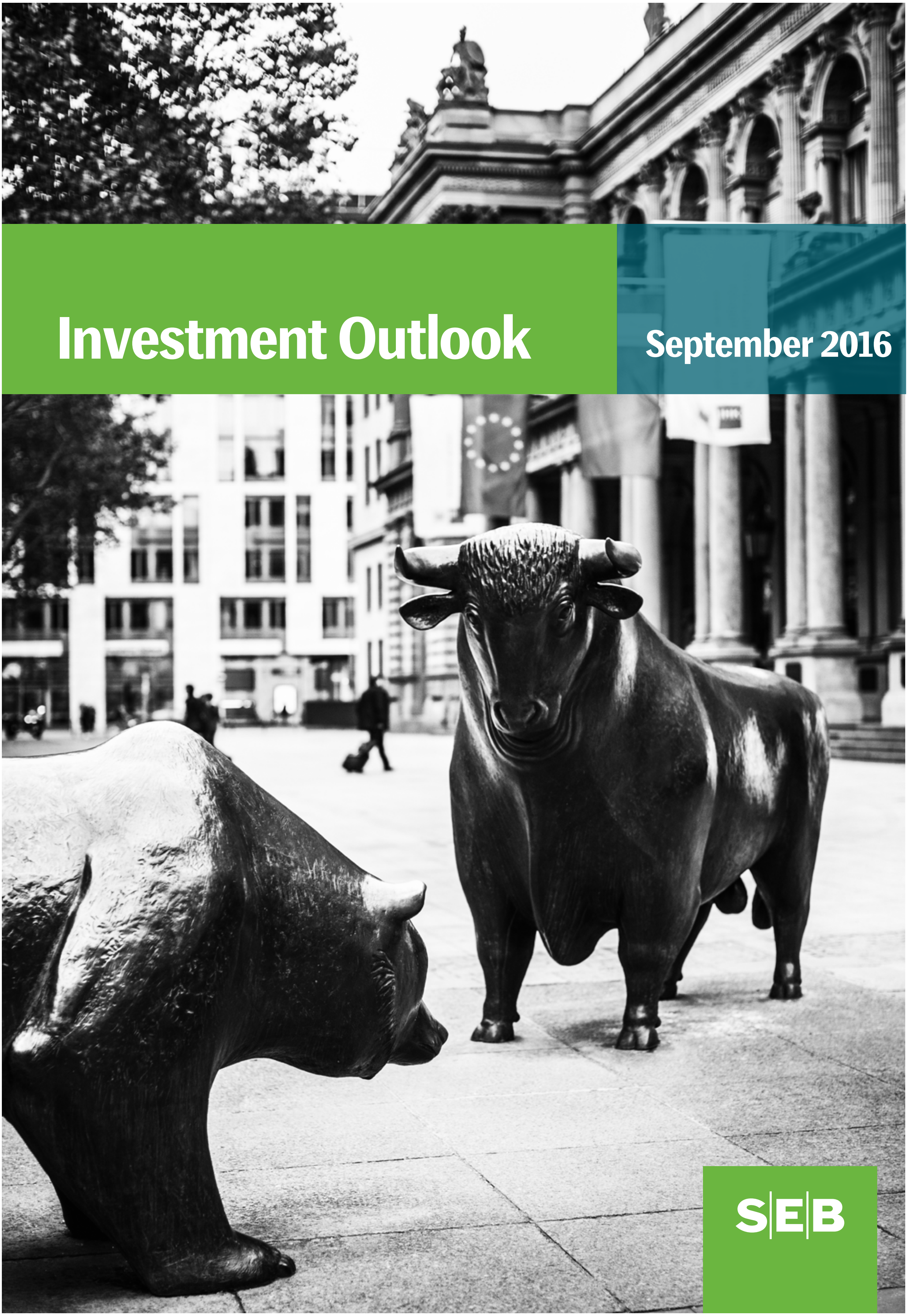
Investment Outlook

September 2016



This report was published on September 13, 2016. The contents of the report are based on information and analysis available before September 7, 2016.

Small market movements despite earlier Brexit turmoil

OUR ANALYSIS AT THE TIME OF the June 23 "Brexit" referendum in favour of a British exit from the European Union was that this event was largely political, not economic. Investors interpreted it in the same way. Risk appetite increased, and financial markets have shown impressive strength after a very negative initial reaction.

There are a number of factors that explain rising risk appetite in the wake of the Brexit vote. Robust economic signals combined with continued aggressive central bank policies are two examples. In addition, the outcome of the latest quarterly report season was more in line with expectations than for a long time.

Offsetting these positive driving forces are continued sluggish economic growth – despite central bank actions – and rising global debt. While second quarter corporate earnings were in line with expectations, they remain relatively flat. However, the state of the commodities sector has improved from the more or less acute situation that prevailed early in 2016.

Valuations of most assets are fairly high in a historical perspective, and among the most costly exposures are European and Japanese government bonds, which in many cases carry negative yields even for long maturities.

Is the prevailing low volatility a sign that investors are underestimating risks, or an indication that things are actually looking better? Will monetary policy fade in importance and be replaced by more fiscal policy measures?

In this issue of *Investment Outlook*, we present our economic forecasts and our expectations on individual asset classes. We also describe how we believe that a portfolio can be composed in order to achieve a reasonable balance between positive and negative market forces.

Returns on European equities are lagging behind returns in stock markets in many other parts of the world. One contributing factor is the financial services sector. We thus take an in-depth look at European banks and examine their potential for a recovery. One industry that is operating under completely different circumstances is gaming companies. Their underlying growth has been impressive. We analyse the industry in a third theme article.

Wishing you enjoyable reading,

FREDRIK ÖBERG
Chief Investment Officer, Private Banking

Market view
Summary

We continue to advocate a somewhat cautious approach, even though our forecasts for the coming year in the table below are mainly positive. Our approach remains a balancing act between negative concerns and positive expectations.

On the one hand are sluggish real global growth rates, weak earnings and sales growth in the corporate sector and high valuations in a historical perspective. On the other hand are still-aggressive central banks, hopes of faster economic and earnings growth ahead and – especially – the fact that investors are continuing to be driven from their defensive current position towards greater risk-taking.

Prices of "low-risk" fixed income investments are record-high, which may be driving investors to take risks in search of returns.

One should also keep in mind that the upward economic cycle, measured as a positive stock market trend, has been under way since 2009. In other words, it should be approaching its end. The question is whether this is a traditional cycle, or whether it is a period in which central banks and their monetary policies have changed the economic rules of the game. If this is the case, fiscal policy measures might help extend this cycle or period for another while, assuming yearly global economic growth of around 3 percent.

ASSET	WEIGHT	TACTICAL EXPECTATION (12-MONTH)	
		RETURN	RISK
EQUITIES			
Global equities	1 2 3 **4** 5 6 7	5.5 %	14.3 %
Emerging market (EM) equities	1 2 **3** 4 5 6 7	6.7 %	17.1%
Swedish equities	1 2 3 **4** 5 6 7	9.1 %	14.7 %
FIXED INCOME			
Government bonds	**1** 2 3 4 5 6 7	-0.7 %	2.6 %
Corporate bonds, investment grade (IG)	1 2 **3** 4 5 6 7	1.6 %	2.8 %
Corporate bonds, high yield (HY)	1 2 3 4 **5** 6 7	5.3 %	4.9 %
Emerging market (EM) debt	1 2 **3** 4 5 6 7	7.4%	11.7 %
ALTERNATIVE INVESTMENTS			
Hedge funds	1 2 3 **4** 5 6 7	N/A	N/A
Commodities	1 2 **3** 4 5 6 7	N/A	N/A
CURRENCIES			
CURRENCY PAIRS	**FORECAST ON AUG 31, 2016**	**Q3 2016**	**Q4 2016**
EUR/USD	1.11	1.10	1.08
EUR/SEK	9.52	9.60	9.30
USD/SEK	8.55	8.73	8.61

"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 August 17, 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.

IN THE LAST ISSUE OF *Investment Outlook* (published in June 2016), we advocated a reduction in risk-taking, among other things because of sluggish economic growth and Brexit risks. This was a correct strategy, even in the days following the Brexit referendum. Looking at the period as a whole, it would have paid off to have had a somewhat higher risk exposure.

We are sticking to our recommended asset allocation, that is, a risk level just below neutral. The following is a review of factors that will influence future developments.

Central banks: Continued low interest rates and stimulative securities purchases, except in the United States, where there is a risk of underestimating the Federal Reserve (Fed)'s planned interest rate hiking cycle. Potentially more aggressive Fed action would risk generating market turbulence and putting new pressure on the commodities sector via a stronger dollar.

Growth and earnings: We expect some improvement next year, but the risk is that the global economic growth rate will remain at around 3 percent. Thus it is also risky to have very high earnings growth expectations. One change that might occur is a gradual transition to more aggressive fiscal stimulus measures, which would reduce downward pressure on interest rates and yields. However, one problem is that the countries with the greatest needs also have the least room for fiscal stimulus.

Valuations: One effect of record-low interest rates and an unimpressive earnings cycle in recent years is that valuations of financial assets have gradually risen to relatively high levels. However, equities and credits remain a better bargain than government bonds.

Risk appetite: Indicates whether the period behind us was euphoric in the sense that risk exposure was excessively profitable (as in 1998-2000) or the opposite (2008-2009). Today's signal is neutral and provides no guidance when looking at all asset classes. However, this method is signalling danger for such assets as European sovereign debt.

Expected returns: As indicated in the table on the previous page, we continue to expect positive returns over the next 12 months, but they are lower than the historical average.

Risks: With a rising capital market trend since 2009, there are plenty of risks; a potentially weaker economy, the high level of global debt, the pricing of financial assets and expected US interest rate hikes are consequences of these.

To sum up all the above factors, we find it appropriate to maintain a moderate risk exposure. This means we will remain slightly underweighted in equities and overweighted in credits in our fixed income sub-portfolios. In global equities, we are still overweighted in European and Asian stock exchanges. In alternative assets, we have a broad diversification among various hedge fund strategies.

OUR PORTFOLIO MANAGEMENT – ASSET ALLOCATION

- A little less risk than usual, underweighted in equities and overweighted in credits and alternative investments.
- Positive forces: central banks, relative valuations, expected returns in a 12-month perspective and a potential increase in the economic growth rate.
- Negative forces: sluggish current GDP and earnings growth, global debt, potential Fed rate hikes and a period of strong performance behind us.

GLOBAL EQUITIES

- A return forecast of 5-6 per cent this coming year, based on a corporate earnings upturn during the second half of 2016 and continuing into 2017.
- This forecast is a bit subdued because stock exchanges have already performed well.
- We expect interest rates to remain low, thus enabling stock market valuations to remain high.
- Emerging markets will experience a mini-cyclical upswing due to higher commodity prices and a stable China. We view this as a rebound after an excessively large earlier downturn.
- European earnings growth looks good, except in the banking sector and in oil and gas.

SWEDISH EQUITIES

- Stockholm's OMXS30 index recovered 90 per cent of its Brexit-vote decline in 4 days.
- Cyclical sectors are showing strength.
- Negative risk-free interest is forcing investors into the stock market.
- Second quarter company reports were better than expected, but worse than last year.

FIXED INCOME INVESTMENTS

- The Riksbank will not cut its repo rate again, but has further postponed its first rate hike.
- The European Central Bank is awaiting new data and will leave its refi rate at 0 per cent.
- The Fed is aiming at a hike before year-end.

ALTERNATIVE INVESTMENTS

- Trendless uncertainty prevailed ahead of the Brexit vote.
- Volatility provided new investment opportunities.
- Stable trends this past summer.
- Oil prices are ever-closer to equilibrium.

Market view

Macro – Central banks helping to offset political risks

Since the last Investment Outlook *(published in June 2016), political uncertainty has increased while the economic picture has stabilised. One source of political worries is the Brexit process, which will mainly have political consequences. These effects may be significant unless the negotiations go well; the entire EU project may come under pressure. The US presidential election may thoroughly rattle financial markets this autumn, while new terrorist acts and the political disarray in Turkey are a source of concern. However, we expect a benign outcome from the Brexit process and a Hillary Clinton victory in November. All else being equal, this should provide stability to markets.*

In economic terms, this past summer brought the prospect of some speed-up in growth, and it remains to be seen whether these hopes will finally be realised. The US economy is now showing clear signs of acceleration, while Chinese growth appears to be gliding into a calm slowdown, Europe continues to make modest progress, while the situation in emerging market countries is stabilising as commodity prices move slightly higher. The major central banks are also showing great sensitivity to the need for measures to help sustain growth. We do not yet foresee a traditional increase in economic activity (meaning a boom). Because of demographic headwinds, slower productivity growth and a huge mountain of debt, we will probably have to become accustomed to substantially slower growth rates ahead. A "low-everything environment" – with slow growth, low inflation, low interest rates and lower returns on risk assets – is probably about to become the new normal.

US – improving climate forecast

The traditionally weak first quarter was followed by an equally pale second one, but the latest statistics have been more encouraging. Stronger indicators, help from financial markets in the form of lower interest and exchange rates and less drag from the oil industry suggest good growth acceleration in the second half. Because of relatively high saving (room for consumption to increase) and a robust labour market, households are likely to keep driving growth, while manufacturing has left its recession behind. The labour market will remain strong. We expect a tighter job situation, implying that wage inflation is likely to accelerate. Due to faster growth, core inflation will also rise. We thus expect another key interest rate hike in December, followed by two increases each in 2017 and 2018. This is higher than consensus forecasts but is well justified, given the strength of the economy and the tightness of the labour market. This autumn's presidential election will generate headlines and potential market turbulence. Because of Donald Trump's recent media setbacks, we expect a Hillary Clinton victory in November and this is the basis for our forecast.

Euro zone – Consumers defy storm clouds

There is no shortage of challenges and storm clouds in the euro zone, especially political ones. Yet economic developments continue moving in the right direction. As earlier,

PURCHASING MANAGERS INDICATE CONTINUED GROWTH

Source: Macrobond, SEB

After the situation improved in the manufacturing sector, the overall picture (including a strong service sector) has again become positive according to US purchasing managers' indices. Historical associations are clear, and we anticipate an economic acceleration this autumn.

PAY HIKES ARE ACCELERATING

Source: Macrobond, SEB

After a long period of job growth, the US is approaching equilibrium unemployment – the level at which labour shortages emerge. We expect a continued strong labour market, which means that wage and salary growth will probably rise from low levels, an important factor for the Federal Reserve and future Fed interest rate hikes.

households are the main driver, thanks to job growth and rising asset prices. Partly due to relatively low resource utilisation, the European Central Bank (ECB) can continue its very expansionary monetary policy for a long time, but subdued global growth and persistently weak industrial production are holding back GDP increases, while a high share of bad loans in the euro zone banking sector risks limiting the supply of capital to companies, making business investments harder. In geographic terms, weaker performance in France and Italy (which has the weakest banking sector) is being offset by healthy growth in Spain and to some extent Germany. In the overall euro zone, we expect stable and decent growth in 2017-2018, but far from a boom. Brexit will mainly pose political risks, whose effects are examined on page 9.

Japan – Stimulus measures amid headwinds

Despite yet another large stimulus package, the Japanese economy is continuing to perform sluggishly. Without help from global demand, domestic structural problems will again dampen economic growth. Due to clear demographic headwinds, a lack of structural reforms and a long-lasting deflationary environment that hurts the propensity to consume as well as invest, growth will be pushed towards zero in the next few years. But the corporate sector is performing well, although a stronger yen is squeezing some areas of manufacturing.

China – Near-term focus, long-term worries

China's economy continues to grow at a healthy pace, while risks of weaker performance have decreased, at least in the short term. Official support, mainly via monetary policy, has provided a floor but has not speeded up growth. Fiscal policy is now expected to take over via government investments, but that effect will also fade and growth will decelerate at a controlled pace. Services remain the engine of the economy, with growth driven by a stronger labour market rather than higher productivity, in line with official targets. But there is a risk of goal conflicts; the desire to meet ambitious growth targets may hamper necessary long-range reforms. One clear example is the credit market, whose short-term expansion poses a risk to long-term stability. This is the biggest risk now that the housing market is improving, but we expect that the authorities can manage the risks arising from excessive lending, especially to inefficient state-owned industrial firms.

Emerging markets (ex China) – Commodity storm fading

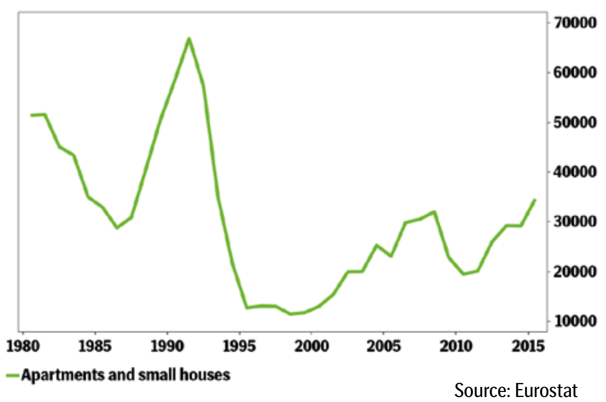
In other emerging market (EM) countries, the picture remains mixed, although gaps between strong and weak economies are narrowing. In particular, commodity-dependent problem economies are now seeing the light at the end of the tunnel, due to the stabilisation of oil and other commodity prices. Another positive factor in Russia is lower inflation, which is slowing the decline in private consumption while industry is bouncing back. In Brazil, too, negative GDP growth will turn positive next year, with exports providing help after a sharp currency depreciation. But looking ahead, growth rates will be modest for both countries as well as other commodity-dependent economies.

Elsewhere in the EM sphere, the picture is generally brighter. India is still growing fastest, driven by private consumption. Also helping to maintain India's growth rate will be some important reforms, such as a long-awaited national goods and services tax (GST). In other Asian economies, the picture is generally stable and growth is good. The same applies to countries like Poland, the Czech Republic and Hungary, where domestic demand and a decent export outlook (with Germany as the main trading partner) will ensure growth.

Nordics ex Sweden – headwinds subsiding

The Nordic countries (excluding Sweden) are struggling with various headwinds, but their growth prospects look set to improve. In Norway, the negative impact of sharp cutbacks in the oil industry is likely to fade. Due to loose monetary policy and the resulting weaker krone, as well as stimulative fiscal policy, growth bottomed out last winter. The recovery is hampered, however, by a continued

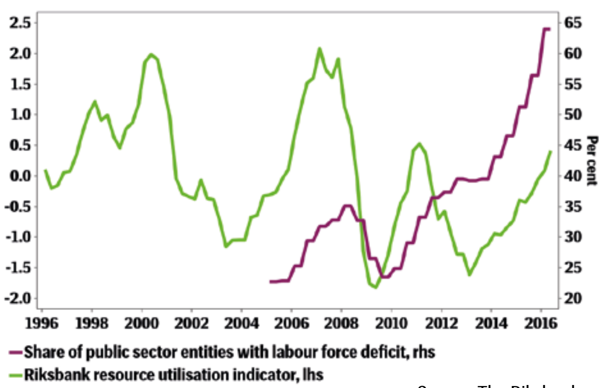
EURO ZONE HOME PRICES CLIMBING



Source: Eurostat

Job growth, low interest rates and rising real incomes due to low inflation are benefiting households. This is reflected in home prices, most clearly in those countries with the fastest economic growth.

RESOURCE UTILISATION SUGGESTS HIGHER KEY RATE



Source: The Riksbank

Historical associations between resource utilisation and inflation suggest higher interest rates. But the weak global economy and price trend, along with Sweden's ability to import labour from other EU countries, will hold back inflation. The Riksbank is thus likely to keep interest rates low for at least one more year, in order to weaken the krona and thus import a little inflation.

decline in oil investments and weak private consumption. We expect a sustained, cautious upturn. In Denmark, the economy is recovering after a weak 2015. This process is unexpectedly slow, but because of a decent pace of private consumption along with rising capital spending, growth will accelerate to a relatively good level next year. Finland has grappled with the biggest economic problems, but here too the situation is becoming brighter. The labour market, consumer confidence and the construction market are positive forces. Yet prolonged recession has left its mark, for example in the form of a weak labour market. Weak public finances are another reason why economic improvement will occur at a slow pace.

Sweden – Rapid growth for another while

As a result of weaker-than-expected exports during the first half, we are adjusting our 2016 growth forecast for Sweden downward. However, we expect continued good growth – among the highest in Europe. Growth is being driven mainly by a sharp upturn in housing construction and strong public consumption due to last year's refugee arrivals. These effects will fade in 2017-2018, leading to a slowdown, but growth will remain strong. The labour market has also performed strongly, leading to a tighter resource situation. On the other hand, due to international conditions, inflation pressure will remain low next year, falling short of the Riksbank's 2 per cent target. Combined with continued expansionary monetary policy in other countries, we expect the Riksbank to extend its bond purchasing programme until next summer and postpone its rate hikes until autumn 2017.

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

- Growth is stabilising in China and looks set to accelerate in the US, but lower recession risks are largely discounted in share prices.
- Political risks have increased: Brexit, the US election, geopolitical tensions.
- Brexit-vote effects on the economy have been less than expected – so far – and thus not on the market's radar. They may reappear next year as negotiations begin.
- The US presidential election may again cause market turbulence. The outcome is uncertain, but Clinton is favoured.
- More and more observers are talking about "secular stagnation" – long-term slow growth – which pushes down interest rates, bond yields and corporate earnings growth. Does it justify higher valuations?
- Continued central bank stimulus measures are needed in Europe and Japan, while the Fed's next rate hike is approaching.
- EM economies have stabilised, thanks to commodity prices and the Fed. Problem countries are rebounding, but risks remain.

GDP – YEAR-ON-YEAR PERCENTAGE CHANGE	2015	2016 (F)	2017 (F)
United States	2.6	1.6	2.4
Japan	0.5	0.5	0.5
Germany	1.7	1.7	1.6
China	6.9	6.6	6.3
United Kingdom	2.2	1.7	0.9
Euro zone	1.7	1.6	1.7
Nordic countries	2.2	2.1	2.0
Sweden	4.2	3.7	2.8
Baltic countries	1.8	2.2	2.8
OECD	2.3	1.7	2.0
The world (PPP)*	3.1	3.1	3.5

Source: SEB Research & Strategy, *Nordic Outlook*, dated August 2016.

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

Theme – Brexit follow-up

More challenging for politicians than investors

Until the British referendum on continued EU membership, most observers agreed on two things: The Remain side would win, and if – against all odds – the Leave side won, the negative impact would be big, especially in financial markets. British voters supported Leave (or "Brexit"). Aside from a much weaker pound, the market impact largely failed to materialise. The London Stock Exchange is even higher today than before the referendum. How is this possible?

There are several explanations for the market's optimism. Although we were wrong about the outcome of the referendum, our assessment that Brexit is primarily a political issue, with manageable economic and financial market effects, seems to have been correct. After a brief period of paralysis, British politicians delivered relatively clear signals on a way forward, which calmed the markets. Several major central banks have also expressed their readiness to provide more stimulus if required, while economic signals – especially from the US – have brought upside surprises.

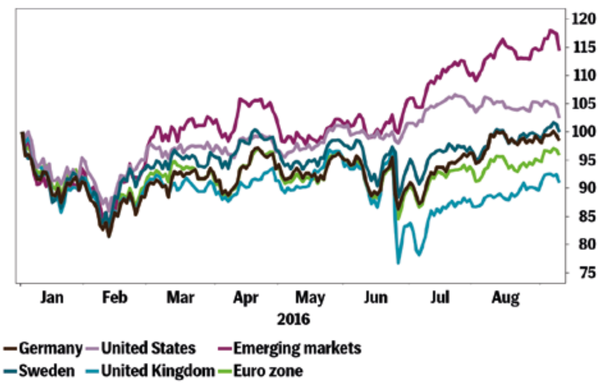
As for the political process, to begin with it seems plain that the United Kingdom will leave the European Union, given the clear signals from the newly appointed prime minister, Theresa May. The difficult process of implementing British withdrawal will formally begin when the UK submits its application. We expect this to happen early next year, well before the spring presidential election in France. If the process takes the planned two years, withdrawal will occur at New Year 2019 (a year-end is appropriate timing), ahead of the spring 2019 European Parliament elections. However, there is a clear risk that the process will take longer, given its great complexity.

The negotiations risk becoming difficult. EU political leaders face tough decisions, not least driven by growing EU- scepticism and nationalism in various member countries. Pursuing too hard a line against the British will not benefit future cooperation and trade, while an overly generous agreement risks signalling the possibility of a "successful" exit for other countries as well.

The basic problem centres on the EU's four freedoms; freedom of movement within the union for goods, services, capital and people. The referendum campaign dealt largely with the immigration issue; the British are unlikely to accept all four freedoms. Among various models for the UK's future relationship with the EU illustrated below, we thus view the Swiss model as the most probable.

We nevertheless expect a relatively positive outcome from the negotiations, not only with the EU but also regarding trade agreements the British must conclude with such partners as the US and China. Along with positive growth effects from a weaker pound and further Bank of England stimulus measures, plus the government's explicit ambition to make the UK "super-competitive", we expect the negative impact on the UK economy to be relatively manageable and mainly short-lived. The impact on the euro zone economies will thus be almost negligible. This also means that the market effects of Brexit are behind us, although this scenario may change rapidly in case of hitches in the negotiating process over the next couple of years.

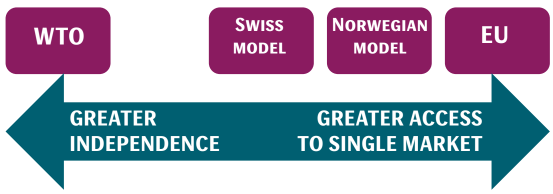
RAPID STOCK MARKET RECOVERY



Source: Macrobond

After an initial stock market shock, central bank support, economic optimism (in the US) and political clarity in London helped exchanges quickly shake off post-referendum turmoil. Among the summer's stock market winners, aside from EM exchanges, is the London Stock Exchange.

THE BRITISH WILL KEEP COMPANY WITH THE SWISS



Norwegian model: Member of the European Economic Area (EEA), which provides nearly full access to the single market, but Norway must fully accept the EU's four freedoms while also contributing to the EU budget.
Swiss model: Various bilateral trade agreements provide partial access to the single market in exchange for a small contribution to the EU budget.
WTO model: Member of the World Trade Organisation (WTO).

Source: SEB

The British are not likely to accept the freedom of movement of people, which prevents a Norwegian model relationship with the EU. A solution similar to that of Switzerland, along with favourable trade agreements with other major countries, is emerging as a both plausible and sound solution.

Global equities

Search for returns is pushing up markets

Although this summer's price surge was driven by stronger economic indicators, a reduction in large cash reserves and the firm conviction among investors that the world's central banks will provide continued support to the market have also fuelled stock market upturns. Global equities have a lot to recommend them in the current low interest rate environment, which offers few alternatives in the search for returns, but corporate earnings growth still looks sluggish and we believe that analysts' forecasts are too high. Due to the risk of downward earnings adjustments, combined with high valuations and the recent rally, we are adopting a cautious attitude in the near term.

- Good price increases this summer as investors boosted their risk, triggered by the Brexit vote. Market participants reduced their large cash reserves, benefiting equities in particular.
- Emerging market (EM) equities have pulled ahead of developed markets (DM) counterparts after years of sluggish growth. Brazil is this year's stock market winner, driven by rising commodity prices and hopes of political reforms.
- Global consumption and service sectors are showing good growth, and the new shopping and travel habits of Chinese consumers are creating investment opportunities throughout Asia.
- Global equities are trading at a high price/earnings ratio of 16 (based on 12-month forecasts) and companies will show only marginal earnings growth this year.
- The risk of downward adjustments in earnings estimates, combined with high valuations, suggests a slight underweighting of equities in the near term.
- We are focusing on undervalued European equities in our portfolios. Among EM equities, we prefer Asia.

THE SUMMER BEGAN WITH SHAKY markets and worries about the British referendum on possible exit from the EU ("Brexit"). Share prices fell steeply after voters chose Brexit, but since then prices have climbed steadily upward. Large fluctuations and long-time economic uncertainty had led to low risk-taking in investors' portfolios. After the Brexit vote, they increased their risk, boosting equity holdings from neutral to overweight. The market also received support from stronger global indicators that point to stability, and from a firm conviction among investors that central bank actions will remain supportive of equities.

The second quarter report season must be described as mediocre, but divergences from low expectations were quite small, which the market interpreted favourably. Weak sales and earnings growth indicates continued slow global GDP growth and marginal earnings growth in 2016. In Europe, companies with a high proportion of sales in EM countries showed clear improvement after three weak years. Earnings estimates in cyclical sectors were revised downward, while health care and consumer durables companies saw projections of their future earnings revised upwards.

Global equities are trading at a P/E ratio of 16 (based on 12-month forecasts), which is high from a historical perspective. The US market P/E ratio is 19, thereby pulling up the average. Meanwhile shares in EM countries excluding China are trading at 14 and in China at 13 times expected earnings. Because of the strong price upturn, the EM discount to the world index has shrunk but is still wider than the historical average. European and Japanese firms are midway between US and EM companies in terms of valuations. US earnings are expected to grow by 1.5 per cent in 2016, then accelerate greatly next year to 13 per cent growth. The best earnings growth in 2017 is forecast for energy and commodities, though from a lower base than in the past since these companies have been struggling for several years. Earnings of consumer-related companies as well as pharmaceutical, IT and industrial firms are expected to grow at a healthy 10-12 per cent in 2017.

Emerging markets at the top

Emerging markets have enjoyed a powerful tailwind this year. At the top is Brazil's Bovespa index, with a return of more than 30 per cent in local currency since January. Meanwhile the Brazilian real has gained 20 per cent against the US dollar this year, boosting returns for foreign investors. Brazil's economy is heavily dependent on commodity price trends.

EM EQUITIES PULL AHEAD OF DM AFTER SEVERAL SLUGGISH YEARS

Source: Bloomberg

The world equity index has risen 6 per cent in local currencies so far this year. Emerging markets, led by countries like Brazil and Thailand, have outperformed developed markets. US equities are showing somewhat better returns than European ones. The worst performers have been Japanese equities (in local currency). Energy and commodities are at the top, while the banking and financial sector is the big loser. Health care has also struggled.

Rising commodity prices this past spring, combined with investors' renewed interest in the EM countries and hopes of political reform ambitions with a new president in charge, have fuelled the stock market. But Brazilian economic data are unimpressive and the commodity price surge may well be over this time around. There is a risk that large flows of foreign capital that were attracted to Brazilian equities may turn into outflows when hopes of political reform and higher corporate earnings are not met. We thus have a cautious approach to Brazil at present.

Asian stock markets are more attractive than Latin American ones. In Asia there is still good potential for long-term growth, and the corporate earnings outlook is better. Stock markets have performed sluggishly for several years, and valuations thus appear attractive compared to advanced economies. The outlook for companies that sell products and services to consumers is especially bright. Demand for expensive brands and various types of services is increasing as wages rise.

Asian consumers on the march

But to ensure that EM stock markets keep performing well, the US Federal Reserve must not raise its key interest rate faster than expected, which would lead to a stronger dollar and have negative consequences for EM countries. Lower commodity prices may also hamper economic growth in the EM sphere, since many countries are commodity exporters and are dependent on price trends. The Chinese yuan must not appreciate too much either, thereby dampening economic activity. There are extraordinarily good opportunities to find attractive investments in China and elsewhere in Asia as these countries gradually shift from investment-led to consumer- and service-led growth. Companies in sectors like media, the internet and health care will show high growth, as exemplified by the Chinese market for mobile phone advertising, which has rapidly grown to number two in the world after the US. Chinese tourism is growing by 25-30 per cent yearly and is having a positive effect on everything from Japanese duty-free stores and South Korean cosmetics manufacturers to airport operators in Thailand, Australia and New Zealand. Chinese tourists are generating investment opportunities throughout Asia, highlighting China's obvious shift towards a consumption-led economy.

European exporters should benefit

Stock market performance in Europe has been disappointing this year, largely due to lower-than-expected earnings growth for banks, which weigh heavily in the index. Macro data for Europe are promising, though, and the impact of Brexit on earnings is likely to be marginal. We are continuing to overweight the region in our portfolios, since earnings growth and valuations are attractive compared to the US and Japan. The actions of central banks will be supportive, and further monetary policy measures will weaken the euro and benefit exporters. European companies export a larger proportion of their products and services than their US counterparts.

US listed companies have delivered positive returns this year. Macro data look fairly good, purchasing managers have faith in a brighter future and earnings are rebounding. Corporate margins have reached record levels after cost-cutting and efficiency improvements. Margins may thus be difficult to maintain. However, the US is viewed as a safe haven when times are tough. The shareholder-friendly climate and the large percentage of companies that show stable earnings and high returns on equity will always attract investors in turbulent periods. However, European and Japanese stock markets should outperform the US market if inflation and growth accelerate.

Near-term uncertainty

Aggressive central banks, record-low interest rates and large cash reserves among the world's investors will favour global equities. On the other hand, there are earnings forecasts that should be adjusted downward from current levels, while valuations are historically high and there is political uncertainty this autumn. We have a cautious attitude towards equities in the short term after their post-Brexit rally. Near-term political uncertainty, such as Italy's constitutional referendum in October and the US presidential election in November, may also impact the stock market. If we move past these obstacles without unpleasant surprises, we expect late 2016 and early 2017 to be positive for global equity markets.

LOW RELATIVE VALUATIONS STILL FAVOUR EM EQUITIES

Source: Bloomberg

The chart shows how emerging market (EM) equities became cheaper than developed market (DM) ones after a multiple expansion in 2006/2007 and a short-lived rally following the autumn 2008 financial crisis. EM shares are trading at a discount to DM shares despite this year's rally. Actually this is because DM shares have become expensive. In valuation terms, EM shares remain in line with their 10-year average.

"NEW" CHINA IS GROWING NICELY

Source: Bloomberg

Old, traditional companies in China – such as public utilities, industrial firms and the banking and financial sector – are showing slow growth. What instead looks attractive and should drive future economic growth is fast-expanding new sectors like digital media, IT, entertainment, travel, renewable energy and health care. The authorities will actively promote these sectors during the coming decade in order to change China's economic profile and help improve the environment.

Nordic equities

Faith, hope and monetary policy

In the absence of corporate earnings growth, investors this year have found comfort in hopes of a better economy in 2017, an expectation clearly demonstrated by their partiality to cyclical sectors, and in the fact that returns on many other investments are non-existent or even worse. Second quarter reports this year revealed a deterioration in earnings, but they were still better than expected after the sharp downward revisions in earnings forecasts early in the year. Stock market anxiety about the United Kingdom's surprising decision to leave the European Union was extremely short-lived. We expect a continued strong focus on monetary policy this autumn.

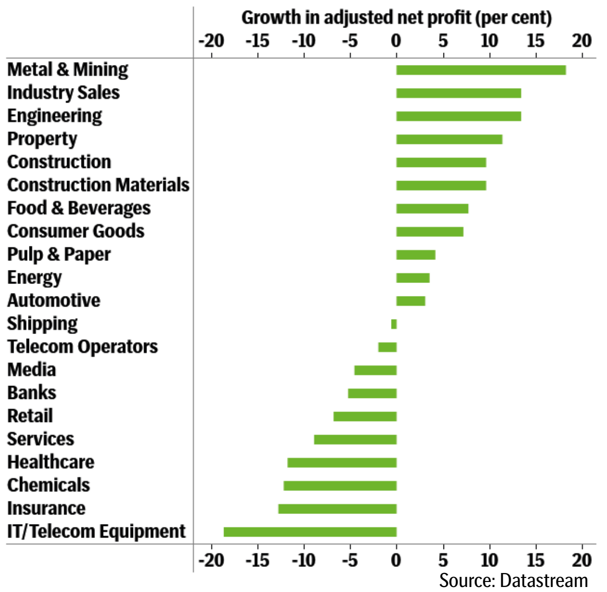
- The OMXS30 index in Stockholm recovered 90 per cent of its Brexit plunge in four days.
- Cyclical sectors are showing strength in stock markets.
- Negative risk-free interest rates are forcing capital into the stock market in search of returns.
- Second-quarter corporate earnings reports were better than expected, but worse than last year.
- Banks and insurance companies offer attractive dividend yields.

INVESTORS HAVE BEEN PARTIAL TO EQUITIES in "cyclical" sectors for six months now. Macroeconomic signals during the same period have been mixed. At a large investor seminar held recently by SEB, in which senior executives representing seven of Sweden's biggest industrial corporations presented their respective company prospects, the picture was clear; no weakening in overall demand is foreseen, but there will be no improvement either. To boost earnings going forward, companies need to achieve efficiency gains, cut costs, make acquisitions and innovate, at least if we are to believe their own executives. From the perspective of these companies, any improvement in the market – that is, a global upswing in industrial output – would be icing on the cake. We wonder whether such a scenario is sufficiently positive to keep them in investors' good graces over the next year. Stronger economic growth than signalled today by leading indicators, such as purchasing managers' indices, is probably needed to sustain earnings growth for the rest of the year. Expect increased investor interest in early economic indicators during the autumn.

What kind of Brexit?

The very surprising news that the United Kingdom intends to leave the EU jolted European stock markets on June 24 (a holiday in Sweden). In Stockholm on Monday, June 27, the stock market saw one of its worst-ever declines: 8.4 per cent. Yet investor anxiety dissipated almost as quickly as it had appeared, and the Stockholm exchange recovered nine tenths of this drop by the end of the week. As of September 7, the OMXS30 index stood one per cent higher than the day before the Brexit referendum. One explanation is that the effect of the Brexit vote on real economic growth is, despite everything, relatively modest in a global perspective, and most large listed companies today are global. However, it is also probably just as important that, after the many crises in recent years – especially those linked to the euro zone – financial markets have great confidence in central banks' willingness and ability to tackle and remedy various troublesome situations by means of new monetary stimulus measures. Economists and investors have also recently intensified their discussion about the possibilities and benefits of supplementing the unprecedented monetary stimulus pursued for almost eight years with additional fiscal stimulus measures. Speculation about such fiscal stimulus was probably another reason why optimism about commodities and industrials bounced back so quickly after the Brexit-related market slide. Immediately after the slide, which during the first two trading days pulled down all types of companies and sectors, investors mostly bought shares in defensive sectors such as food, tobacco and telecom operators. However, interest shifted relatively quickly back to more cyclical sectors.

CYCLICAL SECTORS HAVE OUTPERFORMED THE STOCK MARKET



The chart shows the percentage change in share prices by sector this year to August 24. There is a clear pattern, with the increase for more cyclical sectors indicating faith in better general economic performance going forward.

Cheap banks in search of a catalyst

One sector that was hit especially hard during the market slide following the Brexit referendum, and which still appears relatively depressed, is banking. Before the Brexit vote, we had hopes that a return to zero key interest rates in Sweden (from today's negative rates) in the not too distant future would help boost investor interest in Swedish bank shares as early as this year (although at that point an interest rate hike was expected in 2017). Because of Brexit, the timing of such a change has been delayed and the current period of sharply lower profitability due to negative interest rates has been extended, which is detrimental to the earnings potential of commercial banks. Banks stand out with their attractive share valuations, particularly since a dividend yield of 5.6 per cent plus buybacks for 2016 and a projected dividend yield of almost 7 per cent for 2017 are appealing to investors. Unfortunately, we must note at the same time that it is difficult to identify any catalyst for revaluations in the near future. As we emphasise in our theme article on European banks, share prices for Nordic banks are also closely correlated with the performance of the European banking sector as a whole.

Ensuring a good dividend yield

Another unfashionable sector that stands out with its good dividend yields is insurance. In the Nordic stock market, the insurance industry is almost totally dominated by stable casualty (non-life) insurance companies, while life insurance companies – which are sensitive to interest rates – are languishing. Although the casualty insurance industry in the Nordic countries provides little growth to speak of, its earnings are stable and cash flow is strong. All the listed casualty insurance companies that we follow have solid balance sheets, allowing for a relatively reliable distribution of large dividends to shareholders. If we exclude life insurance companies from our overview of dividend yields by sector, insurance companies look even more attractive, with a dividend yield of almost 6 per cent for 2016. We are puzzled as to why these qualities are not attracting more interest among investors today.

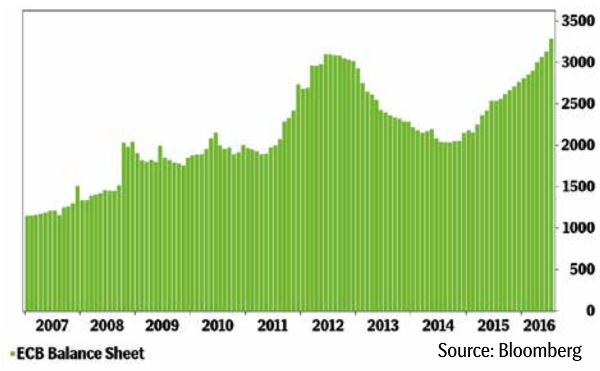
Better than expected, but worse than last year

Second quarter corporate earnings reports for Swedish and other Nordic companies were generally somewhat better than expected, but remain worse than in the year-earlier period if we only focus on earnings growth. Nonetheless, these reports caused analysts to revise their overall 2017 earnings forecasts upwards by 1.5 per cent. For cyclical sectors such as industrials, commodities and oil, 2016 earnings forecasts were also revised upwards. This group currently shows a clear turnaround in forecast revisions, following sharp downward revisions early in the year. We also still expect continued earnings growth in 2016: 5 per cent in Sweden and 2 per cent in the other Nordics. For 2017, we still foresee solid earnings growth, about 11 per cent in Sweden and the other Nordics, but in light of the large downward revisions in recent years, we are naturally concerned that this forecast will also be revised downward before we have achieved that target. If these forecasts are accurate and companies deliver as expected, total Nordic stock market returns should be very competitive over the next year, 14.5 per cent, with unchanged earnings multiples and essentially unchanged earnings growth for 2018 (we expect 11.7 per cent for the Nordics in 2018). However, in order for this to become a reality, better macroeconomic support is needed than leading indicators are signalling today.

The importance of monetary stimulus measures cannot be overestimated

No matter how much we try to dig up anomalies in valuations between different companies and sectors, worry about the lack of growth but hope for and predict an improvement before long, or try to assess various political risks, there is nothing more important for the big picture than central bank actions. The banks' extraordinary monetary policy measures are probably the single most important factor behind the stock market's relatively good performance in recent years. For instance, the European Central Bank's aggressive bond purchasing programme has helped expand its balance sheet to more than EUR 1.1 trillion since early 2015, almost as much as the entire market capitalisation of all the Nordic

ECB IS PUMPING MONEY INTO CAPITAL MARKETS



The chart shows the ECB's balance sheet in billions of euros. When central banks buy bonds, other investors are forced into different asset classes.

SWEDISH DIVIDEND YIELDS FARING WELL AGAINST COMPETITION

The chart shows the expected dividend yield (12 months forward) for the OMXS30 index over the past 10 years. The current dividend yield of 4.1 per cent is a fairly normal level in a short-term historical perspective, but very competitive in relative terms now that the risk-free interest rate has turned negative. As a result, despite weak earnings growth and the Brexit referendum outcome, the stock market has managed to attract investor capital.

companies that SEB tracks today and equal to 24 times the market cap of Sweden's largest listed company, Hennes & Mauritz. When central banks buy such extraordinary quantities of relatively low-risk bonds, other investors are forced to take greater risks, for example by investing in high-risk bonds, real estate or equities. Many investors are also forced to purchase assets that generate returns in order to meet their own obligations, such as pensions. When central banks create these enormous volumes of new money and traditional investment products essentially disappear from the market, that has a great impact on the stock market and how the capital market functions.

Understanding this situation is probably critical to understanding the recent performance of the Nordic stock exchanges. In a large monthly survey of how institutional investors are positioned, conducted by Bank of America Merrill Lynch prior to the UK referendum in June, we saw that these investors had a record level of liquid assets in their portfolios. In itself, a high level of cash is a sign of risk aversion but historically has often signalled record stock market lows, since it reflects how the investor community is already positioned for the worst. We thus believed that a Remain vote in the UK referendum would increase share-related buying pressure among investors who are underexposed to equities, which rally when political risk eases – although the same survey indicated that investors were concerned about both valuations and the general economic trend.

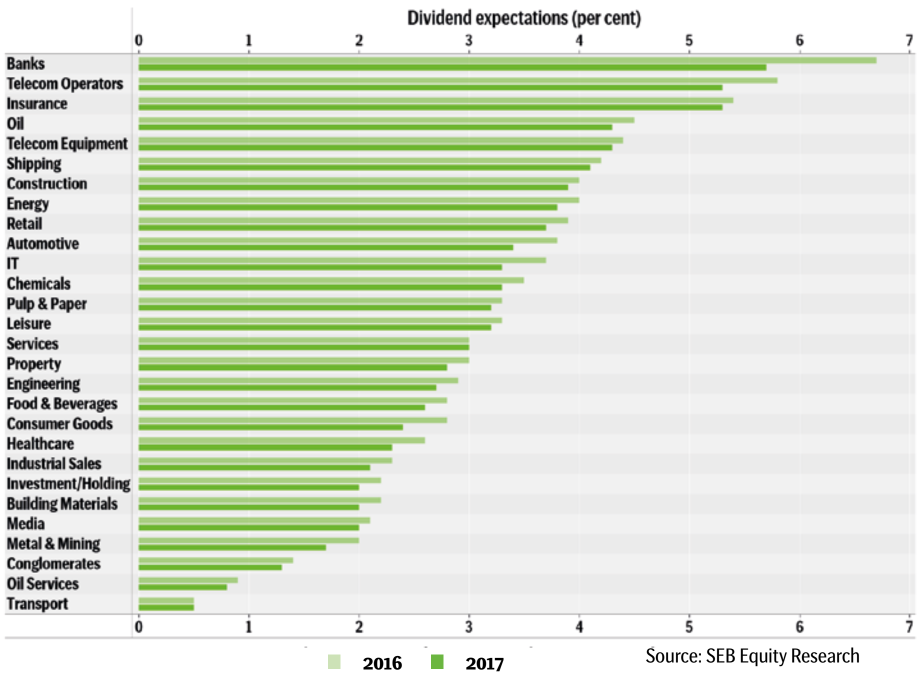
We did not get the expected Remain outcome in the UK referendum, but almost immediately after the stock market's initial plunge, the opposite signal from investors' large cash holdings still had an impact. Despite a clear increase in political risk and concerns about companies exposed to the UK market – with many investors viewing the stock market as overvalued and earnings growth among listed companies as meagre – share prices around the world have risen compared to the day before the referendum. The driver behind this is probably large amounts of capital searching for returns. When central banks pump money into the financial market in the way they are now doing, some of this capital eventually ends up in the stock market.

Continued focus on the Fed

As usual the United States is also ahead of Europe when it comes to monetary policy, so investors are almost obsessed with following the statements of the Federal Reserve and all its Federal Open Market Committee members, led by Chair Janet Yellen. The Fed is expected to indicate whether, how and when it will dial back its current monetary policy measures.

SEB expects a slow increase in the Fed's key interest rate from today's 0.5 per cent to 1.25 per cent in December 2017 and 1.75 per cent in December 2018.

BIG DIFFERENCE IN DIVIDEND YIELDS BETWEEN SECTORS



Source: SEB Equity Research

The chart shows expected dividend yields by sector in the Nordic stock market. Dividend yields are very attractive relative to the current interest rate and bond yield environment, and the big difference between sectors and companies makes it relatively easy to put together a portfolio with a far higher dividend yield than the overall Nordic average of 3.5 per cent, but also the OMXS30's 4.1 per cent. Note, however, that a high dividend yield is often high for a reason. We highlight the uncertainty and opportunities for banks in more detail in our theme text on European banks.

Fixed income investments

%

Long-term yields move towards new lows as Federal Reserve holds off on rate hikes

After a turbulent period in late June, the rest of the summer was far quieter, and risk appetite rebounded surprisingly fast after the Brexit referendum. This new-found risk appetite gained its strength mostly from expectations of even more accommodative central bank measures. A majority of observers agree that most central banks are done cutting their key interest rates, but there is good reason to believe that supportive asset purchases will continue for another while.

- The Riksbank is done cutting rates, but its first rate hike has been further delayed.
- The European Central Bank (ECB) is awaiting new economic data and will leave its key rate unchanged at 0 per cent.
- The US Federal Reserve is aiming at a key interest rate hike before year-end.

Government bonds (ex emerging markets)

As expected, Sweden's Riksbank left its repo rate unchanged at -0.5 at its latest meeting and made no changes in its asset purchase programme. Its first interest rate hike has been put off to the second half of 2017, and only in mid-2018 is the key rate expected to return to zero.

Our forecast is that the Swedish central bank will start raising its repo rate in October 2017 and we believe it will decide already this year to extend its asset purchases for another six months to June 2017, buying about SEK 30 billion more worth of bonds. Swedish 10-year government bond yields fell during the summer and at this writing are around 0.15 per cent. That means the yield gap against German 10-year government bonds has narrowed from 0.6 percentage points to around 0.2 percentage points during the past three months. Meanwhile foreign holdings of Swedish government bonds fell from around 50 per cent in early 2014 to around 35 per cent in late May 2016. It was welcome news that foreign investors reduced their exposure, since this makes it easier to meet the growing demand for bonds due to the Riksbank's asset purchase programme. However, there is the risk of a supply shortage if foreign investors return to the market. Meanwhile the Swedish central bank will probably extend its asset purchase programme.

After the UK's EU referendum, the Riksbank revised its forecasts for both global and Swedish GDP growth downward, especially for next year. However, due to a somewhat worse trend for Swedish exports and lower public sector consumption following measures to curb the number of asylum seekers in Sweden, GDP will be slightly lower this year as well, according to the Riksbank's forecast. The central bank believes that CPIF inflation (CPI excluding interest rate changes) will not return to 2 per cent until year-end 2017 and does not seem prepared to start its interest rate hikes until this inflation target is within reach. Nevertheless, SEB is sticking to its view that the Riksbank's outlook on how quickly inflation may rise is too optimistic.

During the summer the ECB chose to leave its key interest rate unchanged at 0 per cent, but it is prepared to provide further monetary easing if the euro zone outlook deteriorates. The ECB states that there is still not enough information about the effects of Brexit and has reiterated that its key interest rates will remain at current levels (or lower) for an extended period. Its current monthly bond purchases of EUR 80 billion will continue until March 2017, but our forecast is that the ECB will extend them until September 2017. If we are right in our assessment, ECB interest rates will continue to serve as an anchor for international bond yields going forward.

After the British voted to leave the EU, the situation deteriorated in the UK manufacturing and construction sectors. As a result, the Bank of England (BoE) decided to lower its key interest rate from 0.5 per cent to 0.25 per cent, while indicating the possibility of further cuts.

NARROWING CREDIT SPREADS DUE TO ECB ACTIONS

Source: Bloomberg

The ECB's corporate bond purchases, together with rebounding commodity prices, have increased confidence in the credit market, which is reflected in narrower credit spreads.

The Federal Reserve (Fed) closely monitors macroeconomic developments in the US and has recently been forced repeatedly to reconsider its assessment as to when – and how quickly – it can raise its key interest rate. Robust employment figures, combined with strong signals from purchasing managers, suggest a rate hike, but second quarter GDP was a disappointment, producing a picture that is difficult to interpret.

We expect the next rate hike to be made at the Fed's December policy meeting, with the central bank raising its key rate again twice in 2017. This is more than the market is factoring in today and would mean an upside risk for long-term US interest rates and yields if our scenario is correct. All in all, we still believe that downward forces will continue to dominate for another while, which would imply that long-term yields will only gradually move upward as the Fed nears its next rate hike. Meanwhile, the US central bank has a number of political events to take into consideration during the autumn: the EU summit meeting on September 16 to discuss the fallout of the Brexit vote, a debate on Brexit in the UK Parliament and, last but not least, the US presidential election on November 8.

Corporate bonds – Investment grade and high yield

Last spring, the European Central Bank (ECB) decided to launch a new asset purchase programme. This also includes the purchase of non-financial euro zone corporate debt issued by investment grade companies (with a rating no lower than BBB-). This measure has had a stabilising effect on the European credit market and has also limited the negative effects of the Brexit vote. The Nordic credit market has also been favourably affected by the ECB's purchases, although most Nordic bonds are not included in the programme.

US high yield bonds outperformed their European counterparts during the summer, driven primarily by rising oil prices but also because the Brexit referendum had little impact. Going forward, the limited effects of the Brexit vote together with continued ECB stimulus should provide stable conditions for the European high yield market. In the US, the oil price recovery is a positive driver. The energy sector accounts for about 15-20 per cent of the total US high yield market. As a result of rebounding oil prices during the spring and summer, the number of expected defaults fell, thus eliminating much of the uncertainty that had existed earlier. As for investment grade bonds, both the US and Europe generated stable returns during the summer. Stable growth prospects in the US and Europe, together with sustained strong demand for investment grade bonds due to ECB bond buying, suggest continued good performance for that category.

Emerging markets – Robust recovery, helped by rising commodity prices

The global recovery in the stock and credit markets, together with the upturn in commodity prices, has had quite a positive effect on emerging markets in recent months. Meanwhile, stronger local currencies relative to the US dollar have been one factor contributing to stronger government finances in some countries. This has indirectly reduced the credit risk for some governments and companies. There should thus be potential for a continued positive trend in emerging markets. However, investors should be somewhat cautious given that valuations have risen in a short time and the correlation between general economic conditions and commodity prices in some countries is substantial.

ASSET	WEIGHT	TACTICAL EXPECTED YEARLY RETURN			RISK		
		SEK	EUR	USD	SEK	EUR	USD
Cash	**1** 2 3 4 5 6 7	-0.5%	-0.6%	0.5%	0.1%	0.1%	0.1%
Government bonds	**1** 2 3 4 5 6 7	-0.7%	-0.3%	0.3%	2.6%	2.6%	2.6%
Investment grade (IG) corporate bonds	1 2 **3** 4 5 6 7	1.6%	1.8%	2.3%	2.8%	2.8%	2.8%
High yield (HY) corporate bonds	1 2 3 4 **5** 6 7	5.3%	5.4%	5.9%	4.9%	4.9%	4.9%
Emerging market debt*	1 2 **3** 4 5 6 7	7.4%	7.4%	7.4%	11.7%	11.7%	11.7%

"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.
** Returns in local currencies.*

Source: SEB

Alternative investments

Brexit paved the way for more stable performance

If uncertainty and a lack of stable trends characterised the period before the UK Brexit referendum for European hedge funds, since then conditions have been far more stable for most strategies. Volatility in the days following the United Kingdom's vote to leave the European Union produced a variety of effects – benefiting some hedge funds while others were hit quite hard. After that storm died down, the picture became clearer and more consistent. Many hedge funds have taken advantage of the opportunities that arose and have identified good investment opportunities in a more stable market climate over the past few months.

- Trendless uncertainty dominated the period up to the UK referendum.
- The resulting volatility created new investment opportunities.
- Stable trends during the summer.
- Oil prices getting ever closer to balance.

Hedge funds – Stable summer with strategies varying in strength

The trend in July and August entailed positive returns for most hedge fund strategies. On the positive side, event-driven strategies stand out; except for January they have generated strong returns throughout 2016. Macro hedge fund managers have had a tougher climate, with ultra-low interest rates and yields and a USD trend that has been hard to read. For trend-following strategies, performance this year has been variable, to say the least, and June turned out to offer optimal conditions.

Equity long/short

After having been hit hard by volatility in conjunction with the Brexit referendum, this strategy made a significant recovery, bolstered by stronger stock markets in late summer. For fundamental hedge fund managers, a number of investment opportunities materialised during the summer, which partly explains the current strength of this strategy and the healthy yields generated by these investments. Provided that stock markets maintain their stable performance and avoid major reversals, the strategy should be able to perform well going forward.

Credit long/short

The recovery of the commodity sector in general and the oil price rise in particular have helped significantly reduce uncertainty in the credit market. This has caused credit spreads to narrow across the entire ratings scale, although the impact has been greatest on high yield bonds (corporate credits with the lowest credit rating). As with equity long/short strategies, this movement has produced underlying price changes, which in turn create opportunities for these credit strategies.

Event-driven

Apart from difficulties during the first month of the year, the event-driven strategy has performed well in 2016. All three sub-strategies (merger arbitrage, special situations and distressed credits) have done well. The market for corporate deals – merger arbitrage – continued to show good activity, while the price mechanism has trended positively. Distressed credits has benefited significantly from the oil price recovery, since most problem credits are in the energy sector. Meanwhile, special situations, which invests in companies in the process of changing their corporate structure, has had an additional boost from the general strength of the stock market.

Macro/CTA

Unlike for many other strategies, June was the strongest month for the CTA trend-following strategy for a long time. Long positions in interest rate and USD futures were a winning concept following the vote for Brexit. Uncertainty caused interest rates and yields to fall on a broad front while capital flowed to the USD, which strengthened. At present, the overall picture is that there are still long positions in interest rate futures while some weakness in the USD has led most managers to reverse their long position and instead think the dollar will weaken.

HEDGE FUNDS RECOVER AFTER BREXIT VOTE

Source: Bloomberg

After difficulties for hedge funds early in the year, the Brexit referendum – against all odds – was a positive turning point. Most strategies recovered quickly after the turbulence following the vote and turned in a strong performance during the summer months.

Commodities – Oil prices headed towards balance

During the summer, Brent crude oil prices fell from over USD 53/barrel in early June to below USD 45 dollar/barrel in late July before rising again in August. Concerns that higher production would lead to oversupply were the main factor keeping crude oil prices in check during the summer. There are also signs that US production capacity measured as the number of active oil rigs has recently increased somewhat.

The US shale oil revolution in recent years has led to a sharp increase in American oil production, and since Saudi Arabia has decided to raise production at a corresponding pace in order to maintain market share, this has created a global oil oversupply. Because the lifespan of shale oil wells is relatively short, there is a continuous need to drill new wells. Given this short lifespan, along with the relatively high costs per barrel of oil produced, shale oil production was squeezed hard during the oil price decline early this year, with a subsequent sharp reduction in the number of active shale oil rigs. However recently, the number of active oil rigs has once again started to rise, though from low levels. Many companies have also managed to find new methods to keep production going longer.

The rebound in oil prices is driven in part by speculation about new production freezes by the Organisation of the Oil Exporting Countries (OPEC). Reports from the International Energy Agency (IEA) that the oil oversupply is starting to ease and consumption is on the rise are also bolstering oil prices. Saudi Arabia's energy minister has hinted at co-ordinated OPEC efforts to support the market. However, an OPEC production freeze does not appear likely, since higher oil prices would cause US shale oil producers to further speed up production. This would cut into OPEC's market share, rather than sustaining high oil prices. With the number of active US drilling rigs now on the rise again, it is difficult to see what will drive up oil prices from today's levels. Some OPEC members have long argued in favour of freezing oil production, but Saudi Arabia has stuck to its policy of only going along with limits if all oil exporters do. Meanwhile, Iran has stated that it will not comply with any kind of production cap until it reaches its pre-embargo production levels. Iraq has also expressed its intention to return to previous production levels.

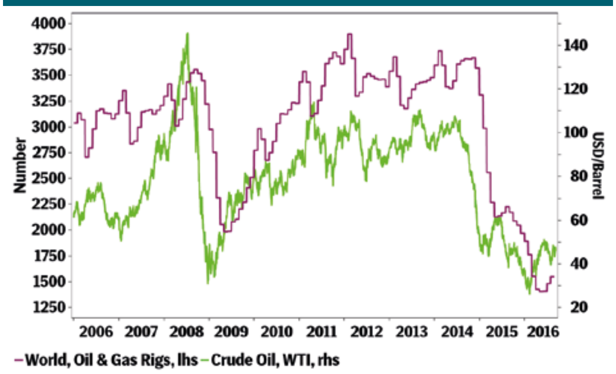
Our forecast is that the oil market is heading toward balance, and we expect the oversupply to disappear next year. Levels around USD 50/barrel should be high enough to increase shale oil production, which should indirectly create a price ceiling of around USD 60/barrel. Due to a moderate increase in demand combined with drastic capital spending cuts in recent years, crude oil prices will rise somewhat from an average of USD 50/barrel for the second half of this year to USD 55 in 2017 and USD 60 in 2018. But there are downside risks.

Commodities – Precious metals

Since they reached bottom in late 2015, gold prices have risen by about 25 per cent – mostly at the start of the year. Gold and other precious metals have been an alternative to fixed income investments, since an ever-larger percentage of global bonds are trading at negative yields. There has been broad demand for investments in gold, with both central banks and small savers being buyers. One indicator of this is the sharp increase in flows to exchange traded funds (ETFs) that follow gold prices.

Due to continued strong demand and falling production, the outlook remains bright, not just for gold but also for other precious metals. The Bloomberg financial news service notes that the price differential between gold and silver is at its narrowest since 2014, and when the precious metals market is in an optimistic phase silver tends to outperform gold. The forecast is that silver production will fall 2-5 per cent this year, which should be enough for silver to maintain a rising price trend. So there should be reason to believe that silver will do better than gold in the medium term.

HIGHER OIL PRICES DUE TO FEWER ACTIVE DRILLING RIGS



Source: Bloomberg

After the oil price rise over the past six months, the number of active oil rigs has started to climb, though from very low levels. Oil prices around USD 50/barrel are enough to end the decline in the number of rigs, but not high enough to cause a noticeable increase.

GOLD PRICES AND GERMAN 10-YEAR GOVERNMENT BOND YIELDS

Source: Macrobond

In an environment of negative long-term government bond yields, gold represents an attractive diversification option for investors looking to invest in the low-risk segment.

Currencies

Global central bank policies also cooling FX market

The global foreign exchange (FX) market has grown significantly in the past 30 years. Between 2001 and 2013, average daily volume more than quadrupled (to 5.3 trillion dollars) according to the Bank for International Settlements (BIS). In early September, BIS published data for 2016 indicating that the level of activity has fallen somewhat compared to 2013. Extensive quantitative easing (QE) by central banks, whose goal in many countries has been a weaker currency, has led to uncertain forecasts. New market participants (automated trading systems) have also appeared, contributing to occasionally irrational currency movements. Other players, such as hedge funds, have reduced their market presence, thereby reducing market liquidity. This combination of new uncertainties, with more currencies trading today near their equilibrium and with marginal differences in key interest rates between countries, could lead many market participants to view the FX market over time as a zero sum game, thus causing them to refrain from expressing strong views on currencies. We believe that the FX market will continue to show limited exchange rate movements and relatively subdued activity in the months ahead.

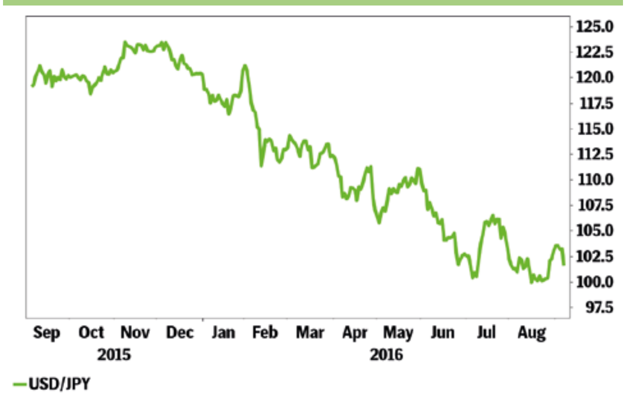
- EUR – A bit too strong for ECB head Mario Draghi's taste.
- USD – Cautious rate hikes will provide marginal support.
- JPY – Appreciation pressure is easing; new unconventional monetary policy measures this autumn.
- GBP – Undervalued, with potential for short-term appreciation.
- CHF – Tailwinds from the Brexit vote are fading; a weaker franc is expected this autumn.
- SEK – Credible monetary policy is putting a stop to quick recovery.
- NOK – Strong flows will challenge the Norwegian central bank's acceptance of a surging currency.

Among FX traders, Japan's currency is notorious for being hard to read; 2016 has also been a year of surprises for the yen's performance. Despite highly expansionary monetary policy measures, including negative key interest rates, in trade-weighted terms the yen has strengthened by 20 per cent so far this year. Valuations play a key role here; our model for long-term equilibrium exchange rates indicates that falling yields and interest rates around the world, together with low inflation in Japan compared to other countries, have improved the country's competitiveness. However, the JPY is slightly overvalued now. The dramatic oil price decline has strengthened Japan's current account balance, which for a time was "dangerously" close to zero. Market speculators long used the JPY as a funding currency (sold JPY). When the US Federal Reserve began hesitating about future interest rate hikes, the market was quick to close this position. However, another key driver is that global interest rates and yields have fallen to Japanese levels, which has helped change Japanese investors' incentive to hedge their foreign exposures. The country has a record-sized positive position in foreign currency assets; this is also the single most important reason why the yen is more negatively correlated to risk appetite than other currencies – in bad times, capital returns home to Japan. If any country introduces "helicopter money" (central banks provide their country with permanent liquidity), Japan should be the first. Its inflation targeting has been a failure and its fiscal policy is limited by high government debt. One variant of "helicopter money" would be for public debt to be written down, with the Bank of Japan alone accepting a loss. The stimulus provided by the central bank's QE programme would thus shift from temporary to permanent. That would provide leeway for the government to increase public debt and could also lead to higher inflation expectations.

EUR – Limited upside

The euro has defied economic – but above all political – challenges since the Brexit vote, and today the currency is only marginally weaker than when the European Central Bank (ECB) introduced QE. We expect the ECB to extend its QE programme in the autumn, which should help limit

UNEXPECTEDLY STRONG YEN



Source: Macrobond

The chart shows the trend for the US dollar against the Japanese yen (USD/JPY) during the past year. This stronger JPY trend has been more enduring than we expected. The JPY is slightly overvalued at current levels.

the upside. Meanwhile the US Federal Reserve will only raise its key interest rate once this year (in December). The appetite for relatively cheap European equities could also help strengthen the euro more than expected. The EUR/SEK currency pair will trade at attractive levels (+9.60) seen from a longer-term perspective (1 year).

USD – Fed driving dollar trend

US monetary policy and the dollar's status as a global reserve currency often determine the FX market outlook. The Fed backed down from previous plans to raise interest rates, allowing depressed emerging market (EM) currencies to make a major comeback. Capital flow statistics indicate that risk appetite for US equities and fixed income investments has waned over the past few quarters. As long as inflation shows no sign of acceleration and the Fed does not raise interest rates more drastically, the overvalued dollar will not enjoy any strong support. The Swedish krona will continue to trade weakly against the dollar in the autumn, but levels of around 8.60-8.80 still make it attractive to sell, seen from a 1-2 year perspective.

GBP – Continued fall following Brexit vote

The UK's vote to leave the EU came as a shock to financial markets. However, the effect was mostly temporary except for the pound; we see a short-term upward risk of the GBP/SEK currency pair trading towards 11.50-11.70. The UK economy will be hurt by Brexit, although we are not as pessimistic as the market consensus. In its future negotiations with the EU, the British look set to say no to the free movement of labour. This in turn should limit the country's access to the single market, so the UK will need a weak pound to maintain its competitiveness.

JPY – Slightly overvalued yen

The trend towards a stronger yen has endured longer than we anticipated. At today's levels, the JPY is slightly overvalued. Downward pressure on global interest rates and yields to "Japanese levels" has been a positive factor for the currency. One likely reason is that Japan has very large net holdings of foreign assets. The pressure on global interest rates and yields has probably led to worse conditions for Japanese investors to hedge their holdings. During the autumn, the Bank of Japan (BoJ) may introduce rather drastic measures including helicopter money. There is also speculation that the BoJ will take extreme action and write off some of its Japanese government bond holdings. This suggests that the JPY has seen its strongest levels and that the currency will start falling again. Our 12-month forecast for the JPY/SEK currency pair is 7.70.

CHF – FX interventions continue

Brexit had a temporarily negative impact on global risk appetite, which should have benefited the Swiss franc. But despite better market sentiment and interest rates well below zero, the Swiss National Bank (SNB) has been forced to continuously intervene in the FX market to limit appreciation pressure (the Swiss FX reserve has increased at a relatively constant pace in 2016, from CHF 571 billion to 615 billion). It seems the SNB is trying to keep the EUR/CHF currency pair above 1.08. We do not think they will change strategy in the near future – on the contrary; inflation measured at an annual rate is just below zero, and the economy is growing very slowly. We expect the CHF/SEK rate to fall towards 7.50-8.00 in the longer term.

SEK – Weak krona will get weaker

Before summer, we wondered whether the Riksbank would finally gain credibility for its monetary policy. The weak FX trend over the summer provides support for that view. Primarily foreign investors closed what were once positive positions in the krona. The SEK is significantly undervalued, and investors have neutral/short positions in the currency. As long as the Riksbank makes clear that it will not accept too strong a krona, it is difficult to argue in favour of positive krona flows again. The FX market also trades on credit spreads, where the krona is almost the worst option. As a result, this autumn we will probably see a continued weak krona if the Riksbank also follows the ECB and extends its QE programme. However, over time its monetary policy will begin to deviate from the ECB's, so the outlook for the krona is bright as we look towards year-end 2016/2017.

NOK – Competition requires weak krone

Norwegian inflation is high and growth is weak. Norges Bank has the same focus as Sveriges Riksbank, however – its country's currency. But if the Swedish "problem" is low inflation, Norway's problem is competitiveness; the country needs a weak exchange rate after the fall in oil prices and deceleration in growth. However, the krone is still strongly supported by factors such as flows and valuations. The risk of appreciation will "force" Norges Bank to threaten further interest rate cuts, despite high inflation. The appetite for returns should cause euro investors to continue buying Norwegian fixed income assets without hedging them. We believe the EUR/NOK rate will fall towards 9.20 in late 2016.

CURRENCY PAIR	EXCHANGE RATE				CHANGE %	
	Now*	Q3 2016	Q4 2016	Q1 2017	Q3 2016	Q4 2016
EUR/USD	1.11	1.10	1.08	1.09	-1.2	-3.0
EUR/SEK	9.52	9.60	9.30	9.20	0.8	-2.3
EUR/NOK	9.29	9.35	9.20	9.15	0.7	-0.9
USD/SEK	8.55	8.73	8.61	8.44	2.1	0.8
USD/NOK	8.34	8.50	8.52	8.39	2.0	2.2
EUR/CHF	1.10	1.09	1.10	1.10	-0.6	0.3
CHF/SEK	8.68	8.81	8.45	8.36	1.4	-2.6
EUR/JPY	115	114	113	117	-0.5	-1.4
GBP/USD	1.31	1.31	1.29	1.31	-0.1	-1.9
GBP/SEK	11.20	11.43	11.07	11.08	2.0	-1.2

**Currency forecasts were made by SEB Research & Strategy as of August 31, 2016. Please ask for a copy of our current forecasts.*

Theme – European banks

Important to restore confidence in the banking sector

The European debt crisis was triggered by the US housing sector collapse in 2007-2008. Banks across the world had investments linked to mortgages and began losing money when US homeowners could not meet their payments. The US federal government, together with private stakeholders, was quick to recapitalise banks, and more or less compulsory mergers were carried out. The US Federal Reserve (Fed) took over a number of bad loans and provided liquidity. Stress tests were introduced to increase transparency and confidence in the banking sector. In hindsight, it is clear that the US's quick actions were the right recipe in that situation. European banks had also invested in the US housing market and consequently suffered huge losses.

- Debt problems are causing difficulties for European banks.
- Problems with bad loans are both political and economic.
- Restoring confidence in the banking sector is a top priority.
- The mutual dependence between governments and banks is cause for concern.
- The effectiveness of ECB measures is weakened by bad loans on bank balance sheets.
- Historically low valuations for European bank shares.

European bank losses were significant. The private capital available had already largely been ploughed into US banks. So national governments had to intervene and rescue the banks in their own countries that were threatened with bankruptcy, providing extensive support measures and capital infusions while the European Central Bank (ECB) supplied liquidity. During 2009, Europe went into recession. Banking problems spread to new countries, especially in southern Europe, where borrowing costs skyrocketed. Europe, which did not act as quickly and forcefully as the US after the financial crisis, is still suffering from debt problems. Some banks continue to have difficulties.

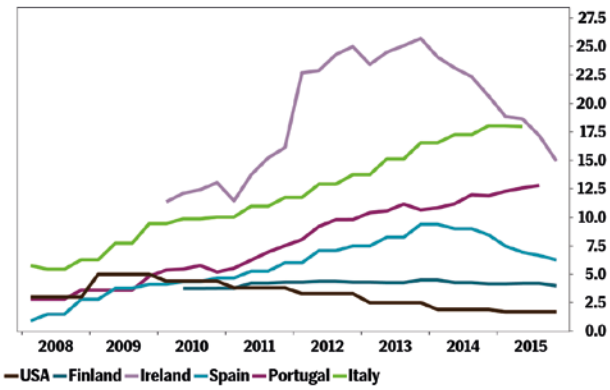
The number of people employed in the European banking sector has fallen by 10 per cent since 2007, and the number of branches has been reduced. Meanwhile the aggregate balance sheet of euro zone banks has fallen from EUR 33 to 28 trillion. Tier 1 capital (shareholders' equity as a percentage of risk-weighted assets) during the same period strengthened from 9 to more than 13 per cent (at the end of 2015), which means higher capitalisation and thus larger buffers.

Credit rating agencies have upgraded many European banks this year. These upgrades are dominated by northern European banks, whereas Italian banks have been downgraded due to higher volumes of bad loans, which reduce profitability, increase funding costs and tie up capital. That reduces access to capital and has a negative effect on growth.

Bad loans hamper economy and ECB policy

Bad loans cause economic problems; ECB policies do not have their full impact. They also cause political problems: will the "bail-in" principle – writing down the holdings of stockholders and bondholders – still apply or will governments need to prop up banks? The bail-in principle was introduced to safeguard the most important functions and stakeholders in the financial system, such as payment systems and savers. Bondholders, who were protected during the financial crisis, will now have to take a big hit if banks run into difficulties. Many countries' banking systems have large volumes of bad loans; meanwhile the mutual dependence between governments and banks is worrisome. The total volume of bad loans is estimated to be almost EUR 1 trillion, with EUR 360 billion of this in Italy. These problems concern not just southern Europe; Germany and France also have banks that are vulnerable according to the Fed's stress test methodology. The stress test results published by the European Banking Authority (EBA) in late July 2016 provided temporary relief. But after criticism that the tests were too lenient and, among other things, did not take into account the banks' vulnerability over an extended period of negative interest rates, the market is once again wary.

STILL A HIGH PERCENTAGE OF BAD LOANS



Source: IMF

Especially in Italy (green) and Portugal (burgundy), both the level and the trend of bad loans as a percentage of total loans are worrisome, but the total level of bad loans is also troublingly high.

The ECB and the Bank of Japan have introduced negative interest rates. As a result, bank profits – or more specifically net interest margins – in these countries have deteriorated. Meanwhile loan volumes have not increased enough to offset this. European banks need to build up their equity capital, and this is best done through gradually higher earnings. To counter low profitability in the banking sector, the ECB is offering advantageous loans to banks for lending to the real economy. The central bank is also buying corporate bonds to further push down corporate borrowing costs, which has had a clear effect on interest spreads. Put simply, it is very cheap today for many companies to fund their operations.

Restoring confidence in the banking sector is vital if ECB policies are to have a full impact

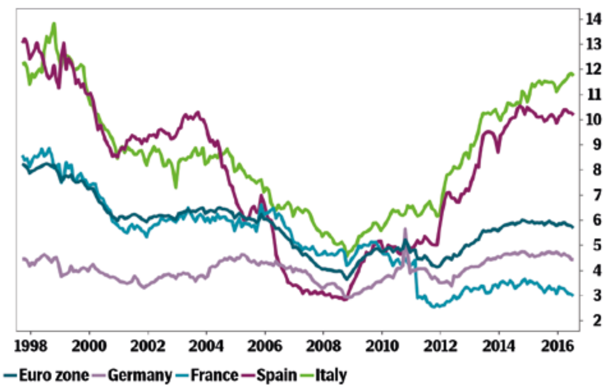
Roughly 85 per cent of the capital provided to euro zone companies goes via the banking system (compared to about 15 per cent in the US). ECB stimulus measures are pushing down interest rates while increasing demand for loans, according to ECB surveys. But lending is increasing at a modest pace, and in Spain and Italy lending is even continuing to decrease. However, as regulations tighten, we expect more capital to be provided from outside the banking system. This would be beneficial since banks would then be relieved of pressure, boosting the credit supply. International Monetary Fund (IMF) studies indicate that bad loans on bank balance sheets are one crucial reason why lending has not accelerated in an environment with a healthy demand for loans, low interest rates and good liquidity. Bad loans have drawn considerable attention recently, since non-performing loans now constitute 17 per cent of all Italian bank lending. In comparison, the average is 6 per cent in the EU, 2 per cent in the US and 1 per cent in Sweden. One bank in particular, Monte dei Paschi di Siena, is in bad shape and was singled out in the EBA's latest stress test. A privately funded investment vehicle has been formed in Italy to take over and liquidate bad loans. This fund has the same purpose as the company Securum had in Sweden during the 1990s banking crisis. However, there is one major difference – Securum was funded and managed by the government, whereas the Italian version is managed by the banks themselves according to the "bail-in" principle. This means that strong banks will support weak ones.

Mutual dependence between governments and banks also cause for concern

Low risk weights on government debt give banks reason to buy government securities. A large holding can then provide banks with an incentive to make further purchases, since they want to prevent failed bond issues by governments with large deficits, which would lead to a fall in the value of their own bond portfolios. There is significant variation in banks' holdings of government securities issued by their own country; banks in Spain and Italy, in particular, stand out with their large holdings. Germany, for example, has called for differentiating the risk weightings of government securities as a way to keep banks in southern Europe from making excessive purchases of sovereign bonds issued by their own country.

The most common way to resolve bad loan problems is to transfer these non-performing assets to a so-called "bad bank". This has been done to varying degrees in most crisis-hit countries. These "bad banks" can cover the non-performing assets of either a specific bank or several banks. Another option is loss guarantees, which do not appear in government debt statistics even if they are issued by the government. Although EUR 260 billion has been injected into the euro zone banking sector since 2011 (according to the EBA's estimate), more money is needed. As a result of new EU regulations, not just shareholders but bondholders too must assume losses (under the bail-in principle) before the government can get involved. Government measures (bail-outs) must also be approved at the EU level, since they are considered state aid. As the IMF has emphasised, another problem is that laws concerning bad loans vary among euro zone countries. We anticipate that more will be done but, as in many other respects, institutional inertia will delay the process.

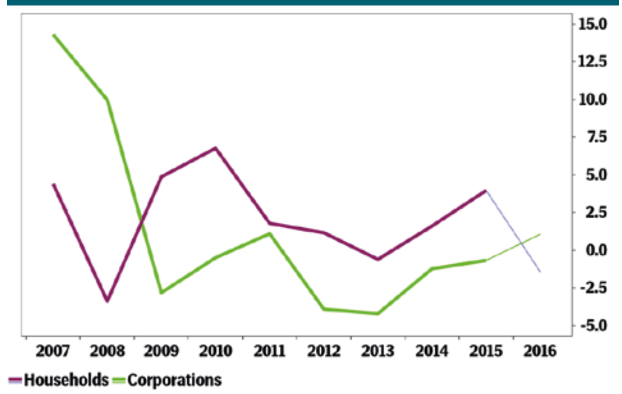
BIG DIFFERENCE IN BANKS' GOVERNMENT BOND HOLDINGS



Source: Macrobond, ECB

Spanish and Italian banks stand out because of their large government bond holdings, which risk creating a high degree of dependence on the financial health of their country's government.

GROWTH IN CORPORATE LENDING



Source: Bloomberg

Efforts by central banks and political leaders to speed up economic growth enjoy high priority. Transparency in the banking sector has improved since the financial crisis. We may be seeing a change for the better in corporate lending, since the growth rate of European corporate lending has risen for the first time in five years.

There are many indications that bad loans in the banking system hamper monetary policy effectiveness
Having a large proportion of bad loans reduces profitability through higher funding costs, while bank capital that is tied up in government bond purchases has a negative impact on the credit supply and, in the long term, on growth. Small businesses, which rely on bank funding to a greater extent, risk being hurt the most. Developments in the US indicate that resolving these banking problems is crucial to economic recovery. The situation in the euro zone is more complicated – with numerous countries, the European Commission and the ECB involved. It is difficult to see how the banking sector can quickly deal with the debt situation solely by using private capital. In the choice between a protracted crisis in which the bail-in principle is applied and a faster bail-out, our view is that the European Commission will allow the governments of the countries with the biggest problems to once again assume some of the burden, despite new regulations. The key to a better-functioning banking sector and an economically stronger euro zone is thus to facilitate the transfer of bad loans to "bad banks", develop secondary markets for these loans, and strengthen and simplify regulations.

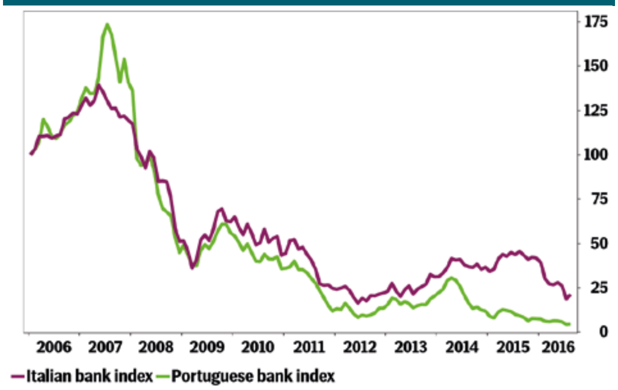
The European stock market was previously dominated by banks. However, the proportion of banks in the Eurostoxx 600 index is now down to 10 per cent, compared to Sweden, where the proportion is 18 per cent. In the US, banks represent just over 5 per cent of the stock market. Nonetheless, the European credit market is dominated to a large extent by banks, which account for more than 30 per cent of loan value outstanding. The credit market is also important to the stock market, since investors' view of risk is reflected in bond prices. The ECB has now entered the corporate bond market (though it has not yet directly bought bank bonds) and is pushing up bond prices and driving down yields, which also has a positive impact on the stock market. Companies are seizing this opportunity and refinancing their loans at far lower interest rates. All else being equal this increases earnings, which can then be distributed to shareholders.

The share price trend for the European banking sector has been dismal, with a decline of more than 70 per cent since the 2007 peak. The sector is by far the worst performer on European stock exchanges. In Italy, Spain, Portugal and Greece, market capitalisation is a fraction of what it once was. For example, Italian and German banks have fallen by around 85 per cent and Portuguese banks 97 per cent from their peak in 2007. Large credit losses, new share issues that dilute shareholder's equity, weak domestic economies as well as weak demand for credit and declining profitability all help to explain this abysmal performance. There are faint hopes that European banks will be able to generate profits in the future, which is reflected in a price-to-book (P/B) ratio of 0.65, compared to more than 2 in June 2007. The gap between banks in terms of valuations and operational performance has widened; Deutsche Bank in Germany is now valued at a quarter of its shareholders' equity. This is in sharp contrast to Handelsbanken in Sweden, for instance, whose share price has risen 50 per cent during the same period.

European bank share valuations at historical lows
The table below shows ten of the largest European banks and their valuation forecasts one year forward. If we believe these consensus forecasts, the valuations certainly look attractive. Add to that a dividend yield of over 5 per cent. The market clearly distrusts these forecasts. There are obvious structural impediments that worry investors. Many investors consider low interest rates to be structural, since they depress net interest margins. In addition, tighter regulations force banks to hold more capital, pushing profitability down further. Competition from niche players and financial technology or "fintech" companies (that use technology to make financial services more efficient), which can benefit from tighter banking sector regulations and capture market share, is a long-term threat.

EUROPEAN BANKS	FORECAST RETURN ON EQUITY IN %	P/E RATIO FORECAST	P/B RATIO FORECAST
HSBC	6.4	12.2	0.82
Banco Santander	6.8	8.9	0.60
BNP Paribas	7.9	7.8	0.59
UBS	7.9	11.1	0.93
Lloyds	11.2	8.9	0.94
ING	9.1	9.8	0.82
Banco Bilbao	7.9	8.8	0.69
Barclays	7.1	11.0	0.49
Intesa Sanpaolo	7.3	9.8	0.71
Nordea	10.8	9.9	1.10

BANK SHARES UNDER PRESSURE



Source: Factset

Bank shares in Italy and Portugal are among the losers, both in a long-term perspective and in recent years. The banking sector's weak share performance is weighing down the European stock market as a whole. The chart shows the trend for each country's bank index.

Having said this, we should note that banking is not a sector that will grow and flourish over time, but rather one that in relative terms will be forced to consolidate and focus on internal efficiency (that is, costs). On the positive side, valuations are low. Unexpected help may also come from a strong US economy. The likelihood is remote that Europe will press for interest rate hikes, but a strong US economy, with a gradually rising key interest rate and consequently stronger USD, is a likely scenario. European banks would benefit from this, since the EUR would become relatively weaker – helping the ECB with economic growth and thus reducing the likelihood of further interest rate cuts. European long-term interest rates and yields would rise, thus making the yield curve steeper, which would also be good for the profitability of European banks. Earnings forecasts would thus be unchanged, and dividend yields would still be attractive. All in all, banking sector valuations would be revised upward and share prices would rise as a result. However, as usual, investors should be selective and should choose banks that have not employed excessively loose lending practices.

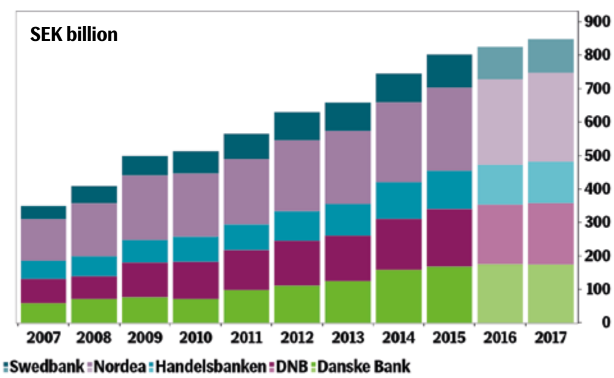
Sector sentiment and new products also driving Nordic bank shares

While price fluctuations in Nordic bank shares can often be explained by changes in market sentiment about the sector internationally, the difference in share price performance over longer periods is enormous, and quite rightly. During the 2008 plunge in share prices and their subsequent recovery in 2009, there was not a big difference between the general trend (though there was a difference in magnitude) for Nordic bank shares and the European bank index (or for that matter, the US bank index). But since then, shares of Norway's DNB and of Swedish banks have far outperformed the European index. Since 2014, Denmark's Danske Bank has also pulled far ahead of its competitors on the European Continent.

Solid balance sheets, good earnings growth

Bank profitability has deteriorated since 2007, both in the Nordic countries and elsewhere in Europe, but the big Nordic banks are expected to generate a return on equity this year of 10-14 per cent, whereas the 2016 consensus forecast for other European banks is 7.5 per cent. Nordic banks also have strong balance sheets, allowing distributions to shareholders equivalent to a dividend yield of 5-7 per cent for 2016. Meanwhile it is suspected that some competitors in Continental Europe will need to raise more capital through new share issues. The reduced profitability of Nordic banks is simply a function of a larger capital base; earnings in absolute terms have already exceeded those in the previous record year, 2007. The big Nordic banks are stable and well capitalised. They are expected to generate steady, attractive dividends in the years ahead. Moreover, valuations of Swedish bank shares have not been revised upward to the same extent as the OMXS30 index average in the past year, which means that their valuation discount has increased. On the other hand, there are the persistent challenges of low or negative interest rates, costly regulations and rapid technological advances. In the short term, it is likely that investor sentiment towards the European banking sector will remain the most important factor in determining the share price trend.

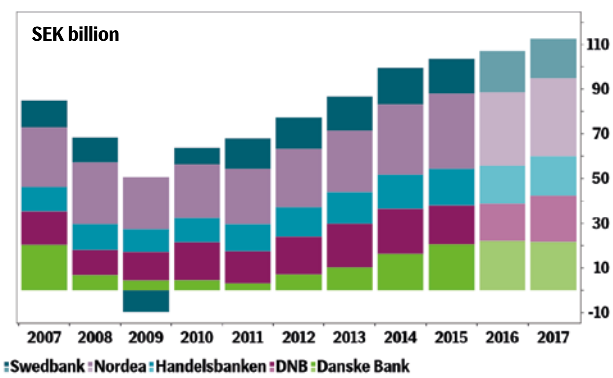
EQUITY CAPITAL HAS MORE THAN DOUBLED SINCE 2007



Source: SEB Equity Research

The chart shows equity capital excluding intangible assets since 2007 for the five major Nordic banks that we track, and forecasts for 2016 and 2017 in Swedish kronor. By means of new share issues as well as accumulated earnings, the banks have built up sizeable reserves. The equity capital of the five banks, excluding intangible assets, has grown by SEK 475 billion or 136 per cent in nine years. This can reasonably be expected to create greater future stability in the Nordic banking sector.

POSITIVE EARNINGS TREND



Source: SEB Equity Research

The chart shows adjusted net income since 2007 for the five major Nordic banks that we track, and forecasts for 2016 and 2017 in Swedish kronor. Although profitability has deteriorated since 2007, earnings in absolute terms are at record levels. Return on equity of around 10-14 per cent is good in a European comparison. Combined with greater balance sheet stability and the wider valuation discount compared to the rest of the stock exchange in Stockholm, the banking sector seems relatively attractive.

Theme – Gaming companies

Gaming sector continues to grow

The internet-based gaming business has grown sharply in popularity over the past decade, with significant growth in both revenue and market capitalisation. Internet gaming is rapidly continuing to capture market share from physical casinos, gaming kiosks, lotteries etc. and we believe that gaming companies have good potential for further structural growth. They are continuing to expand, their market is growing geographically and the somewhat challenging but necessary regulation process is under way, which are all positive factors. Valuations in this sector are also relatively low – despite high historical growth of 18 per cent annually over the past decade in Europe. Gambling for money is controversial in various ways. Both the problems surrounding gambling addiction and possible links to economic crime are issues that must be addressed. We thus support continuing regulation of the gaming industry.

- The global internet-based gaming industry has grown by 11 per cent annually over the past decade. In Europe, yearly growth has been 18 per cent.
- Of the total gaming sector, including physical casinos and betting shops, online gaming accounts for about 18 per cent in Europe and around 10 percent globally.
- Casinos and sports gaming via mobile phones are the primary driving forces right now.
- Demand is not affected by economic cycles.
- Regulation is necessary and challenging, but manageable.
- Relatively low valuations in the sector, despite high growth.

THE GLOBAL GAMING MARKET IS one of the world's largest and oldest industries and continues to combine pleasure with risky betting. The gaming market is the biggest segment in the entertainment industry, about 15 percent larger than pay TV subscriptions, which are the second largest. The market's revenue has grown by 4 per cent annually over the past decade and is worth around USD 400 billion. One tenth of the global gaming market (which includes casinos, gaming kiosks, lotteries, bingo, racetracks and online gaming in all its forms) is now internet-based. In the early 2000s, this part of the business was basically non-existent.

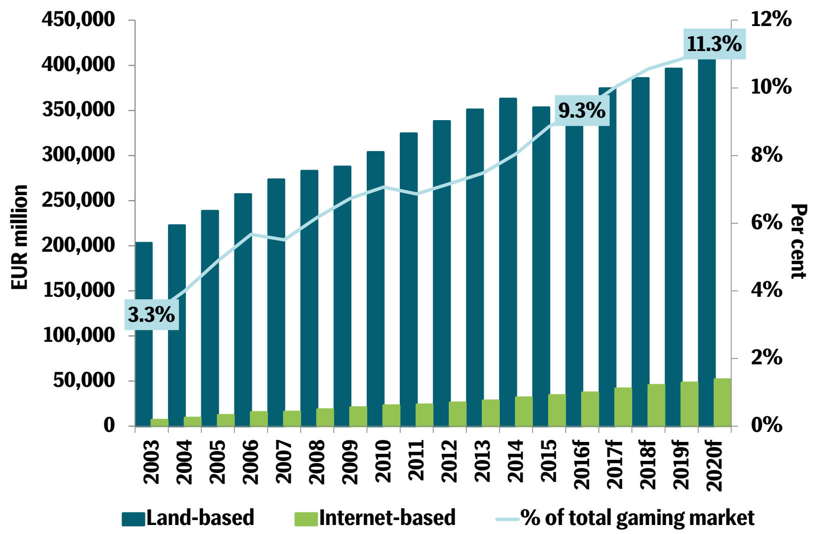
World-class growth

The gaming sector has experienced rapid growth, and the earnings performance of industry players has been impressive. Financial markets have happily embraced the almost non-cyclical and structurally growing internet-based gaming market. This segment of gaming has expanded by 11 per cent annually over the past decade (see chart below). Most of its current growth is occurring outside mature markets (where historical growth largely occurred) – in countries where online gaming has not penetrated the market to the same extent as in Sweden and the United Kingdom, for example. Industry experts are predicting annual growth of about 9 per cent over the next five years, which assumes that the business will capitalise on existing geographic expansion, both in Europe and in the United States (potentially also in Asia).

Bright future, shift away from physical gaming

The European gaming market (physical and online) amounts to over USD 106 billion (2015), of which 18 per

ONLINE GAMING INCREASING FASTEST IN A GROWING WORLD MARKET



Source: SEB Equity Research

The chart shows that the world market for gaming has grown since 2003, broken down by land-based (physical casinos, gaming kiosks and lotteries, etc.) and all gaming activity on the internet. Internet gaming has increased its market share significantly and is predicted to continue doing so during the next few years.

cent (USD 20 billion) consists of gaming via the internet. Nearly half of the global online gaming market is in Europe, while one third is in Asia and 13 per cent in North America. The large European market has been created based on a positive consumer response to mobile gaming, high internet penetration and proactive legislation. In other countries, unfavourable taxes and strict requirements or prohibitions have held back digital expansion. Over the next five years the market for online gaming in Europe is expected to grow by nearly 50 percent overall (8 percent annually), while land-based gaming is expected to grow by 14 per cent (3 percent annually), according to forecasts by SEB Equity Research. The difference in growth illustrates the shift to digital media – a shift that is expected to continue. By 2020, online gaming is expected to account for 22 per cent of all gaming in Europe. The internet-based gaming sector is still a young part of the digital economy, and European market players (mainly British and Swedish) are world leaders.

Operators versus developers

Gaming operators have direct contact with players and market their brands via all imaginable channels, while game developers are the companies that build the casino and odds-computing software that is supplied to operators. The globally largest online gaming companies are (mainly) in Europe, and the largest operators have been successful at growing both organically and through acquisitions. Each year a number of acquisitions take place in the sector, so consolidation has been significant. After historic regulation measures in various European countries, the overall number of gaming market players has declined, partly because regulation increases the importance of having a large-scale administration (for example, an IT platform), but also because major players simply want to grow even faster and have the financial muscle to do so. Game development companies have grown faster than operators over the past five years. They have good potential to sell their software to operators worldwide, thus enjoying better long-term growth conditions than operators.

Innovation and accessibility

The strongest trend in gaming is the increased use of mobile devices, which increases accessibility for players. In 2010, 5 per cent of gaming business revenue in Europe was earned via mobile devices, while in 2016 mobile gaming is expected to account for almost 30 per cent – an impressive 55 per cent annual growth rate. Growth is projected to total around 18 per cent annually over the next five years, and innovative games such as live casino and real-time sports betting are ways of playing that enhance the entertainment experience. Live casino is a hybrid between going to a casino and playing at a casino at home over a mobile phone. In this type of game, the player sees a real croupier who deals the cards and behaves just like a "normal" croupier. Online sports betting accounts for about 40 per cent of all sports betting activity, an increase from just over 10 per cent a decade ago. With many conceivable innovations that have the potential to revolutionise the gaming experience, there is every reason to believe that this percentage will continue to increase significantly, perhaps to as high as 70-80 per cent in the long term.

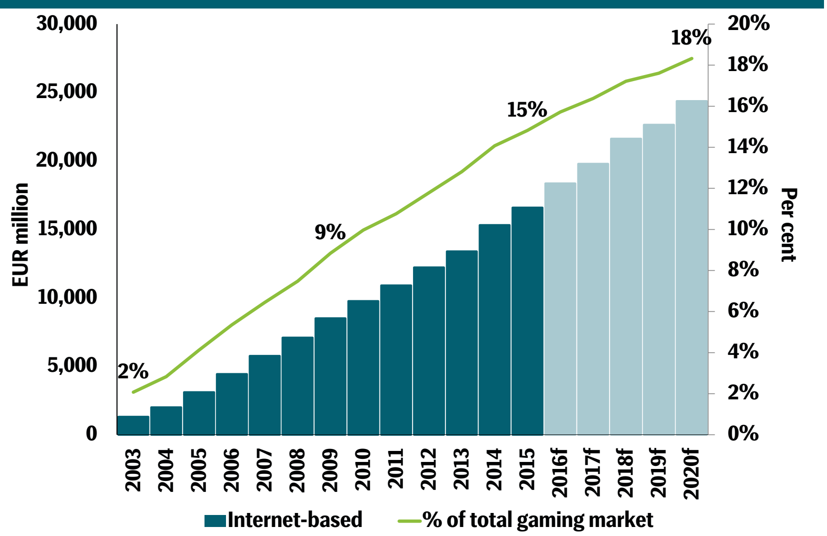
Regulation is complex and a must for gaming

One continuous concern and constant challenge for the sector is regulation. Its purpose is to legitimise the online gaming market. All operators must obtain a licence in order to compete on equal terms with existing government monopolies, resulting in improved marketing opportunities via more channels, but also resulting in the introduction of taxation. Several European countries (the UK, France, Spain, Italy, Belgium and Denmark) have already regulated their gaming markets. In the short term, regulation adversely affects gaming company earnings, since taxes of about 10-25 percent on revenues have been introduced (companies previously held licences in tax-advantaged countries or territories such as Malta or Gibraltar), but faster growth as a result of regulation and reduced marketing costs has led to higher earnings after a certain period.

Consolidation – one effect of regulation

There are a number of examples of how earnings have been affected by the introduction of a licensing system and the imposition of taxes on previously untaxed earnings.

GAMERS ARE INCREASINGLY CHOOSING INTERNET CHANNELS



Source: SEB Equity Research

The chart shows how rapidly the internet-based gaming market in Europe has grown since 2003 and is predicted to grow in the next few years.

The United Kingdom is a successful example of how gamers can be covered by consumer protections that are introduced as part of regulation. When operators had to apply for licences in late 2014 and the tax rate was set at 15 per cent (low for the industry), 90 per cent of gaming activity became part of the regulated system. During the first half of 2015, the operating incomes of the largest gaming companies rose by an average of 5 per cent, while revenue growth was about 30 percent.

Denmark regulated its gaming market in 2012, with a tax of 20 per cent. The following year, the gaming market grew by nearly 50 per cent – a major acceleration compared to previous years. The number of gaming operators fell by a quarter between 2012 and 2015 – a clear consolidation. The French market was regulated as early as 2010, with a tax rate of about half of gaming operators' revenues (!). At that point, half the operators left the country, paralysing the French gaming market.

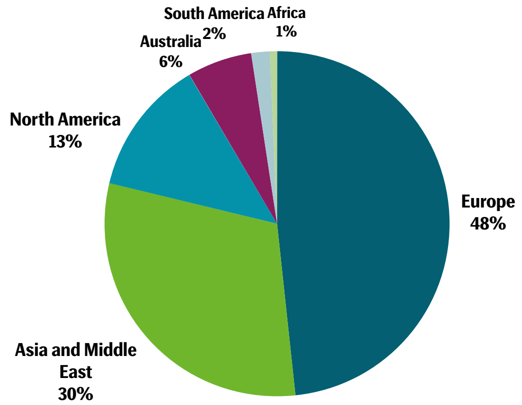
Swedish regulation in 2018
Most observers expect the Swedish government to publish a report on the internet-based gaming market during 2017. This will provide the basis for creating a regulation system in 2018. We expect the tax rate on gaming operators' revenues to be set at 20 per cent. With the government gaming monopoly continuously losing market share to foreign-based private operators, the government is losing potential revenue. This is one reason why the government wants a regulated system. We expect that major operators will be able to benefit from changes in their cost base after the market has been regulated and that faster market growth will offset the negative impact of new introduced taxes on their earnings. We also expect a consolidation of the industry, with larger operators taking over smaller ones. The Netherlands and Norway are also expected to regulate their markets during the new few years.

Combating gambling addiction is vital
Some 1.7 per cent of people in Sweden are "problem gamblers", according to a report from the Ministry of Health and Social Affairs. Although nearly 75 percent of them improve their gaming habits each year, the percentage of problem gamblers remains relatively constant, since about the same number is added each year. An international review of more than 200 studies showed that 2.3 percent of the average population has gambling problems, a proportion that has been relatively stable over time. In two Swedish population surveys conducted 10 years apart, the proportion of the population with such problems was unchanged.

All gaming companies, whether government monopolies or private internet operators, need to enact significant preventive measures to reduce gambling addiction. Gambling problems have negative consequences for both gamers and those around them. Regulation is the only way to force gaming companies to undertake the necessary measures, such as staff training. Other measures include self-exclusion from casinos and the internet, restrictions on gaming speed, options and/or limiting access to money while gaming. Such measures also include regulation of marketing to young people, who should be approached with caution. All operators must assume their responsibilities – both government monopolies and private gaming companies. Regulation is a must, which many European countries have already implemented. It is time for Sweden, Norway and the Netherlands to do the same.

Expansion to new continents
The European market dominates online gaming and will do so for many years to come. But the US market is certainly worth keeping an eye on. So far, a few US states have indicated their openness to online gaming and a handful of states are discussing regulation. The US has significant potential since it is the world's largest economy and gaming market. If online gaming is approved in more states, it would be another growth engine for European gaming companies. Countries in South America and Asia are also eager to find new tax revenue sources, but the trend in gaming is sluggish. Game development companies are extremely well placed to grow in countries that choose to introduce regulated gaming markets.

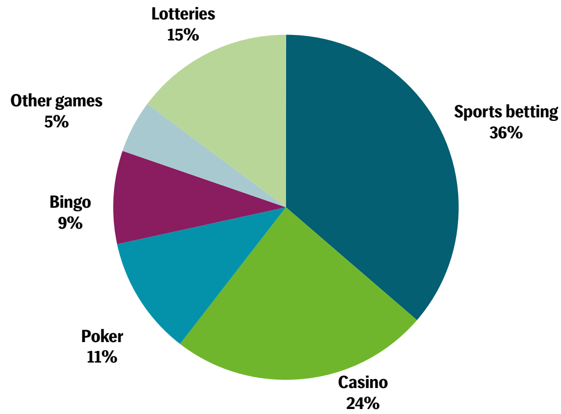
THE GLOBAL INTERNET GAMING MARKET



Source: SEB Equity Research

The above chart illustrates the dominant role of Europe in the global internet gaming market, at 48 per cent of the total, while North America is a relatively small player considering its economic size.

THE EUROPEAN INTERNET GAMING MARKET



Source: SEB Equity Research

The chart shows that sports betting and casino together dominate the European online gaming market, while lotteries and bingo games are less common but not insignificant.

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