Investment Outlook

December 2017

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Healthy growth, but mounting risks

AFTER HAVING BEEN MORE CAUTIOUSLY positioned earlier in the summer, in August we raised our equity allocation. During the third quarter corporate report season, risk appetite increased and both the stock and credit markets performed strongly. We thus ended up in a situation where quite a lot was already priced in. We again chose to adjust our portfolios downward, closer to a neutral situation. That is where we are at this writing.

How do conditions look in the final stretch of the year and ahead of 2018?

Among the repercussions of the positive report season, which was accompanied by solid economic statistics, volatility in both the stock market and credit market reached levels that may very well turn out to be lows for this cycle, implying that at this very moment the economy was at its strongest and investors had the most risk in their portfolios – a reflection of great optimism.

If we look at the underlying economic drivers, the potential for growth remains good and inflation remains at rather moderate levels. Based on this, we expect the corporate sector to continue delivering earnings increases during 2018.

Offsetting this are various constraining factors, such as gradually more restrictive central banks – although we are not expected to reach the breakpoint until a year from now – as well as historically high valuations and an investor community that has aggressive portfolios.

If the expansion continues as robustly as today, we may very well enter a final phase of strong stock markets during 2018 before it is time for an economic deceleration or before central banks slow the process. One alternative scenario is that investors will not wish to add more risk. This would imply rather flat market movements despite an economic boom. Alternatively, the economy could turn downward sooner than expected and the market would probably follow suit. This issue of *Investment Outlook* provides more details about this complex equation, how we assess the potential for various asset classes and what risk level we consider appropriate.

Turning to our theme articles, we present an in-depth look at two current topics that are based on technological advances. The first article deals with the digitisation of China and the highly successful domestic technology sector that has emerged as a result. The second article is about the inherent threats and opportunities of digitisation connected to information technology (IT) security.

Wishing you enjoyable reading,

FREDRIK ÖBERG
Chief Investment Officer, Investment Strategy

Risk exposure and allocation

Summary

WE HAVE REDUCED THE RISK in our portfolios and are close to our neutral position, but remain slightly overweight in equities. We expect a more volatile period, since this autumn has offered strong stock markets and rising expectations. That is apparent, among other things, from valuations and the average investor's portfolio, which has become more risk-seeking.

We continue to believe that the probability of an economic downturn is small, but the likelihood that leading indicators will point to an economic levelling-out has increased. As a rule, this usually results in rising volatility. In a 12-month perspective, we still foresee favourable economic growth and expect higher returns for most asset classes. However, it is increasingly likely that these will be more moderate than we have become accustomed to.

RISK EXPOSURE	
THIRD QUARTER 2017	FOURTH QUARTER 2017
Overweight	Slight overweight

Our risk exposure is based on the proportion of equities in a diversified portfolio. The weight of equities is described as underweight, neutral or overweight. What a neutral weight is will depend on what risk profile the individual portfolio has.

The following is a review of a number of important factors that justify our more neutral approach to risk assets today, and how these factors may influence future developments.

Growth and earnings: We have now experienced a period of healthy economic growth, which boosts expectations, thereby increasing the probability that we may encounter a situation where leading indicators fall. Global growth is expected to end up at nearly 4 per cent in the coming year, with inflation just below 2 per cent. This in turn will lead to continued rising profits, but with a risk that near-term expectations are too high.

Central banks: The US Federal Reserve is continuing to hike its key interest rate and also intends to shrink its balance sheet (decrease the volume of fixed income investments it owns), which will reduce liquidity in the market. Other central banks are lagging behind, and the net effect of their actions is expected to remain positive, but clearly less positive than before. Interest rates and yields should gradually rise. This will occur in an economic system which already has a high volume of debt, which will increase risks. Sweden's Riksbank is still among the most expansionary central banks.

Valuations: This autumn's robust stock market has driven up valuations, despite a healthy global earnings increase. Share prices are high from a historical perspective. Compared to government bond valuations or risk-free interest, valuations of equities and corporate credits are more normal – provided that economic growth lasts.

Risk appetite and positioning: Positioning is at high levels, while risk appetite is falling slightly. This means that some profit-taking can be expected and that investors are relying on persistently strong economic growth.

Expected returns: Outcomes are dependent on a correct growth forecast. We expect positive returns for most asset classes over the next 12 months. These expected returns are lower than historical averages, while risk is intact.

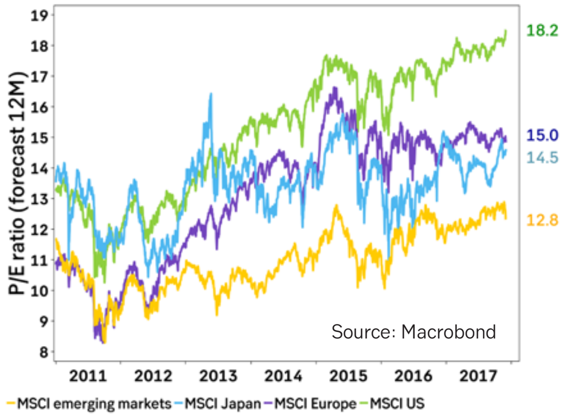
Examples of risks: A downturn in the economic cycle would have a major impact, but recession risk is low. Valuations are high from a historical perspective. After major liquidity injections and record-low key interest rates, central banks are expected to gradually normalise their policies during 2018 and onward, which means that a large "subsidising" force will fade. Global indebtedness is high. There are signs of weaker home prices here and there.

OUR PORTFOLIO MANAGEMENT

ASSET ALLOCATION

- In early November we reduced our risk by selling global equities and buying fixed income investments. We have a continued small overweight in global equities, a neutral position in Swedish equities and alternative investments and a small underweight in fixed income investments. Overall, we are close to a neutral situation.
- In global equities we have continued to slightly underweight the US while overweighting other regions.
- Corporate credits with short maturities dominate our fixed income portfolios, while our alternative investments are characterised by a defensive hedge fund portfolio.

STOCK MARKET VALUATIONS ARE RISING



The above chart shows a consensus price/earnings ratio forecast, looking ahead 12 months, for major regions. Earnings performance has been strong during 2017, and stock markets have discounted this and a bit more. The only exception is Europe, where valuations are unchanged.

EQUITIES

- Strong macro data and a good report season resulted in rising stock markets after the summer.
- Thanks to record earnings, the Japanese stock market was a winner this past quarter, but other major stock markets are not far behind. The World Index rose by 8 per cent.
- The technology sector is a winner, with strong revenue and earnings growth.
- High valuations will limit potential returns.
- Concerns about the housing market in Sweden and Norway.
- A continued favourable international macro environment.
- Selectivity is increasingly important in a mature economic upturn.
- Banking shares are paying record-high relative dividend yields.

MARKET	TACTICAL EXPECTATION (12-MONTH FIGURES)	
	RETURN	RISK
Global equities	6.4%	10.0%
Emerging market equities	7.9%	12.0%
Swedish equities	9.3%	11.1%

Source: SEB

FIXED INCOME

- Continued expansionary global monetary policies despite reduced stimulus measures.
- In its forecast, SEB has delayed the Riksbank's first rate hike until September 2018.
- New US Federal Reserve (Fed) chairman Jerome Powell is expected to continue pursuing a gradual rate hike strategy.
- Limited initial impact as the Fed trims its balance sheet.

MARKET	TACTICAL EXPECTATION (12-MONTH FIGURES)	
	RETURN	RISK
Government bonds	-2.3%	1.8%
Corporate bonds, IG*	0.7%	3.2%
Corporate bonds, HY**	2.5%	4.9%
Emerging market debt	5.1%	11.3%

* Investment grade ** High yield

Source: SEB

ALTERNATIVE INVESTMENTS

- Healthy underlying economic performance will contribute to a recovery for hedge funds and commodities.
- More fundamental pricing has created better conditions for hedge funds.
- Clearer monetary policy map.
- Sharp upturn in oil prices, driven by production caps and political risks.

MARKET	TACTICAL EXPECTATION (12-MONTH FIGURES)	
	RETURN	RISK
Hedge funds	3.5%	6.0%
Commodities	N/A	9.8%

Source: SEB

Tactical expected return is based on the SEB House View as of November 15, 2017. Index/basis for estimates: Global equities – MSCI All Country World Index in local currencies. Emerging markets – MSCI EM TR in local currencies. Swedish equities – SIX Portfolio Return Index in SEK. Government bonds – OMRX T-bonds in SEK. Corporate bonds (IG and HY), IBOXX Investment Grade Index in USD and IBOXX High Yield Index in USD. EM debt – JP Morgan Emerging Markets Bond Index in local currencies. Hedge funds – HFRX Global Hedge Fund Index in USD.

Market view – Macro
Good stable growth, continued low inflation

The world economy has now entered what looks like a mature expansion period. There is healthy growth in all major economies and in most sectors. We are thus raising our forecasts a bit. Despite political uncertainty, we also anticipate that this healthy growth can last for another couple of years, without inflation necessarily speeding up significantly, even though this is one of the biggest threats to our bright picture.

In our last *Investment Outlook* (published in September 2017) we described the world economy as undergoing a transition where strength in various economic indicators was being followed by acceleration in actual growth. This transition now appears to be over, the growth rate has climbed and global GDP is now expanding at nearly 4 per cent year-on-year – a level that we believe will persist in the next two years as well.

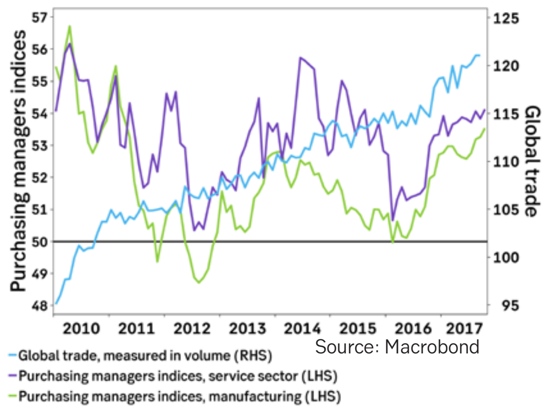
This growth is clearly broad-based. In the United States, GDP growth figures have surprised on the upside during the past two quarters. We expect continued good momentum and are adjusting our forecast of US growth upward in 2018. This includes a marginal contribution to growth from the limited tax reform we believe will be launched early next year. In the euro zone, Germany and Spain remain impressive, while the situation has also improved in France and Italy. Because of strong labour markets as well as good momentum in exports and capital spending, we are adjusting our euro zone growth forecast upward as well. The Japanese growth figure may not be impressive, yet it is the highest in years and if we take the population trend into account it represents a decent level. In the world's emerging market (EM) economies, too, bright spots have predominated – Chinese growth has provided an upside surprise, while commodity-dependent giants Russia and Brazil are both climbing up from their deep recessions of recent years. Although India is currently an exception, with a sharper slowdown than expected, we anticipate a recovery there during the next couple of years.

Looking at our own immediate surroundings, the acceleration in global growth is clearly also benefiting our Nordic neighbours, which will all grow at a healthy pace both this year and during 2018-2019. Swedish economic growth will be even higher, but its driving forces are changing. A weakening in the housing market will slow down growth, while exports and industrial capital spending will accelerate, driven by international expansion and fuelled by a weak krona.

Strong driving forces behind growth

After 8-9 years the economy has finally left behind its recovery phase following the deep crisis of 2008-2009 and has now entered a more traditional mature expansion period. This is a phase characterised by strong labour markets and increasing wealth which generate optimism in the household sector, while high capacity utilisation stimulates capital spending. This dynamic is usually quite powerful even though we have come a long way in the economic cycle,

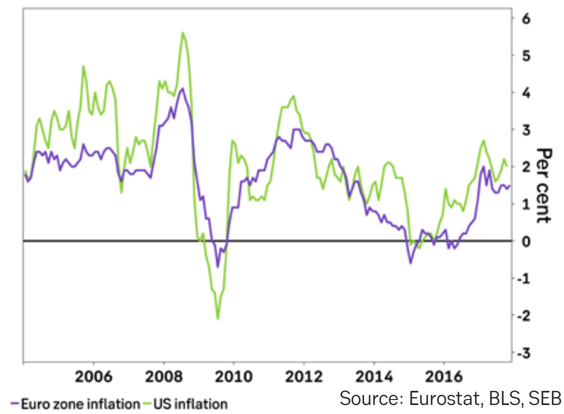
CLEAR INCREASE IN GROWTH



Source: Macrobond

After bottoming out early in 2016, worldwide purchasing managers' indices have climbed dramatically. This forward-looking indicator is now also accompanied by an actual increase in growth, illustrated here by a clear acceleration in the pace of global trade (measured in volume).

INFLATION AT PLEASANT LEVELS



Source: Eurostat, BLS, SEB

The economic slump of 2015-16 pulled down inflation and created deflation worries. The recent increase in growth has caused broad inflation metrics to climb, driven by energy prices. As long as wages do not take off, we do not expect any surges in inflation.

which is one reason for our assessment that the upturn may last for another couple of years. However, it is relevant (as always) to think about the risks during this phase – the things that might cause significant changes in the growth picture. Many observers will perhaps note the political risks. Indeed, there is no shortage of these: the Brexit process, the European Union's future integration efforts, American domestic politics, as well as geopolitical events such as the North Korea conflict, new tensions in the Middle East and more. Some of these have also managed to have an impact on financial markets, but their effects have quickly faded. Naturally we cannot rule out that some political event may develop in a way that has long-term consequences on the world economy, but this would require a fairly deep crisis – something we do not see in the cards at present. After all, many of these risks have already shaken financial markets without affecting consumption and investment decisions. An uncertain political landscape, in itself, is no obstacle to a favourable growth picture.

At present, the risks are of a more cyclical nature. One common way that economic expansions end is when unemployment has become so low that wages and salaries climb faster. This leads, in turn, to accelerating inflation as businesses raise their prices to compensate for cost increases, which consumers must be able to afford. Accelerating inflation leads, in turn, to rising interest rates. This makes borrowing more expensive and saving more attractive, dampening both consumption and capital spending, after which growth falls. The relationship between unemployment, wages and inflation is usually described using the "Phillips curve", which shows schematically how much inflation is expected to climb, given various levels of unemployment.

After many years of decent growth, unemployment in many countries has fallen to its lowest level in decades. Especially in the US, for some time the jobless rate has been below the level that economists call equilibrium unemployment – the level at which labour shortages generate faster pay increases. In spite of this, wage inflation has not taken off significantly, which is surprising and makes a couple of different future scenarios possible.

Several factors behind lower inflation

One argument used by a number of observers is that we have new forces in the economy that are counteracting inflation and invalidating the old relationship, killing off the Phillips curve. They mention globalisation (the risk that jobs will move to other countries if wage demands become too high) and automation (where a robot takes over the job) as the most important of these forces, along with new and more fleeting forms of employment: the "gig economy".

Others maintain that the Phillips curve is still alive, but that it has a "knee". In other words, unemployment can fall further than theory and history tell us, for the above-mentioned reasons, without triggering higher inflation, but that at some level inflation will suddenly surge – a kind of ketchup effect.

Our approach is a mixture of these scenarios. Bottleneck problems in the labour market are likely to eventually enable businesses and employees to raise prices and wages. But the relationship between inflation and unemployment has weakened, and the effect arrives after a substantial delay. And this does not apply to all parts of the economy, but is instead more sector-specific. As a result, aggregate inflation need not take off very significantly. Because of globalisation and greater openness between economies, inflation is also determined to a diminishing extent by domestic factors. This reduces the risk of rapidly rising inflation in a country like Sweden, despite high growth and the beginnings of labour shortages in the country. On the other hand, it creates problems for central banks, which have historically used this relationship to determine the actions they take to defend inflation targets.

Too early to worry about inflation

We expect inflation in the advanced (OECD) economies to peak at just above two per cent this year, among other things driven by rising energy prices, then fall to just below two per cent next year. In other words, no raging inflation appears likely. This means that central banks, with the Fed as a partial exception, will not need to and probably will not hike their key interest rates during the next few quarters. For more on this, see the "Fixed income" section on pages 14-15 and the theme article on page 16.

GDP – YEAR-ON-YEAR CHANGE, %	2016	2017 (F)	2018 (F)	2019 (F)
United States	1.5	2.3	2.6	2.0
Japan	1.0	1.5	1.2	1.0
Germany	1.9	2.2	2.2	2.0
China	6.7	6.9	6.6	6.2
United Kingdom	1.8	1.5	1.3	1.1
Euro zone	1.8	2.3	2.3	2.1
Nordic countries	2.2	2.7	2.3	2.2
Sweden	3.3	3.2	2.6	2.4
Baltic countries	2.2	4.0	3.4	3.1
OECD	1.8	2.4	2.3	2.0
Emerging markets	4.3	4.9	5.1	5.1
The world (PPP)*	3.2	3.8	3.9	3.8

Source: SEB, OECD

* PPP= Purchasing Power Parities; economies have been weighted to account for price differences.

Global equities
Growth-driven earnings increases

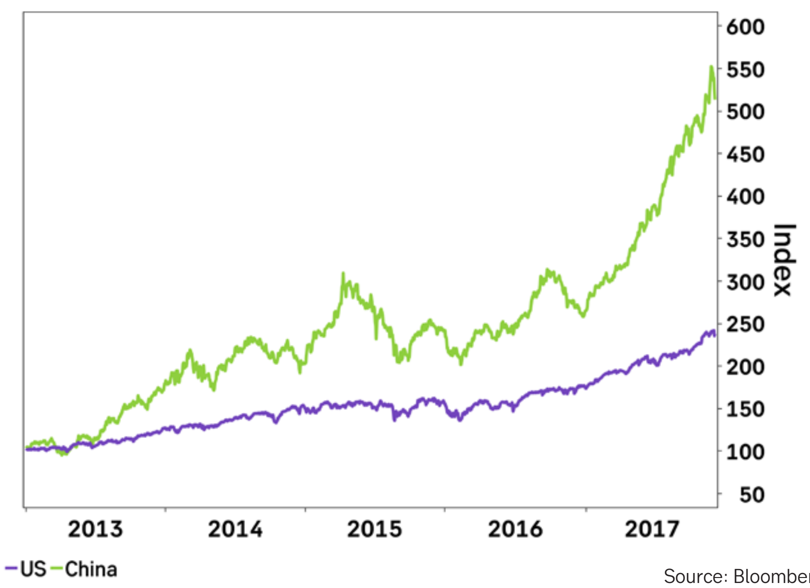
The past three months was an excellent period to own equities, as international stock markets have continued their upward climb. The MSCI World equity index has gained nearly 7 per cent. The upturn has been dominated by technology companies with strong financial reports and by oil companies that have benefited from rising oil prices. Robust macroeconomic data from both Western and emerging market economies have continued to pour in, with a positive impact on third quarter company reports.

Cyclical sectors have generally shown volume increases and have been able to raise prices. This, in turn, has led to increased margins and has helped speed up earnings growth. In contrast, defensive sectors have had a tougher time, since cost increases have not been sufficiently offset by volume increases. The investor community's love affair with the technology sector is continuing. This sector's cyclical and structural growth is attractive. Strong company reports have been accompanied by major share price upturns.

The Japanese stock market has been one of the best performers among the major exchanges, up 13 per cent in the three months calculated in JPY. Companies are showing record earnings and have also provided upside surprises compared to expectations. The large cyclical element, modest comparative figures and a weakened currency explain the unexpectedly strong report period in Japan.

Europe has surprised marginally on the upside, but earnings increases in industry are somewhat disappointing. The manufacturing sector is benefiting from economic conditions, but the strong euro is holding back earnings growth. The banking sector is strengthening its capital situation, but third quarter earnings growth compared with the year-earlier period was extremely marginal. Because of a continued flat yield curve (a narrow difference between long- and short-term bond yields) and the European Central Bank (ECB)'s negative deposit rate for banks, earnings growth will be delayed. The MSCI Europe index is up 6 per cent in EUR over the past three months.

CHINA'S TECHNOLOGY SECTOR IS DOMINANT



Source: Bloomberg

The chart shows the MSCI Chinese technology index (green line) compared to the MSCI US technology index (purple line). This is where we find the main reason behind the dominance of technology in EM equities, as well as China's increased weight in the EM index. China's technology sector has gained 422 per cent in five years, while its US equivalent has risen by 150 per cent. During the same period, the S&P 500 has climbed by 90 per cent.

The US stock market is dominated by technology companies, which account for about 25 per cent of index weight. Their sales growth totalled 11 per cent during the third quarter, and their earnings grew by 20 per cent compared to the same period of 2016. Apple, Facebook, Alphabet, Amazon (partly a technology company), Intel and Microsoft all published reports that impressed the market. The S&P 500 equity index has climbed close to 8 per cent in USD during the past three months, while US-based technology companies gained more than 10 per cent and the banking sector was up 14 per cent. Aggregate-level banking profits were a few per cent above expectations, but some sources of concern are discernible. One early sign that the economic cycle is in a late stage is that consumer loan loss provisions are increasing. Topping the wish list of US banking shareholders are a tax cut and a steeper yield curve, which would boost profitability.

The MSCI emerging markets index rose by about 6 per cent calculated in USD during the past quarter. The information technology (IT) sector rose by 13 per cent, while the next biggest sector – consisting of financial and banking companies – rose less than 1 per cent. Emerging market countries were dominated by Asia, with China leading. China accounts for 30 per cent of the emerging market index, South Korea for 16 per cent and Taiwan for 12 per cent. China's index is dominated by technology companies, of which Tencent and Alibaba are among the global top ten listed companies in terms of market capitalisation. The Korea and Taiwan indices are also dominated by technology firms, with Samsung in Korea and Taiwan Semiconductor Manufacturing Company (TSMC) as the largest. The four above-mentioned companies account for nearly 20 per cent of the EM Index, and their quarterly reports have been impressive. They are growing rapidly and are highly profitable. Their reward is rising share prices. The two Chinese IT companies have each gained more than 100 per cent so far this year, Samsung over 47 per cent and TMSC over 33 per cent, all in local currencies. The EM technology sector as a whole has gained close to 65 per cent this year. Excluding the tech sector, the returns in other sectors are similar to those in Western stock markets.

The banking sector, which is the second largest sector in EM stock markets, faces the same structural challenges as those in the advanced economies and thus has similar characteristics: low valuations and profitability, as well as low earnings growth. Chinese banks, which account for much of the weight among financials, partly consist of state-owned enterprises (SOEs). For many years their shares have been low-priced in relation to their profit generation, since there is great uncertainty about the quality of their loan portfolios. The doubtful quality of their balance sheets and their lack of transparency are reasons behind their low valuations. For example ICBC, which is regarded as a relatively high-quality bank (for China), is valued at a price/earnings ratio of 6.5 and a price/book ratio of 0.9. Add a return on equity of 13.5 per cent and a dividend yield of 4.5 per cent and ICBC appears cheap, which has attracted some members of the investor community.

Valuations

Using absolute figures, world stock market valuations remain high in a historical perspective. In relation to interest rates and other asset classes such as bonds and real estate, however, equities remain preferable. Implicit return (the inverted P/E ratio) remains around 6 per cent, which we regard as a fair valuation at present.

Positive economic outlook and strong reports

China and Europe are regions whose economies have surprised on the upside, compared to what we thought at the beginning of 2017. The US, which is in a later stage of the economic cycle, is showing few signs of stagnation – but rather the opposite.

REGIONS AND COUNTRIES	P/E RATIOS 2017 (CONSENSUS)	P/E RATIOS 2018 (CONSENSUS)
Emerging markets	13.9	11.9
Japan	14.9	14.4
Nordic countries	17.0	16.3
Europe	15.8	14.6
United States	19.2	17.6
Global	17.1	15.6

Source: Bloomberg

Compared to three months ago, valuations have climbed a bit. US shares stand out with their high valuations while EM shares carry low valuations, but the gap between them reflects historical differences well. We see few reasons for short-term changes in the current differences between regions.

SECTORS (ALL INDICES MSCI)	P/E RATIO, 2018	ROE %, 2018
China technology index	29.3	22.9
US technology index	18.1	26.5
EM technology index	12.7	19.0
EM banking index	8.2	11.8
European banking index	11.1	9.5
US banking index	12.9	9.5

Source: Bloomberg

Global asset managers are overweighted in the technology and banking sectors. Looking at valuations, this is easy to understand since their P/E ratios are relatively low and return on equity (ROE) is high. Chinese-based global giants Alibaba and Tencent pull up valuations in their index.

In their third quarter reports, companies indicated a broad recovery. Most sectors are showing healthy growth in the majority of geographic areas where companies operate. Industrials, technology and commodity-related companies are especially optimistic, but banks work in a tougher environment where regulations, low interest rates and a flat yield curve have hampered their earnings performance.

Technology companies are living in a particularly good environment right now, since internet use has spread to virtually all parts of society. Technology is rapidly making old business models obsolete. Internet and technology companies are winners in this structural shift, which has been especially clear this year. Investments in new business models and technology have begun to bear fruit, resulting in higher profitability and higher earnings. Examples of new niches that generate high profits are cloud services supplied by Microsoft, IBM and Amazon. These are particularly lucrative, with net margins of around 25 per cent and in Amazon's case 40-50 per cent. Social media, led by Facebook (FB), have exploded and are receiving an ever larger share of global marketing budgets. FB now has a net profit margin of 50 per cent! Most sectors are being forced to devote an ever-larger percentage of their capital spending budget to IT, in order not to fall behind. It appears natural that the tech sector is a winner this year, with an upturn of 40 per cent in local currencies. Right behind it are the commodity-related sector, up 20 per cent, and the manufacturing sector with an upturn of 17 per cent.

Positioning within global equities

We recently lowered our risk and decreased the proportion of global equities in our portfolios, but this step is mainly tactical in nature since stock markets have recently climbed rapidly. We have downweighted Japan due to a rapid share price upturn and a certain multiple expansion (a fancy expression for something that has become more expensive). We have downweighted EM equities after two years of sizeable gains because we believe there will be profit-taking. The US Federal Reserve will also continue to withdraw liquidity, which has historically had an adverse impact on EM assets. Looking further ahead, however, we have a positive view of both the EM sphere and the tech sector.

Among global equities, we foresee decent potential in Europe over the next several years. Solid industrial activity will benefit large portions of the European stock market, which is also reasonably valued. Economic growth has gained a foothold in the region, which will benefit the important banking sector when the European Central Bank (ECB) hikes its key interest rate. We believe this will occur in the spring of 2019. Helped by the economic cycle, traditional sectors should achieve higher profitability, which the high operating leverage in Europe suggests. Technology companies weigh lightly in a European index, which is not a disadvantage in the short term since there has been a sharp upturn in that sector this year. Profit-taking in the IT sector would not hurt the European stock market as much as US and EM equities.

In a longer time frame, we have a positive view of the Japanese stock market as well as EM equities, but we believe that these stock markets are sensitive to short-term profit-taking. The US market has defensive characteristics, relatively high valuations and a large element of technology, but our overall assessment is that US equities will perform in line with the world index in the coming months. We are still positive towards the global stock market but have adopted a more cautious positioning in the short term.

Nordic equities
High valuations require greater selectivity

We expect a continued favourable macro environment for the stock market, with healthy economic growth in all relevant regions, low interest rates and a continued expansive credit market. Upside potential is unfortunately limited by high valuations, and we believe it has become more important to be selective in choosing individual equities. Looking ahead, dividend yields will probably become an even more important element of total returns. In particular, we find the dividends from banks very attractive at current levels. The housing market is now cooling off, which is welcome, but we do not expect any crash similar to the one in Spain or Denmark. On the contrary, we are seeing that concerns about the housing market are already exaggerated in some respects.

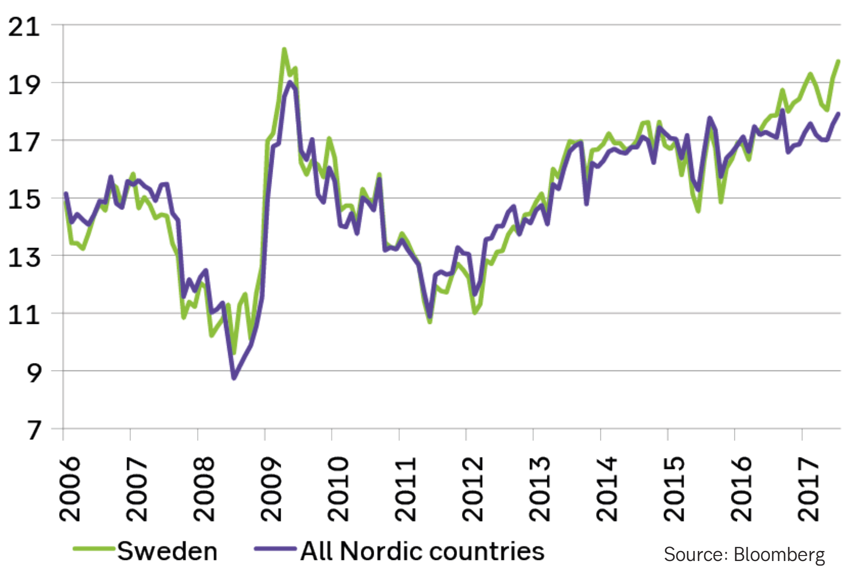
The macro environment remains strongly supportive of the stock market, with healthy and steadily improved economic growth – especially in the euro zone, which is of great importance to many Nordic companies. We also believe that the credit market and the monetary policy environment are actually more favourable than many observers probably realise today. There is a lot of focus on the US Federal Reserve's plans to shrink its balance sheet, that is, roll back some of the large-scale quantitative easing of the past decade. But from a purely practical perspective, we believe that the near-term effects of this are modest. Other considerably less publicised factors, for example that US commercial banks are now easing their lending conditions, may have at least an equally large and opposite effect in the immediate future.

Selectivity and dividends increasingly important

Equities in the Nordic countries, like those listed on the leading international stock exchanges, carry high valuations in a historical perspective. This limits their future upside potential. Their total returns may thus be expected to derive almost exclusively from earnings expansion and dividends, while the multiple expansion that has been an important factor in the past decade will reasonably play a smaller role and perhaps even turn negative.

Over the past ten years, the Nasdaq OMX Stockholm exchange's OMXS30 Index has provided a total return of 101 per cent. Of this, 60 per cent comes from dividends and 37 per cent from multiple expansion – higher price/earnings ratios – and 4 per cent from higher earnings (based on 12-month forecasts). So far this year the index has provided a total return of 10.8 per cent, of which 3.8 per cent has come from dividends, 0.5 per cent from multiple expansion and 6.5 per cent from expectations of growing profits. If we look at the extreme period that has marked the past nine years, the same index has provided a total return of 257 per cent, of which 87 per cent from

STRETCHED VALUATIONS LIMIT POTENTIAL RETURNS



The chart shows P/E ratios based on projected earnings during the coming year, according to the OMX Stockholm Benchmark Index (SBX) and the Vinx Benchmark Index of 30 leading Nordic equities.

dividends, 84 per cent from multiple expansion and 39 per cent from higher earnings. If multiple expansion has now reached the end of the road, as we expect, this will have a major impact on total stock market returns and their composition.

With a P/E ratio of 16.4 for the Vinx Nordic Index and a P/E ratio of 18.0 for the OMX Stockholm Benchmark Index, earnings now carry high valuations even taking into account low interest rates. Compared to the average for the past ten years, this is a premium of 18 per cent for Nordic equities and 26 per cent for Swedish ones. The stock market has thus already probably partly, but not fully, factored in continued good earnings performance not only in 2018 but also in 2019.

Bank dividends are attractive

Given the limited potential for higher valuations in the stock market as a whole, we believe that selectivity – an investor's selection of individual equities – has already become important and will be even more important in the future. We find banking share valuations especially attractive, thanks to high dividend yields. The capitalisation-weighted SBX Index in Stockholm will provide only a 3 per cent dividend yield according to consensus forecasts, which of course is reasonably attractive compared to market interest rates but historically low in absolute terms. Banking shares usually pay a higher dividend yield than the exchange average but the current ratio, with banking shares expected to pay dividend yields twice as high as the exchange average, is historically extreme.

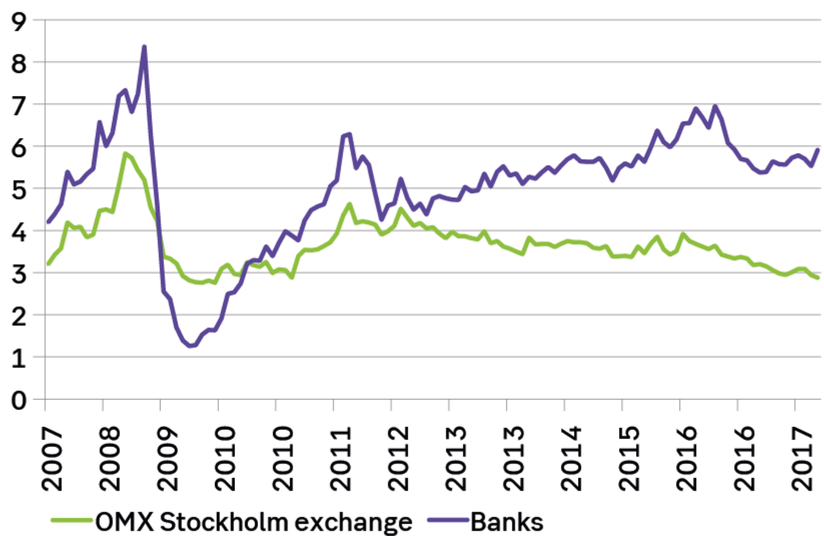
A number of factors are behind attractive dividend yields for banks: earnings valuations are unusually low and dividends as a percentage of earnings are high. High dividend percentages reflect a combination of strong balance sheets and limited lending growth. During the past 15 years, major Swedish banks have ordinarily been valued at P/E ratios that are 15-25 per cent below the average for the OMXS30 Index, although more extreme levels have occurred during brief periods. With a discount of 25 per cent, the discount is at the bottom of this normal range.

Danish banks are valued even lower than Swedish ones and today appear more attractively positioned than Swedish ones from a macroeconomic perspective, since the Danish economy is showing accelerating growth from a lower level than the Swedish economy. Today Swedish growth is also slowing after a long period of expansion. While the Swedish housing market is cooling down, the upturn in the Danish housing market has only recently reached outside major cities. During the past quarter, all significant Danish banks have shown larger loan recoveries than loan losses. Like Swedish banks, most major Danish banks distribute a very large proportion of their earnings to shareholders. Danske Bank has the largest total distribution (total dividends plus buy-backs of its own shares as a percentage of market capitalisation) of the six largest Nordic banks.

Housing worries create buying opportunities

One important source of concern that affects the OMX Stockholm exchange in particular is price trends in the housing market. A cool-down after decades of almost uninterrupted large price upturns is apparent right now, but if anything this should be welcomed from a macroeconomic perspective. We see no basic

SWEDISH BANKS PAY RECORD-HIGH DIVIDEND YIELDS COMPARED TO ALL SHARES



Source: Bloomberg

The chart shows the consensus forecast for dividend yields this coming year on the Stockholm exchange (SBX Index) and an unweighted average for the four major banks. Historically, banking shares have paid a good relative dividend yield, but the difference is now record-high. Banks are expected to pay more than twice as high a dividend compared to share price as the average for the Stockholm exchange.

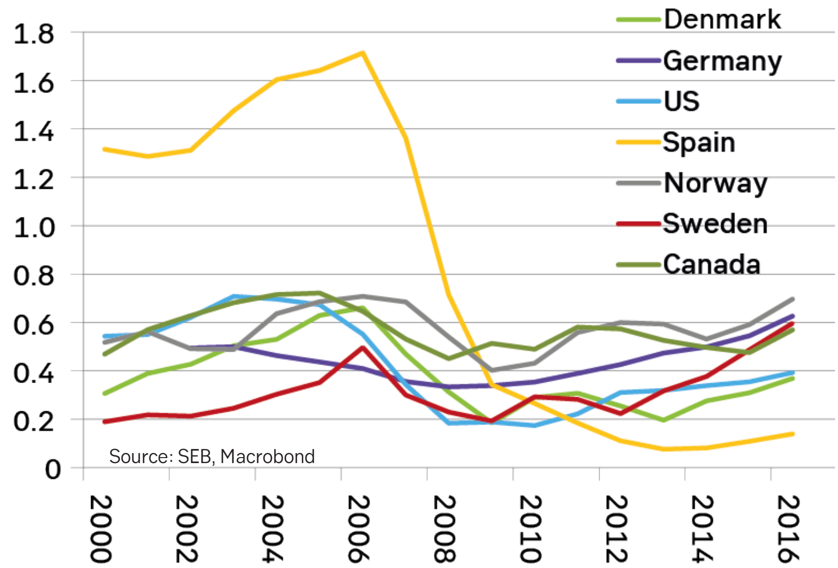
potential for a deep downturn, but instead estimate that prices will fall by a national average of about 5-10 per cent during a 12-month period. This national average includes sub-markets with substantially larger price declines as well as relatively stable sub-markets. A major housing crash such as those in the US, Denmark and Spain ten years ago would obviously have far-reaching consequences for many sectors and companies, but this is not what we expect.

Demand and the ability and willingness to pay are primarily determined by interest rates and the labour market. Today these are very favourable in Sweden, with low interest rates and a strong labour market. We expect this to be the case for a long time to come. Meanwhile supply, especially new tenant-owned cooperative units, has increased dramatically in recent years and residential construction in Sweden has risen very sharply from low levels over the past five years. In fact, completed units this year are expected to be equivalent to 0.69 per cent of the population. This is at the level of construction activity in such countries as the US and Denmark about 10 years ago, before the housing bubbles in these two countries imploded, but comparisons with pre-crisis Spain appear ridiculous (see the chart below).

In other words, there is reason for some concern about the housing market and the cool-down we have seen this summer and autumn as a result of the larger supply of homes. Even though the increase in supply has been large in percent from the low point, and construction activity in 2017 is high in an international perspective, cumulative construction over the past 5-10 years has been very modest compared to the above-mentioned countries prior to their respective crises, but even compared to other countries such as Germany. The upturn in Sweden occurred from a very low level, and construction activity has still not been high enough for long enough to have caused any major imbalances. The surplus of homes that may now have occurred in the Swedish housing market must therefore be relatively easy to absorb compared to the US and Denmark before the Lehman Brothers crash and non-existent compared to Spain. It may very well turn out that these problems are fairly isolated in certain small segments of the housing market, for example high-end flats in central Stockholm and some of the country's medium-sized cities – some of the same segments that were previously red-hot.

Obviously the cool-down in the housing market means that various directly exposed companies risk running into problems. Major banks should hardly be impacted by any significant loan losses, but it is reasonable to expect slower lending growth. Looking ahead, some areas of private consumption may also be adversely affected. But we foresee no crisis for Sweden and actually believe that many attractive buying opportunities have arisen in various construction sector companies with relatively limited exposure (<15 per cent of operating income) to Swedish home prices, but which have recently experienced significant share price declines due to the sector they belong to.

SWEDEN'S CONSTRUCTION BOOM IN AN INTERNATIONAL PERSPECTIVE



The chart shows yearly housing construction in relation to population in selected countries during the period 2000-2016. Residential construction in Sweden has increased sharply in recent years to levels similar to those in the US and Denmark before their crashes, but this high construction activity has not yet been under way especially long in Sweden, so cumulative construction over the past five years is substantially lower than in the US and Denmark before their respective crises and less than one third as high as in pre-crisis Spain.

Fixed income investments

Central banks proceed cautiously

Although most central banks are increasingly signalling a gradual decline in monetary stimulus due to strong economic growth, tightening lies relatively far in the future for most regions. We believe that a gradual reduction in stimulus will lead to higher interest rates and yields, but this rise will be limited somewhat by weak inflation pressure.

Government bonds (excl emerging markets)

Since the Riksbank is not sending any signals that it is about to change its monetary policy, and is instead focusing on countering a Swedish krona appreciation, we have delayed our forecast of its initial rate hike to September 2018. We believe that the Riksbank will then implement three further rate hikes of 0.25 percentage points each, which means its repo rate would reach 0.5 per cent by the end of 2019. It is not out of the question that the Riksbank will choose to extend its bond-buying programme through the first half of 2018. Although this would be a clear signal to the market, our main forecast is that it will end its bond purchases by December 2017.

The ECB announced a while ago that it intends to continue its bond purchases until at least September 2018 but at the same time will reduce its monthly purchases to EUR 30 billion. Our main forecast is that these purchases will actually end in September, although there is some chance that they will be extended to December. After that, we expect the ECB to raise its deposit rate for banks to -0.25 per cent in March 2019, while hiking its refi rate in June and December the same year, ending up at 0.50 per cent by the end of 2019. The euro zone economy is growing quickly, but as long as higher inflation seems far in the future and the ECB continues to expand its balance sheet, it is difficult to see any clear upward trend for bond yields. However, tapered bond purchases towards the end of 2018 will help push 10-year German government bond yields to 0.75 at the end of 2018 and to 1.10 at the end of 2019.

Despite lower than expected inflation during the autumn, the US Federal Reserve (Fed) launched a gradual shrinking of its balance sheet and also clearly signalled that the third rate hike of the year will take place in December. The negative effect of the Fed's rate hikes has been partly offset by rising stock markets and a persistently narrow yield spread between government and corporate bonds.

LOWER RETURNS FOR HIGH YIELD CORPORATE BONDS EXPECTED

Merrill Lynch US HY Index

Source: SEB

Recently, the spread between high yield (HY) and US Treasury bonds has widened to about 350 basis points (3.5 percentage points), which may be a warning signal that the economy is heading for a downturn. However, we do not believe this is something that will happen in 2018. In 2014-2015, the spread widened due to growth disappointments and energy sector defaults. In 2017, the number of credit events has fallen sharply, bolstering the HY market.

In our view, together with strong GDP growth, a tighter labour market and gradually larger pay rises, this will help push the Fed to deliver three more rate hikes in 2018 and one in 2019. That would mean a federal funds rate of 2.50 per cent at the end of 2019, which is slightly lower than the Fed's own forecasts. We believe the Fed's new chairman, Jerome Powell, will continue to support the current strategy of gradual rate hikes. Future rate hikes and a cautious shrinking of the Fed's balance sheet point to a slow rise in long-term US yields going forward. Our forecast is that 10-year US Treasury yields will be 2.80 per cent at the end of 2018 and 2.90 at the end of 2019.

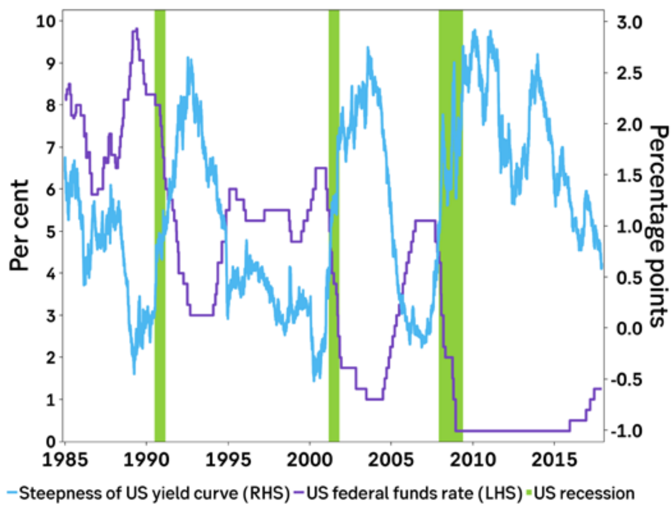
Emerging markets – EM debt

Strong global economic growth, stable commodity prices and good investor risk appetite have benefited investments in emerging market (EM) assets. However, risks continue to include political uncertainty and protectionism, which may temporarily darken the increasingly bright picture we see in emerging markets. In the choice between investments in USD and local currencies, we see an advantage for local currency investments since EM currencies should have continued potential to strengthen. Many EM countries are less vulnerable given far better current account balances. In itself, this limits the negative effects of rising US interest rates and a stronger dollar on EM currencies.

Corporate bonds – Investment grade (IG) and high yield (HY)

Investment grade bonds have benefited from central bank bond buying, but as central banks reduce their bond purchases, this effect will wane. Reduced bond purchases and rising interest rates and yields are to some extent an uncertainty factor for the investment grade segment, which carries a higher proportion of interest rate risk and is thus far more sensitive to interest rate and yield increases. The low-yield environment and narrow yield spreads between government bonds and corporate credits to some extent limit the return potential for high yield corporate bonds, which have a higher credit risk. Still, interest rate risk is lower for high yield bonds, one segment of the fixed income market that is generating relatively good returns in absolute terms, although considerably lower than over the past three years.

FLATTER YIELD CURVE A RECESSION SIGNAL?



Source: SEB

The yield spread between 10-year and 2-year Treasury securities has narrowed substantially due to the Fed's interest rate hikes. When the 10-year Treasury yield approaches the 2-year yield, this has historically represented an increased recession risk. But 10-year yields are still far higher, and we also believe that long-term yields will rise as the Fed gradually hikes its key interest rate.

ASSET TYPE	TACTICAL EXPECTED YEARLY RETURN			RISK		
	SEK	EUR	USD	SEK	EUR	USD
Cash	-0.8%	-0.7%	1.5%	0.0%	0.4%	0.3%
Government bonds	-2.3%	-0.7%	1.1%	1.8%	1.7%	3.0%
Investment grade (IG) corporate bonds	0.7%	-0.8%	2.3%	3.2%	3.2%	3.2%
High yield (HY) corporate bonds	2.5%	2.6%	3.9%	4.9%	4.9%	5.0%
Emerging market debt*	5.1%	5.1%	5.1%	11.3%	11.3%	13.1%

*Returns in local currencies

Source: SEB

Theme – Central banks

No threat to the economy or risk appetite

Central banks are shifting away from "money-printing" policies, but gigantic excess liquidity persists. There are always risks with an indebted system and fairly high valuations, but the risk of recession is low and central banks will probably act cautiously and keep a close eye on the market.

Since the 2008 financial crisis, central banks have had a supportive function in promoting economic growth by lowering interest rates and buying bonds in order to push down interest rates for households and companies. These central banks have generated a gigantic excess money supply of about USD 15 trillion, which is equivalent to around 20 per cent of global stock market capitalisation.

Most central banks have begun or are now planning a cautious normalisation of their monetary policies, although the timing varies sharply depending on where they are in the economic cycle. The US Federal Reserve (Fed) is further along than many other central banks and is moving forward largely on its own. We believe the Bank of England has delivered a one-off rate hike and will now wait until 2019 before taking the next step. Our forecast for the European Central Bank (ECB) is that the first rate hike will not take place until 2019, while our forecast for Sweden's Riksbank now postpones the first rate hike until September 2018.

Nervous asset markets

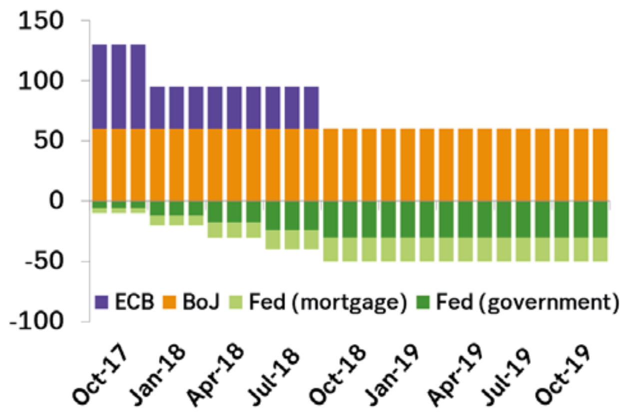
As with every turning point, there is a risk of uncertainty and volatility, but global monetary policy will remain expansionary for a while. Although the Fed is shrinking its balance sheet, the ECB and the Bank of Japan will continue their quantitative easing.

As a result, the tightening effect of the Fed's actions will be very limited at first. In 2018, the effect will be roughly equivalent to a single interest rate hike. The Fed will be cautious, hiking interest rates at a slow and predictable pace in order not to hurt the economy or risk appetite. These rate hikes will take place over an unusually long period, with the shrinking of the Fed's current 4.5 trillion dollar balance sheet expected to take place over about four years. Depending on the final level chosen and the general economic trend in the years ahead, the idea is for this process to be completed sometime around 2020-2021.

The negative effect of the Fed's rate hikes has been partly offset by rising share prices and a persistent narrow yield spread between Treasury and corporate bonds. This will enable the Fed to continue its normalisation policy and thus creates room for further interest rate cuts during the next recession.

Once central banks normalise their interest rates, we will gradually see higher government bond yields. As long as higher yields are driven by growth and inflation does not rise too sharply, we believe that higher interest rates will not constitute a threat to the stock market. Central banks will also continue their role of supporting growth and the capital market, and we will not be able to blame monetary policy if economic growth weakens or stock prices fall in the near future. However, an unexpected upswing in inflation, which would force central banks to raise their key interest rates faster than expected, could be a threat to the stock market. Nonetheless, this is not something that we think will take place in 2018.

DIFFERENT AGENDAS FOR CENTRAL BANKS



Source: SEB, Macrobond

The Fed began to shrink its balance sheet in October, while the Bank of Japan and the ECB are injecting new liquidity. In net terms, liquidity will increase by USD 360 billion globally during the last quarter of 2017 even though the Fed has already begun to shrink its balance sheet.

Alternative investments

Continued recovery for hedge funds and oil prices

With less than a month left before the end of 2017, it is fairly safe to guess that the focus will be on the global economic recovery. The world economy is growing by almost 4 per cent year-on-year and is expected to do so in 2018 too, with advanced economies as well as emerging markets contributing significantly to growth. Unemployment in advanced economies is also at a record low in a number of countries. There is a long list of factors underlying this economic recovery, but is that the only reason why hedge funds have recovered in 2017?

Hedge funds

The short answer to the question above is yes and no. By studying the most established hedge fund strategies, we can rather easily draw the conclusion that hedge funds as a whole perform better in a world where stock markets are rising rather than falling. However, that does not necessarily mean they perform poorly when share prices fall. If we then assume that an economic recovery leads to higher share prices, then the recovery – all else being equal – should also be one reason behind the favourable conditions for hedge funds that we have experienced this year.

But other at least equally important factors have also had an indirect impact on hedge fund performance. The fact that financial markets have been characterised this year by the pricing of individual securities based on fundamental data rather than "digital herd behaviour," where risk is either on or off, should also be seen as a significant factor contributing to the more stable trend noted in equities, fixed income and currencies. And as a result of more fundamentals-oriented financial markets, there is better potential for talented managers to separate winners from losers, while the lower number of digital risk decisions (decisions that tend to do more harm than good) limits both unexpected and extreme price movements.

Equity long/short

Despite somewhat overly optimistic forecasts for third quarter corporate earnings reports, the majority of companies achieved or exceeded expectations. Meanwhile, the second quarter pattern was repeated; companies with strong reports were rewarded with higher share prices and those with disappointing earnings saw declines.. As discussed above, this has led to price differentials based on fundamental data, so the strategy had good potential. In our view, this environment may persist for a while. We thus believe the equity long/short strategy has good potential for continued stable performance.

Credit long/short

The credit market remained stable during the third quarter, and the trend towards an ever lower percentage of corporate defaults has held. One of the current challenges to this strategy is that the spread between the risk-free interest rate and credit yields has narrowed to record lows due to strong economic growth. As a result, there is limited scope for positive movements in bond prices as well as in the coupon that bonds pay.

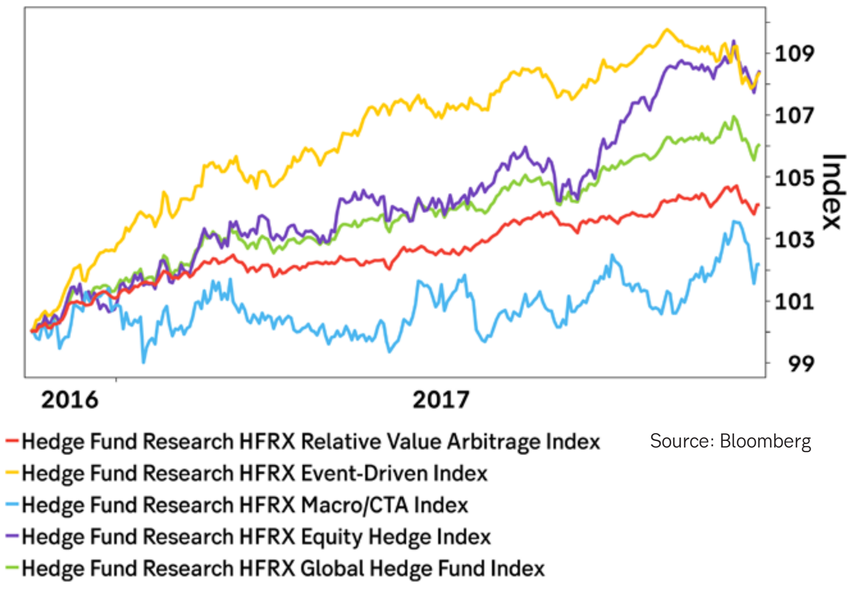
Event-driven

The event-driven strategy falls into the category of hedge funds that benefit from rising share prices and has thus been bolstered by this year's strong stock market. Yet that is far from the only explanation for its good performance this year. Given that this strategy in many cases also involves making investments in problem credits, that segment also contributed to its performance. In recent years, this type of credit has been overly established in the energy sector, which has seen extremely favourable conditions given the sharp rise in oil prices. Furthermore, there is reason to believe that the US tax reform now being considered by Congress will generate increased business opportunities in the mergers and acquisitions (M&A) segment.

Macro/CTA

Unlike the previous strategy, CTA and macro strategies are relatively insensitive to stock market performance. For macro strategies, the greater clarity of messages from the world's central banks has led to better potential both in the government securities market and for the performance of various currencies – potential that we expect to last for a while. Trend-following CTA strategies had a difficult time in the first half of 2017, with short-term trends and sudden shifts in most asset classes. However, during the second half, the picture has changed as a result of clearer signals on interest rates as well as stronger trends in currencies and commodities. This favourable situation may also continue, assuming that our positive forecasts for the global economy prove correct.

RECOVERY FOR HEDGE FUNDS IN 2017



Source: Bloomberg

Boosted by a more stable economic trend, hedge funds have performed better in 2017 than in 2016. The pricing of securities during the year was driven more by fundamental than psychological factors, providing hedge funds with better potential to generate returns.

Commodities

Since early August, (Brent crude) oil prices have risen more than 20 per cent and are now just above USD 60 per barrel. There are several factors underlying this strong trend.

In the US, the number of active oil rigs had risen continuously since May 2016 but is now falling. Since early August, their number fell from 766 to 729. We see this as a clear signal. Obviously, individual shale oil wells can be profitable when oil prices are around USD 50 per barrel, but since the majority of oil producers have other costs to bear, higher oil prices are thus needed for companies to be profitable. As a result, market expectations about US shale oil are being re-evaluated. It is now apparent that the US will not deliver an unlimited supply of shale oil at prices of around USD 50 per barrel.

For high-quality US oil – West Texas Intermediate or WTI – prices for some delivery times (the forward curve) are currently just under USD 55 per barrel.

Since the summer, it has been clear that participating countries have complied with the production caps agreed between the Organisation of the Petroleum Exporting Countries (OPEC) and Russia and that this has had an impact. Statistics indicate that since early August, global oil stockpiles have fallen by about 100 million barrels. That is one of the most important reasons why, at this writing, Brent oil prices for delivery next month are USD 13 higher than for delivery in five years. Previously, oil for delivery within one month was USD 1 cheaper than for later deliveries. Brent oil prices have also been boosted by increased geopolitical risk in the Middle East. Saudi Arabia's young heir to the throne, Mohammed bin Salman, has had powerful ministers and rival princes arrested for corruption. Moreover, in early November, Iranian-supported rebels in Yemen fired a missile at the Saudi capital of Riyadh, reinforcing uncertainty in the region.

We believe that US shale oil producers need (WTI) oil prices of at least USD 55 per barrel to be profitable. The tax burden resulting from limited capacity to export oil from Oklahoma to the Gulf of Mexico should also be taken into consideration, and the geopolitical risks noted above will affect Brent oil prices. Our overall estimate is that oil prices, currently around USD 55-60 per barrel, will remain at that level for the next year.

There is currently a supply deficit in the global oil market. However, it is worth noting that this deficit is artificial and only exists as long as OPEC and Russia agree to keep supply in check. If their agreement were to fail, we would once again see excess supply and increasing global stockpiles with falling prices as a result.

Currencies

Weak krona risks even more of a beating

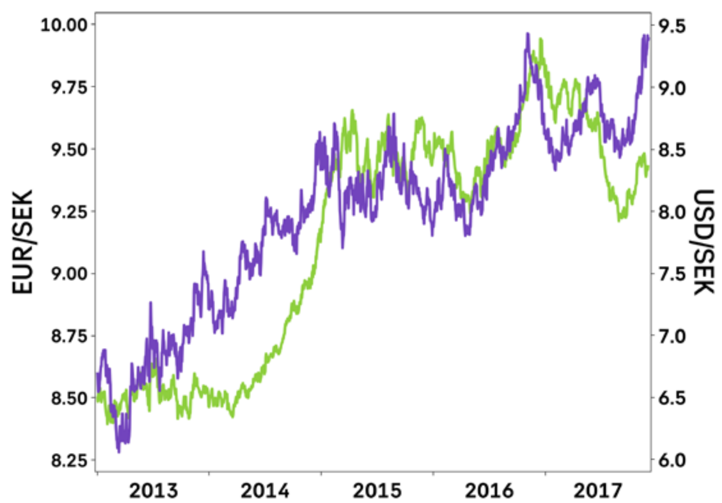
The global foreign exchange (FX) market currently lacks a clear common theme. In the absence of lasting trends and obvious mispricing, the drivers for different currencies vary. Monetary policy has dominated exchange rate movements for a long time, but the impact of central banks has clearly declined.

After a sizeable euro appreciation last spring and summer, the **EUR/USD** exchange rate has fallen this autumn and is now approaching the upper end of its recent trading range (1.05-1.15). A rise in the dollar, as perceptions of Fed policy were re-evaluated, is also completely consistent with our forecast. There is some remaining room for dollar appreciation, but in a longer perspective the dollar is more likely to weaken once again as other central banks begin their normalisation and as differences in monetary policies begin to shrink.

USD exposure in the currency portfolios of central banks and other global managers increased noticeably between 2013 and 2016. The corresponding downturn in euro exposure has been under way since 2010 and has presumably been connected to increased political and economic uncertainty in the euro zone and questions about the future of the common currency project. However, the recent trend towards stronger euro zone economic growth and reassuring election outcomes have contributed to a re-evaluation of the risk picture in a favourable direction. It is thus likely that the euro will regain lost ground and that we will see outflows from the dollar, especially considering the political challenges facing the US after the last presidential election. Our forecast is that the EUR/USD exchange rate will eventually move higher, reaching 1.20 at the end of 2018 and 1.25 at the end of 2019.

The British pound (**GBP**) remains at a historically weak level due to the uncertainty surrounding the Brexit process. The pound gained temporary support when the Bank of England raised its key interest rate by 0.25 percentage points to 0.50 per cent in November. Yet we view this as a one-off rate hike aimed at taking back the rate cut that was implemented soon after the referendum on EU membership, when the BoE feared a substantially bigger negative impact on the British economy than later turned out to be the case. Brexit negotiation results will probably remain the most important driver of pound exchange rate movements. Although the negotiations will probably be difficult and time-consuming, our main forecast is that the two sides will finally arrive at a solution that will result in a fairly orderly withdrawal from the EU. We thus expect the GBP risk premium to shrink eventually, with the EUR/GBP exchange rate falling from 0.92 at the end of 2017 to 0.88 at the end of 2018 and 0.84 at the end of 2019.

EASY TO CONFUSE STRONG EURO WITH WEAK KRONA



–EUR/SEK (LHS) –USD/SEK (RHS)

Source: Bloomberg

The Swedish krona recently traded at more than 10 to the euro for the first time in a long while. We expect the krona to remain weak for some time. Meanwhile, we may be misled by a lopsided focus on the krona's trend against the euro. So far this year, the krona has actually strengthened against most currencies, especially the US dollar.

The **Chinese yuan** continues to slowly strengthen. We expect the USD/CNY exchange rate to reach 6.70 by the end of 2017, and then fall to 6.30 by the end of 2018 and 6.10 by the end of 2019. The People's Bank of China's has adjusted its policy to keep the currency stable, with a slight tendency towards strengthening. In that way, the PBoC will attract foreign capital, which can bolster the domestic stock and bond markets.

This autumn the **Swedish krona** depreciated as the Riksbank has again dashed expectations that it will normalise its monetary policy during the first half of 2018. In addition, increased uncertainty about the Swedish housing market has helped weaken the krona. In our forecast, the Riksbank's first rate hike has been postponed until September 2018, which means we now expect a longer period of krona weakness and only a slight strengthening of the krona during the first half of 2018. The krona will therefore not strengthen more measurably until the second half of next year. We expect the EUR/SEK level will be slightly above 9.00 by the end of 2019. Looking further ahead, the krona will also have a hard time to climb higher against the euro in a global environment where the role of the euro is strengthening.

At the same time, we may be misled by a lopsided focus on the krona's trend against the euro. So far in 2017, the krona has actually strengthened against most currencies, especially the US dollar. In a broader perspective, krona appreciation will still be relatively large. The USD/SEK exchange rate will fall as far as 7.35 late in 2019.

The oil price recovery does not seem to have been enough to significantly strengthen the **Norwegian krone**. Although Norway's economy has recovered from the slowdown that followed the oil price decline of 2014-2015, in the past year inflation has fallen to levels far below target. As in Sweden, this contributes to uncertainty about monetary policy and the possibility of diverging greatly from the ECB and thereby risking krone appreciation. The weakness of the Norwegian housing market is probably also a negative factor, but given an undervalued NOK and the larger inflows created when the government supplements its budget with large-scale oil revenues, appreciation is likely. We thus expect a cautious downturn in the EUR/NOK exchange rate to 9.20 at the end of 2018 and a slight further movement to 9.00 by the end of our forecast period.

CURRENCY PAIR	EXCHANGE RATE				CHANGE, %	
	Now*	Q4 2017	Q1 2018	Q2 2018	Q4 2017	Q1 2018
EUR/USD	1.17	1.14	1.16	1.17	*-2.9*	*-1.2*
EUR/SEK	9.99	10.00	9.80	9.70	*0.1*	*-1.9*
EUR/NOK	9.75	9.50	9.45	9.30	*-2.5*	*-3.0*
USD/SEK	8.51	8.77	8.45	8.29	*3.1*	*-0.7*
USD/NOK	8.30	8.33	8.15	7.95	*0.3*	*-1.9*
EUR/CHF	1.17	1.16	1.17	1.18	*-0.5*	*0.4*
CHF/SEK	8.57	8.62	8.38	8.22	*0.6*	*-2.2*
EUR/JPY	132.0	130.0	134.6	134.5	*-1.6*	*1.9*
GBP/USD	1.32	1.24	1.27	1.30	*-6.4*	*-3.7*
GBP/SEK	11.27	10.87	10.77	10.78	*-3.5*	*-4.4*

**Currency forecasts were made by SEB Research & Strategy as of November 21, 2017. Please ask for a copy of our latest forecasts.*

Theme – China's IT companies

The digital dragon is growing

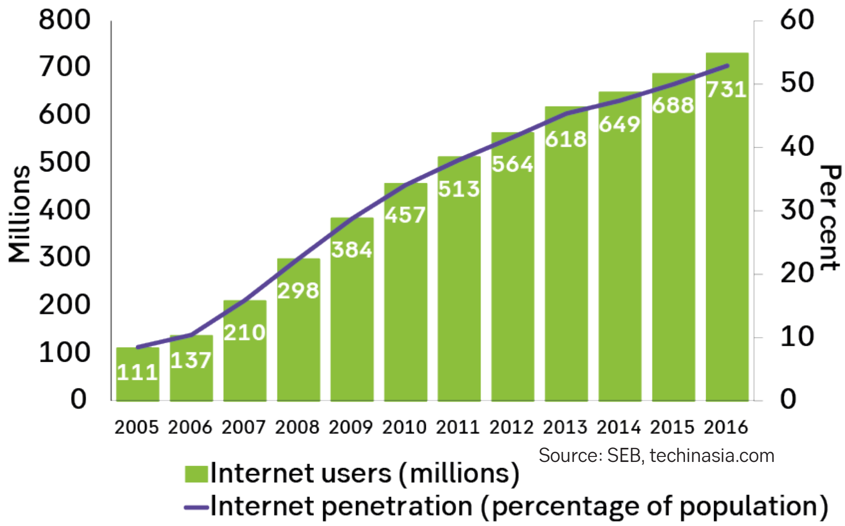
Most internet users are likely familiar with Facebook, Amazon and Google, but probably not everyone is familiar with Tencent, Alibaba and Baidu – the Chinese counterparts of these US companies. The Chinese trio is growing rapidly, driven by the exceptionally high level of adaptability to modern products and services in China's urban areas. That adaptability is higher than in the rest of the world, even though internet users number only slightly more than 50 per cent of the country's population. Despite strict government censorship, the Chinese digital economy is vibrant. It is time to learn the names of the digital dragons from the Middle Kingdom.

By far the two biggest digital dragons on the Chinese IT map are Tencent and Alibaba, which are comparable to Facebook and Amazon, respectively, but with a larger percentage of earnings from video games for Tencent than for Facebook. One year ago, the two Chinese companies' market capitalisation was about two thirds that of their US counterparts, but after the market capitalisation of these Chinese companies doubled, the difference is only about one tenth despite a 50 per cent increase in the value of both Facebook and Amazon over the same period. The reason for the increases is the innovativeness of the Chinese dragons, which have spread their wings over a country with almost one billion people of working age.

The digital economy has the potential to drive the entire Chinese economy to even greater heights over the next few years. According to external consultant forecasts, up to about one fifth of GDP growth by 2025 will be potentially attributable to this digital evolution. Everything from manufacturing to retail is affected and could potentially experience a significant productivity increase. As a result, internet-based applications will enhance the country's competitiveness from an international perspective. To combat continued high wage inflation and the consequences of an ageing population, "digital literacy" needs to be improved. Chinese productivity has increased substantially over the past decade but is still far behind that of countries such as the US, Japan and Germany. Yet we are convinced that the country's current rate of investment in digitisation and automation – which is also exceptionally high – will continue and even increase.

What is happening today in China?
More than 1.3 billion mobile phones are used in the country – about 100 million of them by young people (born in the 21st century). It is far more common to buy products online using a mobile phone in China than for instance in Sweden. As for digital services in education, health care, automotive and bicycle

NUMBER OF INTERNET USERS RISING AND THEIR ADAPTABILITY IS UNMATCHED



Source: SEB, techinasia.com

Chinese internet penetration increased from 10 per cent in 2005 to 53 per cent last year, an increase of about 620 million people who now have an internet connection. This explosive growth is unparalleled and points to favourable long-term prospects for Chinese IT companies.

transport, groceries, payments and communication, the Chinese market is the fastest-growing in the world. There are more internet users in China than the entire population of Europe, and more than 95 per cent of these users have mobile coverage. That means roughly half of the Chinese population has a mobile internet connection, whereas the corresponding penetration rate for more developed countries is over 90 per cent.

In China internet-based retail commerce accounts for around 12-13 per cent of retail sales, compared to about 9 per cent for Sweden and the rest of the world. The fact that almost 300 million people in China use internet-based food delivery illustrates the country's great adaptability to digital services. Virtually all internet users rely on digital payment solutions, with services such as Alipay (Alibaba) and WeChat (Tencent) being a nightmare for people who handle cash. There are also more than 100 million users of digital bicycle sharing platforms, while about 170 million people use digital ride-hailing platforms such as Uber and Didi. Some 80 per cent of internet users communicate via WeChat, Tencent's extremely successful communication tool, which could be compared to Facebook or WhatsApp on steroids. Many young people in urban areas basically use only their mobile to purchase consumer products.

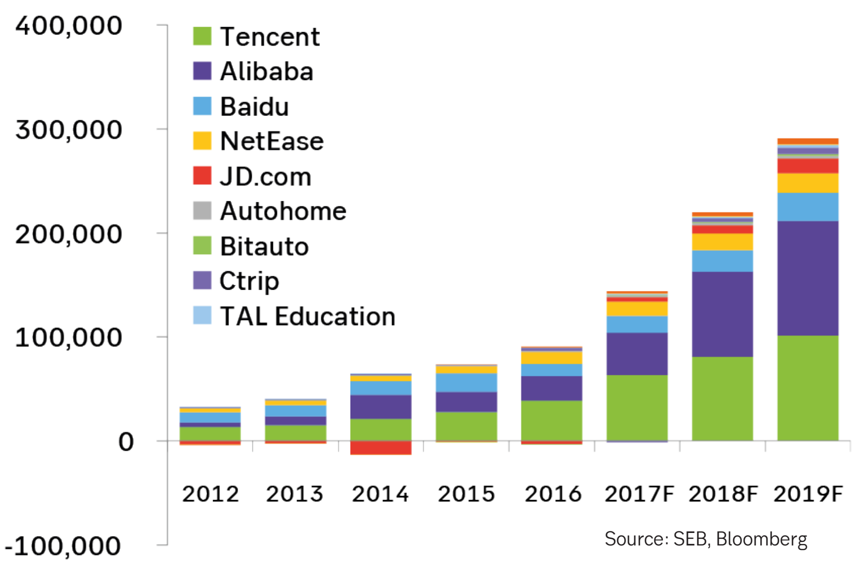
What do we learn from the statistics?

Mainly that adaptability is much stronger among people in China than in the West and that the absence of competition from US players, which are not allowed access to the market to any significant extent, does not impede innovativeness. Business executives such as Jack Ma (Alibaba) and Ma Huateng (Tencent) are fuelling innovation, and their long-term ambition is to digitise Chinese society, while international expansion is imminent. The Chinese business community is relatively young and has constantly had to adapt to far more advanced economies around the world. Forecasts indicate that about one billion people in China (70 per cent of the population) will live in cities by 2030, forcing society to make logistics more efficient. The key to this development will be smarter transport of products, services and people – for which smart digital platforms are needed.

Shenzhen – Tough competitor to Silicon Valley

China has every opportunity to put pressure on America's Silicon Valley. The high-tech metropolitan region of Shenzhen – adjacent to Hong Kong – is leading the way, with companies such as Tencent, Huawei, BYD, ZTE and OnePlus headquartered there. Thanks to Shenzhen's free trade zone, which is highly favourable to entrepreneurs, the city – with a larger population than Sweden – is being called the "new Silicon Valley". Starting as a collection of small rice-growing villages, since 1979 the region has developed into a major city with a complete ecosystem featuring everything from physical manufacturing to software production. Shenzhen has produced the most billionaires of all Chinese cities and is home to a majority of the world's manufacture of consumer electronics. Nokia and Motorola were killed not only by Apple's entry into the market; Shenzhen's low costs and skill at copying were the main factors that felled these former market giants (although Apple also helped significantly). Shenzhen is a fleet-footed region with enormous manufacturing capacity. In this environment, people are spurred to test new ideas and thus start new companies. All in all, Shenzhen is a tough competitor to Silicon Valley.

ANNUAL EARNINGS OF MAJOR IT COMPANIES IN CHINA AND 2017-19 FORECASTS (CNY MILLION)



Source: SEB, Bloomberg

The chart shows annual earnings growth for some of the largest and fastest-growing Chinese IT companies, measured in millions of yuan. Alibaba and Tencent are the giants, but other companies are also growing rapidly.

Let us consider some of these digital dragons in more detail to gain a better understanding. The next two pages describe a dozen fast-growing digitally-based Chinese companies.

Tencent – Entertainment and communication dragon

Tencent's market capitalisation is almost 500 billion dollars, and the majority of the company's earnings comes from video games, primarily licensed ones but also games developed in-house. Other earnings are generated via the company's leading communication platforms WeChat and QQ. WeChat is the largest mobile payments player in the country, in a market that overall is 30 times larger than its US equivalent. The company was founded in 1998 by Ma Huateng (Chairman and CEO) and Zhang Zhidong, two men who understood early on that developments taking place in the US would also occur in China. In 1999, the company launched its digital messaging service. In 2003 it entered the video game market and the next year its stock gained a market listing in Hong Kong. WeChat currently has more than 800 million monthly active users, who spend around one third of the total time that people spend on mobile internet in China. Tencent is a dominant force that is constantly investing in new application areas such as machine learning, electric bicycles and bicycle sharing (Didi).

Alibaba – Digitising the entire retail sector

Alibaba is a digital marketplace with a business model based on extremely efficient distribution of products. In 2014 Alibaba launched its initial public offering, which became the world's largest IPO ever – larger than those of Google, Facebook and Twitter combined. Alibaba is the world's largest internet retailer and has a market share in China of about 50-60 per cent of internet-related consumption of physical products and 11 per cent of total retail trade. Alibaba works with the online retail sale of goods but also digital media and cloud services as well as digital payments, saving, finance and insurance. Alibaba's revenue has grown almost 60 per cent annually over the past seven years. Its profit margin has increased from around 10 per cent to 34 per cent today.

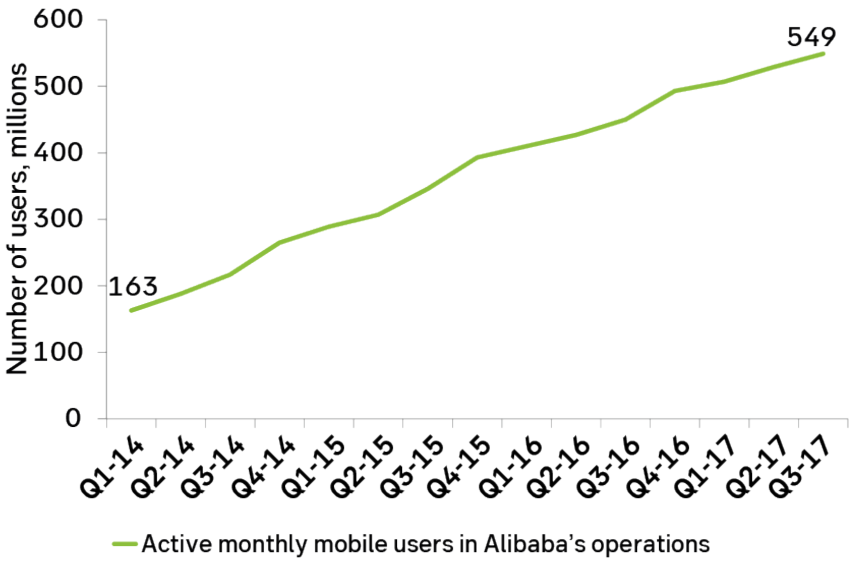
Baidu – Continuously evolving search giant

Baidu is China's search engine giant, with a market share of about 75-80 per cent, and its role model is undeniably its US counterpart, Google. Baidu is only about one sixth the size of Alibaba and Tencent but has increased its earnings by an average of 43 per cent over the past ten years and is continuously expanding its product portfolio. In addition to the unique search platform that Baidu has created, the company has a number of other growth drivers such as machine learning (artificial intelligence), self-driving cars and internet-based video streaming similar to the US entertainment company Netflix (iQiyi, which it is rumoured will launch a separate IPO in 2018).

Other interesting digital companies

China's digital landscape includes many companies, but one of the biggest and best known is **Huawei**, which has grown dramatically over the past 20 years. The company has now surpassed Ericsson, a Swedish national treasure, in terms of earnings from its telecom network equipment. Huawei is also at least as strong in consumer electronics, producing phones that are tough competitors for any telephone company in the world. Another company is **JD.com**, a competitor to Alibaba, which has the same core product – retail dis-

HIGH ACTIVITY THAT CONTINUES TO INCREASE ON ALIBABA'S PLATFORM



Source: Alibaba

The total number of active monthly mobile users in Alibaba's various operations has grown rapidly during the past four years: by the end of the third quarter of 2017 it had quintupled, which means an increase of about 460 million users.

tribution. JD.com has a market share of about 25-30 per cent in China, and on November 11 – Chinese Singles' Day, the largest e-commerce day in the country – posted sales of about 160 billion kronor, which is 80 per cent of the current annual sales of Swedish clothing retailer Hennes & Mauritz (H&M). Alibaba sold products totalling the equivalent of SEK 210 billion on that day, more than H&M sells in one year.

Weibo is the Chinese counterpart of Twitter, but with about 10 per cent more monthly users (some 365 million), an extraordinary profit margin of about 30 per cent (2017 forecast) and without Donald Trump's daily tweets. Weibo is a micro blog, which in turn is an opinion-based social network platform. Then there is **Ctrip**, partly owned by Priceline, which operates China's equivalent of the US travel company Booking.com, a digital market platform for trips, hotel stays, experience packages etc. The Chinese company **NetEase** is a rapidly growing video game company whose underlying driver is the growing global game phenomenon (both on mobiles and computers). Its financial history is impressive, to say the least, with annual growth of 36 per cent over the past ten years.

One company that many people do not know about is **Autohome**, a leading internet destination for Chinese car buyers. The company offers a digital interface for physical dealers as well as an extensive vehicle database. The Chinese automobile market is the largest in the world and is increasingly digitised with each passing month. Another company working in this industry is **Bitauto**, which also provides an online sales platform for cars. Bitauto's particular ambition is to also offer credit to consumers in an industry that is currently almost entirely cash-based.

The last of the Chinese twelve companies we have chosen to highlight from a digital perspective are **TAL Education**, **Yirendai** and **Baozun**. The first works to digitise education and offers a wide array of subjects for most segments of the school system. More than one million people use TAL's services. Yirendai works in consumer lending and offers a more attractive return compared to bank lending but at higher risk. Baozun, like the US company Shopify, offers assistance in building digital sales platforms. The company provides comprehensive solutions, including design, development, operation, IT infrastructure, customer service, digital marketing, warehousing and logistics services.

To summarise, the adaptability of people in China is much higher than in most other countries. The digital part of the economy will keep becoming larger, given continued urbanisation, healthy economic growth and increasing internet penetration. Chinese IT companies are extremely innovative and operate in the world's largest and fastest-growing market – Shenzhen has every opportunity to compete with Silicon Valley. It is time to learn the name of these digital dragons from the Middle Kingdom. China is more than capable of leading this evolution among emerging markets. It is time to expand our horizons when looking at IT companies.

Theme – IT security
Both threats and opportunities

Crime via digital channels, or cybercrime, is unfortunately a rapidly growing category of crime. The costs associated with this type of crime are enormous, and cybercrime represents a serious threat to the digitisation now taking place in society. IBM CEO Virginia "Ginni" Rometty says, "Cybercrime is the greatest threat to every company in the world." It is therefore also a serious threat to investors. On the other hand, this trend also creates opportunities; there are plenty of fast-growing companies in the IT security industry.

No one can avoid the rapidly growing flow of news stories about cybercrime. The recent IT security scandal about unauthorised outsourcing of sensitive personal data by the Swedish Transport Agency was just a light breeze compared to the storm caused by the Equifax scandal in the US, where the credit rating details, personal data and in many cases credit card numbers of more than 145 million people were stolen. Prior to this, in May 2017, the computer virus WannaCry infected 230,000 computers (at companies and other organisations) in 150 countries in what Europol described as "an attack of an unprecedented level." On unscrupulous websites, anyone who wants to can buy personal data and passwords to various websites for less than EUR 10 a person.

So-called distributed denial of service (DDoS) attacks, which are attempts to overload a server, preventing legitimate users from accessing a website, have become frighteningly common. – for instance triggering massive delays for the Swedish train operator SJ on October 11 this year as well as rioting and looting in Estonia in 2007. The shipping company A.P. Møller-Maersk was hit by a virus attack this past summer, which cost around 300 million dollars.

Some people go so far as to argue that the outcome of the US presidential election could very well have been different if not for the hacking of US Democratic Party computers thought to have been perpetrated by Russians during the election campaign.

In short, online crime has become a threat to all of society. In particular, the digitisation that is expected to generate extensive savings through increased efficiency is under threat of failure without better security. For instance, who would dare ride in a self-driven car if a hacker could suddenly take over the controls?

Well-organised scoundrels challenge naïve companies and government authorities
Criminal gangs hack the computers of both private individuals and companies and encrypt them so that they can sell stolen information back to their rightful owner for payment in Bitcoin. Today these gangs operate like companies, with 24-hour "customer support" for those affected. People who do not know how to buy and use Bitcoin to pay the ransom can receive surprisingly clear, practical and well-organised help – from the same cybergangsters who attacked them.

While these criminals are characterised by good organisational skills and determination, the opposite is often true of their victims. According to industry experts, it was clear, for example, that the Swedish Transport Agency, led first by the director-general and subsequently by the acting director-general, did not at all understand the potential value of the data it had made accessible to unvetted foreign computer contractors. When an organisation does not even know that it possesses valuable information, there is an extremely high risk that it will not protect or understand that it should protect this information.

Unfortunately, this situation is not at all unique to the government authority in question. According to the CEO of the Finnish IT security company F-Secure, whom we met recently, these situations are more the rule than the exception. The company says that it is not just top executives who often lack relevant knowledge about the subject and underestimate the threat they are exposed to; their IT departments often also have a surprising lack of expertise in these matters. For example, the CEO of F-Secure has repeatedly been contacted by worried chief executives of major organisations, who then invited the company to test their protection against data breaches. F-Secure has not only breached its clients' innermost domains, for example adding Donald Duck and Mickey Mouse to the customer list in a company's administration system – but the breach has not even been discovered by each company's own IT organisation, in any case until F-Secure drew it to their attention afterwards.

This picture of relatively unprepared companies is confirmed by a report published by the specialist insurance company Hiscox, which conducted a survey earlier this year showing that fewer than half of the 3,000 companies surveyed in the US, Britain and Germany were prepared to handle a cyberattack. At the same time, there are also obviously companies such as banks that are very aware that they possess valuable, attractive data and spend an incredible amount of money to protect it.

Competitors suspected of hiring criminals

As if it were not enough that criminal organisations hack companies on their own initiative to blackmail them or steal data, one survey recently published in the respected daily *The Financial Times* showed that companies largely suspect their competitors of being behind various breaches, especially DDoS (overload) attacks. For example, a surprisingly large percentage of online flower retailers have been attacked just before Valentine's Day, a major holiday for the industry. The hackers behind such attacks have even admitted to their victims that they were hired by other legitimate (but clearly unscrupulous) companies that compete with the attack victims.

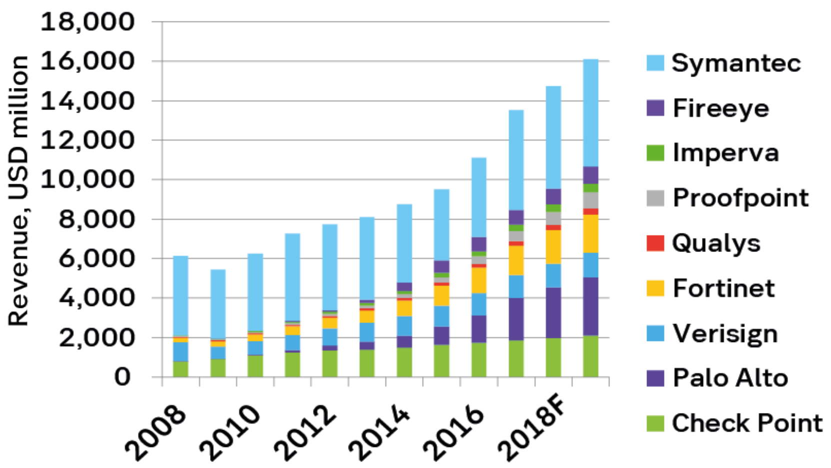
Cybercrime leads to massive costs

The cost of cybercrime is enormous and rapidly rising. It is uncertain exactly how much cybercrime costs and how quickly the cost is rising – this is partly a question of definition – but according to estimates by the insurance company Hiscox and the consulting firm Hamilton Place Strategies, the annual cost is already around 450 billion dollars and growing by about 15 per cent a year. In 2015, the insurance company Lloyds estimated the total cost to be 400 billion dollars, which tends to confirm similar figures published elsewhere, while other estimates in the media are many times larger. What these surveys and estimates all have in common is a high rate of growth. A study by the Ponemon Institute and Accenture, "2017 Cost of Cyber Crime Study", which surveyed 254 companies in seven countries with at least 1,000 users of their business administration systems, reports an average cost increase of 23 per cent over the past year to 11.7 million dollars per year per company. The number of security breaches increased 27 per cent to 130. The biggest cost for these companies is from data theft, followed by interruptions in business operations and lost sales. However, a large proportion of cyberattacks are never detected. New computer viruses are being developed at an astounding pace, and today IT security companies must use artificial intelligence (AI) to keep up with, detect and design security solutions for the new viruses. However, hackers also use AI to develop new viruses, so industry experts say that in the long run it will be a contest between criminal hackers and IT security companies. Who has access to the most powerful and advanced AI to develop or to detect and eliminate new viruses?

One man's meat, another man's poison

For investors, cybercrime is obviously a risk. For instance, the US consumer credit reporting agency Equifax lost one third of its market value within one week in September after the announcement of a data breach that involved the theft of 145 million people's credit details, including personal data and often credit card information. However, the problem also creates investment opportunities, since IT security is one of the fastest growing sectors. According to the Ponemon Institute/Accenture study, investments in IT security companies are very profitable for the 254 companies analysed. For example,

IT SECURITY IS A FAST-GROWING INDUSTRY



Source: Bloomberg

The chart shows revenue by company and year in millions of dollars for nine US listed IT security companies. Average annual growth in 2008-2016 was 8 per cent for the group as a whole and 16 per cent excluding Symantec. Good growth is also expected going forward, with a consensus forecast of 13 per cent annual growth for the group as a whole in 2016-2019 and 15 per cent annual growth excluding Symantec. (Symantec's historical revenue has been adjusted for the sale of its non-security division Veritas Software.)

investments in data security systems and advanced technology for identity checks and access control are expected to generate an estimated annual return of about 20 per cent. However, the study also notes clear signs of inefficient capital allocation between different types of security solutions in the companies' IT security budgets.

A selection of relatively well-known large US listed IT security companies also demonstrates impressive earnings growth, as shown in the chart below. Over the past five years, the nine companies in the chart had average annual sales growth of 3-55 per cent. For the median company in this group, annual growth was 23 per cent. Analyst consensus forecasts indicate good growth as well in 2017-2019. Yet far from every company is generating substantial earnings, since growth in high-tech industries such as these requires enormous investments in order to provide quality solutions.

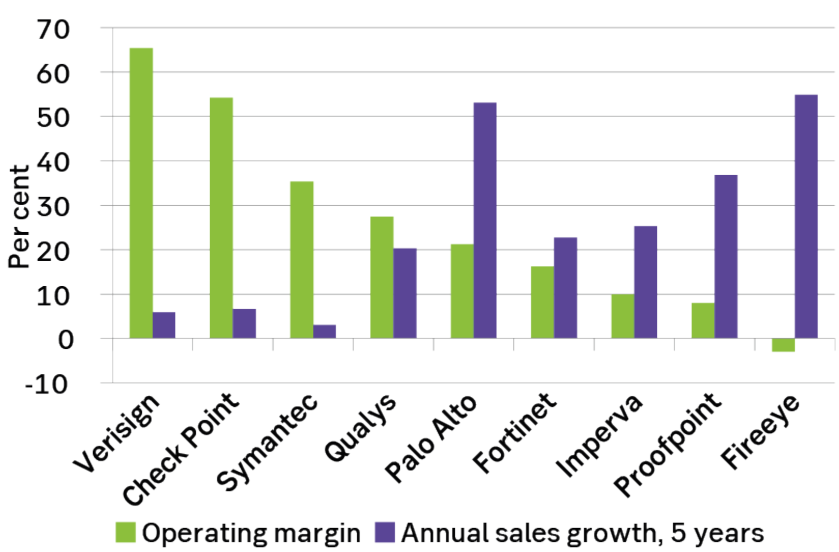
Many other companies can also capitalise on the threat of cybercrime. For example, improved security is an important sales argument for the highly profitable and fast-growing "cloud" solutions provided by companies such as Amazon, Microsoft and Google.

Whom do you dare let into your computer system?
Given the widespread distrust between companies and IT engineers in different geographic regions – for instance, European customers often distrust US security providers while US government authorities prohibit Russian security providers in critical sectors – there should be good potential for many companies from different geographic regions to be successful in IT security. This is in clear contrast to many consumer-oriented companies that sell products and services in the IT sector, where a small group of US giants have managed to take control of virtually the entire global market (outside China).

However, this distrust is not unfounded. Many American IT security companies, such as Symantec and McAfee, have recently announced explicit decisions to refuse government authorities access to source codes, in order to ease potential customers' concerns that the US National Security Agency (NSA) would be able to spy on them through "back doors" in their security software. Well-publicised viruses such as WannaCry and Petya/NotPetya are said to have been developed on the basis of information about weaknesses in Microsoft's Windows operating system that NSA detected and then spread by mistake. The NotPetya virus has cost the affected Nordic listed companies hundreds of millions of dollars this year but has hit Ukrainian companies and government authorities especially hard. The attack is suspected of being politically motivated and orchestrated from Russia. The computer worm Stuxnet has affected many different companies across the world but is said to have been developed by US and Israeli government authorities in order to damage Iran's nuclear technology programme.

A number of small Swedish and Finnish IT security companies that we recently met underscore their European origin as a major competitive advantage in sales pitches to European customers. For the hugely successful Russian IT security company Kaspersky Lab, whose antivirus software is among the most popular in the world with 400 million users, its rumoured links to the Russian security police

PROFITABILITY VARIES GREATLY IN THE IT SECURITY INDUSTRY



Source: Bloomberg

The chart shows the consensus forecast for adjusted operating margins during the current financial year and average annual sales growth over the past five years for a selection of nine US listed IT security companies.

are an obvious problem. Recently, the UK's Government Communications Headquarters (GCHQ), which gathers intelligence by monitoring signals, expressed concern that Kaspersky's antivirus software has been used by Russian spies to access sensitive data from the computers of British citizens. US authorities have prohibited federal civil servants from using Kaspersky's products, even though the company has offered the authorities access to its source code specifically in order to restore American users' faith in its products. Regardless of how widespread a phenomenon the government misuse of security software for spying is, suspicions about this create business opportunities for European companies in the industry.

Digitisation is continuing at a very rapid pace, and it is clear that part of the efficiency gains it generates will need to be re-invested in IT security solutions. This means that the future growth of digitisation will go hand in hand with the growth of the IT security industry.

SOME NOTABLE CYBERATTACKS OVER THE PAST DECADE

EVENT – WHERE/WHO?	WHEN?	WHAT?
Estonia	April 2007	Synchronised cyberattacks on businesses, government authorities and other organisations, which led to rioting. Russia was blamed but denies responsibility.
Google	December 2009	Chinese hackers obtained data from Gmail on Chinese human rights activists and more.
Stuxnet	2010-2015	Believed to have been created by US and Israeli agents to obstruct Iran's nuclear technology programme, but it also damaged other industries
Yahoo!	August 2013	Three billion e-mail accounts were hacked.
TV5Monde	April 2015	Hackers took control of broadcasting on France's largest TV network for three hours. Islamic propaganda was shown, but Russian hackers are suspected.
Petya/NotPetya	2016-2017	Virus believed to have been based on data from the NSA which shut down some Ukrainian businesses, but the Danish shipping company A.P. Møller-Maersk's subsidiary Maersk Line also lost 300 million dollars in the attack.
WannaCry	May 2017	230,000 computers in 150 countries were infected with the virus, believed to have been based on information from NSA.
Equifax	July 2017	Personal credit details and credit card numbers of about 145.5 million people were stolen.

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