to the market average than is historically normal.

The ideal combination is, of course, companies which can both be expected to grow and to meanwhile distribute capital to their shareholders (through dividends, redemptions or buy-backs). One useful financial ratio for assessing a company's ability to generate distributable cash flows and grow at the same time is return on capital employed. A high return on capital employed means that there are limits on the earnings that need to be reinvested in the business to enable the company to take advantage of available growth opportunities. This frees up capital that can instead be distributed to the shareholders.

In keeping with the above, but at the other end of the scale, we believe that investors today should be mindful of the opportunities companies will have to distribute capital in the long term – not only what they are actually distributing at present. We note that some companies are once again borrowing in order to pay for dividends and/or buy-backs. This may provide a flattering dividend yield or directly help to sustain share prices, but it does not generate value for shareholders. It is merely a transfer of assets from one account to another. Meanwhile other companies are building up cash reserves that will be distributed to shareholders in the future.

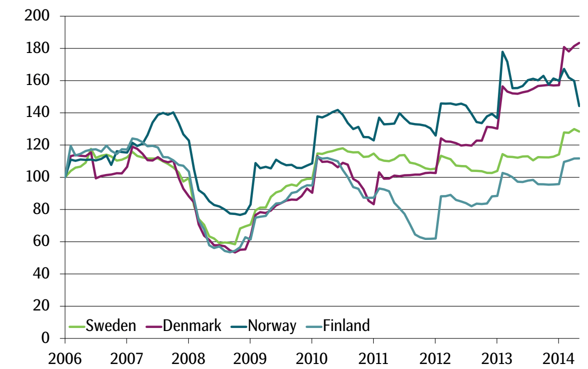
GOOD PROFITABILITY ENABLES DIVIDENDS AND GROWTH



Source: SEB Equity Research

The chart shows return on capital employed for listed companies in the Nordic region in 2014-2016, based on our forecasts and broken down by country. The higher the profitability of companies, the less capital is required in order to leverage the available growth opportunities. Shareholders can thus receive a larger percentage of profits in the form of dividends without hampering growth.

INDEXED EARNINGS TREND BY COUNTRY



Source: SEB Equity Research

The chart shows the consensus earnings forecast during the next full year for the largest companies listed on the stock exchanges in Sweden, Norway, Denmark and Finland. Earnings are indexed at 100 in 2006 and are stated in the local currency for each country. Sweden is represented by the 30 largest listed companies (OMXS30), Finland by the 25 largest (OMXH25), Denmark by the 20 largest (OMXC20) and Norway by the 25 largest (OBX).

Because of their different sectoral structures, the Nordic exchanges complement each other well. The heavy element of oil-related companies on the Oslo Stock Exchange resulted in significantly better earnings growth in Norway until 2011, but poorer growth more recently. Denmark outperforms the other countries over the period as a whole, and after the restructuring of Nokia the earnings of Finnish listed companies improved markedly.

% Fixed income investments

Search for returns focuses on high yield and EMD

A few years ago, most fixed income investments offered attractive potential in the form of high effective yields and room for falling yields, which meant bond price gains. But as central banks have begun to launch new stimulus measures and inflation worries have been replaced by deflation worries, bond yields have fallen and the number of attractive fixed income investments has dwindled. In Europe, some government bonds even have negative yields. These give investors a guaranteed loss if they keep the bonds to maturity. Investors in search of a decent positive yield have to look to high yield corporate bonds and emerging market (EM) bonds.

- Government bonds least attractive.
- Investment grade corporate bonds far less attractive than high yield.
- Prospects more uncertain for emerging market debt.

Government bonds (non-emerging market)

In late April and early May, government bond yields began to surge, especially in Europe. This rise was in response to better European macroeconomic data and easing deflation worries. However, the expansionary monetary policy still generally being pursued around the world points to a deceleration in this rebound, which will soon be followed by lower government bond yields again. This applies especially to countries and regions where monetary policy will be even more stimulative going forward. That means low yields, especially in the euro zone and Japan, but also in Sweden and Norway, where the two central banks are expected to cut their key interest rates in the near future.

ECB policy leading to low yields in 2015

Key factors pointing to low European government bond yields during 2015 are the European Central Bank (ECB)'s major bond-buying programme – which will continue until September 2016 – and its key interest rate, which will remain at around zero for a long time. The ECB's purchase of German government bonds could exceed 200 billion euros by next autumn. Meanwhile net issues of these bonds will only be in the EUR 5-10 billion range. The ECB may thus be forced to modify its programme by adjusting the country weightings for government bond purchases and/or include corporate bonds in its stimulative purchases.

Gradual rise in government bond yields during 2016

There are reasons to believe in a gradual rise in government bond yields on both sides of the Atlantic in 2016. By then, deflation worries should have been allayed by rising consumer prices. Meanwhile monetary policy in the US and Britain will be gradually tightened. The ECB will end its major bond-buying programme, and in the Nordic countries both Sweden's Riksbank and Norges Bank in Norway will start hiking their key interest rates during the second half of the year.

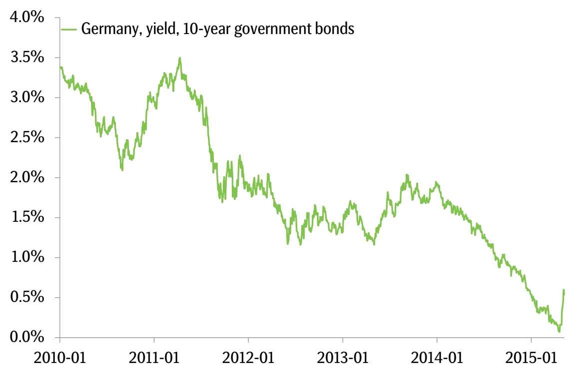
Corporate bonds – Investment grade

Towards the end of the financial and economic crisis in the spring of 2009 and after the financial drama during the third quarter of 2011, investment grade (IG) corporate bonds were considered very attractive. That was because they offered effective yields 4-5 percentage points higher than equivalent government bonds. Since then, they have become less attractive as the yield gap has narrowed to its smallest since 2008 (about 0.75 percentage points in Europe).

Less attractive yield gap

One factor that still weighs in favour of IG to some extent is the ECB's expansionary policy and the improved financial health of companies in both Europe and the US as the economy rebounds. Another factor is that yield gaps against government bonds were only 0.25-0.50 percentage points before the 2008-2009 crisis. Compared to high yield (HY) corporate bonds, IG bonds are nonetheless far less attractive.

EXTREME MOVEMENTS FOR GERMAN BOND YIELDS



Source: Macrobond

The multi-year declining trend for German 10-year government bond yields strengthened during 2014 and early 2015. The reasons for this were weaker general economic conditions combined with growing deflation worries and the ECB's expanded stimulus measures. Towards the end of April, there was a significant yield rise due to slightly better economic growth and reduced deflation concerns.

Corporate bonds – High yield

High yield (HY) corporate bonds clearly offer less room for a rise in value now than in 2011, for instance. However, because current yield gaps with government bonds are about 4.5 percentage points in the US and around 4 percentage points in Europe, HY corporate bonds are far more attractive than IG corporate bonds, even taking into consideration HY's higher risk.

Oil prices have clear impact on American HY

One important reason for the substantial widening of the yield gap for American HY bonds in 2014 was the dramatic decline in oil prices, which hit companies in the energy sector hard. These companies have a far greater weight in the HY market in the US than in Europe. With oil prices now apparently having bottomed out and expected to rise modestly over the next year, what was once a significant factor for the HY segment in the US is no longer relevant.

Favourable fundamentals

In terms of fundamentals, the most important factors for high yield investments are the economy and growth, monetary policy and interest rates, the financial health of companies, the number of corporate bankruptcies, and the attractiveness of alternative fixed income investments. All of these factors favour HY bonds. The economy will gradually strengthen in 2015-2016, global monetary policy will remain highly stimulative, the financial health of companies is generally good judging from the most recent corporate report season, and the number of credit events or bankruptcies is expected to increase modestly and remain below the historical average. Other investment alternatives in the fixed income market (apart from EM debt) offer significantly lower effective yields than HY, which thus benefits when fixed income investors look for yield.

Emerging market bonds

Except in Latin America, yields on emerging market debt (EMD) have fallen sharply since last summer, with bond prices climbing as a result. This has benefited EMD investors. However, taking a look ahead, these conditions look set to deteriorate.

Yields nearing the bottom

By all indications, EM bond yields are nearing or have reached their lows. When the US Federal Reserve begins to raise its key interest rate in the autumn, there will be greater pressure for higher yields, especially in Latin America and Africa, but also to some extent in Eastern (including Central) Europe and Asia. In Eastern Europe, ECB policy will help to limit the pressure on yields. In Asia, Chinese monetary policy is poised to take over the role previously played by Fed policy. Due to prospects of lower key interest rates in China, there is generally little risk of sharply rising yields in the emerging economies of Asia.

For EMD investors in Europe and the US, the currency outlook is naturally very important. The risk of depreciating EM currencies appears to be greatest in parts of Latin America – excluding Mexico – and least in Asia, while prospects are more mixed in Eastern Europe and Africa. For more, see the "Currency" section on page 18.

ASSET TYPE	WEIGHT	TACTICAL EXPECTED YEARLY RETURN			RISK		
		SEK	EUR	USD	SEK	EUR	USD
Cash	**1** 2 3 4 5 6 7	-0.4%	-0.2%	0.2%	0.1%	0.2%	0.7%
Government bonds	**1** 2 3 4 5 6 7	0.3%	1.0%	0.2%	4.2%	3.8%	3.9%
Investment grade (IG) corporate bonds	1 **2** 3 4 5 6 7	1.4%	1.6%	0.7%	2.4%	2.4%	2.4%
High yield (HY) corporate bonds	1 2 3 **4** 5 6 7	3.7%	4.0%	4.3%	3.6%	3.6%	3.6%
Emerging market debt	1 2 3 **4** 5 6 7	6.5%	6.5%	6.5%	9.4%	9.5%	9.8%

"Weight" indicates how we currently view each asset type 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 type.

Source: SEB

Alternative investments

Keeping pace after strong start to the year

Hedge funds in general had a challenging year in 2014. Global economic events, together with turbulent markets, made life difficult for most hedge fund managers, and returns did not reach levels achieved in previous years. With that fresh in their minds, fund managers are probably determined to prove to investors that last year's disappointing performance was an aberration and that hedge funds still have the ability to deliver stable returns over time. The fact that they have a low correlation with other asset classes also means that hedge funds can provide good portfolio characteristics.

- Desire for revenge among hedge funds after a problematic 2014.
- Strong start to the year tested by the recent trend reversal.
- Sharp rise in oil stockpiles as a result of current excess supply.
- The oil market is not expected to be in balance until 2016.

Hedge funds – Keeping pace after strong start to the year

Judging from the start of 2015, a desire for revenge among hedge fund managers appears to have had some effect. During the first four months of the year, the HFRX Global Hedge Fund Index was up about 2 per cent in SEK terms, despite turbulence in late April that caused a one per cent decline in the index. The generally steady rise in share prices this year, a strong US dollar and falling bond yields are factors that have favoured many strategies. Expectations of tightening monetary policy in the US, combined with central bank stimulus in the rest of the world, turned out to be a winning concept for many strategies. The trend-following macro/CTA strategy, which after a strong close in 2014 was last year's winner, continued to generate impressive returns in early 2015. By mid-March, the HRFX Macro/CTA Index had seen a gain of almost 5 per cent since the turn of the year.

It is painful when rallies are nipped in the bud and trends reverse. The stock market slump in recent weeks, a weakening US dollar and rising bond yields have entailed challenges for many strategies. The trend-following Macro/CTA strategy noted above experienced the greatest challenge, losing essentially all its gains for the year according to the HFRX Macro/CTA Index. The equity long/short strategy likewise saw some decline in connection with stock market jitters. Still, this strategy is up 3 per cent since the start of the year.

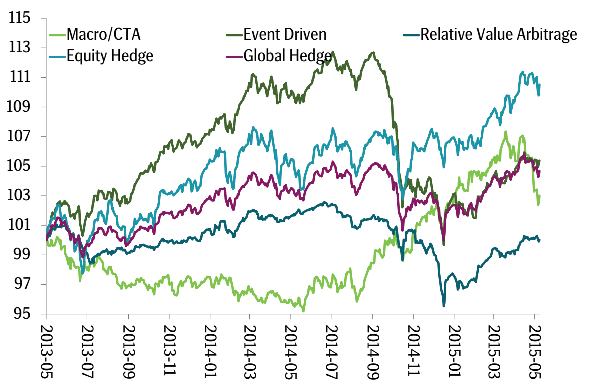
Equity long/short

After a difficult 2014 for these fund managers, their existence now looks somewhat brighter. The stock market's impressive vigour during the first quarter of 2015 is naturally a contributing factor, but greater variation in the performance of individual shares enhances the potential to generate returns. The European Central Bank's launch of quantitative easing has meant indirect support for this strategy in general and for European fund managers in particular. Fund managers with a long bias – positive net exposure – benefited from buoyant stock markets during the first quarter. If there should be any doubts about the continued strength of the stock market, the preference is for fund managers who can quickly change their net exposure.

Relative value

Despite tough conditions as a result of the extremely loose monetary policies being pursued around the world, most fund managers in this category fared rather well early in the year. The HFRX Relative Value Arbitrage Index was up almost 3 per cent during the first four months of 2015. This strategy has also shown a stable yield curve in 2015 and resilience to declines in periods

APRIL'S TREND REVERSAL IS TESTING FUND MANAGERS



Source: Bloomberg

Given expectations of key interest rate hikes in the US and continued expansionary monetary policy elsewhere in the world, the first quarter provided good conditions for hedge funds, but the recent trend reversal for the USD, bond yields and equities has put pressure on this asset class.

when other strategies have had difficulties. The lower co-variance between individual securities has helped to offset historically narrow credit spreads.

Event-driven

The fourth quarter of 2014 was a lost quarter for event-driven strategies, largely as a result of increased volatility due to geopolitical tensions and after a number of key corporate transactions were called off. However, the start of the year looked promising, and there is potential for continued strength.

In the US, companies continue to carry out restructuring and cost-cutting in order to improve efficiency. Combined with a good deal of shareholder activism, this is driving the market for corporate transactions. The euro zone is benefiting from a weak currency at a time when cross-border transactions are becoming more common. In Europe generally, low funding costs and continued pressure on management to generate shareholder value in a world of low growth continue to provide good potential for these strategies.

Macro/CTA

With 2015 starting off in the same strong fashion that 2014 ended, macro/CTA strategies have encountered some resistance in recent weeks. Market conditions changed significantly when bond yields, currencies and the European stock market reversed the clear trends seen since earlier in the year. Short-term-oriented fund managers have handled the turbulence better than those with a long-term orientation, since they can change their allocation and the focus of their positions more quickly. Long-term-oriented fund managers have certainly reduced their risk, but in most cases their focus on long positions in USD, equities and fixed income instruments remains the same.

Commodities – Higher oil prices but continued market imbalance

After (Brent crude) oil rebounded from a market low of about 47 dollars per barrel in January, it was trading at just over US 60/barrel at the time of the last issue of *Investment Outlook* (March 2015). We expected prices to remain at that level during the first half of 2015 but noted that there was an imminent risk of a short-term price fall. There were no further price falls and, at this writing, oil is trading at just over USD 65/barrel.

Our earlier forecast was a market in balance during the second half of the year, but we now expect excess supply throughout 2015, although this surplus will diminish. A deliberate production cut from the Organisation of the Petroleum Exporting Countries (OPEC), an oil cartel, or a supply disruption could potentially change this scenario. In March, OPEC produced 31 million barrels of oil per day, with Saudi Arabia accounting for 10.3 million barrels of this. These figures are near record levels. Reduced OPEC production with a subsequent price rise would probably lead to greater US shale oil production and thus renewed price pressure. OPEC would then end up in a situation with lower production but without significantly higher oil prices, which makes this scenario relatively unlikely. The world's two largest oil importers, the US and China, have absorbed most excess supply, which led to new record oil stockpile levels in the US twenty weeks in a row (an increase of almost 1 million barrels per day).

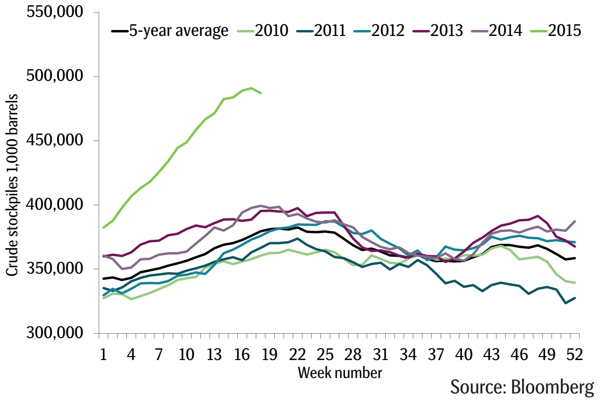
The excess supply in the oil market has decreased somewhat. Demand has strengthened, and the growth in non-OPEC supply has started to decelerate. In the US, demand has risen somewhat this year, mostly driven by increased demand for petrol. Both average car travel distance and new car sales are up. Chinese oil imports have also risen 8 per cent this year.

Because of falling oil prices, the number of US rigs operating onshore is now decreasing. Meanwhile productivity has increased, but it will ultimately decline. US production has been resilient in the face of oil price declines, but the figures now being reported (with a two-month lag) indicate that January production was down somewhat.

We believe the global oil market will achieve balance between demand and supply in 2016, but that developments related to Iran have potential to change this scenario. Recently, there has been a growing likelihood that an agreement on Iran's nuclear power will be reached, thus increasing the country's potential to export oil. Although this is still far in the future, the agreement, if completed, could increase the country's exports by up to 1 million barrels per day during 2016.

As before, our forecast is that oil will trade at around USD 60-65 per barrel over the next few quarters and close to USD 70 towards the end of the year, then remaining at around that level over the next couple of years.

EVER LARGER US OIL STOCKPILES



Source: Bloomberg

As show in the above chart, US crude oil stockpiles have risen sharply week after week. The current situation diverges dramatically from the trend for the past five years

Currencies

Affected by and affecting the economy

In hindsight, a number of factors have taken turns in being most important to the foreign exchange market, but in the past couple of years the direction of monetary policies has had the greatest impact by far. This is especially clear in terms of movements between the US dollar, the Japanese yen, the euro and the British pound. While the US Federal Reserve and the Bank of England are moving towards raising interest rates, the Bank of Japan and the European Central Bank (ECB) are expanding their monetary stimulus measures, in order to boost growth and inflation in Japan and the euro zone. In the Nordic countries, the policies of Sweden's Riksbank and Norway's Norges Bank have instead focused on keeping their respective currencies weak.

- USD appreciation will again accelerate.
- The Bank of Japan will further weaken the JPY.
- The ECB is taking steps to weaken the EUR.
- The GBP will weaken against the USD, but strengthen against the EUR.
- The CHF will depreciate against both the USD and EUR.
- The SEK will keep falling against the USD, but strengthen against the EUR.
- The NOK will keep pace with the SEK.
- EM currencies will follow different paths against the USD.

USD – A pause in dollar appreciation

During the latter part of 2014 and early in 2015, the US dollar (USD) strengthened sharply against other world currencies. The driving forces were strong US macroeconomic statistics and expectations that the Federal Reserve (Fed) would introduce rate hikes during the spring or summer of 2015. Since then, the USD has weakened temporarily because of unexpectedly weak US economic data and subsequent speculation in the foreign exchange (FX) market that the Fed will delay rate hikes.

Higher growth and Fed will give USD new strength
Given our view that the US economic dip is short-term and that the Fed will introduce interest rate hikes in the autumn, the USD is likely to resume its appreciation. Another factor in this scenario is that other central banks such as the European Central Bank (ECB) and the Bank of Japan (BoJ) will increase their monetary stimulus at the same time.

JPY – Weaker yen part of Abe's strategy

"Abenomics", the strategy launched by Japanese Prime Minister Shinzo Abe in late 2012, is based on three "arrows" – fiscal stimulus, monetary stimulus and structural reforms. This policy is aimed at weakening the yen (JPY), accelerating the rise in wages and keeping bond yields low. In the next phase, this is to lead to an easing of deflation worries so that an inflation rate of 2 per cent can be reached, and to an increase in Japanese economic growth. So far, Abenomics has had limited success, but the goal of weakening the JPY has largely been achieved.

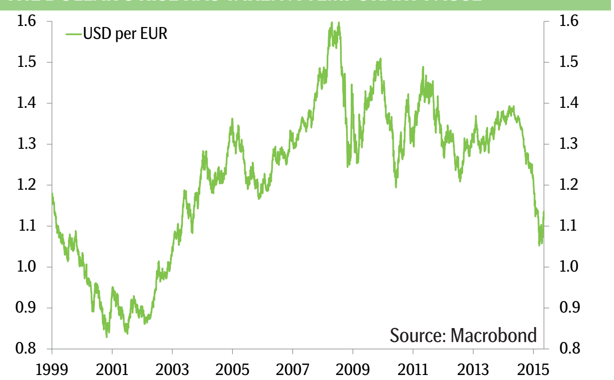
Further stimulus will weaken the JPY
Growth has been disappointing, and there is still a long way to go before the inflation target is met. This has increased the need for more stimulus, and the BoJ should provide the bulk of this. Such moves would help to further weaken the JPY, which would benefit growth and inflation.

EUR – Euro zone will benefit from depreciation

The ECB's monetary policy is also aimed at promoting growth and, via a weaker currency, creating inflation expectations and inflation. The ECB's escalated bond-buying in early March also had the intended effects in terms of rising economic indicators and higher inflation expectations going forward. But in order to sustain this success, by all indications the EUR needs to depreciate further.

ECB policy will lead to declining euro
Since the ECB is expected to keep its key interest rate at

THE DOLLAR'S RISE HAS TAKEN A TEMPORARY PAUSE



After the USD had long traded in the range of 1.30-1.50 against the EUR, this pattern was disrupted in the spring of 2014 when the USD rapidly strengthened in the direction of parity thanks to better growth in the US than in the euro zone and the divergent monetary policy paths of the Fed and the ECB. We believe that the recent slump in the USD is temporary, since US economic growth will pick up soon again after a downswing in early 2015.

around zero for a lengthy period and continue its bond-buying programme until the autumn of next year, a continuing weakening of the EUR is in the cards – especially since euro zone economic growth over the next couple of years is expected to be much lower than in the US.

SEK – Riksbank focuses on the krona

Since the Swedish Riksbank began to focus forcefully on its 2 per cent inflation target, the SEK has become its number one tool for raising inflation expectations and inflation. Using stimulative monetary policy – for instance, a negative key interest rate, a downward-revised interest rate path and large government bond purchases – the central bank hopes that the SEK will be weak enough for Sweden to pay higher import prices and thus be able to import inflation through trade.

SEK will fall against USD but rise against EUR

Our forecast is a continued, long-term weakening of the SEK against the USD, but we expect the krona to strengthen against the EUR a little further ahead. One reason for this is that the Riksbank is not expected to provide as much monetary stimulus as the ECB.

NOK – will keep pace with the SEK

Norges Bank (NB) is focused on the NOK when it determines its monetary actions, and, as with Sweden's Riksbank, the NB's aim is now a weak currency. In contrast to Sweden, the main goal is not inflation, but increased economic growth and international competitiveness. The Norwegian key interest rate will thus probably be lowered soon. Like the SEK, the NOK will probably strengthen against the EUR a little further ahead, as the NB ends its stimulus measures and oil prices climb above USD 70 per barrel. Still, the USD should gradually become more expensive for Norwegians as well.

GBP – Pound will take a middle course

In many respects, the macroeconomic environment for the pound (GBP) is similar to the one of the USD. In both the UK and the US, growth last year was fairly high, followed by short-term dips early this year.

The Bank of England (BoE) and the Fed are also among the central banks expected to lead the way in introducing interest rate hikes. However, we predict that the BoE will delay its first rate hike until early 2016 and then raise its key interest rate at a slower pace than the Fed. This suggests that the GBP will not rise as much as the USD, but the GBP will nevertheless strengthen against the EUR.

CHF – Swiss National Bank in firm control

Over the past year, the Swiss National Bank (SNB) has fought hard to ensure that the Swiss franc (CHF) does not rise in value, among other things by setting a negative interest rate on deposits in the SNB. This has made it more expensive for banks and other financial institutions to hold the CHF. For the time being, buying pressure on the CHF is relatively limited, but the ECB's continued stimulus programme and the Greek financial drama could lead to increased investor interest. In our view, the SNB will then further lower its key interest rate in order to make the CHF less attractive and/or sell francs in the foreign exchange market. Our main scenario is that the CHF will weaken over the next year or so against both the USD and EUR.

Emerging markets – Currencies will diverge

Over the next year, currencies in the emerging market (EM) sphere are expected to take divergent paths against the USD. In Asia, which has the best macroeconomic and financial conditions, a number of currencies could rise in value, including those of India, Indonesia and the Philippines. In Eastern (and Central) Europe, the main trend is falling exchange rates, although the Russian rouble could continue to strengthen after its steep fall if oil prices rise.

African currencies, such as Nigeria's and Kenya's, look set to remain relatively stable against the USD, whereas South Africa's is expected to fall.

In Latin America, Brazilian elections mean uncertain prospects for the country's real (BRL), whereas Mexico's peso has potential to strengthen significantly against the USD.

CURRENCY PAIR	EXCHANGE RATE					CHANGE IN EXCHANGE RATE, %			
	Now*	Q2 2015	Q3 2015	Q4 2015	Q1 2016	Q2 2015	Q3 2015	Q4 2015	Q1 2016
EUR/USD	1.11	1.05	1.00	0.95	0.96	-5.7	-10.2	-14.7	-13.8
EUR/SEK	9.30	9.30	9.15	8.95	8.85	0.0	-1.6	-3.7	-4.8
EUR/NOK	8.40	8.65	8.45	8.25	8.10	3.0	0.7	-1.7	-3.5
USD/SEK	8.35	8.86	9.15	9.42	9.22	6.1	9.6	12.9	10.4
USD/NOK	7.54	8.24	8.45	8.68	8.44	9.3	12.1	15.2	12.0
EUR/CHF	1.04	1.05	1.07	1.08	1.10	0.7	2.6	3.5	5.5
CHF/SEK	8.91	8.86	8.55	8.29	8.05	-0.6	-4.1	-7.0	-9.7
EUR/JPY	134.6	128.1	125.0	123.5	125.8	-4.8	-7.2	-8.3	-6.6
GBP/USD	1.55	1.48	1.46	1.45	1.47	-4.6	-5.9	-6.5	-5.2
GBP/SEK	12.9	13.1	13.4	13.7	13.6	1.2	3.2	5.5	4.6

** Currency forecasts were made by SEB Trading Strategy as of May 20, 2015. Please ask for a copy of our current forecasts.*

Theme – valuations

Valuations another reason to diversify risks

Strong share prices and falling interest rates and yields in recent years have driven up valuations. As a result, we are analysing current financial market pricing and return potential going forward. The period from the onset of the financial crisis in 2007 until now has been characterised by mediocre growth and very low inflation. The world's central banks have responded with record-low key interest rates and extensive stimulus packages, which have led to recovery and stabilisation for the global economy. Unprecedentedly low interest rates and yields, combined with enormous liquidity injections, have driven up prices of other financial assets and have limited the return potential in certain segments.

- All assets have risen in price, and none is cheap.
- Parts of the government bond market are the most expensive asset class.
- Risk-adjusted expected returns for equities and corporate credits are in line with one another.
- The forecast of increasing global economic growth still suggests that equities will have the highest expected return.
- Assumptions about returns are clearly dependent on economic cycles, thus highlighting one of several risks.

Expensive but not extreme stock market valuations

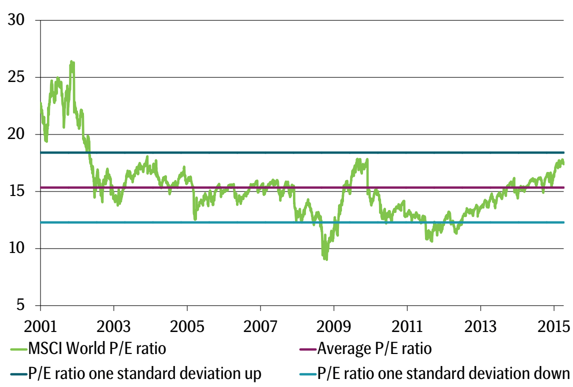
In the chart "Global stock market valuations" we show how different stock markets are priced relative to their historical performance and to one another. We have chosen to study pricing relative to expected earnings for the next 12 months (the price/earnings or P/E ratio). This valuation metric has fluctuated sharply over the years, with today's strong prices at relatively high levels in an historical perspective. That means current prices reflect an assumption that growth and earnings will improve in the years ahead.

As visible in the chart "In absolute terms, European shares appear to be the cheapest", the US stock market today is valued at almost 18 times next year's forecast earnings. That is about 19 per cent more expensive than the historical average for the past ten years.

The European stock market is valued at more than 15 times next year's expected earnings. In absolute terms, this is cheaper than the global stock market but more than 30 per cent higher than the historical average for the past ten years.

The Japanese stock market today is valued at more than 18 times next year's expected earnings. In absolute terms, this is more expensive than the global stock market but lower than the historical average for the past ten years. The Japanese stock market has been volatile, and in 2009 valuations were at an extreme level, which pushes up the average. All in all, equities have been valued at levels in the upper part of their historical range. Meanwhile government bond yields have hit new record lows.

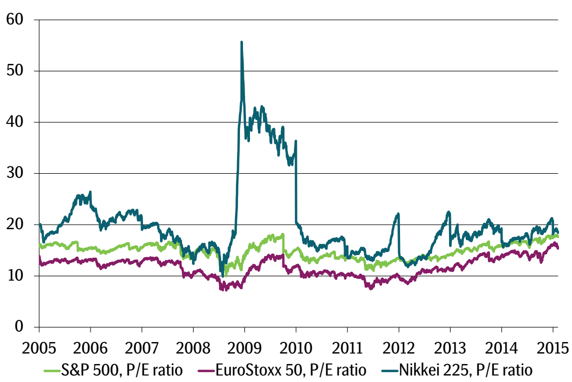
GLOBAL STOCK MARKET VALUATIONS



Source: Bloomberg

The global stock market, measured by the MSCI World AC Index in local currencies, is today valued at more than 17 times next year's estimated earnings, compared to the historical average of just over 15 for the past 15 years.

IN ABSOLUTE TERMS, EUROPEAN SHARES APPEAR TO BE THE CHEAPEST



Source: Bloomberg

The chart shows the share price trend, measured as the P/E ratio, for Europe (Eurostoxx 50 Index), the US (S&P 500) and Japan (Nikkei 225).

European bonds stand out as the most expensive

Weak growth, low inflation pressure and active central banks have led to a trend of falling bond yields. For instance, since the early 2000s, European government bond yields have fallen almost 98 per cent, as illustrated in the chart "Long era of falling yields in the euro zone and the US". The question is whether the long-term trend of falling European and US government bond yields has now come to an end.

Over the past 15 years, US 10-year government bond yields have fallen from about 6 per cent to just over 2 per cent today. This trend has been driven by weak economic growth and low inflation, causing the US Federal Reserve to cut its key interest rate and launch various stimulus measures (known as quantitative easing, QE) to boost US economic growth and drive up inflation expectations.

Over the past 15 years, European 10-year government bond yields have fallen from more than 5 per cent to 0.075 per cent at their lowest in April this year. Just as in the US, this trend is driven by weak economic growth and low inflation, which have given central banks reasons to stimulate the economy with lower interest rates and quantitative easing. Yields in the euro zone today are comparable to Japanese 10-year bond yields, which have been kept down by the Japanese central bank since the 1990s in order to combat weak growth and deflation.

Just as the European Central Bank has done for a while, the Bank of Japan has started buying securities in the market in order to inject liquidity and stimulate investment. Government bonds have never been more expensive than they are now, and this has created ever growing interest in various corporate bonds, which offer higher absolute yields, but normally also a higher risk.

Increased risk-taking in the search for returns

The low return or yield on government securities provides potential for other asset classes. In the bar chart on the last page of this theme article, we compare return levels for the various asset classes to levels 10 years ago. We have also taken euro zone and US inflation into consideration in order to compare the real rates of return.

One way to try to compare the valuations of different asset classes is to see what returns they generate today compared to ten years ago and how they compare to one another. Effective returns on both government bonds and corporate bonds have fallen substantially over the past 10 years but, given today's low inflation, real returns are not significantly worse. Government bond yields in emerging markets (EM debt, or EMD) are generally unchanged compared to 10 years ago. Countries such as India, Mexico and China have reduced their debts, and their government bonds are trading at attractive levels relative to those of many industrialised countries. Corporate bond yields have also been adjusted downwards, but here too real returns are more in line with historical yields.

As yields have become ever lower, investors have moved farther out on the risk scale in the search for returns. Nominal dividend yields on equities, unlike effective yields on fixed income investments, are higher today than 10 years ago and far higher in real terms. Given the absence of returns on fixed income investments, equities today are treated to some extent as a substitute for yields on bond investments. A higher real dividend yield from equities can to some extent justify higher valuations in many stock markets.

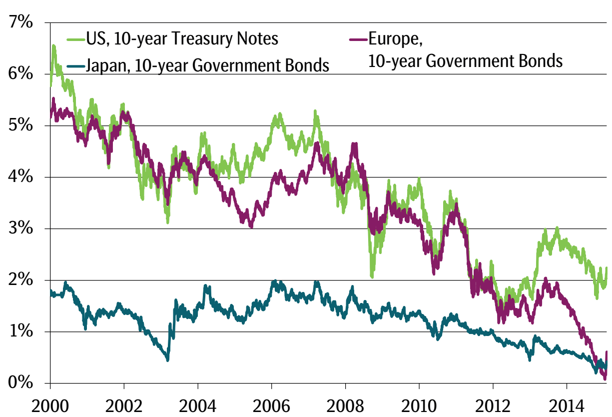
Time to adjust yield expectations downward

If current growth and inflation forecasts hold, we are probably facing a period of gradually rising yields, and today's valuations instead reflect some kind of normalisation rather than continued multiple expansion.

Equities still the best asset class

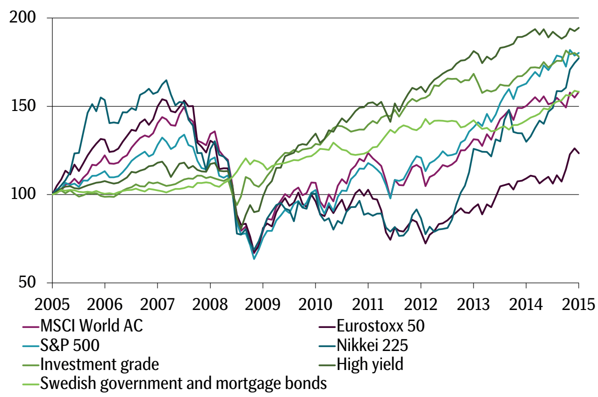
Expected global economic growth of about 3.5 per cent in 2015 and almost 4 per cent in 2016 lends credibility to forecasts of higher corporate earnings in the years ahead. All asset classes are more expensive today than their

LONG ERA OF FALLING YIELDS IN THE EURO ZONE AND THE US



Source: Bloomberg

STRONG PRICE TREND FOR BOTH STOCK AND FIXED INCOME MARKETS IN THE PAST SIX YEARS



Source: Bloomberg

Partly due to falling interest rates/yields, corporate bonds in the high yield segment – represented by the US IBOXX High Yield Total Return Index – were the asset type that showed the strongest price gains for the past ten years. During the same period, European equities, represented by the Eurostoxx 50 Index, were the worst-performing asset type.

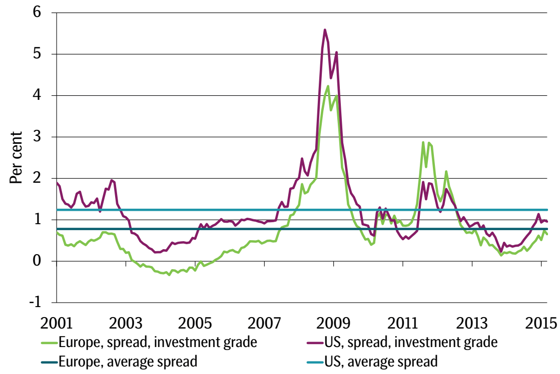
historical averages for the past 10 years. Low interest rates and bond yields have probably bottomed out, and we are probably facing a period of slowly rising interest rates and yields.

Lower expected absolute returns at unchanged or higher risk underscore the need for diversification. This is achieved by holding a higher proportion of global equities than usual. Geographically, Europe appears to be a cheap market in absolute terms compared to others, but relative to its historical average prices nonetheless seem fairly high. However, given continued currency movements along with a stronger dollar and central bank stimulus measures, the greatest potential for higher earnings is in Europe.

Japan stands out as relatively cheap. Further stimulus and a more investor-friendly policy are expected. In the fixed income segment, corporate bonds will provide reasonable compensation compared to government bonds, as long as the general economic trend is favourable. However, in the long term, rising yields and interest rates will mean that investors ought to keep maturities short.

All in all, valuations combined with a positive economic outlook suggest that investors should maintain their exposure to equities, and we believe that it is appropriate to overweight Europe and Asia. In the fixed income segment, record-low interest rates and yields bode well for corporate bonds, but maturities should be kept short. With exposure to equities and fixed income instruments highly dependent on economic cycles, there is a growing need for alternative investments that can generate returns via other factors. If our economic, yield and interest rate forecasts prove incorrect, a situation may arise in which government bonds in Western countries once again become an attractive asset class to hold. Dependence on economic cycles is a clear risk to return potential in capital markets.

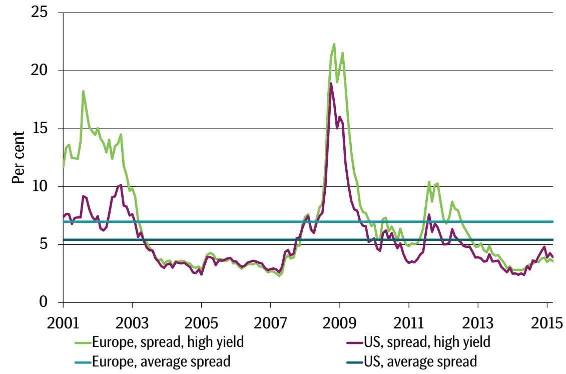
10-YEAR GOVERNMENT VS INVESTMENT GRADE BONDS



Source: Bloomberg

The yield gap between 10-year government bonds and investment grade corporate bonds (credit ratings AAA to BBB-) is in line with the historical average for the past 15 years. Extremely low government bond yields, especially in the euro zone, make this gap seem large given the stability of the underlying companies.

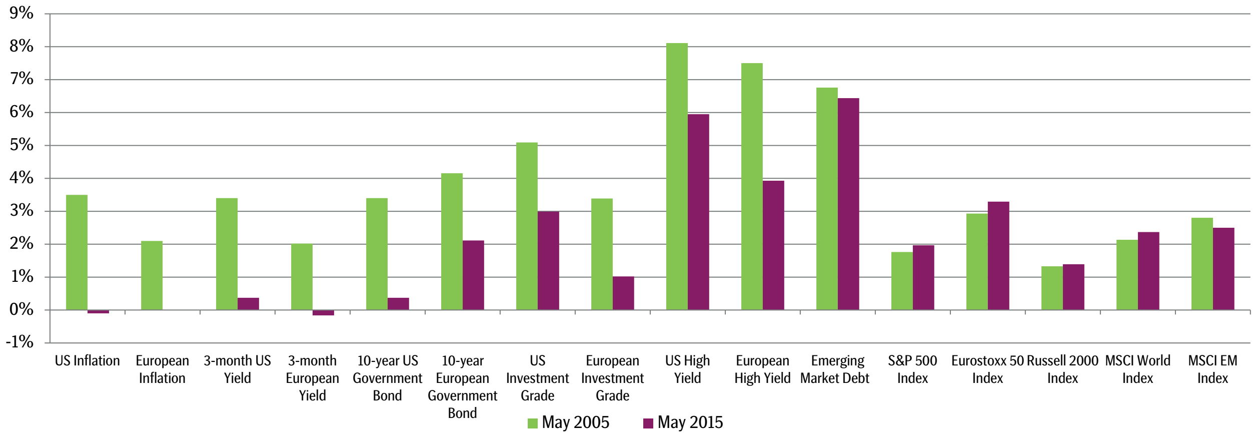
10-YEAR GOVERNMENT VS HIGH YIELD BONDS



Source: Bloomberg

Corresponding yield gaps in high yield corporate bonds (credit ratings lower than BBB-) indicate that levels in Europe are well below the average for the past 15 years. Absolute yield levels should, above all, provide compensation for the expected default rate. According to Moody's, this rate is expected to be 2.6 per cent in 2015. That is still low, and on the whole, high yield corporate bonds offer reasonable yield compensation relative to government bonds.

COMPARISON BETWEEN REAL RETURNS ON EQUITIES AND FIXED INCOME INVESTMENTS



Source: Bloomberg

ASSET CLASS	RETURN (SEK)	RISK (SEK)	RISK-ADJUSTED RETURN*
Treasury notes	0.00 %	1.0 %	-
Government bonds	1.00 %	5.0 %	0.20
Corporate bonds	2.20 %	8.0 %	0.28
Global equities	4.70 %	17.0 %	0.27

*The ratio between expected return and historical risk   Source: SEB

The table on the left shows historical risk and expected annual return given our five-year forecast assumptions. Estimates include an assumption of lower future valuations, which will eliminate some return potential. This means that annual return estimates for the next five years are lower than our forecast for the next 12 months (since we do not expect any change in those valuations). Adjusted for risk, corporate bonds and global equities appear to be similarly valued.

Theme – Risks

Threats to equities mainly in the financial world

The prevailing stock market upturn, or "bull market", is now over six years old. More and more people are thus concerned that the upturn is nearing its end. An inventory of what could make it turn into a "bear market" shows that the situation in the real economy poses no major threats. Instead, the risks to equities are primarily financial. Some of these are related to the consequences of unprecedented central bank monetary policies, as well as the impact of significant exchange rate shifts on companies in emerging markets. The common denominator is the risks posed by large, unexpected price movements.

- It is important for long-term asset managers to distinguish between traditional stock market cycles and mini-cycles.
- Periods of rising stock markets have often been interrupted by large, unexpected price movements.
- Today the real economy poses no major threats to equities.
- Accelerating price upturns for financial assets are a concern.
- Central bank actions have created a bubble in the bond market and have increased the risk of such bubbles in the stock and real estate markets.
- The Federal Reserve's upcoming interest rate increases are a source of concern.
- The appreciation of the US dollar is hurting businesses in emerging markets.
- Greece is a risk, but less than before.

THE LENGTH OF TRADITIONAL bull markets has varied significantly over the past 60-70 years, with a tendency to become longer in recent decades. On average, periods of rising stock markets have lasted almost five years while declines, or bear markets, have lasted an average of 10-12 months. In recent years, stock markets have also increasingly been characterised by mini-cycles: brief share price setbacks of a few weeks or months, followed by new upturns.

For long-term asset managers, it is thus very important to be able to determine whether a sudden stock market decline is the beginning of a traditional bear market. In that case, the logical decision is to reduce the proportion of equities in the portfolio. It might also be the start of a mini-cyclical setback. If so, it makes sense to remain calm and prepare to enlarge the weighting of equities in the portfolio ahead of an imminent new price upturn.

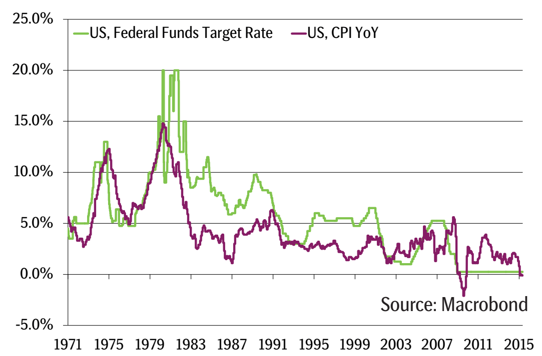
The reason why periods of stock market gains are interrupted has often been large and unexpected price movements in the real economy and/or financial markets. These have triggered events that led to market declines.

A faster rate of price increases on goods and services in the real economy – higher inflation – due to a shortage of production capacity usually causes central banks to hike their key interest rates and leads to a rise in market interest rates. It increases the cost of consumption and loan-financed investments, hurting economic growth and making the economy slide into recession. This is probably coupled with a bear market for equities.

If prices of goods and services instead fall faster – accelerating deflation – this leads to lower corporate earnings, deferred consumption and delayed investments (since goods and services are expected to become even cheaper in the future). The economy ends up in a recession, and shares are hit by a bear market.

Sharp price increases for commodities such as oil undermine purchasing power, thereby lowering economic growth in oil-importing countries, to the detriment of their stock exchanges. On the other hand, sharply falling oil prices benefit growth in oil-importing countries but hurt growth and stock markets in oil-exporting countries as well as the energy sectors of importing countries that have their own oil and gas production. Overall, world economic growth is hurt when oil becomes more expensive, while it benefits from cheaper oil.

INFLATION AND INTEREST RATES FOLLOW THE SAME PATH



History shows a clear association between US inflation and Fed interest rate policy. The central bank has battled high inflation by means of vigorous key interest rate hikes. This has contributed to periods of recession. Since 1990 inflation has slowed, and Fed rate hikes have thus become gentler. At present, consumer prices are falling and the key interest rate has been close to zero for some time.

After a period of accelerating price increases for financial assets such as equities, bonds and real estate, they become expensive, when measured in various ways (see the "Theme - Valuations"). Ultimately, speculative bubbles may inflate. When they burst, the effects may be dramatic and geographically widespread in economies and financial markets, as illustrated by the bursting of the IT/dotcom bubble at the start of the 2000s and of the "sub-prime" mortgage loan bubble in the US during 2007-2009.

As of May 2015 there is very little risk of soaring inflation, and last winter's deflation threat has diminished. The commodity price situation is meanwhile benefiting the overall global economy. Although Brent crude oil prices have rebounded from a low of around USD 47 per barrel in mid-January to nearly USD 70/barrel in mid-May, oil remains about 35 per cent cheaper than one year ago.

The current situation in the real economy thus does not seem to pose any major cyclical or stock market threats, assuming that the first quarter growth slump in the US was indeed temporary and that the Chinese economy is decelerating gently. Instead, we should look for threats in the financial world. As for stock market valuation risks, see the theme article on valuations on page 20.

Since 2010-2011, prices of government bonds have risen significantly as a result of lower central bank key interest rates and quantitative easing (asset purchases). These monetary policies have included moves into previously unknown territory, with the cost of money at close to zero (or even below zero) and with negative bond yields.

Through their actions, central banks are directly helping create a bubble in the bond market and are also indirectly helping inflate bubbles in the stock market and real estate markets as investors take greater risks in their search for returns. This creates unstable market conditions, as illustrated by the sudden surge in German and other European government bond yields in late April and early May this year. Furthermore, there is a risk that within a year there will be a shortage of German government bonds if the European Central Bank (ECB) continues to pursue its bond-buying plan. This would increase uncertainty in the bond market. Continued low government bond yields would also make it difficult for many European life insurance companies to meet capital adequacy rules. These companies manage an impressive EUR 4.4 trillion in assets.

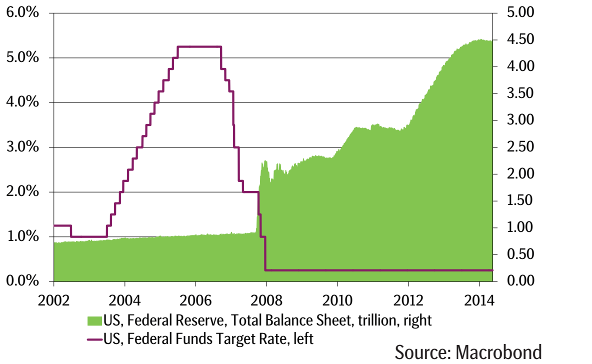
While the ECB and the Bank of Japan continue their current (bubble-creating) stimulus path, the US Federal Reserve (Fed) is poised to move in the opposite direction. The normalisation of US monetary policy may occur smoothly if financial markets and the Fed are in synch, but it may also lead to large movements in interest rates and bond yields if the market is uncertain about where the Fed is headed.

Large exchange rate movements also risk contributing to setbacks in economic growth and stock markets, especially in the emerging market (EM) sphere. In recent years, many EM-based companies have increasingly taken out loans in foreign currencies, mainly US dollars. These companies have thus been hard hit financially during the past year as the USD has sharply appreciated. Especially vulnerable are commodity and oil companies, which since 2007 have accounted for a full one third of all non-financial EM corporate bond issues in US dollars and other "hard" currencies. Falling real estate prices in China are another EM risk. This decline in prices hurts the balance sheets of Chinese banks, and there is a risk of consequences in other EM countries as well.

The contagious effects on portions of the European economy and the financial world if Greece were to withdraw from the euro zone should not be underestimated, but the consequences are likely to be far more modest than if this had occurred a few years ago.

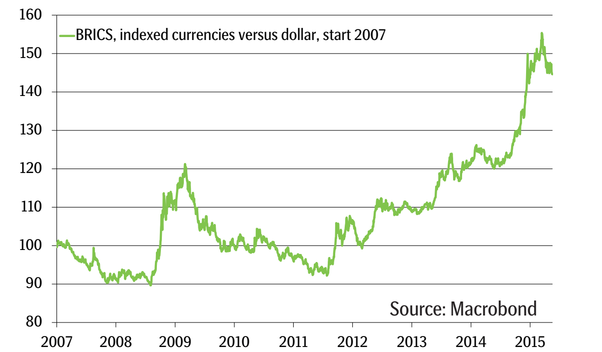
Finally, there are geopolitical threats such as escalating drama in Ukraine or the Middle East as well as geological disasters such as earthquakes, which might cause dips in share price curves. These dips will be brief, however, provided that economic growth and corporate earnings are not adversely affected to any great extent.

FED POISED TO BEGIN NORMALISING MONETARY POLICY



Since autumn 2008, the Fed has maintained a key interest rate of 0.00-0.25 per cent. The bank carried out massive bond purchases in three rounds, swelling its balance sheet to about USD 4.5 trillion. Net bond purchases ended last autumn, but net divestments are likely to be delayed for a fairly long time. However, the first key rate hike will occur in September 2015, according to SEB's forecast.

USD APPRECIATION HAS PUT PRESSURE ON EM COMPANIES



For some time, many companies in the emerging market (EM) sphere have financed more and more of their operations in foreign currencies, especially the US dollar. As the USD has appreciated against EM currencies (in the chart, USD against a basket consisting of BRICS currencies), these companies have been squeezed financially. Their debts and debt service costs (interest payments and principal repayments) have grown rapidly in local currency terms.

Theme – Euro zone

How is the euro zone doing?

After a difficult period for many euro zone countries, the situation now looks much better. After six straight quarters of recession, GDP began to grow again during 2013 and we are now in the ninth straight quarter of growth. High unemployment and large central government debts are still challenges in the region, but household confidence has improved and consumption is up. Many countries are now more competitive because of the weak euro, and exports have begun to rise. Ultra-low interest rates, lower oil prices and a weaker euro are factors that should support this positive trend going forward. Greece remains an exception.

- The financial crisis revealed the euro zone's fundamental weaknesses, with the situation being most serious in the "GIIPS" countries.
- The first emergency loan was disbursed in 2010 to Greece, with the "Troika" (EU/ECB/IMF) as lenders.
- Requirements linked to the loans were intended to strengthen recipient countries' economies.
- The ECB played a major role in managing the crisis.
- The competitiveness of European companies has improved.
- Most economies look much better today, with Greece as an exception.
- Large central government debts and high unemployment are still challenges.

THE FIRST FUNDAMENTAL WEAKNESS to emerge in the euro zone was that government finances proved to be in far worse condition than expected in a number of countries, primarily the so-called GIIPS countries (Greece, Ireland, Italy, Portugal and Spain). The financial and economic crisis caused deficits and debts to explode, and serious banking problems were soon a reality. The first country to experience a crisis situation was Greece. In May 2010, the country had government debt equivalent to 115 per cent of GDP and a budget deficit of almost 15 per cent of GDP, while its 2-year note yield was almost 20 per cent.

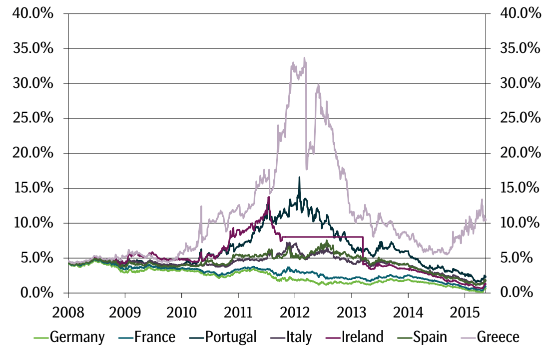
During the second quarter of 2010, the first step was taken to extend emergency loans to Greece totalling EUR 240 billion (7.2 billion of which has not yet been disbursed), with the European Union (EU), the European Central Bank (ECB) and the International Monetary Fund (IMF) – the so-called "Troika" – as lenders. During the summer of 2011, other GIIPS countries ended up in financial crisis, with major political turmoil as a result. During the winter of 2011/2012, Portugal and Ireland, like Greece, were granted emergency loans. The major problems faced by several euro zone countries were reflected in the fixed income market. In June 2011, the yield gap between Greek and German 10-year government bonds was 14 percentage points. In comparison, at that time the yield gap between US government bonds and corporate bonds for industrial companies with a very low credit rating (CCC) was 7.5 percentage points.

The Troika's main requirements for extending loans have been that countries reduce their budget deficits, carry out structural reforms to eventually boost growth through better functioning economies and improve their international competitiveness. Borrowers have had a very difficult time meeting these requirements.

Measures produced results

During the second quarter of 2013, a six-quarter-long recession in the euro zone ended when GDP grew again (see chart on the next page). Meanwhile, the competitiveness of these countries had improved and their current account deficits had narrowed. At the same time, the ECB's policies and actions had stabilised financial markets. Exports began to rise not only in Germany, but in a number of the GIIPS countries, with the best example being Spain. Some production began to shift back to the euro zone after having previously been located in low-cost countries. Especially Ireland, but also Spain, implemented measures that have significantly improved their government finances and economies.

GOVERNMENT BOND YIELDS BACK AT 2009 LEVELS



Source: Bloomberg/Macrobond

Apart from the rise in Greek bond yields, government bond yields are now below 2009 levels. This signals that market confidence in the region has been restored and that the ECB's stimulative policy has had an impact.

The need for further budget-cutting has generally diminished in the euro zone, and countries have been able to shift their fiscal policy focus from tightening to neutral, and in some cases slightly stimulative. The exception is Greece, where private sector lenders have written down much of the country's debt. This means that the IMF and euro zone taxpayers are now the largest creditors.

The ECB has played an increasingly important role in managing the crises that have arisen. Its key interest rate, the refi rate, has been cut to 0.05 per cent. The central bank has issued loans with favourable terms to banks, is a member of the lending troika and has promised to buy government bonds with short maturities, provided that a country first gets a loan from the European Stability Mechanism (ESM).

Competitiveness has improved in Spain, Greece, Ireland and Portugal, but not in Italy, France or Germany, although in Germany's case that has not been the aim. Important steps have also been taken towards a banking union. Stress tests on European banks during the summer of 2010 were positively received, which eased concerns about the euro zone banking system. New stress tests were conducted during the summer of 2011, and the ECB has assumed oversight duties.

As for the countries' fiscal policies and their coordination, success here has been far less impressive. There is very poor compliance with the requirements of the European Union's Stability and Growth Pact. According to the Pact, each EU member should keep central government debt below 60 per cent of GDP and its budget deficit below 3 per cent of GDP – requirements that few countries in the EU currently live up to.

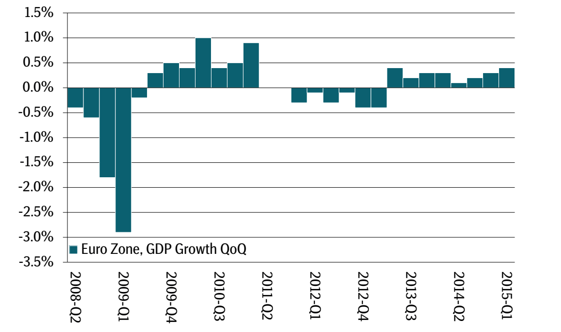
The euro zone today

The current situation, with relatively low oil prices, ultra-low yields and interest rates, a weaker euro and the ECB's stimulative policy of quantitative easing through bond buying, will boost growth in the region going forward. Investors had expected the ECB's policy, which entails buying EUR 60 billion worth of bonds a month until September 2016 – more than EUR 40 billion of this in government bonds and the rest in asset-backed securities (ABSs) and covered bonds. However, the scale of this programme was somewhat larger than the market had anticipated.

Furthermore, consumer confidence is up and retail sales have accelerated. A weaker euro (which will probably weaken even further as a result of central bank stimulus) is benefiting exports, although the effects will vary depending on how long this change in value will last. During the crisis years, general demand was subdued but there are now signs of some recovery, particularly in the household sector. Consumer confidence has risen sharply in recent months, and year-end retail sales increased at a faster pace than for several years. Car sales have also picked up. During the first half of 2015, consumption in the region as a whole is expected to rebound from its decline during the financial crisis and return to its 2008 level. The era of major emergency budget-cutting is now probably at an end, and fiscal policy will be more neutral in the years ahead in most of the region's countries.

There has been a great deal of improvement, but many challenges remain. Unemployment is still very high in the region as a whole, although the trend is slightly downward. There is considerable variation, depending on the country. German unemployment is at a historically low level, while both Spain and Greece have unemployment of more than 20 per cent. Government debt levels are still very high, and the situation in Greece is once again critical.

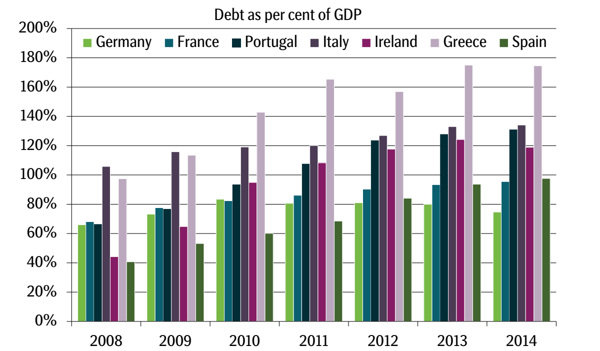
GROWTH IS NOT STRONG BUT APPEARS SUSTAINABLE



Source: Bloomberg/Macrobond

As shown in the chart above, the euro zone returned to economic growth during the second quarter of 2013. Although the upturn has not been especially strong, we are now in the ninth straight quarter of growth.

GOVERNMENT DEBT HAS EXPLODED



Source: Bloomberg/Macrobond

Apart from Germany's central government debt, which has been fairly stable as a percentage of GDP, the government debt of every other country has exploded. Most of the countries shown in the chart have government debt that is more than 100 per cent of GDP. It is worth noting that all countries have levels above 60 per cent, which is the maximum level allowed by the EU's Stability and Growth Pact.

Theme – Japan

Two out of three arrows have weak impact

In the September 2013 issue of Investment Outlook, *we described the ambitious economic plans that Japan's then relatively new prime minister, Shinzo Abe, was launching. Their aim was to get Japan's large but long-stagnant economy moving. The reform programme, popularly known as "Abenomics", was supposed to eradicate deflation and revive the economy through a combination of stimulus measures – monetary, fiscal and structural. Abenomics was presented to voters as being analagous to the Japanese folk tale about a ruler whose three sons were individually incapable of breaking a bundle of three arrows, yet easily able to break one arrow each – thus the recurring references to "arrows". SEB viewed its likelihood of success as mixed: "hopeful scepticism". Our prediction of sizeable movements on the Tokyo Stock Exchange certainly proved correct. Otherwise, Abe has under-delivered to some extent, which was in line with our fears, but he has also exceeded expectations in some respects. All in all, it is still too early to write off Abenomics, but in order for it to go down in history as a success, more productive structural reforms are needed*

- Mixed marks for Shinzo Abe so far.
- Aggressive monetary policy is lifting inflation.
- Weak yen is lifting corporate earnings and share prices.
- Challenging labour market.
- More structural reforms needed.

SOME 20 MONTHS AFTER OUR last analysis in *Investment Outlook*, we can say that Abe has been successful in stoking inflation through aggressive monetary stimulus measures. Although SEB believes that the measures taken so far to attack the country's long-term deflation problem do not constitute a sustainable solution, this trend must be considered a success for Abenomics.

The Tokyo Stock Market has also responded positively to the stimulus measures, gaining 35 per cent in local currency terms during this period, even more in Swedish kronor and 12 per cent in US dollars. The upturn has also been driven mainly by growing corporate earnings, while the price/earnings (P/E) ratio has only increased marginally during this period. Although earnings growth is largely a direct function of aggressive monetary policy, we must admit that, on this front, Japanese companies have exceeded our expectations of 20 months ago.

However, the real economy has not responded as positively. Industrial production is contracting, and business optimism according to the Tankan index has levelled off – at a far higher level than before Abenomics was launched, yet at a lower level today than one year ago. (Tankan is a large quarterly survey carried out by the country's central bank, focusing on how Japanese companies view the economic climate.) Retail sales rose sharply prior to the consumption tax increase in April 2014, but have been weak since then.

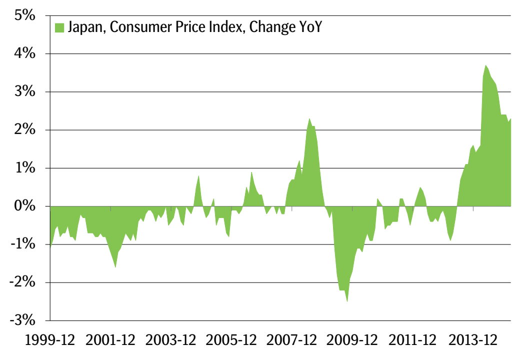
Arrow 1 – a bullseye, which can be re-launched

Anyone looking for explanations for the mediocre performance of the real economy need not look far. Of the three so-called reform arrows (monetary policy, fiscal policy and structural reforms), only one – monetary policy – was fired off with sufficient force to hit its target. On its own, monetary policy can also only achieve temporary and partial victories, in our view. SEB expects that the Bank of Japan will be forced to add further monetary stimulus as early as this summer.

Arrow 2 – missed the target even before its launch

As for fiscal stimulus, there was already extremely limited room to manoeuvre from the start. Japan's central government debt is gigantic, and the government has tried to stimulate the economy for a very long time by running sizeable public sector deficits. This part of Abe's stimulus package was not new. Fiscal stimulus had limited success before he took office, and that is still the case.

THE BANK OF JAPAN WON THE FIRST ROUND AGAINST DEFLATION...



Source: Bloomberg

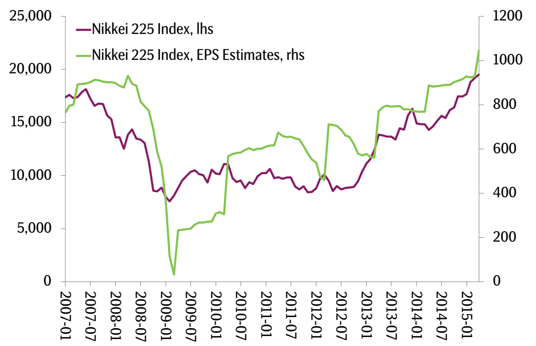
The chart shows year-on-year inflation in per cent according to the consumer price index. Shinzo Abe, with help from the Bank of Japan (BoJ), won the first round against deflation, which has long plagued the Japanese economy. The BoJ is now poised for a new round, but more than an aggressive monetary policy is needed in the future.

Arrow 3 – will it fly all the way?

The toughest and most controversial part of Abenomics from the very start has been structural reforms. Some progress has been made, but to date it has been far from sufficient. The labour market is one of the biggest challenges in getting the economy going again. Japan suffers from an inverted population pyramid, which means that a gradually smaller percentage of the population is of working age while the percentage of pensioners is increasing. A low proportion of women participate in the labour force and child care is poorly developed, making the situation even more difficult. Meanwhile, the country's immigration policy is highly restrictive. All in all, this means that Japanese companies – despite the lack of growth in the real economy – are already complaining about shortages of qualified workers. It is also easy to suspect that the dualistic structure of the labour market – a mix of relatively high age-based salaries and lifetime employment on one hand and widespread temporary low-paying jobs on the other – is not optimal from a growth perspective.

There have been no rapid or radical structural reforms to date, which is why sceptics argue that Abe (as expected) has missed the target with his crucial third arrow. Optimists contend that great progress has been achieved, but that the political system makes changes extremely difficult and that the focus so far has been on fundamental political processes that will make more significant reforms easier further down the road.

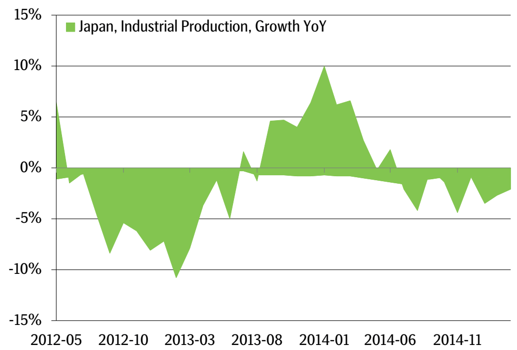
NIKKEI DRIVEN UP BY STRONG CORPORATE EARNINGS GROWTH



Source: Bloomberg

The chart shows the Nikkei 225 stock market index and an expected earnings index based on a consensus among analysts for the coming 12 months. The earnings index is structured in such a way that an index value of 1046, combined with a Nikkei index of 19520, means that the 225 equities in the Nikkei index are valued at an average P/E of 18.7 based on the consensus forecast for the current year.

INDUSTRIAL OUTPUT NOT RISING DESPITE CURRENCY SUPPORT



Source: Bloomberg

The chart shows year-on-year percentage growth in industrial production. This weak performance is a failing mark for Abenomics and probably an indication that success in the real economy requires major structural reforms, especially a more dynamic labour market.

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