Investment Outlook

June 2016

In this issue:

This report was published on May 31, 2016. The contents of the report are based on information and analysis available before May 25, 2016.

Central banks making sure the recovery keeps going

THE US FEDERAL RESERVE (FED) managed to carry out one key interest rate hike late in 2015 before it was time for a pause. For months the Fed had telegraphed its intention to raise the federal funds rate, then await and interpret economic signals before considering new rate hikes. Plunging oil prices early this year created a lot of financial market uncertainty and volatility. It was reasonable for the Fed to take this into account at its first few policy meetings in 2016. The lack of new rate hikes led to a clear decline in the US dollar. This served as a risk damper, since the weaker USD immediately triggered a recovery in commodity prices. This, in turn, eased pressure on both the stock market and credit market due to upturns in financial assets connected to commodity companies and exporters. We also saw an appreciation in the ravaged currencies of various commodity-exporting countries. Signals of more stable economic performance in China also helped diminish worries and push markets higher. Recently the Fed also signalled that its next key rate hike may occur sooner than the market had anticipated. Our forecast is a rate hike in July.

At this writing, investors are asking themselves questions like:

- Is it finally time for an acceleration in the global growth rate, or will we keep puttering along at around 3 per cent yearly?
- Reported first quarter corporate earnings were not impressive, nor were they as weak as feared. Will global companies now start to deliver rising profits, after a few years of weak performance?
- So far during 2016, cyclical assets have been among the winners after several years of lethargic performance. Is this a sustainable turnaround, and did February's lows also signify a turning point for global stock markets?
- What is happening with valuations of financial assets?
- "Brexit" (possible British exit from the European Union), Chinese debt and the global growth rate are causing market worries. What risks will threaten market performance in the near term?

In this issue of *Investment Outlook*, we present our views on the above questions and what factors will have the greatest impact on market performance, as well as on how we expect various asset classes to behave.

We also provide in-depth examinations of the Brexit problem, expected developments in the European car industry and the outlook for alternative energy sources such as wind and solar power.

Wishing you enjoyable reading.

FREDRIK ÖBERG
Chief Investment Officer, Private Banking

Market view

Summary

- Global economic growth remains about 3 per cent yearly.
- Central bank stimulus measures have decreased risks.
- Asset markets are back at last autumn's levels.
- Brexit and Chinese debt are causing market worries.
- Investors have accepted that we are in a low-growth, low-inflation environment.

In the last issue of *Investment Outlook* (published in March 2016) we described a number of factors that might create stability and boost risk appetite among investors. Some of these things occurred; the US central bank held off from rate hikes, resulting in a weaker dollar and rising commodity prices. Along with China's stimulus measures, this triggered a cyclical market rally and calmed investor worries.

One quarter later, the economic situation has improved. Commodity prices have recovered and global consumers are still in a good mood. Many assets have rebounded strongly from the worst market turbulence in February. If we lift our gaze and look further ahead, the picture is somewhat different. The question is whether what we now see is actually a fundamental improvement, or rather a return to the situation in the autumn of 2015, with oil prices of nearly USD 50/barrel, year-on-year global growth of about 3 per and an environment more favourable to consumer-related companies than to cyclical industrials. World stock markets and credit markets are also back at levels similar to those of last autumn. We have thus experienced more volatility than change in the past six months. Market players continue to foresee a low-growth, low-inflation environment where central banks are expected to continue providing support in problematic situations. This indicates that as long as central banks maintain extremely low interest rates and supportive asset purchases, "subsidised" and indebted consumers will feel good and keep consuming.

As for the willingness of governments to carry out capital spending funded by taxes or borrowing, we are seeing more cautious behaviour. The corporate sector's willingness to invest is also dominated by caution. The overall outcome is expected global growth of some 3 per cent, but with upside potential. Risks are always a feature of the economic environment. At present, markets are focusing on Brexit and debt in the Chinese economy. Also hovering in the background is a scenario of mediocre global growth combined with rising US inflation.

MAIN STRATEGIES IN OUR PORTFOLIO MANAGEMENT

It is easy to become fixated on global growth, but the question is whether we need an accelerating growth rate to enable corporate earnings and asset prices to climb from current levels.

In principle the answer is no, but it would make things easier. In recent years, global growth has been around 3 per cent. During the same period, earnings have remained weak, with a commodity price slide explaining much of this.

The recent commodity price recovery is helping push growth higher, but to achieve a real take-off, sales (which are connected to the growth rate) and pricing (connected to the inflation rate) must improve. This trend is occurring slowly. Meanwhile valuations are fairly high.

We believe in less risk-taking

Our portfolio exposure is tilted towards a cautious approach. Before ramping up our risks, we will need either signals of a higher growth rate or signs of improving corporate earnings. Or else pricing must be adjusted through profit-taking, thereby making valuations more attractive. Despite the danger that investors may have become too defensive-minded, we have chosen to decrease our risk-taking in the past three months. We are now underweighted in both Swedish and global equities, but overweighted in the high yield corporate bond segment in our fixed income sub-portfolios. In global equities, we are still overweighted in Europe and Japan at the expense of emerging markets and the US. Our alternative investment sub-portfolios have a broad, stable asset structure.

At present, growth appears unlikely to accelerate beyond its prevailing 3 per cent pace. This creates a clear risk of a subdued financial market trend for another while.

We expect favourable returns this coming year

Our somewhat cautious approach does not, however, imply that we expect falling stock markets this coming year. With a strong period behind us and risks such as Brexit around the corner, however, we believe in a more cautious portfolio ahead compared to March, when we had a neutral view of risk and foresaw good potential for a market rebound.

ASSET	WEIGHT	TACTICAL EXPECTATION (12-MONTH)		REASONING
		RETURN	RISK	
EQUITIES				
Global equities	1 2 3 **4** 5 6 7	5.5%	12.3%	Dividend yield is expected to exceed 2 per cent. The broad exposure of this asset type provides stability in a highly volatile environment. The big differences between various sectors will persist. From a Swedish perspective, we expect extra returns due to a stronger USD.
Emerging markets equities (EM)	1 2 **3** 4 5 6 7	6.4%	15.6%	After a strong recovery due to a weaker USD and rising commodity prices, we now expect a more modest trend but do not foresee a price slide again, like that of early 2016.
Swedish equities	1 2 3 **4** 5 6 7	9.6%	13.6%	Swedish equities have higher expected returns than global equities, due to weak performance in the past year. Further ahead, there are clear risks connected to the real estate market and higher future interest rates.
FIXED INCOME				
Government bonds	**1** 2 3 4 5 6 7	-2.2%	3.1%	Due to low government bond yields, portions of the bond market are unattractive. A strengthening of economic conditions or a somewhat higher inflation rate may also lead to gradually rising yields during the coming year, with a risk of negative returns.
Corporate bonds, investment grade (IG)	1 2 **3** 4 5 6 7	1.9%	2.8%	Low yields provide low but positive returns in the IG segment. This asset type may work well in a portfolio that includes other, higher-risk assets.
Corporate bonds, high yield (HY)	1 2 3 4 **5** 6 7	5.7%	4.4%	Yields of around 4-7 per cent stand out in the fixed income world, but as a consequence there is also significantly higher risk than with IG bonds, for example. Worth pointing out is that default risks have decreased thanks to the commodity price upturn.
Emerging market (EM) debt	1 2 **3** 4 5 6 7	7.1%	14.3%	Yields are high in local currencies, but weak currencies risk undermining returns in terms of the investor's home currency. Commodity prices have recovered, as have commodity-producing countries' currencies, thus decreasing risks, but this trend may reverse – which is one risk associated with this asset type.
ALTERNATIVE INVESTMENTS				
Hedge funds	1 2 3 **4** 5 6 7	N/A	N/A	Lower volatility – combined with the opportunity to generate returns even from negative trends – makes this asset class attractive in a portfolio. Lower future expected returns on equities and credits combined with varying volatility reduce such potential.
Commodities	1 2 **3** 4 5 6 7	N/A	N/A	In a long-term perspective, this asset class is attractive if inflation rises along with commodity prices. The oil price decline was primarily a supply-side issue and the crisis early in 2016 increases the likelihood that producers will become more inclined to reach a consensus on suitable production volumes.
CURRENCIES				
CURRENCY PAIRS	**MAY 25, 2016**	**Q2 2016**	**Q3 2016**	**COMMENTS**
EUR/USD	1.12	1.10	1.09	Euro weakness is part of our forecasts, but will depend on the US Federal Reserve (Fed) initiating key interest rate hikes.
EUR/SEK	9.26	9.25	9.20	A less cyclically sensitive krona will increase the degree of currency hedging – a process that pushes the krona higher. Our forecast is continued krona appreciation during the next 1-2 years.
USD/SEK	8.31	8.41	8.44	The dollar has lost ground, but our forecast is a recovery as we move closer to Fed key rate hikes this summer.

"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 11, 2016. Currency forecasts are as of May 24, 2016. Index/basis for estimates: 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 (IG and HY), IBOXX Investment Grade Index in USD and 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 – Lower risks, uncertain potential

The economic growth outlook has provided both good and bad news since the last issue of Investment Outlook *(published in March 2016). Another weak first quarter for the US economy and a still-subdued global manufacturing sector have forced us to lower our worldwide GDP forecasts – especially for the US. The much-anticipated acceleration will thus remain elusive for some time to come. Meanwhile some of the storm clouds from last winter look significantly less threatening. Oil and other commodity prices have rebounded, industrial activity has stabilised and China's growth and currency policy have both unfolded more in line with expectations.*

Central banks have (once again) "rescued" economic growth – especially the US Federal Reserve (Fed), which softened its message about future rate hikes in response to such events as falling commodity prices, but also the European Central Bank (ECB) and Bank of Japan, which are continuing their stimulus measures. But we now see signs that stimulus effects are fading, while underlying demand is not really picking up momentum and is being hampered by structural problems in some economies. We thus expect continued sluggish growth this year but believe that a relatively favourable trend for household finances and consumption in the US as well as Europe and China may still provide some acceleration during 2017.

US – Back to decent growth

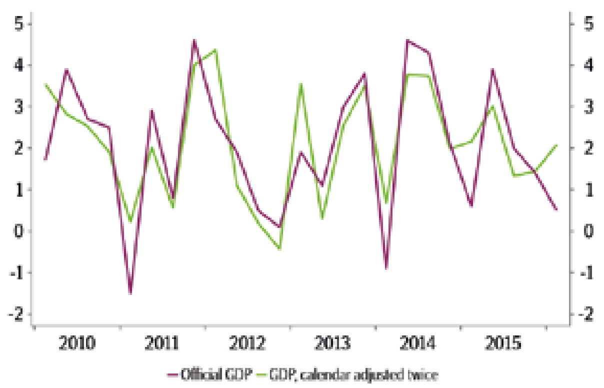
As in prior years, first quarter US growth was clearly below expectations. Unlike before, there is no obvious explanation this time around such as extreme winter weather or the like. Yet we still do not believe that this weakness reflects an underlying economic deceleration. Instead we are more inclined to view seasonal effects as an explanation (see chart below). Worries about a manufacturing-led recession have faded, while financial conditions have again improved. Despite good household finances, the savings ratio is relatively high. Looking ahead, we see potential for improved consumption. Job growth and the broad impact of lower oil prices suggest this. Because of an increasingly strong labour market, we expect somewhat higher wage and salary inflation, which will put pressure on the Fed. The gentler tone adopted by the Fed this spring in response to international market turbulence and falling oil prices has served its purpose, but we believe that renewed economic strength will justify a Fed key interest rate hike by July, and two more during the coming year.

Europe – Economy overcomes politics

Despite the refugee crisis, Brexit worries and Grexit (potential Greek exit) discussions, euro zone growth remains stable. Here too, households are the most important growth engine, thanks to rising employment, low inflation and low interest rates. Meanwhile capital spending is cautiously gaining momentum from low levels, hand in hand with increased credit market activity. Yet weak balance sheets at banks, especially in southern Europe, threaten to hold back economic activity. The ECB continues to pursue expansionary monetary policy, but inflation is expected to remain low for a long time. Overall, we foresee stable though not vigorous growth. The biggest risks are political: in the near term the referendum on a possible British exit ("Brexit") from the European Union, and a bit further ahead structural issues related to the future path of the EU. The new opt-outs recently negotiated by the United Kingdom create uncertainty, not only about the speed of the EU's progress towards an "ever-closer union" but also about what countries will follow that path towards integration.

In the UK, economic growth has slowed sharply during the first half of 2016 while awaiting the outcome of the Brexit referendum. Subsequent developments will depend on the referendum outcome and are described in our theme article on page 20.

BETTER THAN IT LOOKS



Source: Bloomberg, BEA

The unexpectedly weak first quarter growth figure in the US follows the pattern of earlier years. More and more analysts are asking whether customary seasonal adjustment (smoothing data over the year to take into account the impact of weather and other factors) is sufficient. In this chart, we have chosen a double seasonal adjustment. This results in a more reasonable growth curve and boosts first quarter growth in 2010-2016 from 0.7 per cent (in the conventional series) to 2.4 per cent, which matches other indicators significantly better.

Asia/China – Soft landing and consumers are creating stability

China forecasts have long been dominated by worries about an economic hard landing, due to the transition from an export- and investment-led economy to one more driven by private consumption and services. After a turbulent start to the year, we are now seeing clear signs of stabilisation. The service sector, accounting for more than 50 per cent of the economy, is growing rapidly because of a strong household sector, while Chinese authorities are using looser monetary policy and higher capital spending to help sustain the financial system and growth. This supports our unchanged forecast of a continued soft landing.

Elsewhere in Asia, the Indian economy is still growing at a healthy pace but is being held back by the Narendra Modi government's inability to maintain a desirable pace of major reforms that are needed and have been promised. After delays, the national sales tax will probably be enacted this year. Land purchase and labour market reforms are moving sluggishly. In other countries, the economic picture is mixed but relatively stable. In Indonesia, growth has steadied in response to rising commodity prices. South Korea and Taiwan should benefit from future global acceleration.

Japan – Forlorn hopes

Japan continues to struggle with problems on several fronts. In the long term, structural problems – especially in the labour market and due to an ageing population – will slow the country's economic growth. In the near term, Prime Minister Shinzo Abe's "Abenomics" reform policies are not providing the desired inflation and growth rates. GDP will increase only slightly in 2016 and 2017, driven by higher consumption. Notably, corporate earnings are climbing. Yet pay hikes and capital spending are insufficient to achieve economic targets. Because of weak public finances and already loose monetary policy, policymakers have only limited manoeuvring room, but we expect a further key rate cut this year in an attempt to import a little inflation.

Latin America – Continued problems may lead to new disappointments

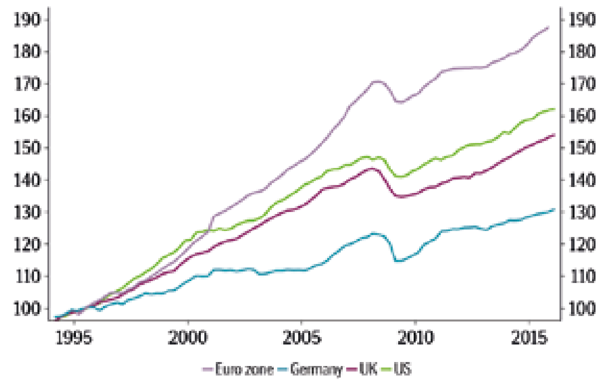
More dovish interest rate signals by the Fed have weakened the US dollar, leading to rising commodity prices and a greater appetite for emerging market assets. This is why Latin America, led by Brazil, is among this year's currency and stock market winners. Although the commodity price upturn is easing some of the pressures, many big problems remain – especially in regional giant Brazil, where political turbulence remains severe, high inflation is undermining purchasing power and capital spending is down. Bright spots include falling imports and slowly rising exports, which are improving Brazil's external balance, though from unfavourable levels. The positive market trend is most likely being fuelled by hopes of major policy shifts in case of a (probable) change of president, but the government has little manoeuvring room and there is a risk that the market will exaggerate Brazil's potential.

Eastern Europe – Russia bottoming out, other economies chugging along

Due to the oil price recovery, slower inflation and expectations that EU sanctions will be eased this year, we believe that the Russian economy is past its worst period. With oil prices around USD 50/barrel, government finances remain squeezed and cost-cutting is necessary. Economic data such as industrial production, retail sales and exports are continuing to fall, but the downturn is showing clear signs of decelerating. Despite continued problems, we expect Russia's real economy to gradually improve, with year-on-year GDP growth showing a weak upturn in the second half of 2016.

The countries of Central Europe will maintain their growth at a healthy pace, with Poland leading the way followed by the Czech Republic and Hungary. Stable finances, strong household sectors and decent demand from the EU are important drivers, while low global price pressures and interest rates will keep inflation down.

SUBDUED GLOBAL GROWTH RATE



Source: Eurostat, BEA

More and more observers, including both the International Monetary Fund (IMF) and influential central bank executives, are now discussing the concept of "secular stagnation", which means a lengthy period of significantly slower growth. There is lively debate as to whether this problem exists and, if so, how to solve it. We believe that during the coming years, lower productivity growth, more unfavourable demographic trends and overhangs from heavy debt will probably lead to generally slower growth than the historical trend.

THE DOLLAR "RESCUES" COMMODITIES

Source: The World Bank

In response to falling commodity prices and global financial market unrest, the Fed chose to sketch a more cautious picture of the world economy this winter and tone down expectations of new key rate hikes. This helped commodity prices to rebound, alongside indications that falling oil prices were beginning to have supply-side effects. More stable economic performance in China and continued Fed caution suggest that commodity prices may stabilise, providing support to troubled EM assets. New Fed rate hikes could disrupt this scenario, however.

Nordics – Sweden is steaming ahead, while the others are rebounding

The performance of the Nordic economies remains divergent, though most indicators are generally favourable. Norway, which has been hard pressed by falling oil prices, seems to have bottomed out during the first quarter. Demand in the mainland economy is providing upside surprises, driven by household consumption and fiscal stimulus measures. The Finnish economy is struggling against headwinds, but surprisingly strong statistics during the winter and spring and a brighter export outlook will lead to weakly positive growth, despite hard-pressed households. In Denmark, we view the slump during late 2015 as temporary and expect economic growth to accelerate somewhat this year, driven by job growth and stable export markets.

Unlike its struggling neighbours, Sweden is showing a very solid economic growth rate. This rapid GDP increase is attributable to strong domestic demand, while the relatively weak krona is benefiting exports. Domestic demand is mainly being driven by record levels of public sector consumption and investments, largely due to refugee-related spending aimed at achieving an ambitious level of integration into Swedish society. Strong private consumption is helping to sustain growth, while imbalances in the labour market and other sectors are causing some concern.

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

- Recession risks have diminished, justifying some upward revaluation of risk assets, but much of this is already discounted by financial markets.
- Downward revisions in growth forecasts have been followed by downgraded corporate earnings forecasts. We expect another year of near-zero earnings growth.
- Structural weaknesses, debt overhangs and subdued industrial activity are slowing growth, with a risk of new disappointments and/or recession worries.
- Stock market performance has largely been driven by oil and US dollar movements. If stabilisation continues, other forces (earnings and macroeconomics) will become bigger factors.
- We expect the stronger US labour market to drive private consumption and thus economic growth, but pay increases threaten to squeeze profit margins.
- If the US economy fails to accelerate, this will lead to continued dovishness by the Fed, which should benefit commodities and EM assets but would be negative for the dollar.
- The Brexit referendum will create market worries in the short term, and potential major effects in the long term if the outcome is British withdrawal from the EU (see the theme article on page 20).
- We expect China's economic deceleration to continue at a reasonable, controlled pace. If we are right, this should gradually be perceived as more favourable by market players.

GDP – YEAR-ON-YEAR PERCENTAGE CHANGE	2015	2016 (F)	2017 (F)
United States	2.4	1.9	2.5
Japan	0.6	0.5	0.5
Germany	1.7	1.7	1.8
China	6.9	6.5	6.3
United Kingdom	2.2	1.9	2.3
Euro zone	1.6	1.7	1.8
Nordic countries	2.2	2.2	2.0
Sweden	4.1	4.0	2.8
Baltic countries	1.8	2.6	3.1
OECD	2.1	1.9	2.3
Emerging markets	3.9	4.1	4.7
The world (PPP)*	3.1	3.1	3.7

Source: SEB Research & Strategy, Nordic Outlook, analysis dated May 2016.

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

Global equities

Stronger economic signals desirable

After a weak start to the year, global equity prices have risen recently, due mostly to a weaker dollar, which has helped lift depressed commodity markets. This rebound was dominated by a rotation toward cyclical and emerging market (EM) assets. Manufacturing activity has stabilised, but the lack of clear trends, valuations on the high side and uncertainty about earnings make us cautious. While awaiting stronger indicators of economic growth, we are taking a cautious approach to global equities. We prefer developed market (DM) to EM equities and have chosen to focus on Europe.

- Global equity prices have recently risen, thanks mostly to a weaker dollar. We have seen a rotation toward cyclical assets and emerging markets.
- The world equity index shows negative returns this year, but emerging markets are in positive territory, with commodity-dependent countries such as Russia and Brazil serving as share price engines.
- Global equities are trading at a price/equity (P/E) ratio of 16 (based on 12-month forecasts), which is on the high side in a historical perspective. Aggregate corporate profits continue to be revised downward and are expected to grow by 2 per cent in 2016.
- We expect continued low but positive earnings growth. Sluggish economic growth and mediocre earnings growth combined with high valuations suggest lower risk exposure.
- Developed markets are a safer bet, since there are greater risks associated with economic recovery in EM countries. We are focusing on European equities.

THE YEAR STARTED OFF WITH WIDE fluctuations and falling share prices as financial market participants questioned the strength of global manufacturing and abandoned risk assets such as equities. However, over the past three months, the stock market has recovered thanks to a weaker dollar, a strong rebound in commodities and more stable macroeconomic data from China. We have seen a rotation toward cyclical assets, which benefit from a weaker dollar, and a change in the direction of flows from Japan and Europe to the US and emerging markets.

Since the turn of the year, global equities have generated negative returns. The benchmark index for emerging markets is in positive territory thanks to strong stock markets in commodity-dependent countries such as Russia and Brazil (which are otherwise weighed down by other problems). US equities have performed better than European ones, and in Japan a stronger yen has weighed down the stock market. The EM energy and commodity sectors top the list of performers, whereas finance, pharmaceuticals and IT have had a rough time.

Downward revisions in US corporate earnings have been unusually big this year. Although a large share of companies have exceeded low analyst expectations, first quarter reports showed negative earnings growth for the fourth straight quarter for US companies in the S&P 500 index. Companies in Europe and Japan likewise posted lower earnings and sales. Consumer goods and pharmaceuticals still managed to deliver positive results on both sides of the Atlantic, but corporate earnings in the industrial, financial and energy sectors declined the most.

Global equities are trading at a P/E ratio of 16 (based on 12-month forecasts), which is on the high side in a historical perspective. The US market is more expensive than the world index, while Europe is in line with the average. Aggregate corporate profits are expected to grow 2 per cent in 2016 and then accelerate next year to growth of 10 per cent. Overall, the P/E ratio for EM equities is 11.5, with Asia and especially China more attractive than countries in Latin America. Brazil tops the list in terms of improved corporate earnings after several years of negative numbers, but the political risk and the risk of downward revised earnings there are also great. The Indian stock market is highly valued (P/E 16) but should show healthy earnings growth both this year and next.

EM BUOYED BY WEAKER DOLLAR AND RISING COMMODITY PRICES

Source: Bloomberg

The year began with plunging share prices, but over the past three months, the world index has recovered nicely. EM countries that depend on commodities, such as Brazil and Russia, have topped the list since the turn of the year, driven by a weaker dollar and rising commodity prices. Things have not gone as well for Europe and Japan, with the Japanese stock market weighed down by a stronger yen.

Opportunities in value shares

Last autumn, we wrote that there was reason to focus on value shares, that is, companies with low valuations and high dividend yields. Banks, other financial companies and commodity companies fall into this category. Our argument was that growth shares, including companies in IT and biotechnology with high earnings growth forecasts and good margins, have long outperformed value shares. We continue to spotlight value shares, which have performed well so far this year. In Europe, value companies have historically low valuations while their dividend yields are significantly higher compared to growth companies. We find European growth companies in such sectors as chemicals, steel, construction and heavy industry. There are also attractive investment opportunities in banking and insurance. However, it should be noted that this preference for value shares is of a tactical nature, since valuations are depressed. Economic growth without too many downside surprises is needed for this style to outperform the rest of the market.

Growth is a key factor

Despite a more stable environment recently, we are more cautious than before. We certainly expect continued low earnings growth, but sluggish economic growth and mediocre corporate earnings growth combined with high valuations suggest lower risk exposure. In earnings terms, 2016 will be a bit of a lost year, but next year growth is expected to accelerate, with earnings increasing by about 10 per cent. The pace of earnings growth is a key factor; if it is weaker than current GDP growth of about 3 per cent, this will probably trigger investor concerns. There are plenty of storm clouds on the financial horizon at present. Questions persist about how growth and debt will trend in the Chinese economy. In Europe, the EU referendum in the United Kingdom is causing headaches. Unexpectedly large increases in US wages and salaries could give the Federal Reserve reason to raise its key interest rate faster than anticipated. A stronger dollar is also in the cards, which should once again put pressure on the commodities sector and EM economies, which have just begun to recover. There have been large movements in the financial markets this year, and initial fears of a recession and worries about commodity price trends have eased. We have chosen to gradually adjust our risk downward because of weak earnings momentum. Our focus is still on fundamental, underlying drivers such as economic growth and valuations. Expected returns still favour equities over other asset classes, but absolute valuations are high. Chances of upside earnings surprises and revisions are also small. The latest stock market upswing has been helped along by a weak dollar, which has boosted emerging markets and sectors that are more sensitive to business cycles, such as commodities and industrials. These segments are vulnerable if the US economy and currency strengthen, which is our forecast. However, better earnings for cyclical companies are also needed to sustain their improved performance.

Advantage: developed markets

In global equities, we prefer developed markets to emerging markets since there are greater risks associated with the economic recovery and dollar movements in EM economies. A stronger dollar may also cause flows to return to Europe and Japan. In DM countries, our focus is on European rather than US equities since European earnings and margins are historically low and have greater potential for improvement than their US counterparts. Valuations are also lower in Europe. Japanese companies are facing headwinds, with a stronger currency and a government and central bank whose actions are being called into question. Asia is still the most attractive region among EM economies. Corporate earnings growth and the geopolitical situation are more favourable here than in Latin America.

Manufacturing activity has stabilised, and fears of a recession have faded. However, the lack of clear trends in the macroeconomic data and heightened geopolitical risks give us reason to be on our guard. Valuations are on the high side, and uncertainty about earnings forecasts will make us cautious over the next few months. We can no longer count on additional central bank stimulus to boost risk appetite, so stock market upswings from today's levels must occur as a result of rising profits, not higher valuations. While awaiting stronger signals of economic growth, we are taking a cautious stance on global equities.

POTENTIAL FOR EUROPEAN VALUE SHARES

Source: Bloomberg

In Europe, valuations of value shares are at historical lows, and dividend yields are substantially higher than for growth companies. However, it should be noted that valuations are depressed and that economic growth without too many downside surprises is needed for this style to outperform the rest of the market.

COUNTRY/REGION	P/E RATIO 2016 (F)	EARNINGS GROWTH, 2016 (F)
Global	15.7	2.2
US	17.1	1.0
Europe	15.2	0.0
Japan	12.6	1.0
India	16.2	15.4
China	9.7	3.8

Source: JPMorgan /IBES /MSCI

Aggregate corporate earnings have been revised downward and are expected to grow by 2 per cent in 2016, but we expect an acceleration next year. The Indian stock market is highly valued but shows signs of healthy earnings growth going forward. Meeting growth expectations is a key factor in keeping market worries from escalating.

Nordic equities

Purchasing managers foresee no upturn

Low interest rates, bond yields and return requirements are still the primary reasons why equities are attractive as an investment. The earnings trend for Swedish and other Nordic listed companies remains weak. The positive surprises we saw in the first quarter of 2016 are explained by downward adjustments in expectations before the report season, rather than any actual improvement. Despite a continued weak earnings trend, shares in cyclically sensitive companies have performed strongly this year, but sustaining this will require an improvement in leading indicators soon. It is worrying, for example, that purchasing managers around the world do not yet appear to foresee any signs of the speed-up in industrial activity that the stock market is already pricing in. Looking ahead, however, we see potential for a better income trend at Swedish banks and attractive valuations in various companies and sectors where earnings may grow even if the much-anticipated economic boom is delayed.

- Earnings growth is conspicuously absent, with earnings at essentially the same level as in 2011.
- Industrial, energy and commodity share prices have climbed so far this year, despite weak earnings growth.
- Banks have bottomed out. We believe that the worst squeeze on net interest income at Swedish banks is past. Signals of less extreme monetary policy ahead may lead to upturns in the banking sector.
- Gaming companies are worth a bet. While speculating in better times for cyclically sensitive companies, investors have turned away from many of the fastest-growing sectors, such as gaming, making the odds for these companies increasingly attractive.

ALTHOUGH FIRST QUARTER 2016 REPORTS surprised on the upside compared to earnings forecasts – which had been lowered earlier – signals from companies have not been convincing enough to make analysts adjust their forecasts upward again. Nordic operating incomes were also 16 per cent worse than in the year-earlier quarter (8 per cent in Sweden). The problem is not new, but nevertheless is an obstacle to adopting a more positive long-term view of the stock market as a whole.

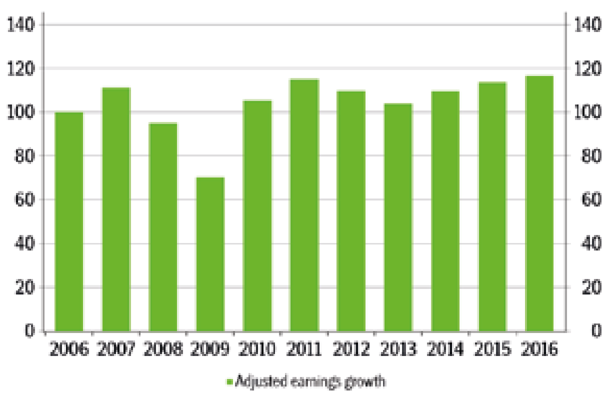
We expect Nordic listed companies for which we have historical financial figures dating back to 2011 or earlier to deliver EUR 68 billion in adjusted net earnings this year, essentially the same as in 2011. The earnings index has risen less than 5 per cent in nine years, assuming that our 2016 forecasts prove correct. Obviously the sharp downturns of recent years in the oil sector play a key role. If we exclude oil companies and offshore/oil services, our 2016 earnings forecast adds up to EUR 65 billion. This is 10 per cent more than five years ago. Yet the problem is too widespread to be explained by the Norwegian oil sector alone. Of the 32 largest companies on the OMX Stockholm exchange (operating companies with market capitalisation exceeding SEK 30 billion), more than one third are expected to report lower earnings per share (adjusted for nonrecurring items) this year than they did in 2011 or 2007. The list of companies whose 2016 earnings are not expected to reach their peaks of five or nine years ago includes such Swedish household names as Ericsson, Volvo, Telia, Boliden and Sandvik.

We expect more substantial earnings improvements in 2017 and 2018 – 9 per cent and 13 per cent, respectively, among Nordic companies, helped especially by a shift from headwind to tailwind in the oil sector by 2018. But to enable investors to dare believe in such a trend, our forecasts must probably remain intact (the pace of downgrades must slow or stop entirely) and early economic indicators must confirm an imminent economic improvement. We see good reasons to search for companies and sectors that can grow even in a continued challenging macro environment.

Cyclical rally, but PMIs foresee no upturn

Over the past few years the financial market has repeatedly been plagued by strong worries about economic trends for brief periods, most recently in October 2014, August 2015 and January 2016. Yet no really dramatic change in market conditions occurred, and these worries faded relatively fast.

NEAR-ZERO EARNINGS GROWTH



Source: SEB Equity Research

The chart shows an index of earnings performance by Nordic listed companies in euros. Earnings growth is conspicuously absent in these companies, with only marginal increases from 2011 and 2007 to this year.

In the same way that it could be difficult during the above periods to understand the magnitude of market worries, today we find it challenging to explain the prevailing optimism about the same cyclical equities that in many cases were being shunned during these periods, but are now being talked up in the stock market.

The five best equities so far this year in the OMXS30 Index (the 30 most heavily traded companies on the Stockholm exchange) show share price increases of 11-34 per cent, while the index as a whole has fallen by 8 per cent (all figures excluding dividends). These five winners are all in cyclical sectors such as heavy industry, steel and oil. After several years of relatively weak industrial activity, obviously several of these companies will see a surge in earnings ahead if industrial activity improves, but leading indicators such as purchasing managers' indices (PMIs) currently provide only limited support for such optimism. See the chart below.

Sharp improvements being discounted

After many cyclical equities bottomed out in January, their rebound was easy to explain as a natural recovery from irrationally strong worries early in 2016, which pushed many of these shares to their lowest levels in some years. This is no longer the case. The market is now discounting major improvements.

Due to several years of falling profits and downward adjustments in earnings forecasts, combined with a strong recovery in share prices this year, the largest industrial company on the Stockholm exchange, ABB, is valued at a consensus price/earnings ratio of 18 for the current year. Based on 12-month moving forecasts, the P/E ratio today is at its highest level for at least 12 years.

Shares of the largest mining company on the Stockholm exchange, Boliden (whose two most important products are zinc and copper), are being traded at the same level as in February 2015, when zinc and copper prices were 22 and 15 per cent higher than today, respectively.

The biggest Nordic oil company, Statoil, is trading at the same level (in USD) as in December 2014, when a barrel of Brent crude cost more than USD 60, about 25 per cent above today's price.

In short, many of these share prices today are discounting a substantial improvement in the macroeconomic environment ahead; it remains to be seen when this will materialise.

Banks foresee better days

Shares of three out of Sweden's four major banks have performed worse than the OMXS30 Index this year. Both elsewhere in Europe and in the US, bank shares have been in the doghouse this year. To some extent, Swedish banks have probably been infected by international worries about the sector, but weak income growth has probably also contributed. The single most important type of income for banks is net interest income, which has been squeezed hard by extreme interest rates, including negative key rates. But we believe that net interest income at banks has already bottomed out, and conditions are in place for the market to begin later this year to discount a significant improvement in 2017.

Net interest income should improve starting as early as Q2 2016, thanks to higher lending margins on corporate loans in the Nordic countries, as well as positive trends for other customer categories in Sweden. We expect gradually improved net interest income at major Swedish banks during the coming quarters, with a significantly better growth rate during the second half of 2016.

Sweden's current ultra-loose monetary policy is extreme in a historical perspective, given the prevailing level of economic growth and capacity utilisation (low underlying

NO REVIVAL OF INDUSTRIAL ACTIVITY

Source: Bloomberg

The chart shows the JPMorgan Global PMI for the manufacturing sector. A level above 50 is compatible with economic expansion. A composite PMI for the worldwide manufacturing sector still provides no support for the cyclical optimism that has emerged in stock markets during the past four months.

unemployment). Later this year, the market should thus begin discounting a gradual key interest rate hike, initially back to zero, starting in the spring of 2017. When the key rate has been raised, this will be very favourable to net interest income and thus to earnings growth at banks. We expect this effect to be accounted for by share prices long before the actual first rate hike.

The combination of 7-8 per cent dividend yields, strong balance sheets – in sharp contrast to many other banks in Europe – and an imminent return to positive growth for the most important income item makes Nordic bank shares look attractive.

Rebound makes gaming companies a good bet

One sector that stands out – with a much more positive earnings trend than the Stockholm exchange average – is gaming: both operating companies and their suppliers. Today's Swedish gaming companies have a combined market capitalisation of more than SEK 70 billion in Stockholm: bigger than the international appliance group Electrolux and about the same as construction giant Skanska. The three gaming companies that we track (with a total market cap of SEK 56 billion), for which we have earnings histories since 2007, have more than quintupled their profits since then – based on our 2016 forecast.

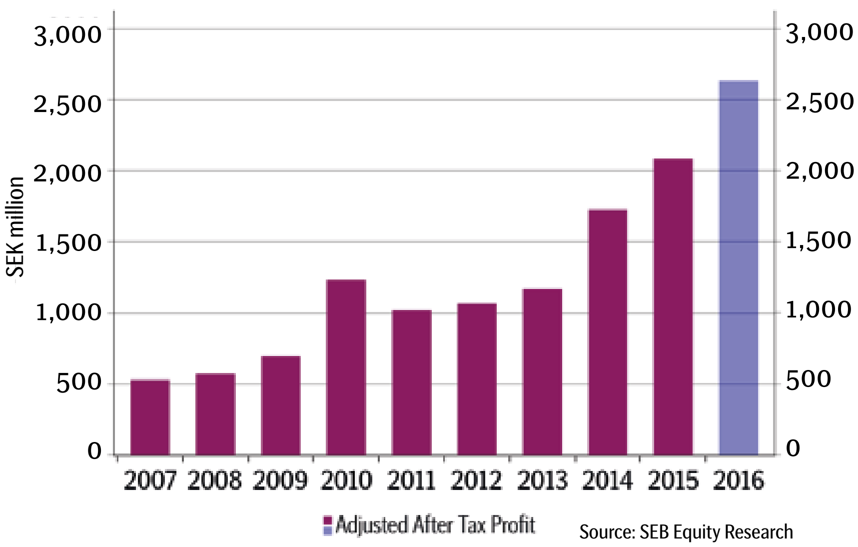
This rapid growth is continuing. The largest gaming company, Unibet, doubled its earnings in the first quarter compared to a year earlier – helped by organic revenue growth of more than 40 per cent supplemented by acquisitions. Looking ahead, the growth potential of gaming is enormous and the early emergence of a private gaming sector in the Nordic countries has helped create a number of companies that may achieve leading positions in Europe.

Yet these shares have been squeezed hard this year due to worries about future regulation and higher taxation in many European countries. However, we believe that higher tax expenses are only one side of the coin. At the same time, more stable rules for the industry will reasonably imply lower risk premiums in valuation of the sector and thus higher valuations.

The gaming industry is characterised by low tied-up capital. This results in strong cash flows, stable revenue due to very low dependence on economic cycles and significant economies of scale, which can be expected to trigger restructuring transactions in the future. When these characteristics are combined with a more stable framework in the form of licensed, regulated and taxed revenue, earnings should be substantially higher than today. Gaming industry suppliers are already valued at significantly higher multiples, probably due largely to the significantly lower regulatory risk that their business model is thought to involve.

We find the combination of lower share prices and higher earnings attractive, especially compared to many other sectors in the Nordic stock markets where the opposite situation prevails.

SHARP EARNINGS GROWTH FOR GAMING COMPANIES



Source: SEB Equity Research

The chart shows adjusted net income in millions of kronor (SEK) for the three Swedish gaming companies we track – Unibet, Betsson and NetEnt – and that have been listed since 2007.

% Fixed income

Monetary policy nearing end of the road

After a lengthy period of monetary stimulus across the world, the question is obvious – how much more can be done? In theory, there is further scope for most central banks to carry out interest rate cuts and asset purchases, according to the International Monetary Fund (IMF), but in practice the possibilities are limited. What worries both the IMF and the central banks is that the transmission mechanism appears to have weakened; in other words, the effects are less than desired. This suggests that most central banks have come to the end of the road with their interest rate cuts, whereas we will probably see further asset purchases.

- Sweden's Riksbank is done cutting interest rates.
- The European Central Bank (ECB)'s asset purchases will bolster the bond market.
- Commodity prices and a weaker USD will strengthen emerging markets.

Government bonds (excluding emerging markets)

Sweden's Riksbank decided in April to extend its government bond buying to the end of 2016. The scale of these purchases is enormous if we compare the outstanding supply of bonds in Sweden relative to that in the euro zone. We believe the Swedish central bank will have bought almost 40 per cent of total outstanding government bonds by year-end, compared to about 20 per cent for the ECB. Meanwhile the Riksbank decided at its most recent Executive Board meeting to keep its repo rate unchanged at -0.5 per cent. The reason for continuing this aggressive monetary policy is, of course, to drive up inflation toward the bank's 2 per cent target via higher consumption, new investment and a weaker krona.

In our view, the Riksbank will now refrain from further stimulus measures and instead evaluate the effects of its current programme and then begin interest rate hikes in April 2017. The refi rate in the euro zone is zero, with the ECB's aim being twofold: stimulate southern European economies in order to overcome government financial problems there and spur inflation towards 2 per cent.

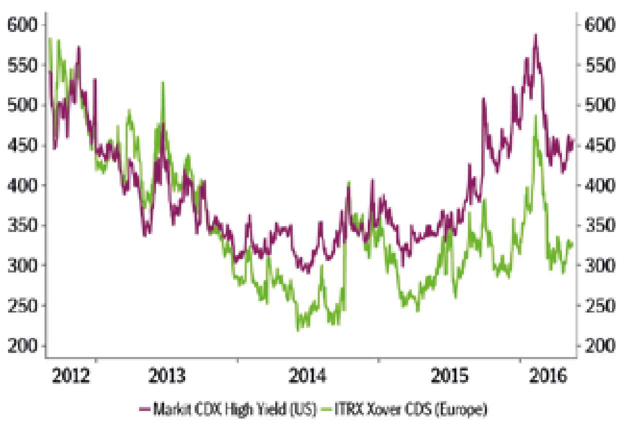
In the United States, the key interest rate will gradually be adjusted upward from its current level. In our view, the Federal Reserve (Fed) will deliver its next rate hike in July after having given the world clear warning of what is ahead. This is earlier than in our previous forecast of September and is driven by the Fed's signals that it has noted global stabilisation and signs of economic strength. Our US inflation forecast is 1.6 per cent at the end of 2016 and 1.8 per cent at the end of 2017, while the Fed's key interest rate will be in the range of 0.75-1.00 per cent at the end of 2016 and 1.25-1.50 per cent at the end of 2017.

Corporate bonds – Investment grade and high yield

During the turbulent period at the start of 2016, only small volumes of new corporate bonds were issued. The majority of issuers during this period had high credit quality and a great need for capital. However, the situation changed in March, when capital market activity picked up as a result of higher and more stable commodity prices as well as greater market confidence. The ECB decided in the spring to launch a new asset purchasing programme that also includes corporate bonds issued by euro zone companies and institutions with the lowest investment grade rating (BBB-). That decision has created expectations of increased stability and should also lead to accelerated purchases by other financial market participants.

The aim of these measures is to promote a functioning capital market and stimulate demand and willingness to invest, with the hope of spurring higher inflation. Meanwhile some banks, mostly in southern Europe, need to reduce their corporate bond holdings. With the ECB's

NARROWER CREDIT SPREADS DUE TO MORE STABLE PROSPECTS



Source: Bloomberg

The recovery in commodity prices, together with a cautious Federal Reserve, has boosted confidence in the credit market.

purchases, banks are being helped to reduce their bond holdings and thus improve their financial ratios. This should have positive effects on the euro zone bond market, which would then probably spread to other markets, including Sweden. The yield spread between European high yield and government bonds has narrowed by almost 2 per cent since the tumultuous period in February, when the gap was at its widest. In a short time, we have gone from a period of great uncertainty about the solvency of issuers to a situation with far more stable prospects. In our view, we will see continued capital inflows to the high yield market as well as increased interest in issuing new bonds.

In the Swedish corporate bond market, there is a large proportion of real estate companies, and we believe this will also be the case going forward. In the choice between fixed or floating rate bonds, floating rate bonds still dominate, since investors want to eliminate interest rate risk while benefiting from higher returns if the Riksbank starts raising its repo rate. A higher repo rate would result in higher STIBOR rates, which would lead to higher returns on floating rate bonds.

The Norwegian high yield market consists largely of companies with some kind of connection to the oil sector. The situation there is somewhat like that in the US, where more small companies are defaulting and requesting debt restructuring. We have yet to see what effects oil prices below USD 50/barrel will have, but there is an imminent risk that some companies in the Norwegian oil sector will request debt restructuring to alter the terms of their bonds during the second half of 2016.

In the US, the credit rating agency Moody's believes that the greatest default risk over the next 12 months is in the steel and mining sectors, followed by oil and gas and the media sector. For Europe, Moody's view is that the greatest risks are in oil and gas, media and forest products.

Emerging markets – More stable prospects with fewer exceptions

At the turn of the year, there was fear that US interest rate hikes would have strongly adverse effects on heavily indebted countries in the emerging market sphere, since these countries had taken advantage of ultra-low US interest rates and easy access to US dollars to fund their current account deficits. With higher US interest rates, followed by a stronger USD, the cost of this debt will grow. Another factor to take into account is that various countries have currencies pegged to the USD, which in this case would mean a decline in competitiveness.

These storm clouds lifted considerably during the spring. The Fed has signalled a slower pace of interest rate increases, and in our view they may carry out two rate hikes in 2016. Meanwhile the Chinese economy has stabilised.

Both Russia and Brazil saw inflation fall during the first quarter. However, both countries are struggling with domestic problems; In Brazil, impeachment proceedings have been set in motion against the president, who is accused of fiscal improprieties, while Russia is suffering from heavy dependence on commodities and from EU and US trade embargos.

ASSET TYPE	WEIGHT	TACTICAL EXPECTED YEARLY RETURN			RISK		
		SEK	EUR	USD	SEK	EUR	USD
Cash	**1** 2 3 4 5 6 7	-0.5 %	-0.5 %	0.5 %	0.2 %	0.2 %	0.2 %
Government bonds	1 **2** 3 4 5 6 7	-4.3 %	-2.1 %	-1.7 %	3.2 %	3.2 %	3.2 %
Investment grade (IG) corporate bonds	1 2 **3** 4 5 6 7	1.8 %	1.8 %	1.3 %	2.9 %	2.9 %	2.9 %
High yield (HY) corporate bonds	1 2 3 **4** 5 6 7	5.6 %	5.7 %	5.9 %	4.3 %	4.3%	4.3 %
Emerging market debt*	1 **2** 3 4 5 6 7	1.5 %	1.5 %	1.5 %	11.3 %	11.3 %	11.3 %

"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.
** Return in local currencies*

Source: SEB

Alternative investments

Volatility for better or worse

During the first few months of the year, market conditions varied sharply in terms of volatility. After great uncertainty and weak performance, these conditions stabilised relatively quickly in March and April. We have experienced an environment with strong price movements, occasionally at extreme levels, with abrupt trend reversals and rapidly shifting correlations between asset classes. As a result, most hedge funds faced a challenging environment. More stable markets and clearer trends should be able to provide better return potential.

Most of the factors that weighed down oil prices starting last autumn have become less negative, which has led to a relatively sharp oil price rebound from recent lows during the spring.

- Volatility has brought difficulties but has also created opportunities.
- More stable trends are discernible following turbulence early in the year.
- Divergent conditions for different hedge fund strategies.

Hedge funds – Shifting conditions for different strategies

Conditions have changed significantly for the various hedge fund strategies in terms of performance so far this year. Volatility early in the year benefited CTAs, whereas equity long/short strategies had great difficulty navigating the extreme price movements that occurred. However, during the recovery this spring, CTAs lost some of their gains, and instead credit long/short together with event-driven strategies performed strongly, which is explained by the energy sector recovery and stronger stock markets.

Equity long/short

The sharp declines in share prices around the world early this year created problems for the equity long/short strategy. In some cases, price movements were disconnected from fundamental factors and driven instead by both fear and lack of liquidity. However, these movements created opportunities for finding sources of returns as long as investor worries did not set the tone for market performance. In terms of investment approach, we prefer funds that maintain a somewhat market-neutral net exposure instead of funds that have a net long exposure.

Credit long/short

Bolstered by the recovery in oil prices, credit markets – led by corporate high yield bonds – turned in a strong performance over the past few months. Taking into account the connection between commodity prices and the performance of US high yield credits in particular, there is reason for caution if there is a sharp reversal in the strong commodity price trend. Credit markets have had stable inflows recently, which have boosted investor confidence. However, liquidity tends to shrink quickly in stressed market situations.

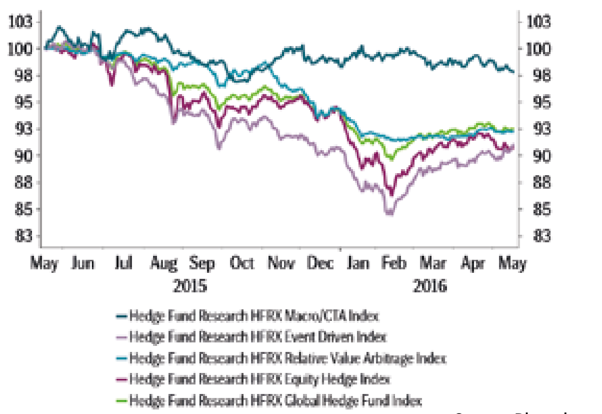
Event-driven

After a tough 2015, when difficulties could be attributed largely to general market uncertainty, the event-driven strategy got off to a better start this year. There is still good activity in the corporate transactions market, and pricing (the difference between offer price and current market price) for announced deals look attractive. A number of funds with this strategy have increased their exposure to corporate transactions and reduced their exposure to credits and specific corporate events, thereby weakening their correlation with stock market performance.

Macro/CTA

Trend-following strategies kicked off 2016 with long positions in government bonds and USD alongside short positions in equities and commodities, a combination

VOLATILE TREND FOR HEDGE FUND STRATEGIES



Source: Bloomberg

During the turbulent period early this year, conditions changed rapidly, leading to sharp reversals in return trends.

that made this strategy a winner early in the year. The recent sharp weakening of the US dollar happened quickly, which frustrated most funds. One factor that bodes well for this strategy is that the correlation between regions and asset classes seems to be decreasing somewhat, which should provide scope for finding additional sources of return.

Commodities – A balanced oil market by autumn

Most of the factors that weighed down oil prices between last autumn and this spring are now less negative. Concerns about the economic trend in China have eased, the dollar has weakened and worries about global economic growth have diminished. Taken together, these factors have led to a relatively sharp rebound in oil prices from the lows seen during the spring. At this writing, prices are more stable despite a continued oversupply of around one million barrels/day in the oil market.

The record-sized oil stockpiles in the mainly affluent countries of the Organisation for Economic Cooperation and Development (OECD) continued to grow during the spring, but at a far more modest pace than earlier. Current stockpiles are estimated at 400 million barrels more than desirable given current consumption of about 96 million barrels/day. A one per cent supply deficit for one year would be enough to enable stockpiles to return to normal levels.

Global oil demand is stable. Both the International Energy Agency (IEA) and the US Energy Information Administration (EIA) forecast demand growth of 1.2 per cent in 2016 compared to 2015, on a par with average annual growth since of 1.3 per cent since 2000. Meanwhile global oil production outside the Organisation of the Petroleum Exporting Countries (OPEC) is falling by about 0.7 million barrels/day year-on-year. For instance, US oil production has declined steadily since last summer, from a peak of 9.6 million barrels/day to around 8.8 million barrels/day at present. The number of active rigs has fallen to 328 from a high of 1,400. Together, these factors lead us to believe that the market will approach balance during the autumn.

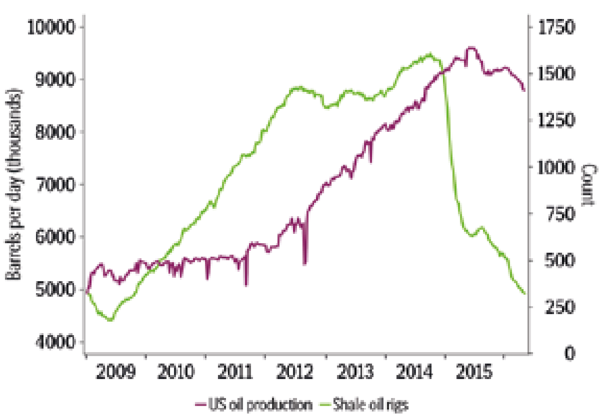
Future OPEC production is more uncertain. Cartel members are currently producing at record levels. Over the next few years, production in Iran, Iraq and Saudi Arabia and eventually also Libya will probably increase further. We do not expect OPEC, or rather Saudi Arabia, to guarantee price stability through future production decreases or increases. Very limited new investment in conventional oil outside OPEC and no willingness within OPEC to adjust to an over- or under-supply will lead to more volatile markets over the next 5-8 years.

Globally, investment in conventional oil extraction has been cut back sharply, and producers will probably be very cautious about new investments even when oil prices recover. The reason for this is that the long term – the next decade – looks challenging for oil since new technologies such as electric cars will most likely reduce the price advantage of oil over other energy sources. There will also be a steady increase in political pressure to tackle environmental problems.

Production of US shale oil is far more flexible than conventional oil production, but it takes time to adjust output. At present, production is falling by 0.7 million barrels/day year-on-year. A return to the pace of growth seen in 2014, about 1 million barrels/day, would take 1½-2 years. So even shale oil has some cyclicality although the cycle is 2 years rather than 5-10 years, which is the case for conventional oil production.

Our forecast is that oil prices will again be at around current levels – USD 50/barrel for Brent crude – toward the end of the year, but we see potential for higher prices during the summer and autumn, occasionally perhaps up to USD 60/barrel. The reasons for this include, along with an increase in demand during the summer (the driving season) of about 1 million barrels/day, indications of an unusually high level of maintenance work in the North Sea, which in that case will reduce supply temporarily. Combined with falling US production, this means potential for somewhat higher prices. For 2017, we expect an average price of USD 50.

DECLINE IN RIGS STARTING TO HAVE AN IMPACT



Source: Bloomberg

The number of US oil rigs in production has fallen dramatically, as indicated above. Increased efficiency has had a delayed effect on supply, which is now beginning to fall.

REBOUND AFTER 18 MONTHS OF FALLING OIL PRICES

Source: Bloomberg

The decline in oil prices, which began late in the summer of 2014, was both steeper and more sustained than most forecasters expected. We now anticipate more stable prices with potential for upswings during the summer and autumn.

Currencies

Monetary policy fading as a driving force?

The importance of central banks to the foreign exchange (FX) market in recent years can scarcely be underestimated. Yet since the late February meeting of the Group of 20 (G20) industrialised countries in Shanghai, the outlook has changed. Participants implicitly pledged to no longer use non-conventional monetary policy to influence the FX market and thus create imported inflation via a weaker exchange rate. The EM sphere is in better health now that the USD has lost a little ground, and commodity prices have started to rise again. If this trend continues, there are more gains to be had in some EM countries with undervalued currencies. Valuations are a more important FX factor now, but with small deviations from equilibrium exchange rates among the main G10 currencies, together with weak but growing risk appetite, we should see small movements and declining volatility in the months ahead.

- **EUR** – The European Central Bank (ECB) cannot allow too strong a euro, but the depreciation that is needed will depend on the Federal Reserve (Fed) hiking its key interest rate.
- **USD** – Has lost ground but will recover some of its decline ahead of the coming Fed rate hike this summer.
- **JPY** – More fairly valued; major challenges ahead point to a weaker yen.
- **GBP** – The EU referendum is overshadowing everything; will strengthen after a likely Remain vote on June 23.
- **CHF** – Moderate weakening will depend on the successful handling of Brexit and the Greek financial crisis.
- **SEK** – Sweden's Riksbank refuses to back down from its extreme monetary policy; more neutral prospects for the krona in the next quarter.
- **NOK** – Rising oil prices, attractive valuations and positive flows will provide tailwinds for the Norwegian krone.

Except for the Japanese yen, the Swedish krona has been the fastest rising currency since the Riksbank introduced negative interest rates and bond purchases (on February 12, 2015). It is not really surprising that the krona appreciated (around 6 per cent in trade-weighted terms) despite aggressive Swedish monetary policy. The currency was greatly undervalued at the time the central bank launched its unconventional monetary policy. The market (both Swedish and foreign participants) already had negative exposure to the krona. The Swedish economy has also outperformed most others since then (thanks to expansionary fiscal and monetary policy), which has contributed to the krona's appreciation. Sweden's strong balance sheet is another sign that the krona is no longer being treated as a strongly pro-cyclical currency subject to business cycles; in times of financial stress, Swedish investors repatriate as much capital from abroad as foreign investors repatriate from Swedish markets. Swedish companies and institutions also still carry a relatively high FX exposure. If, as we believe, the krona is no longer as sensitive to business cycles, it is reasonable to expect a greater degree of currency hedging – this process also benefits the krona. Most models, including our own, indicate the krona is still undervalued. Within 1-2 years, the trade-weighted krona (KIX "krona index"; see chart below) will appreciate by another 2-5 per cent (which means that the EUR/SEK exchange rate will be in the 8.60-8.80 range). At what point this occurs depends on when the Riksbank stops focusing on the currency and shifts its gaze to rising Swedish capacity utilisation and the strong economy. This should happen late in 2016.

EUR – Trading around the equilibrium rate not justified

The ECB has continued its monetary easing to support the euro zone economy. Interest rates and yields are falling, while borrowing is on the rise; the economy has responded with above-trend growth. The problem for the ECB and the euro is that the central bank is very far from reaching its inflation target. The trade-weighted euro is also priced just above what we believe is the long-term trade-weighted equilibrium rate. At present, there is little chance that the ECB can weaken the currency significantly; the euro zone also has a relatively large and growing current account

KRONA NO LONGER HIGHLY DEPENDENT ON BUSINESS CYCLES

Source: Macrobond

Once clearly pro-cyclical and dependent on business cycles, since 2012 the Swedish krona has been de-coupled from general risk sentiment and no longer follows the same patterns, such as closely following risk on/risk off flows.

surplus, which provides a tailwind for the euro. The weaker euro that we forecast will depend on the Fed getting back on course and raising its key interest rate again.

USD – Fed helping sustain strength

Weak global economic conditions and uncertainty about the strength of US growth caused the Fed to retreat from its earlier plan for continued rate hikes. Currency positions also very consistently assumed a strong USD. Combined with lower market expectations about the Fed, this led to a reversal for the dollar. But although the dollar is overvalued, especially against EM currencies, it is too soon to believe there will be a further correction. The US economy continues to recover, and the Fed will tighten its policy, though at a very gentle pace. Non-commercial speculators have also been selling the USD for several months. However, there is a significant risk that the US presidential campaign will focus on lost manufacturing jobs and the strong dollar; greater focus on trade regulations and tariffs could make the FX market more cautious about the dollar's prospects.

GBP – Awaiting the referendum's outcome

The UK referendum on EU membership is overshadowing all other factors. Early this year, it was thought there was a high probability the country would vote to leave the union, and the pound fell sharply. Since then, the currency has recovered somewhat; trading activity is likely to fall before the referendum takes place on June 23. We believe that the outcome will be positive and that 60-70 per cent of undecided voters will vote Remain. The economic arguments for staying in the EU are also more convincing, and we believe a Remain outcome will bring the GBP/SEK exchange rate back to a bit above 12.00 this summer.

JPY – Strength at an end for now

The situation in Japan is producing more questions than answers. The reform policies launched by Prime Minister Shinzo Abe in 2012 ("Abenomics") have not delivered results. Inflation is hopelessly below the 2 per cent target, and the economy has swung in and out of recession. Although the Bank of Japan (BoJ) has joined the negative interest rate club, the JPY has appreciated more than any other G10 currency so far this year. We believe it will weaken again since 1) the currency is no longer as sharply undervalued, 2) speculative investors are now highly overweighted in the JPY, 3) the BoJ will continue to cut its key interest rate and 4) the Japanese government will refrain from hiking its consumption tax in 2017. The JPY/SEK exchange rate will be 7.10 in December 2016.

CHF – Will keep weakening at modest pace

The strong franc is still keeping inflation down in Switzerland, which has experienced deflation since late 2011. But Swiss economic growth and especially the current account balance seem able to handle a strong currency. We believe the UK will vote to remain in the EU. We also believe there will be no new financial market turbulence connected to the situation in Greece. We should thus not see any major financial flows to Switzerland, which – combined with a high valuation – points to continued cautious CHF depreciation. We believe the CHF/SEK rate will reach 8.04 late in 2016.

SEK – Riksbank will stop the krona from appreciating for a while

The krona has been in a sustained appreciation phase since early last year, despite earnest attempts by the Riksbank to limit its rise. In early May, the dollar fell, helping boost the trade-weighted krona to a two-year high. There are a number of reasons for maintaining a more neutral near-term position in the SEK:

- The Riksbank shows no signs of stepping back from its highly expansionary monetary policy.
- Swedish real interest rates are very negative and are expected to provide poor support for the krona.
- The focus among foreign investment managers is shifting to the NOK.

The EUR/SEK exchange rate will be in the 9.15-9.35 range and fall towards 9.00 only when the Riksbank begins to diverge from the ECB's soft monetary policy late in 2016.

NOK – Attractive valuation and flows point to continued upturn

The sharp rebound in oil prices obviously makes the Norwegian economy and the krone more stable. But economic growth prospects will not change dramatically if oil remains at around USD 50/barrel. Growth will decelerate over a sustained period and inflation will gradually fall below Norges Bank's 2.5 per cent target. Meanwhile the Norwegian central bank is buying no less than NOK 900 million per day on behalf of the country's sovereign wealth fund. Combined with an attractive valuation, this leads us to expect persistent upward pressure on the krone. Norges Bank will thus be forced to cut its key interest rate again to offset the strength of the NOK. The EUR/NOK exchange rate will be just above 9.00 in December 2016.

CURRENCY PAIR	EXCHANGE RATE Now*	Q2 2016	Q3 2016	Q4 2016	CHANGE % Q2 2016	Q3 2016
EUR/USD	1.12	1.10	1.09	1.08	*-1.4*	*-2.3*
EUR/SEK	9.26	9.25	9.20	9.00	*-0.2*	*-0.7*
EUR/NOK	9.29	9.30	9.20	9.10	*0.1*	*-1.0*
USD/SEK	8.31	8.41	8.44	8.33	*1.2*	*1.6*
USD/NOK	8.34	8.45	8.44	8.43	*1.4*	*1.3*
EUR/CHF	1.11	1.11	1.12	1.12	*0.4*	*0.8*
CHF/SEK	8.38	8.33	8.25	8.04	*-0.5*	*-1.5*
EUR/JPY	123	123	125	125	*0.5*	*2.2*
GBP/USD	1.46	1.49	1.45	1.44	*1.8*	*-0.5*
GBP/SEK	12.14	12.50	12.27	12.00	*3.0*	*1.1*

**Currency forecasts were made by SEB Research & Strategy as of May 25, 2016. Please ask for a copy of our current forecasts.*

Theme - Brexit

To Brexit or to Bremain?

Whatever the outcome, the process surrounding the June 23 referendum in the United Kingdom will affect not just that country but the rest of the European Union. The impact will mostly be political, but also economic and in financial markets. Whatever the outcome, the UK's negotiated right to refrain from future integration efforts raises serious questions about the future of the EU project, producing a Europe that is moving in two different directions. There may also be a major impact on Sweden, especially politically, if British exit from the EU ("Brexit") actually occurs.

- Our main scenario (a 65 per cent probability) is that the Remain side will win, which would have relatively limited effects economically.
- In the short term, that outcome would probably still produce some market movements, most likely a relief rally for the pound and for British and European equities.
- If the Leave side wins with a weak majority, we expect new negotiations and a new referendum – which would mean a period of anxiety but effects that are still manageable.
- A strong victory for Leave would slow economic growth the most, but not just in the UK, and there would be even greater political uncertainty about the EU.

While UK voters have two alternatives, we see three possible outcomes for the June 23 referendum – a majority for the Remain side, a "soft Leave" and a "hard Leave" scenario. The outcome will affect not only the UK but the entire European Union including Sweden and will have an impact in many ways, both in the short and long term – in other words, a rather complicated situation. Below, we review the different outcomes, in their order of probability, and analyse potential consequences.

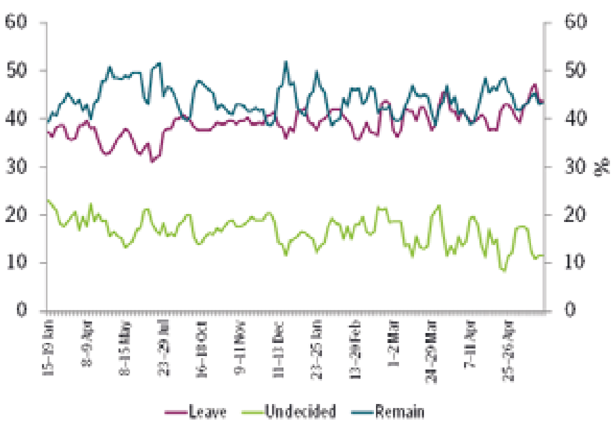
Remain – most probable, least impact

There are currently many reasons to believe that the Remain side will win this battle. They include opinion polls – see the chart below – and the fact that British betting firms, which are usually fairly good at predicting elections results, have Remain as their clear favourite. Recent opinion polls have also shown a negative correlation between the change in the number of undecided voters (which is high) and the percentage in favour of Remain. In other words, most undecided voters appear to be choosing Remain when they do decide. In our view, the probability of the Remain side winning is 65 per cent.

Political impact, whatever the outcome

With a Remain outcome, everything would seemingly stay the same. It is reasonable to assume we would see a relief rally in financial markets if the risk of Brexit is averted. The pound would probably strengthen, as would stock markets in London and elsewhere in Europe – provided that clear indications that voters are leaning this way did not cause the markets to discount this outcome in advance. In economic terms, we can assume that the slowdown caused by uncertainty about Brexit early this year would be reversed

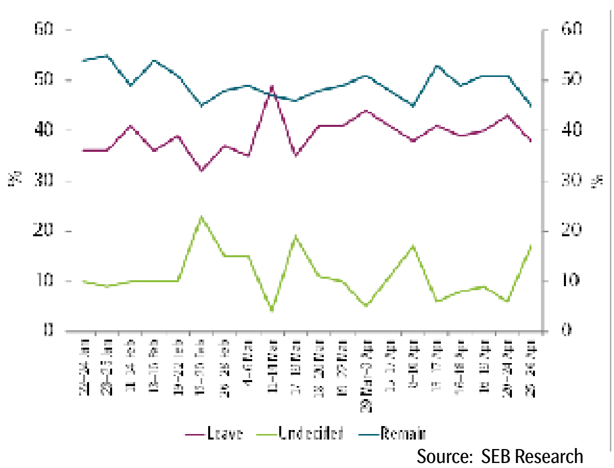
OPINION LOOKS MORE EVENLY DIVIDED...



Source: SEB Research

In the most frequently cited "poll of polls", the two sides are basically even, but with a rather large share of undecided voters. However, these data include both regular telephone surveys of randomly selected people and Internet surveys of people who responded on a voluntary basis.

...THAN IT ACTUALLY IS?



Source: SEB Research

If we instead study only telephone surveys, we see a small but clear majority for the Remain side. One possible conclusion is that people who are negative about the EU are more active on the issue and respond to online surveys to a greater extent, whereas telephone surveys provide a more accurate picture of public opinion.

when investments that are currently on hold are most likely carried out. All in all, the long-term financial and economic consequences would still be limited in case of this outcome.

In political terms, a Remain vote also means more of a normalisation compared to the alternatives. But the opt-outs that the British recently negotiated ahead of the referendum radically redrew the political map of Europe, exposing an old dividing line in the EU project. While the core countries on the European mainland (mainly Germany and France) have traditionally strived for a greater degree of integration and supranationality, the UK has often advocated liberalisations and a greater degree of national autonomy – an approach that Swedes have largely aligned themselves with. The idea underlying the British opt-outs is that the country is no longer part of the EU's drive toward an "ever closer union", which among other things has been outlined in last summer's Five Presidents' Report (compiled by the presidents of the European Council, the Eurogroup, the European Central Bank and the European Parliament, led by the president of the European Commission, Jean-Claude Juncker), laying out the path towards a more cohesive union. Because of the UK's opt-outs, the discussion is no longer about how quickly this integration process can take place (described as a "two-speed EU") but instead about how we now have an EU that is moving in two different directions. There is an obvious risk that more countries will follow the British example, making the EU situation far messier and more unclear.

"Soft Leave" – renegotiation and a new referendum

In case a weak majority votes for Leave, it is not certain that the UK would actually leave the EU – quite the opposite. Boris Johnson, who recently stepped down as Mayor of London and is a leader of the Leave campaign, has said that such an outcome might lead to further negotiations on UK opt-outs and greater autonomy, followed by another EU referendum in which the outcome would be the "desired" one. We have seen a similar course of events on several occasions in EU-related referendums in other member countries. We assign this scenario a probability of 25 per cent.

Prolonged uncertainty would weigh down markets and economies

In a "soft Leave" scenario, the UK would remain in the union and the long-term effects should therefore be similar to those of a Remain vote. But there would probably be a lengthy period of negotiations and great uncertainty, as well as a new referendum with an unclear outcome, which would also entail increased financial uncertainty. We would expect both the pound and the euro to weaken initially, along with stock markets – all else being equal. This reaction would most likely change when (if) new negotiations with the EU got under way. Thus in the short term, we expect the effect on stock markets to be negligible. The effects on UK growth would be greater than in a Remain outcome, since prolonged uncertainty would probably continue to adversely affect investment and most likely consumption. We would expect this uncertainty to also have a slightly negative effect on EU (and Swedish) growth in 2016.

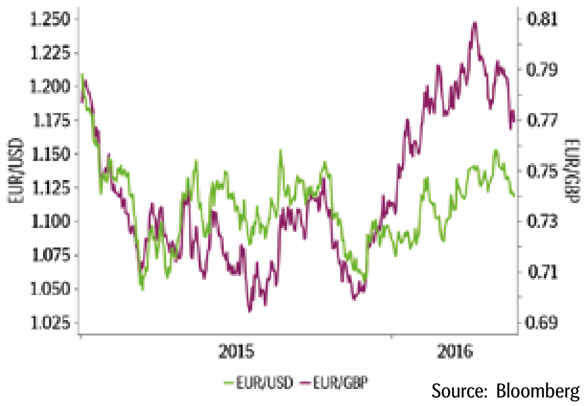
In such negotiations, the EU would need to make further concessions, creating an even greater risk that other countries would consider seeking opt-outs from the EU project. But the opt-outs that have been granted to the UK have already opened the door, so the effect of a further opening need not be that much greater.

Even if a "soft Leave" vote produces a lengthy period of uncertainty (assuming that the UK ends up staying in the EU), we still believe that ultimately the long-term effects of either a Remain or a "soft Leave" vote on economies and markets would be relatively limited. Since we give these outcomes a combined 90 per cent probability, we might end our analysis here. But it is difficult to gauge public opinion, which may quickly swing to a "hard Leave", and the effects of such an outcome could be so sweeping that it merits discussion.

POUND PLUNGED AFTER THE UK'S ERM EXIT

Source: Bloomberg

POUND ALREADY SOMEWHAT WEAKER AHEAD OF THE REFERENDUM



Source: Bloomberg

In the financial world, it is reasonable to assume that the pound would be affected the most by any outcome. Although the situation differs significantly from when the UK abandoned the European Exchange Rate Mechanism (ERM) in the 1990s – see the chart to the left – the plunge in the pound back then nonetheless provides some indication of what could happen. The risk of Brexit is already clearly reflected in how the market has priced the pound – especially against the US dollar. The chart to the right shows how the pound (purple line) has weakened against the dollar more than the euro has. In case of Brexit, we would expect the pound to continue falling against the dollar as well as against the euro. If Remain wins, there is room for an upward relief rally.

A "hard Leave" – intense political pressure, subdued growth

If a clear majority (more than about 55 per cent) vote for the Leave alternative, Brexit would most likely become a reality. The impact would then be fairly substantial, both initially (markets) and over time (economic growth and politics). This impact would naturally be greatest in the UK, especially with regard to markets and growth, but the risk of wide-ranging political effects elsewhere in the EU would also increase significantly. This outcome would also have a major impact on Sweden, especially in political terms. More consideration will be given below to the political consequences and the effects on Sweden, but first a look at the economic consequences.

Sharp deceleration in growth

As the result of a "hard Leave", the pound would probably drop immediately by roughly 10 per cent against the dollar. But the euro would probably also weaken against the USD, given generally greater uncertainty about future EU economic and political cooperation. The Swedish krona too would most likely come in for its share of depreciation, driven by general risk aversion and by the risk of effects on Sweden's EU policy. Similarly, we would expect bond yields to rise immediately in London, but the effects elsewhere in Europe, including Sweden, would be more limited.

These developments would naturally undermine global confidence in the UK as a country in which to invest. The same is true of other European countries to some extent. In stock markets, as with a "soft Leave" we would probably see declines, with the biggest slide in London. But the difference is that these effects would be more permanent, since growth prospects would change. We expect UK growth to be hampered by a slower pace of investment and by uncertainty or deterioration in prospects for exporting to EU countries and in the stability in the financial system. This would be partly offset by a weaker currency, which would bolster the UK economy. Our analysis shows that the overall effect on the country's GDP would be growth that is lower in both 2016 and 2017 than in the case of a Remain vote. The same uncertainties would also affect the euro zone and Sweden to some extent. See the table below.

Political panic – or closer integration?

A "hard Leave" would mark the beginning of a lengthy process to negotiate how Brexit should be implemented. There would also be negotiations about future relations, trade agreements, free movement of capital and labour etc. Nobody has anything to gain from isolating the UK too severely, least of all the UK itself. We expect a high degree of pragmatism in these negotiations, which would in any

GDP FORECASTS FOR DIFFERENT OUTCOMES	2016			2017		
	UK	EURO ZONE	SWEDEN	UK	EURO ZONE	SWEDEN
Remain scenario	2.2	1.9	4.0	2.4	2.0	2.8
"Soft Leave" scenario	2.0	1.8	3.8	2.1	1.9	2.7
"Hard Leave" scenario	1.7	1.7	3.8	1.7	1.7	2.5

Source: Bloomberg

CURRENCY FORECASTS FOR DIFFERENT OUTCOMES	SEPTEMBER 2016			DECEMBER 2017		
	EUR/GBP	EUR/USD	EUR/SEK	EUR/GBP	EUR/USD	EUR/SEK
Remain scenario	0.76	1.12	9.10	0.72	1.10	8.70
"Soft Leave" scenario	0.80	1.08	9.20	0.74	1.09	8.85
"Hard Leave" scenario	0.86	1.05	9.30	0.82	1.06	9.10

Source: Bloomberg

In the short term, uncertainty would affect growth, including cuts in investments. The long-term effects would, on the whole, be greatest in case of Brexit, with a significant decline in UK growth compared to the other possible outcomes, according to SEB's forecast. This is largely in line with the UK Exchequer's estimate of 6 per cent lower GDP in a 15-year perspective. As for Sweden, a smaller decline is expected, which would be partly offset by a weaker krona.

In terms of currencies, the pound would naturally take the greatest hit in case of Brexit. The euro and the krona would also probably weaken against the dollar but strengthen against the pound. Especially in case of any outcome other than Brexit, the trend for the krona and the euro would be determined by other factors.

case make the economic consequences manageable. Politically, the UK would, of course, be more clearly isolated from EU decision-making. This outcome could also create tensions in the country. The Scots are far more in favour of remaining in the EU, so a "hard Leave" might set in motion a new wave of Scottish nationalism. The situation would also change for the people of Northern Ireland, with an EU border dividing their island.

The political effects in the EU are a bit more difficult to predict. It is highly likely that there would be an even clearer risk that more countries would look for alternatives to the integration path proposed by Brussels. Tensions would probably rise; EU sceptics talk about the risks of a collapse and/or major political turmoil. On the other hand, it cannot be ruled out that Brexit would actually facilitate and speed up European integration. The UK has set the tone in the EU's "northern European bloc", together with countries such as Denmark and Sweden. These countries have at times resisted integration impulses from a more liberal standpoint. Without the UK, this opposition would be weaker, which could pave the way for faster integration. In case of Brexit, the EU would also be more clearly dominated by the euro zone countries, in which case introduction of the euro in other countries might be necessary for them to avoid being marginalised.

Would Sweden be forced to choose?

Sweden will be affected politically regardless of how the UK votes. With the UK opt-outs in place – and especially if a "soft Leave" results in further opt-outs – the question arises whether Sweden would follow this example and request its own opt-outs. So far, Sweden has had an ambivalent – if not sceptical – attitude towards the EU project; for instance, it opted out of the euro zone. In the situation where the EU is more obviously moving in two different directions, Sweden would probably be forced to choose sooner or later. If the UK remains in the EU, Sweden at least has the possibility of choosing a variant of the more autonomous path advocated by the UK. However, this position has not been put forward in the debate, nor is it backed by a majority in Swedish opinion polls.

Given the above arguments, in case of Brexit, Sweden could end up in a situation where it is forced to choose between introducing the euro or leaving the EU. Unlike Denmark, Sweden has no formal right to remain outside the euro zone. In a survey conducted last autumn by Statistics Sweden that measured EU preferences, only 14 per cent of respondents in Sweden said they wanted to introduce the euro as their currency. In a more recent Demoskop survey commissioned by SEB, Swedes were asked to choose between leaving the EU or accepting the introduction of the euro as their currency. Some 38 per cent were willing to accept the euro. Although more of the respondents (47 per cent) would choose to leave the EU rather than accept the euro, we interpret this to mean that a relatively large number of Swedes would consider a switch to the euro to be the price they are willing to pay to remain in the EU.

Brexit or no Brexit, increased integration or not, the euro instead of the krona – there are many variations, and it is difficult to make forecasts. But no matter what happens, the uncertainty and the challenges are greatest in political terms; the economic consequences appear to be manageable – especially if one of the more likely scenarios is realised and the UK remains in the EU.

Theme - The car industry

A bright spot in Europe

The car industry is relatively mature and cyclical in nature, which is why car makers are almost always valued at relatively low earnings multiples in good times. But current valuations stand out as historically attractive in absolute terms and very attractive in relative terms. Despite the Volkswagen scandal, earnings in the European car industry are expected to grow to record levels this year. The global car market has grown strongly since 2009. Compared to last year's record sales, the outlook for further volume growth is not convincing, but we are seeing major geographic differences and Europe stands out on the positive side.

- Shares of European car manufacturers have low valuations, both in absolute terms and compared to other equities.
- The car industry is moving towards new record profits despite VW, thus diverging positively from the European average.
- The global car market is at peak levels. Sooner or later it will start falling, but Europe looks relatively promising.
- The credit market does not seem significantly worried about the financial companies owned by car makers.
- The car sector is generally regarded as a "mature industry", but right now it is at the centre of two socially transformative technology shifts.

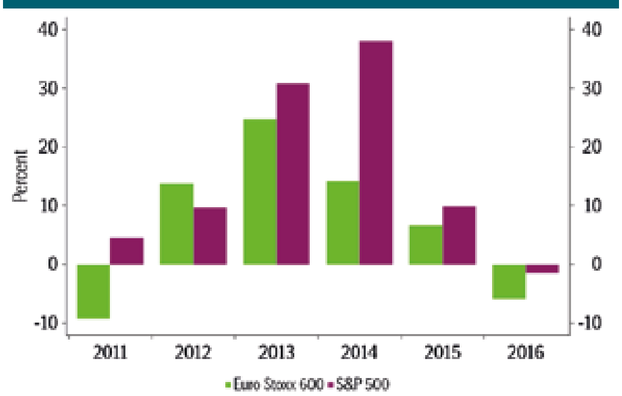
EUROPEAN STOCK MARKETS have performed significantly worse than US markets for a long time, even though valuations have continuously been in Europe's favour. The reason is a substantially poorer earnings trend. Earnings of the Euro Stoxx 600, an index of the 600 largest listed companies in Europe, are still far below their peak levels before the 2008 Lehman Brothers crash. After a short, quick recovery in 2010, there has been a slow leak on the earnings front – with continuous downward revisions in forecasts and flat or slightly falling aggregate earnings.

But although a weak earnings trend fully explains why the total index of major listed companies in Europe has not performed better than has been the case, there are important sub-segments of the market where this explanation is not correct. Over the past year the share price trend for the European car industry has been weak despite positive earnings growth. Shares of car makers have performed worse than the overall equity index, despite a superior trend in their profit outlook. The combination of weak share price performance and a strong relative earnings trend has given rise to an unusually wide valuation gap.

Volkswagen discount for the whole sector?

Obviously the Volkswagen scandal (large-scale advanced cheating aimed at skirting US nitrogen oxide emissions regulations) may serve as an important partial explanation, but VW's problems are also included in analysts' earnings forecasts for the company and the sector. Even though the earnings outlook of VW (Europe's largest car manufacturer) has deteriorated sharply since last summer, it has been adjusted upward for the sector as a whole in Europe. The direct costs of VW's cheating are still difficult to estimate – US authorities will probably not be alone in demanding compensation from VW – but the indirect costs in the form of lost market share appear likely to be rather limited. Despite enormous international media attention to VW's deliberate and sophisticated cheating in an area as politically and emotionally loaded as environmental pollution (which cost both the CEO and the Chairman their jobs and will cost shareholders billions of euros), the VW Group has lost only about 1 percentage point of the European car market: from 24.4 per cent in the first quarter of 2015 to 23.4 per cent in Q1 2016. VW Group sales actually grew during the first quarter of this year, but significantly more slowly than the overall industry, and VW's market share is now back at the same level as during 2011. As for the car market as a whole, it is difficult to see any evidence of the VW scandal at all in the statistics; only market shares appear to have changed.

THE US STOCK MARKET HAS OUTCLASSED THE EUROPEAN MARKET



Source: Bloomberg

The chart shows yearly total returns for European and American equities in SEK.

Yet VW's cheating has probably contributed to increased worries about further scandals in the car sector and thus a certain discount on share prices. These worries were highly evident last autumn and winter, when all types of news or mere rumours about cheating on tests or about regulatory investigations in the industry created sharp short-term price movements in the shares of the affected companies. We are unable to estimate how much risk of a repeat scandal involving another major car manufacturer there is in practice, but cheating and fraud unfortunately sometimes occur in all parts of society. It is far from certain that the next big corporate scandal will occur in the car industry. Although some less far-reaching events have been uncovered in the past six months – most importantly that Mitsubishi cheated on reporting fuel consumption in its Japanese home market – and there is a public conversation about how tests should be designed to provide a fairer picture, there has been nothing nearly as far-reaching as the VW scandal. The portion of the current valuation discount in the sector that can be explained by worries about a repeat of the VW scandal will shrink over time, provided that no new scandals are uncovered.

Credit losses: not a problem so far

The car industry not only sells cars, but also financing solutions to its customers. Although these finance companies ordinarily contribute both profits and repetitive revenue and provide vital support in facilitating actual vehicle sales, they are occasionally the object of financial market worries. Like other financial institutions, these companies are dependent on a functioning credit market. They also have a relatively concentrated risk exposure to consumers and used car prices. During the past year, we have seen two clear outbursts of financial market worries about finance companies in the car industry. One occurred at the time that the VW scandal was revealed, shaking the entire sector for a while. The other occurred in February 2016. At present, however, we are not seeing any major worries about these credit market operations. We can also note that today's historically loose monetary policies, which will probably continue for a long time at least in Europe, are highly beneficial to finance companies like these.

Commodities providing marginal support

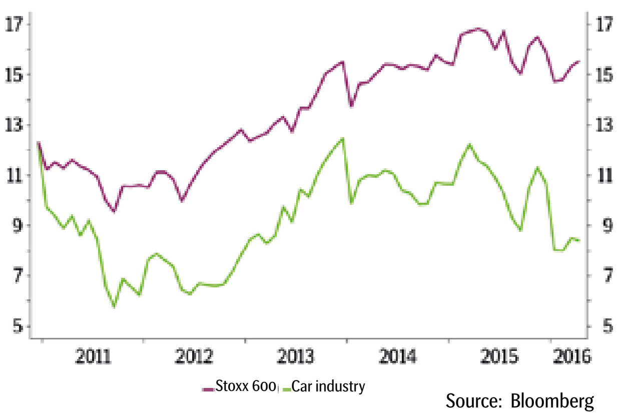
Despite a sharp recovery for various commodity prices in recent months, the prices of important materials such as steel, aluminium, copper and plastics are still low in a recent historical perspective. Due to time lags between spot market prices and actual costs to manufacturers, these low prices will help cost-cutting efforts in the car industry this year. In an industry that works with large volumes of materials and relatively thin profit margins, this is important. Although this should already have been factored into analysts' earnings forecasts for car companies, it is still worth highlighting as a short-term factor benefiting the industry. A new report from Canada's central bank also points out that 85 per cent of the price upturn for base metals in 2002-2010 was driven by extreme growth in Chinese construction activity during this period. Looking ahead, no potential new driver of demand for metals is apparent today. Combined with the sharp increase in supply over the past few years, this suggests that it will take a long time before cost pressure from rising commodity prices – which repeatedly plagued the car industry during the past decade – comes back.

Buying at the peak of the cycle?

The car industry is cyclical in nature, so can it really make sense to invest in it at historical peaks?

Global car sales are already at historical peak levels, and 2016 will probably be the seventh straight year of expansion – the longest period of uninterrupted volume growth in the global car market since the 1980s. This should reasonably imply that we are close to the end of the expansion phase.

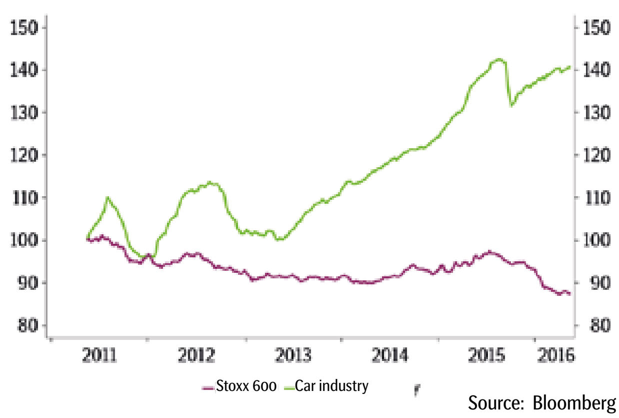
HISTORICALLY LARGE VALUATION DISCOUNT



Source: Bloomberg

The chart shows price/earnings ratios for the European car industry compared to the European stock market as a whole (Euro Stoxx 600).

GOOD EARNINGS OUTLOOK IN THE CAR INDUSTRY



Source: Bloomberg

The chart shows earnings forecasts for the European car industry compared to the European stock market as a whole (Euro Stoxx 600).

But there are major differences between geographic areas:

- In 2015 US car sales set new records, and during the past six months they have hovered around almost the same levels that prevailed during the decade before the financial crisis.
- We expect the Chinese car market to continue growing this year, but more slowly than historically; to some extent, this market is on steroids due to government stimulus measures targeting this sector (especially small and electric cars).
- In other Asian countries, car sales are continuing to grow from record high levels, but the pace of growth has slowed appreciably since 2013.
- In Latin America and Eastern Europe, car sales have been decreasing sharply for the past 3-4 years.
- In Western Europe we are seeing a clearly rising positive growth trend, but in spite of this, car sales have not returned to the peak levels prevailing before the euro crisis.

The combination of a positive trend and continued major recovery potential in Western Europe is unique, making the region appear relatively attractive in the near term in an international comparison.

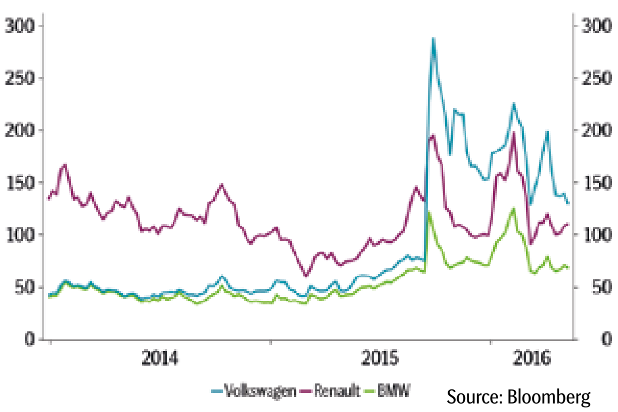
Although the car industry is international and all the major companies have a global presence, European car manufacturers have an especially strong position in Europe. While about 1/6 of all passenger car and light truck sales in the world occur in Western Europe, the major European car makers have a 30 per cent or higher share of their car sales in this part of the world; for the PSA Group (Peugeot, Citroen), this share is about 60 per cent. Although having a large proportion of revenues in Europe has not been a successful position over the past 10-20 years, it will probably be a favourable exposure in the near term.

Two of the most important drivers of car sales – the labour market and interest rates – also remain highly favourable in both the US and Europe. This is why we have difficulty sharing the market's great concern about the performance of the car market, which seems to be reflected in the prevailing sector valuations.

Obviously European car makers will also suffer when the global car market eventually declines again, but having a significant percentage of their sales in Western Europe should be relatively favourable in the near term. SEB also expects continued growth in global car production during 2016 and 2017. But above all, we are seeing that valuations of European car manufacturers are at slow-moving multiples. Like valuations of their reported equity capital, these are far from stretched in historical terms, despite record-high earnings and continued favourable market conditions in the near term as well as extremely low return requirements on nearly all asset classes.

A mature industry on the cutting edge
The car industry is almost the stereotype of a mature sector, yet right now it is at the centre of two technology shifts with the potential to transform society: self-driving cars and electric cars. It feels almost like science fiction to imagine a society where clean, quiet electric cars (charged with power from renewable energy sources) drive around on our streets – especially if they drive by themselves while their passengers need only key in their desired destination. Yet these technologies are developing so quickly that such a vision may become reality within a couple of decades, and the car sector has already begun taking various important steps in this direction. The new technologies are already affecting the automobile industry, but it is a step-by-step evolution that the industry can probably manage. Several European manufacturers have already assumed interesting roles.

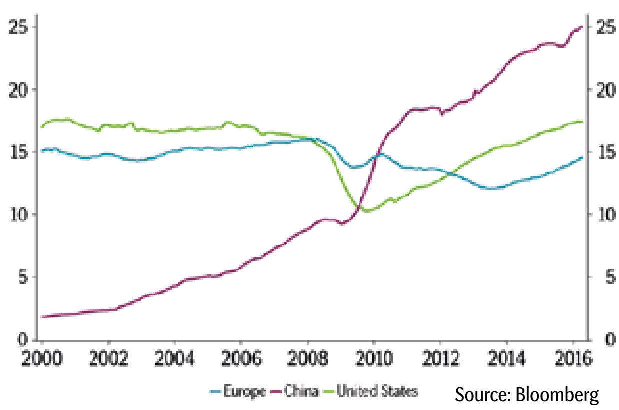
NO ACUTE CREDIT MARKET WORRIES FOR THE CAR SECTOR



Source: Bloomberg

The chart shows the risk premium on lending to some of the major European car manufacturers with the largest financing operations in relation to their market capitalisation. The VW crisis and February's market worries about the economy are clearly visible. For other companies the situation has normalised, while worries about VW are well above those prevailing before the emissions scandal.

CAR MARKET AT HIGH LEVELS, BUT REGIONAL DIFFERENCES



Source: Bloomberg

The chart shows monthly new car sales in the US at a seasonally adjusted year-on-year rate and new car registrations in Europe in the past 12 months on a rolling basis. The Chinese car market has grown extremely fast for a long time. US car sales have probably levelled out close to their "normal level" before the financial crisis. Europe is showing good sales growth from a low level, but still well below earlier peaks.

Today there are already high-performance electric cars, as well as electric cars with a price tag suited to the mass market. Unfortunately it will take another few years before high performance (long driving distance) can be combined with mass market prices. During 2015 only 1 per cent of new cars sales around the world were electric, including rechargeable plug-in hybrids.

As for self-driving cars, they already exist but it will take more than a decade before they become numerous. This will require a much bigger element of preventive safety equipment and technological support systems for human drivers – "active safety" equipment. The effect of such active safety equipment, which is now rapidly increasing its penetration of the passenger car market worldwide, can already be seen in US traffic fatality statistics. Safety systems have greatly improved in recent years, and important initiatives from organisations representing US car makers and from Toyota related to automatic emergency braking (AEB) will guarantee a rapid increase in market penetration over the next several years. Toyota is promising AEB systems as standard equipment in all its models by the end of 2017.

Smarter cars attracting IT heavyweights

Because of these two exciting trends, the car industry is at the cutting edge of technology. This is also confirmed by the fact that information technology (IT) companies like Alphabet (Google) and Apple, but also Samsung, are now investing in smarter automobile technology. Pessimists may of course worry that we are facing a repeat of the revolution that hit telephone manufacturers when "smartphone" software from Apple and Google revolutionised the telecom industry. It took only a few years for Nokia to collapse. Nokia went from being the most profitable company in the Nordic region, with a 40 per cent global market share for mobile phones, to being a loss-making and insignificant company that finally abandoned telephone instrument manufacturing completely. There is also concern that self-driving cars will eventually decrease consumer interest in car ownership. We believe that it is much too early to draw such far-reaching conclusions. The enormous logistic, production and distribution challenges facing the car industry suggest that the role of the IT giants in this sector may turn out to be very different from their role in telecoms.

EQUITY CAPITAL VALUATIONS BELOW HISTORICAL AVERAGE

Source: Bloomberg

The chart shows valuations of reported equity capital in the European car industry. Investors already seem to be discounting the next downturn in this sector. Despite record earnings and ultra-low interest rates, equity capital in the car industry is being valued at somewhat below the historical average of the past 15 years.

Exactly what Apple's ambitions are in the car industry is still unknown and limited to sometimes contradictory rumours in the media, but Google has demonstrated its ambitions in this field for a long time and recently began collaborating with Fiat Chrysler. Together Google and Fiat Chrysler will build 100 self-driving cars. Most other major car manufacturers are investing in their own solutions, but Fiat Chrysler has lagged behind so far and seems to regard sensors and software for self-driving cars as components that the company would be better off purchasing from suppliers instead of developing in-house. Based on this, Google's strategy can also be interpreted as meaning that they would rather be a software supplier to the car industry than a part of it.

As for Tesla, it is probably difficult to overstate how much the company has done for the perception of electric cars, especially as an alternative in the premium segment, but in terms of sales volume Tesla is still a very small company. Renault-controlled Nissan is still the make that has sold the most electric cars worldwide. All car makers have plans to move into this rapidly growing but still limited part of the market. Tesla has contributed and will continue to contribute to the dramatic cost-effectiveness improvements that are under way in battery technology, but the whole industry can benefit from this development work. The unit cost of the lithium batteries that power both purely electric and hybrid cars has fallen by about three fourths in only six years. Planned new investments by several major battery manufacturers, including Tesla's highly publicised battery factory venture, are expected to result in a continued rapid decline in costs between now and 2020.

The car industry faces major technology shifts during the coming two decades, perhaps faster than ever in the recent history of the industry. This will result in both challenges and opportunities. Drawing direct parallels to the telecom sector is doubtful. The established car companies have significant comparative advantages over the IT companies in California. The potential and threats posed by smart electric cars probably explain in part why European car industry shares are trading today at twice their discount to the stock market average over the past five years; the car industry is valued today at a discount of 46 per cent to the Euro Stoxx 600, compared to a 23 per cent average since 2011.

Theme - Wind power
A clean, economical energy source

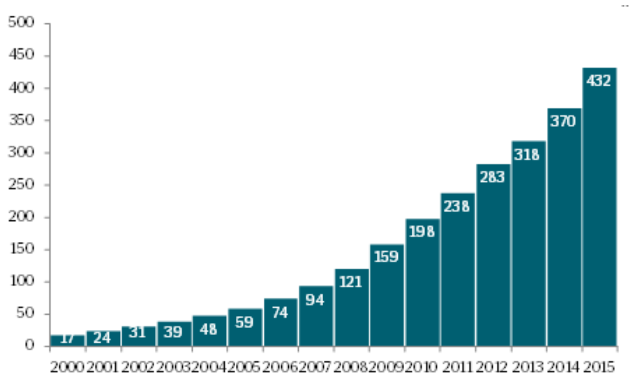
Investments in wind power grew sharply in 2015, with capacity reaching record levels. This growth is driven mostly by China, but many countries are raising their investment ambitions. The price of electricity per megawatt hour generated by wind power has fallen by more than 60 per cent in the past seven years. With equipment costs 20-40 per cent lower, wind power is clearly competitive against coal, natural gas and hydroelectric power in many parts of the world – even without government subsidies. Wind turbine manufacturers are leading the transformation in global energy generation away from fossil fuels, and wind power was the energy source that added the most production capacity last year.

- Investments in wind power reached record levels in 2015.
- Wind power has great potential, since it only accounts for 3.3 per cent of global electricity production, but that share could reach 17-19 per cent by 2030.
- Wind power is growing globally since costs are now far more competitive, even without subsidies.
- Wind farms are growing taller and wider, while becoming more efficient and cheaper to manufacture.
- Emerging market (EM) economies are driving wind power investments, with China leading the way, while countries such as Brazil, India and Poland have also raised their ambition levels.
- The political framework reached at the Paris climate summit will benefit wind power producers.
- Both wind and solar power are important factors in the transformation process away from fossil fuel.

NEWLY INSTALLED WIND POWER CAPACITY reached a record level in 2015. Calculated in gigawatts (GW), it increased globally by 17 per cent, with a total installed capacity of 432 GW. Capacity has thus doubled over the past five years. Wind power now ranks second as a renewable energy source, after hydroelectric power, which has more than 1,000 GW of installed capacity. China added half of all wind power investments last year and accounts for one third of total installed capacity. The United States, Germany, India and Spain are the other countries topping the investment list. China's wind power growth is remarkably high and reflects the country's increased focus on renewable energy. Over the past three years, the majority of investments in wind power have been made by EM countries. The chart below left illustrates installed wind power capacity over the past 15 years; strong tailwinds are driving wind power investment.

Wind power is leading the transformation of the global power generating system away from fossil fuels and was also the energy source that added the most capacity last year. With 432 GW of installed capacity, wind power is now bigger than nuclear power, which has a capacity of 383 GW. The United Nations Climate Change Conference held in Paris last year (with 186 members attending) set ambitious goals to limit global warming and achieve energy production free from fossil fuels by 2050 at the latest. Wind power has the potential to reduce emissions while creating jobs. It can now produce competitive, relatively reliable and clean energy to drive economically sustainable development. Wind power is thus the leading candidate for investment.

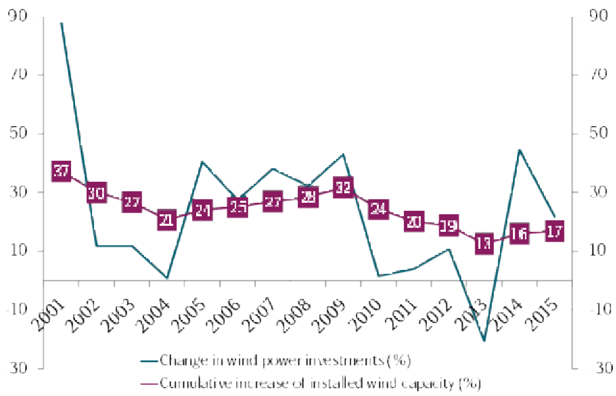
EXPANDING GLOBAL WIND POWER CAPACITY



Source: Global Wind Energy Council

The chart shows global growth in installed wind power capacity, measured in gigawatts (GW).

HISTORICALLY HIGH GROWTH IN WIND POWER INVESTMENTS



Source: Global Wind Energy Council

The chart shows annual growth in the cumulative increase in installed wind power capacity (GW) globally and the change in annual investments in wind power (GW).

Wind power – growing fastest in China

China often leads the way globally in terms of investment volumes in most sectors. That was also the case for wind power last year, with record investments of 31 GW. Of the world's top ten turbine manufacturers, half are Chinese. On the other hand, Chinese companies have had only meagre success beyond the country's borders; the same is true of international players in the protectionist Chinese market. In order for Chinese power companies to renew their permits for coal-fired power plants, they must also invest in "green" energy. That is one reason why some of the profits of wind power companies actually derive from coal power. Harmful health effects in the form of polluted air in industrial regions have further raised the country's ambitions to transform its energy production.

US wind power is still subsidised

The United States is the world's second largest wind power market, both in terms of installed capacity and expansion. Investments in new capacity reached 8.6 GW last year, a 77 per cent increase. Wind power represented 40 per cent of the country's total increase in electricity capacity. US wind power prices are competitive globally, but the market has been volatile over the past 15 years as a result of varying government subsidies. So it was particularly good news that President Obama's budget proposal for 2016, announced in early May, included more generous government tax credits for wind power operators than financial markets had anticipated. Subsidies for new wind turbines can also be expected through 2023, which is in line with US subsidies for solar power.

Europe – biggest installed wind power capacity

The trend in Europe has also been positive, though volatile in recent years. In 2015, Europe's capacity increase was 14 GW, up 6 per cent and far smaller than China's increase of 31 GW. Total installed capacity in Europe reached almost 148 GW at year-end and is still larger than China's (about 145 GW). Wind power accounted for the largest share of the capacity increase for all energy sources, 44 per cent. Germany represented half of this increase, while Poland, France and the UK, combined, invested just over half the German total. Overall, wind power investments increased by 40 per cent last year while capacity installation only increased 6 per cent – as a result of major investment in infrastructure for offshore wind power. Regulations for wind power in Europe are relatively inconsistent. Combined with modest economic growth, this helps explain why wind power investments have not grown more in recent years.

Wind power investments in EM economies

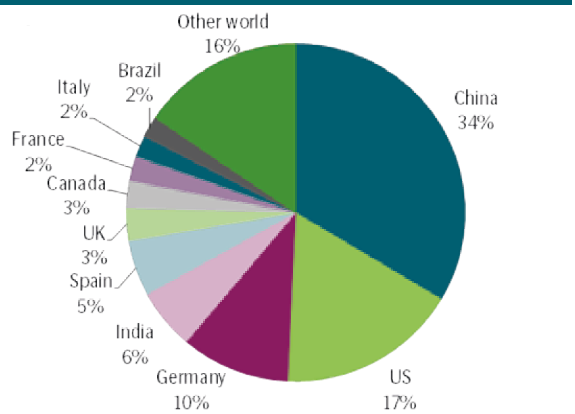
India climbed to fourth place, past Spain, in wind power investments (2.6 GW) during 2015. Its installed capacity is the fifth largest in the world, and the Indian government has plans to increase this from about 25 GW today to 60 GW in 2022. Wind power capacity in other relevant Asian countries, such as Japan, South Korea and Taiwan, is also growing, though from a low base.

Other countries with a significant rate of capacity growth in 2015 were Brazil, Uruguay, South Africa and Egypt – while many others also grew, but at a slower pace. Overall, growth in wind power is more broadly based than previously.

Increasing investment in renewable energy, despite lower fuel prices

Oil prices have fallen by more than half over the past two years, and large portions of the oil sector are loss-making. This is a major challenge of a kind rarely seen in what is historically a lucrative sector. Oil prices of around USD 30/barrel early in 2016 – the lowest in 12 years – rattled financial markets around the world and upset industrial companies' capital spending budgets. Coal prices have fallen by a third over the past two years, while natural gas prices have fallen by almost half. The rule of thumb for investment in sustainable energy sources is that low prices for oil, natural gas and especially coal have a negative effect since these fossil fuel sources then become more competitive. So it is even more remarkable that investments in wind, solar and other renewable energy sources have continued to expand, though at a modest pace in recent years – see the chart below.

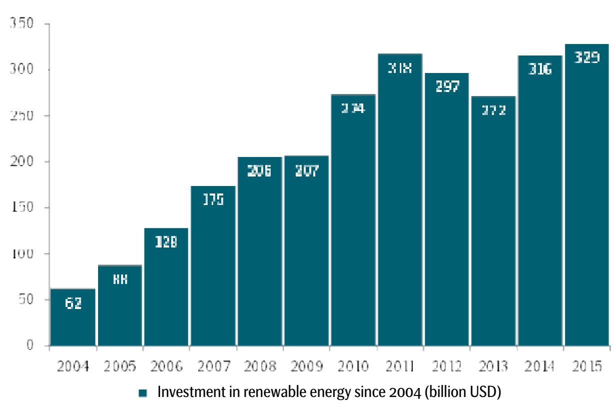
INSTALLED WIND POWER CAPACITY GLOBALLY



Source: Global Wind Energy Council

The chart shows installed wind power capacity globally at the end of 2015 by country

GLOBAL INVESTMENTS IN RENEWABLE ENERGY ARE GROWING



Source: Bloomberg

The chart shows annual investment globally in renewable energy sources, measured in USD billion.

In 2015, USD 329 billion was invested in renewable energy, which is 4 per cent more than in 2014. Wind power has been a volatile industry, partly due to varying subsidy levels. For instance, Europe has gone from being a superpower in terms of renewable energy investments, with twice the investments of China and the US five years ago, to less than half of what China invests and about the same amount as the US. Despite historic volatility, around half of the world's increase in energy capacity last year consisted of wind and solar power investments.

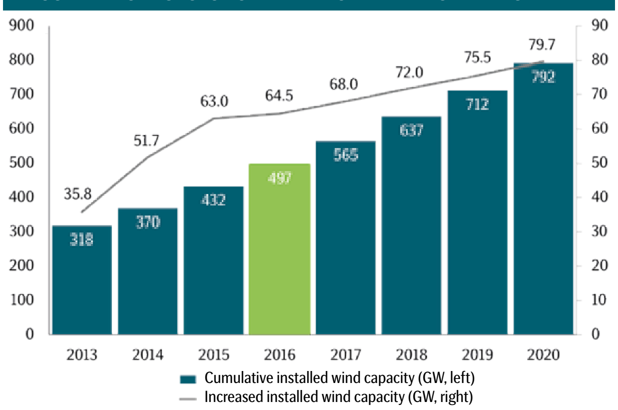
Wind power is far more competitive

Since 2009, wind power equipment costs have fallen by around 20-40 per cent, from USD 1,600 per kilowatt hour (KWh) to around USD 1,200 in the US. Global prices are somewhat lower, at about USD 950-1,200. Prices vary widely depending on the country, wind turbine size and subsidies. From 2000 to 2009, equipment prices increased by about 100 per cent because of higher costs for materials (mostly steel), energy, labour and other factors. Since then, total costs have fallen sharply thanks to lower input costs for materials, robust competition and technological improvements. Meanwhile, efficiency has increased from about 2-3 MW per turbine in the early 2000s to a top level today of about 8 MW. Falling equipment costs and rising efficiency have caused the price of a megawatt hour (MWh) generated from wind power in the US to fall from USD 70 in 2009 to the current price of around USD 23 – about a 66 per cent decrease. Taking subsidies into account, the price is down at around USD 14.

Large cost decreases for renewable energy

For wind power, the price per MWh has fallen by more than 60 per cent globally since 2009, which is largely in line with the US trend. Wind power prices globally have reached an average of USD 25-50 per MWh, making this the most economical of all energy sources under favourable conditions. For solar power, the unit cost has fallen from around USD 350 per MWh to around USD 50-80, a decrease of more than 80 per cent. Recent bidding in the solar power market in the southern US and Dubai has resulted in record lows of around USD 50-60, and over the next few years, a large majority of global solar power will be competitive.

POSITIVE FORECASTS FOR WIND POWER INVESTMENTS



Source: Global Wind Energy Council

The chart shows installed wind capacity globally and annual investments – including forecasts for 2016-2020.

These prices indicate the level at which producers are willing to sell renewable energy. In our analysis of prices, we take into account total lifetime costs of energy sources relative to how much electricity can be generated. Costs such as initial investments (construction and financing), fuel, maintenance, taxes, insurance, degree of utilisation and incentives are all included. However, costs for maintaining backup power systems (in case production fails), transmission and environmental costs are not included.

Production costs per MWh for coal-fired power are around USD 30-70 (cheapest in China), for natural gas USD 40-70 and for nuclear power around USD 90. Prices vary widely in different regions, and coal and natural gas are often cheaper than either wind or solar power, with higher assured delivery. Wind and solar power depend on external factors and cannot be generated 24 hours a day. However, these calculations do not take into account the emissions costs of coal and natural gas, which in all likelihood contribute to the rise in global temperatures. If we also include transmission costs, costs for backup systems, variations in fuel costs over time, emissions of environmentally hazardous gases and nuclear plant disasters, we still arrive at similar results – that is, wind power is competitive in many regions of the world. For solar power, costs generally need to come down a bit further, but in really sunny countries, solar power is competitive. Storing electricity is also an option for better utilisation of solar power, but this is relatively expensive at present.

Forecasts show good growth in the next 5-10 years

During the past decade, installed wind power capacity has grown 22 per cent annually, while the annual capacity increase has grown by 19 per cent. The chart to the left illustrates the market forecasts of the Global Wind Energy Council, an international advisory organisation, for the next five years and the actual totals during the past three years. The forecast for 2016 is 64.5 GW in new installed capacity, a 2 per cent increase in new capacity over last year's record level. During the period 2017-20, annual growth is expected to reach 5 per cent, which means continued increases from previously high rates of growth. This implies that total installed capacity will increase by 15 per cent this year and by an average of 12 per cent in each of the following four years. These forecasts take into account every country's future plans (at present), and indicate that overall annual investment should increase 25 per cent during this period, whereas installed capacity will increase by a total of 83 per cent.

Historically, the industry has been volatile and may remain so going forward, but due to large current order bookings at many wind turbine manufacturers and more competitive prices for wind power production (per MWh and for wind turbines), we are optimistic about the wind power sector. Shares of wind turbine manufacturers have low average valuations as a result of their shaky earnings history. We expect higher valuations in the long term for the sector, due to continuous product improvements and better ability to generate profits (with lower costs in wind turbine production).

Contributors to this issue of *Investment Outlook*

Fredrik Öberg
Chief Investment Officer
fredrik.oberg@seb.se

Jonas Evaldsson
Economist
jonas.evaldsson@seb.se

Esbjörn Lundevall
Equity Strategist
esbjorn.lundevall@seb.se

Henrik Larsson
Portfolio Manager
henrik.y.larsson@seb.se

Helene Cronqvist
Equity Strategist
helene.cronqvist@seb.se

Kai Svensson
Portfolio Manager
kai.svensson@seb.se

Lars Granqvist
Economist
lars.granqvist@seb.se

Christopher Lyrhem
Equity Strategist
christopher.lyrhem@seb.se

Cecilia Kohonen
Investment Communication Manager
cecilia.kohonen@seb.se

Johan Hagbarth
Economist
johan.hagbarth@seb.se

Pernilla Busch
Investment Communication Manager
pernilla.busch@seb.se

Carl Hammer
Chief Currency Strategist
carl.hammer@seb.se

This document produced by SEB contains general marketing information about its investment products. SEB is the global brand name of Skandinaviska Enskilda Banken AB (publ) and its subsidiaries and branches. Neither the material nor the products described herein are intended for distribution or sale in the United States of America or to persons resident in the United States of America, so-called US persons, and any such distribution may be unlawful. Although the content is based on sources judged to be reliable, SEB will not be liable for any omissions or inaccuracies, or for any loss whatsoever which arises from reliance on it. If investment research is referred to, you should if possible read the full report and the disclosures contained within it, or read the disclosures relating to specific companies found on www.seb.se/mb/disclaimers. Information relating to taxes may become outdated and may not fit your individual circumstances. Investment products produce a return linked to risk. Their value may fall as well as rise, and historic returns are no guarantee of future returns; in some cases, losses can exceed the initial amount invested. Where either the underlying funds or you invest in funds or securities denominated in a foreign currency, changes in exchange rates can impact the return. You alone are responsible for your investment decisions and you should always obtain detailed information before taking them. For more information please see inter alia the Key Investor Information Document for funds and the information brochure for funds and for structured products, available at www.seb.se. If necessary, you should seek advice tailored to your individual circumstances from your SEB advisor.

Information about taxation. As a customer of our International Private Banking offices in Luxembourg and Singapore you are obliged to keep yourself informed of the tax rules applicable in the countries of your citizenship, residence or domicile with respect to bank accounts and financial transactions. SEB does not provide any tax reporting to foreign countries, which means that you must yourself provide concerned authorities with information as and when required.