Market view

Investment Outlook

May 2019

SEB

Contents

Introduction

- Our global growth forecast is 3.3 per cent this year and 3.5 per cent next year, which is above trend.
- The US Federal Reserve, President Trump and China will control risk appetite.
- We have reduced our risk exposure to neutral.
- India is attracting investors with rapid economic growth and improving earnings.
- Floating rate notes can protect investors against interest rate risk.

The stock market's performance until May was impressive, but do not forget that much of the fuel was 2018 weakness. In May, the US-Chinese trade talks generated new share price movements.

During last autumn's market volatility, there was great concern among investors about an imminent recession, as economic statistics and the capital market sent signals of a rapid deterioration. We commented on this in the last issue of *Investment Outlook* (February) and urged readers to continue believing in our then-optimistic growth forecast and not to sell shares and other risk assets. This turned out to be a correct call. The tailwinds enjoyed by the market in 2016 and 2017 became headwinds in 2018. We still had good economic expansion, combined with US tax stimulus. However, the US Federal Reserve (Fed) was hiking interest rates and shrinking its huge holdings of fixed income investments. Along with trade wars and Brexit, this resulted in an ever-weaker market, culminating in severe turbulence during the final quarter of the year. Yet Swedish investors did better in 2018, thanks to the positive effect of the weak krona. Market turbulence and worries about declining economic activity eventually persuaded the Fed to ease its tightening policy and led Chinese authorities to step up their growth-supportive initiatives. These actions led to a rebound in falling risk appetite, and market worries faded.

The fact is that stock exchanges and credit markets, after their sharp upswing this year, are back at about the same levels as before the fourth quarter 2018 turbulence. The trend has thus become flatter and volatility has increased, which is quite normal late in a cyclical upturn.

We are now in the interesting situation that shares and corporate bonds are priced much higher than one quarter ago, while the economic turmoil of the past autumn and winter has receded. Looking ahead, however, already relatively high valuations suggest that we will also see a period with more volatility.

If we now experience a scenario of upward-revised earnings, there is potential for a more positive stock market trend. However, since the February issue of *Investment Outlook*, due to share price upturns we have chosen to reduce the risk level in our portfolios to a **neutral stance**. Read more about our market view on the following pages.

In our theme articles, we present our view on how **the next recession** might unfold. Will it be as dramatic as at the turn of the millennium and during the financial crisis? *Read more on pages 9-11.*

We also provide our take on **India**, in the midst of its election. We have been optimistic about the Indian stock market for some time, but will this be true in the future? *Read more on pages 16-20.*

In the fixed income field, we explain how a **floating interest rate note** (FRN) asset works: a type of fixed income investment that provides the opportunity for good returns even if today's low interest rates start to rise. *Read more on pages 27-29.*

Wishing you enjoyable reading,
Fredrik Öberg
Chief Investment Officer
Investment Strategy

Summary by asset class

Because of the late-cyclical phase, with all-time highs on various stock exchange and the return of narrow credit spreads (yield gaps between government and corporate bonds), we are a bit more choosy in our risk recommendation this time around, compared to what we recommended in the previous *Investment Outlook* (February). At that time, risk appetite and valuations were signalling major worries among investors, creating the potential for a rebound. The economic cycle has now been prolonged, since central banks have become more restrictive towards further decelerating growth. The composition of the factors that determine our decisions concerning risk levels has thus changed once again.

Central banks and investor positioning stand out on the plus side. Investors remain wary after last year's stock market slide. On the minus side this time around are valuations, which have surged during the early-2019 rally. A more neutral signal is being provided by global economic activity and the earnings-generating capacity of companies, which are the source of both threats and potential gains ahead. If the economy regains momentum the risk situation will improve, and vice versa. Given the information we have at the moment, as well as the strong period we have already experienced so far during 2019, however, we regard it as suitable to have a more neutral portfolio. It is also important to emphasise that in the late phase of the economic cycle, it is usually profitable to shift between over- and underweighting of risk exposure when the trend levels off and volatility increases. In earlier phases, such as the recovery phase and the stable growth phase, investors should be cautious about underweighting.

For Swedish investors, this year's very strong returns are partly due to a depreciating krona, and at some point they may need to give up some of this gain. The question is when, however, since the weakening of the krona has been under way for longer and has been more extensive than we had expected.

Global equities

- Nervousness, risk aversion and falling share prices late in 2018 have been replaced by greater optimism and rising stock markets.
- The MSCI All Country World Index in local currencies, including dividends, reached all-time highs in early May.
- Share prices have climbed more sharply than earnings. We thus foresee limited potential from current levels.
- The quarterly corporate report season has been better than feared. The low earnings expectations have been exceeded.
- We are sticking to our forecast of low single-digit growth figures for global earnings.
- Fear of American health care reforms has held back the upturn in the health care sector, but valuations are attractive in a long-term perspective.

Nordic equities

- Risk appetite has increased sharply so far in 2019: risk of a sharp downturn.
- China has been a leader in this year's stock market rally, with Nordic companies also climbing.
- Big differences in market sentiment between sectors – favouring industrials and convenience goods over forest products, banking and construction. However, we prefer forest products over industrials within cyclical sectors.
- Banking shares are being squeezed by worries about money laundering.
- Neutral valuations on Nordic stock markets as a whole.

Fixed income investments

- The US Federal Reserve is signalling an unchanged key interest rate in 2019 and 2020.
- Sweden's Riksbank will need to postpone its next rate hike until July 2020.
- Credit markets are benefiting from the more dovish central bank policy stance.
- Economic growth and undervalued currencies will provide support to emerging market bonds.

Return expectations, %, next 12 months (SEK)

Equities	Return	Risk
Equities (developed markets)	7.3%	12.6%
Emerging market equities (local currencies)	7.9%	14.2%
Swedish equities	8.5%	13.0%
Fixed income investments	**Return**	**Risk**
Government bonds	-1.3%	1.2%
Corporate bonds, investment grade (Europe IG)	0.9%	2.7%
Corporate bonds, high yield (Europe HY)	3.7%	3.9%
Emerging market debt (local currencies)	7.0%	8.1%
Alternative investments	**Return**	**Risk**
Hedge funds	3.5%	6.0%

Source: SEB, forecasts in May 2019

Alternative investments

- Broad stock market upturns will provide support to equity long/short hedge fund strategies with positive net exposure.
- Clear trends early in 2019 have generated a recovery for trend-following strategies.
- Relatively sharp movements in the bond and foreign exchange markets are leading to mixed performance by macro funds.
- Rising stock market volatility should provide return potential for hedge funds.

Risk exposure & allocation

We have lowered our risk level to neutral

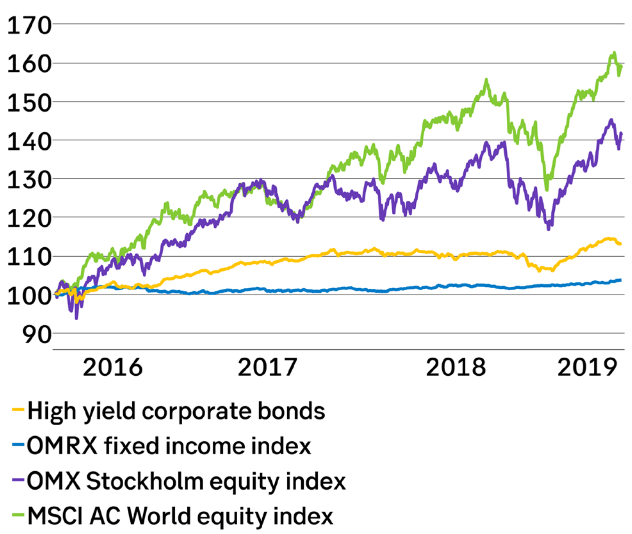
This year's winners in the financial markets are, in most cases, assets that were losers during the third and fourth quarters of last year. For example, at the top we find cyclical shares, Chinese equities and major US growth companies in the technology, consumer goods and communications sectors (Facebook, Amazon and others) as well as high yield corporate bonds. The positions that have not kept pace are of a more defensive nature, such as pharmaceutical shares and other sectors that have been more stable over time.

The late phase of the business cycle is often dramatic – including this time around – with increased volatility and a flatter trend. Over the past year, we have adjusted our recommended risk level on several occasions. We have moved between different levels of risk overweighting and at the lowest have moved down to neutral, which is our current position. Our risk reduction ahead of third quarter 2018 corporate reports worked out well. After a market decline of about 10 per cent, we chose to adjust our risk upward again, which was too early. However, we chose to maintain this level of risk when the market was at its shakiest at year-end and thus regained our relative returns early in 2019. Our latest adjustment was that late in February this year, we again shifted towards a neutral stance. This time, too, we could have rested on our laurels for a while, but we believe that the probability of our hitting exactly the right date is limited. Yet over time it has turned out that these risk adjustments, including changes within asset classes, lead to more robust performance in our portfolios as a whole. At present, central bank actions and investor positioning are factors that favour continued risk-taking, while valuations are a limiting factor. The growth factor and the earnings-generating capacity of the corporate sector have strengthened, but constitute a more neutral signal. The risk situation has thus changed again, with short-term risks being replaced by more structural, general cyclical risks, although President Trump is also perpetuating trade war risk via new initiatives aimed at achieving his desired end results within a reasonable time period.

At this writing, our discretionary portfolios are fairly **neutrally positioned**, with some **overweighing in global equities compared to Swedish equities**. In fixed income investments, we remain **overweight in high yield corporate bonds** and in **short average maturities** (low interest rate risk). **Alternative investments** are diversified and more cautious in nature, so as not to duplicate the risks from the equity and fixed income portfolios. All in all, this results in portfolios that should provide extra returns in rising markets, but also some resilience in downward markets.

Finally, it is worth pointing out that since 2018 we have been in a phase where both overweighting and underweighting in the stock and credit markets can be justified. The average risk level we have chosen is lower in this late-cyclical phase, which is quite natural since expected returns are decreasing as volatility is increasing. On pages 9-11, we look at how the next recession might emerge and what its impact on the capital market could be. We do not believe that a recession is imminent, but we would still like to explore this theme.

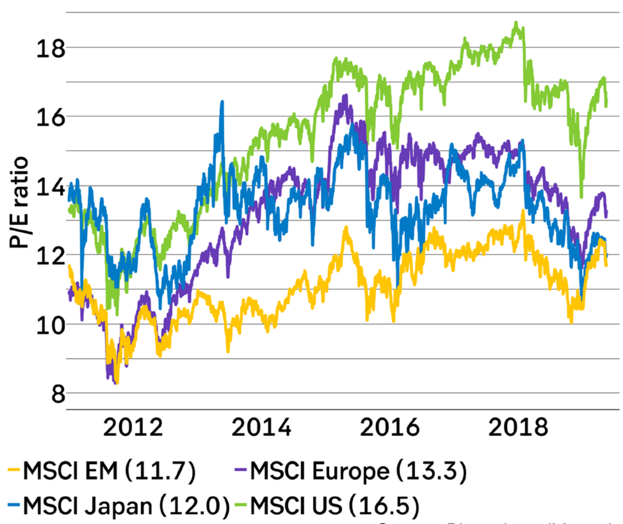
How different asset classes have performed



Source: Bloomberg/Macrobond

The chart shows the return for the MSCI AC World, a broad global equity index; the OMX Stockholm equity index; the OMRX Swedish fixed income index; and a European high yield (HY) index with in local currencies. The lengthy upturn in asset prices since 2009 was not repeated during 2018.

Relatively high share valuations



Source: Bloomberg/Macrobond

Valuations expressed as P/E ratios – share prices divided by earnings forecasts for the next twelve months – have again reached relatively high levels, since stock markets have climbed sharply in 2019, while the earnings forecasts have been adjusted downward to a modest 2-3 per cent in the coming year.

Macro and other market drivers

Central banks prolong economic expansion

Macro

The sharp stock market fluctuations of recent quarters show the difficulty of assessing growth potential going forward as well as judging the economic-political landscape. Last autumn's stock market slide was driven by the US Federal Reserve (Fed)'s clearly hawkish policy, decelerating growth in both Europe (German manufacturing) and China (credit tightening) and worries that the political scene – primarily the US-Chinese trade conflict, but also Brexit – would inhibit growth further. Because of these factors, global trade lost significant momentum towards the end of 2018 while business optimism – expressed as purchasing managers' indices (PMIs) – weakened, though from high levels.

Yet in several respects, the situation has improved. This was reflected in the sharp turnaround in stock market sentiment early in 2019, from negative to positive. The clear shift in Fed monetary policy was probably the most important factor. Early this year the US central bank clearly indicated that it was abandoning its hawkish path, adjusting its monetary policy to the growth situation as well as the financial markets. Meanwhile, Chinese credit easing seems to be starting to have an impact on both global trade and Chinese growth.

Partly offsetting improvements in the policy and political situation, the underlying growth situation has been more fragmented. In the **United States**, signs of strength have predominated. In China, the deceleration has continued, although recent data provide some hope, while weakening tendencies have continued to predominate in Western Europe. The American economy has assumed a slightly different global role in this phase of the economic cycle. The US is normally first in the economic cycle. Since we are now in a mature phase, the US economy should be the first to show signs of weakness. Instead, its growth was surprisingly strong during the first quarter. This is partly explained by temporary factors, but there is no doubt that underlying growth is robust. We expect continued above-trend American growth, driven especially by a strong labour market. But record low unemployment means that labour shortages will hold back future growth. This is one reason why we have revised our growth forecasts marginally lower for 2019. The positive impact of fiscal policy – mainly the tax reform that took effect in 2018 – is expected to fade next year, also contributing to the slowdown. But this decline is being cushioned by a rebound in productivity growth after several weak years. This is an important component of the still relatively bright growth picture we are painting.

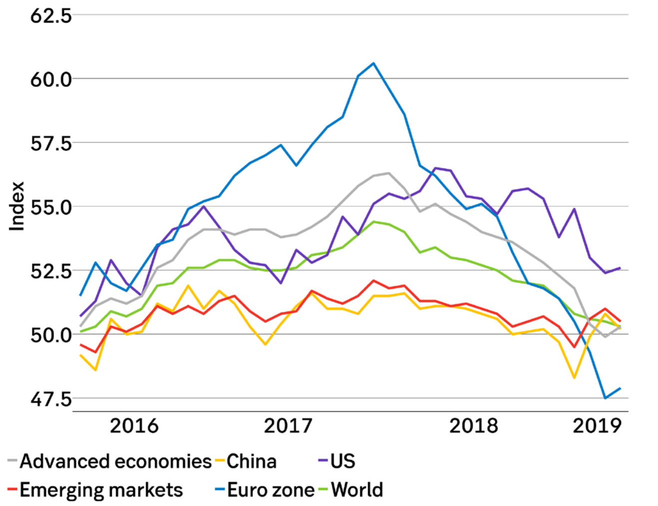
For **emerging market** (EM) countries, growth will be somewhat slower this year than in 2018. However, we believe that their deceleration has already largely occurred, since we now see signs of stabilisation in trade flows and industrial activity. We therefore expect some acceleration in growth going forward. This will make the EM sphere a reliable global engine in the next couple of years, with annual growth of 4.5-5 per cent. Here, developments in China play a vital role. As one of the world's largest economies, and with manoeuvring room in both fiscal and monetary policy, China's role in global growth will be especially important in the coming period. In many other countries, economic policy toolkits are empty, due to already low key interest rates and/or over-extended government finances. Recent Chinese stimulus measures are also the most important reason why we expect a modest and controlled deceleration in China and why signs of stabilisation in China's foreign trade will contribute to a slightly more

GDP forecasts, year-on-year percentage growth

Market	2017	2018	2019	2020	Comments
United States	2.2	2.9	2.3	1.7	The Fed and a strong labour market will slow deceleration
Japan	1.7	0.8	1.0	0.8	Continued structural headwinds
Germany	2.2	1.4	0.7	1.2	Strong finances and better exports will provide support
China	6.8	6.6	6.3	6.1	Gentle deceleration, controlled by Beijing
United Kingdom	1.8	1.4	1.3	1.4	Continued Brexit complications will hamper growth
Euro zone	2.4	1.9	1.1	1.4	Growth will bottom out this summer
Sweden	2.1	2.3	1.6	1.7	Persistent growth, continued low interest rates
Baltic countries	4.4	3.9	3.1	3.7	Deceleration in response to global economic trends
OECD	2.5	2.3	1.7	1.7	The US will lead a slowdown, while the EU stays resilient
Emerging markets	4.8	4.7	4.6	4.8	The EM sphere will remain a global growth engine
World, PPP*	3.8	3.7	3.3	3.5	Low interest rates and inflation will prolong the upturn

Source: OECD, IMF, SEB *Purchasing Power Parities

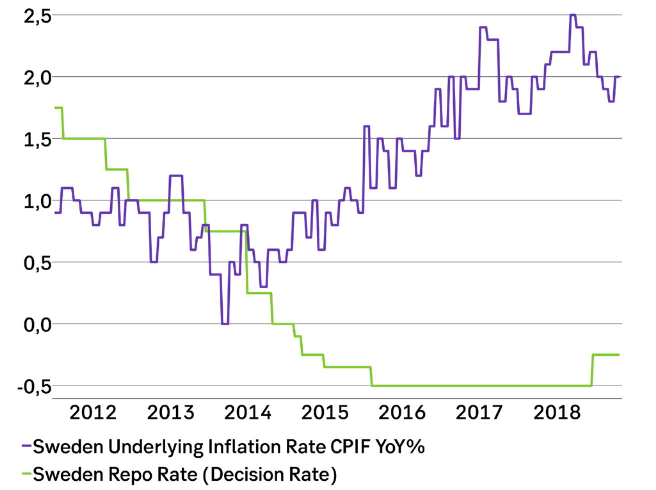
Leading indicators point to deceleration, but increased EM activity



Source:Macrobond

The chart shows purchasing managers' indices (PMIs) in various regions and countries. They show companies' plans and their perceptions of the business climate. Levels above 50 indicate economic expansion. Historically, these indices have needed to be well below 50 to signal a coming recession.

Riksbank key interest rate and Swedish inflation since 2012



Source:Macrobond

The Riksbank's historically very low key rate is one effect of the difficulty of achieving its 2 per cent inflation target. Low inflation is not a uniquely Swedish problem, but the Riksbank is among the central banks that have resorted to the most drastic measures (negative key interest rates) to try to overcome this.

positive outlook for global trade and thus economic growth in the EM sphere. Other factors contributing to this more positive outlook are the Fed's shift from monetary policy tightening to a more cautious stance, continued good growth in India and a slight acceleration in commodity-dependent economies such as Russia and Brazil.

Overall, we are revising our global economic growth forecast for 2019 slightly lower, but we expect growth to remain above-trend, that is 3.3 per cent this year and an acceleration to 3.5 per cent next year.

Inflation and central banks

With the US Federal Reserve (Fed) in the driver's seat, this year we have seen a U-turn in global monetary policies. Other major central banks such as the European Central Bank (ECB) have followed the Fed's example by shelving or greatly postponing their plans to normalise monetary policy (hiking key interest rates or withdrawing stimulus via the bond market). This is being done as a reaction to both growth-related and financial market factors. The deceleration in the global economy has also been accompanied by weak inflation. The acceleration we have seen in wage growth seems to have slowed lately, while inflation remains below central bank targets. This reduces the need to normalise monetary policy and increases manoeuvring room.

It is obvious that central banks still consider it more important to help sustain economic growth and financial markets than to normalise policy at all costs and to hike key rates, in an environment where the inflation situation does not require it. We thus expect the Fed to maintain its current key interest rate (2.25 - 2.50 per cent) both this year and next, with a greater chance of rate cuts because of muted inflation. We now also expect the ECB to keep its interest rate on hold. We also expect new expansionary ECB measures in the form of cheap loans to euro zone banks in order to stimulate the economy via lending. Sweden's Riksbank is following the example of its peers and is postponing its next interest rate hike, while reiterating that it is focusing on the 2 per cent inflation target. We expect an interest rate increase to 0 percent (!) by the middle of next summer, but then no further change. Our inflation forecast is lower than the Riksbank's.

In the short term, this central bank shift thus represents a return to policies that support growth as well as such risk assets as equities, in the form of low key interest rates for a lengthier period. In the long run, however, risks are likely to increase, since central banks have few tools left to use if and when growth will need to be stimulated in the future.

Valuations

Because of rising share prices and narrower credit spreads (yield gaps between government and corporate bonds) – combined with sizeable downgrades in corporate earnings forecasts – the positive valuation signal that was flashing around the turn of the year has once again disappeared. We do not believe that valuation levels will keep rising. It is thus reasonable to expect that returns during the next 12 months will be generated from rising profits and dividends, as well as share buy-backs. Prior to the first quarter corporate report season, global earnings forecasts had been revised downward to a mere 2 per cent for the full year 2019. These revisions seem overly pessimistic and are likely to be adjusted upward to about 3-5 per cent. On the other hand, estimates for 2020 will probably be left unchanged in absolute terms, which would imply an earnings increase of about 5-6 per cent. If these figures prove correct, this will confirm our expectations that 2016-17 was a clear acceleration phase, 2018 a peak year thanks to the US tax reform and 2019-20 a levelling-off period, which is normal in a late phase of the economic cycle. With profit multiples (price/earnings ratios) of around 17 for leading US equities (S&P 500 index) and 15.5 for the MSCI All Country World Index (MSCI ACWI), we are now at levels that – since the stock market bubble around the turn of the millennium – have only been clearly surpassed during the robust growth phase in 2016-17.

Risk appetite and positioning

The strong recovery of risk appetite in 2019 has not had an equally strong impact on investor positioning. There are clear indications that a large proportion of both institutional and private investors have only marginally increased their risk. Most signals suggest that major share purchases have been made by companies themselves (for example in the US) and that certain hedge funds and trend-following strategies have greatly increased their risk level. This means that the need to reduce risk, for example, if economic statistics deteriorate, is less than usual after a period of very strong stock markets. It also means that among more cautious investors, there is potential for higher risk taking. Thus both risk appetite and positioning are more neutral than they usually are, following the big upturn during the early months of 2019.

Examples of risks

The risk that overly restrictive central banks will strangle economic growth has greatly diminished. An economic downturn would still create problems, but the short-term probability of such an event has decreased. Efforts to reach a trade agreement between China and the US are moving forward, and it is in the interest of both countries to achieve a solution (although President Trump is lighting a fire under the process via Twitter). Once such a solution is in place, it will be time for the European Union and the rest of the world to sign trade agreements with the US. The process of reaching these trade agreements is lengthy and complex; it will occasionally impact the stock market mood. The United Kingdom's withdrawal from the EU (Brexit) has been postponed, along with the related risks, but market worries should increase this autumn. Another risk connected to the economic and credit cycles is the build-up of debt that has occurred around the world since the financial crisis a decade ago. Large debt volume, combined with declining average credit quality, may create problems when the economy begins a downturn. This is a normal correlation, but the question is whether we are underestimating its magnitude by looking at historical correlations.

Theme: Economic cycles

Every recession is different

How might the next one look?

If we study the latest recessions and their sharp stock market downturns, it is not certain that developments need be equally dramatic the next time around.

We are in a long-term economic expansion; this must be regarded as a fact. We are seeing various signs that this upturn is nearing its "best-before" date. Global unemployment is at low levels. Other indicators also signal that resource utilisation is high, making the room for growth limited.

The yield curve is very flat, i.e. there is no major difference between yields on short- and long-term bonds. The yield curve shows the gap between yields on bond loans with different maturities. The shape of the curve is determined by market expectations about future changes in yields. If yields are expected to rise, the yield on a bond with a long maturity is higher than the yield on a bond with a short maturity. The yield curve thus shows the fixed income market's yield expectations. A flat yield curve is a warning sign that a recession may be approaching within the next two years.

The capital market has also become more worried over the past year. This has prompted the US Federal Reserve (Fed) to decelerate its key interest rate hikes and its balance sheet reduction in order to curb the slowdown and calm the markets. Thus, everything indicates that we are in the latter part of this prolonged economic expansion. Instead of trying to forecast more exactly when the next recession will occur, we will describe some of the imbalances that have been built up and how they might create disruptions in the financial system as times become tougher.

Big central bank balance sheets, low key rates will increase pressure on fiscal policy makers

We are accustomed to central banks both stimulating and slowing the economic system. The period after 2007 provides an extreme example, when the "global central bank" made genuine use of the available tools – not only by slashing key interest rates to ultra-low levels but also by allowing their own balance sheets to swell. The latter is usually called quantitative easing (QE) and means pumping liquidity into the economy, both through direct purchases of fixed income instruments such as bonds and by providing liquidity to banks in the form of cheap loans.

Some normalisation of central bank policies has occurred in recent years, among other things because the Federal Reserve has raised its key interest rate to the 2.25 – 2.50 per cent range and has also started shrinking its balance sheet. Early in 2019 the Fed paused this move towards higher interest rates and a smaller balance sheet, as a direct response to signs of economic weakness that became apparent during the second half of 2018 and the worries they triggered in the capital market via significant stock market declines.

As today's low key interest rates and the chart below left suggest, it is difficult to imagine that in the next recession, central banks can resort to the same weapons as before. But the previous recession was not of the usual kind; it was a global financial crisis that required an extraordinary response.

Varying regional conditions

Conditions also vary around the world. In Europe, we have very low interest rates but fairly strong government finances in several of the major countries. It would thus be reasonable to use significant fiscal measures to accelerate growth, that is, let countries increase their government budgets.

The **United States** has managed to raise key its interest rates in recent years. This means that the country could use the traditional method of central bank rate cuts, while weak federal government finances will limit the scope for active fiscal policy (bigger budgets).

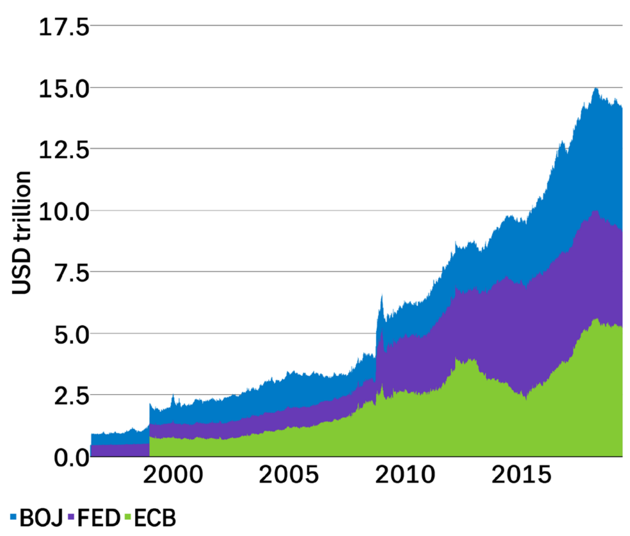
China has the opportunity to use both monetary policy and fiscal policy.

Global debt has risen and changed shape

The financial crisis revealed weaknesses in the financial sector (banks etc.), which was later regulated, recapitalised and transformed. Put very simply, today's financial sector has a higher proportion of shareholders' equity and is permitted to bear less risk than before, making this part of the financial system more robust and reducing the risk of a new banking crisis. But at the same time there has been expansion elsewhere, since total debt has climbed. The most recent period of economic expansion – since the 2008 crisis – has gone hand in hand with increased government debt. The same applies to the corporate sector (excluding financial companies). This time around, credit expansion has largely taken place via the bond market. The Institute of International Finance (IIF) draws the following conclusions:

- Global debt is now equivalent to USD 244 trillion or 318 percent of global GDP (third quarter of 2018).
- National governments and non-financial companies account for the largest debt build-up since 2008.
- Among households, it is mainly in the emerging market (EM) sphere that debt has increased, driven by China – the largest EM economy.
- The bond market, mortgage institutions and special lenders now account for over 50 per cent of credit expansion. This trend applies in most countries, but Japan is an exception, with lending outside banks having decreased.

Sharp increase in central bank balance sheets



Source: Bloomberg/Macrobond

The chart shows how three major central banks have multiplied their balance sheets since the 2008 financial crisis. These increases are synonymous with stimulative purchases of fixed income instruments such as bonds to promote growth and ensure liquidity (BOJ = Bank of Japan, FED = US Federal Reserve, ECB = European Central Bank).

US corporate debt has increased

Source: Bloomberg/Macrobond

The chart shows that debt in the US corporate world, excluding the financial sector, has again reached high levels as a percentage of GDP. Interest rates and yields are low, so interest costs are lower as a percentage of GDP. While companies have increased their debts faster than GDP growth since 2010, the trend among households has been the opposite.

At the same time that debt has risen and the traditional financial sector has lowered its risks and accounts for an ever-smaller proportion of funding, the quality of overall global debt has fallen. In other words, the credit rating of the average debt is lower than before. This is probably because for a long period, banking regulations and extremely low interest rates have made it easy and cheap for the corporate sector to obtain funding.

To gain a longer-term perspective, we can study the total debt among US companies excluding the financial sector as a percentage of American GDP, as shown in the chart on the previous page. It clearly shows how debt has increased. A corresponding chart for Europe, however, would show a decrease in the debt level over the past few years.

What might happen when we enter the next recession?

The heavy global debt burden makes it reasonable to believe that central banks will provide liquidity if the bond market begins to show significant problems. During previous downturns, bank balance sheets have often helped during the messiest periods. Bank support to companies in the form of loans has clearly decreased, due to tougher regulations following the financial crisis. On the other hand, existing debt is now spread among a far broader group of lenders. This will increase the capacity to cope with any problems that may arise. The disadvantage of such broad dispersion is that some of this funding is now being provided, for example, via bond funds and there is a risk that unit holders will choose to redeem their holdings when they face headwinds.

Overall, it remains worrisome that the credit market is showing more signs of vulnerability than before. There is a risk that the next period of instability may lead to the credit market being unusually hard hit, with potential contagious effects on other parts of the economic system. One difficulty in assessing the magnitude of the risk that the credit market will either trigger or worsen the downturn is that the credit market is only one part of the financial system, and that it is possible to argue that the overall picture is not equally alarming.

In the May edition of the quarterly *Nordic Outlook* report, SEB economists write that experience from earlier periods of mature economic growth shows that economic expansion has been able to continue for a long time despite rather tight labour markets. When a recession has arrived, it has been triggered by a reaction to some acute financial crisis, such as the sub-prime mortgage collapse in the summer of 2007 and the Lehman Brother crash in 2008.

Generally speaking, the US financial stress level does not currently seem very high. Household debt has fallen to 105 per cent of disposable income, from a peak of more than 140 per cent in 2007. Corporate debt is higher in a historical perspective, but the upward trend has been quite slow and prolonged. Broader metrics (for example from the Bank of International Settlements and the Bank of England) on the "financial cycle" also confirm that the US is not showing excessive or stressful levels, but instead financial stress is clearly below the historical average. Our conclusion is thus that the risk of the financial cycle reinforcing a decline in the traditional economic cycle is limited.

Summary

If we study the latest recessions and their sharp stock market downturns, it is not certain that developments will necessarily be as dramatic next time around. The events of 2000-2002 and 2007-2009 were very dramatic, but differed in nature. In a historical perspective, they were also different in scope when it comes to stock market declines. The downturn at the beginning of the millennium started with a gigantic stock market valuation bubble. The combination of a financial market crash (sub-prime/Lehman) and a "naturally" approaching downturn made the last recession the deepest since the Great Depression of the 1930s. Despite increased global debt, it is probably an exaggerated assumption that the next recession will have equally dramatic effects on the world's capital markets.

Global equities

Challenging valuations, due to rising prices

Nervousness, risk aversion and falling share prices late in 2018 were replaced by increased optimism and rising stock markets early in 2019. The MSCI All Country World Index in local currencies reached its highest-ever in early May. Lower interest rates and yields, stronger macroeconomic figures than feared and hopes of a constructive trade policy solution between China and the United States were behind the upturn. Potential upturns from current levels are limited, however.

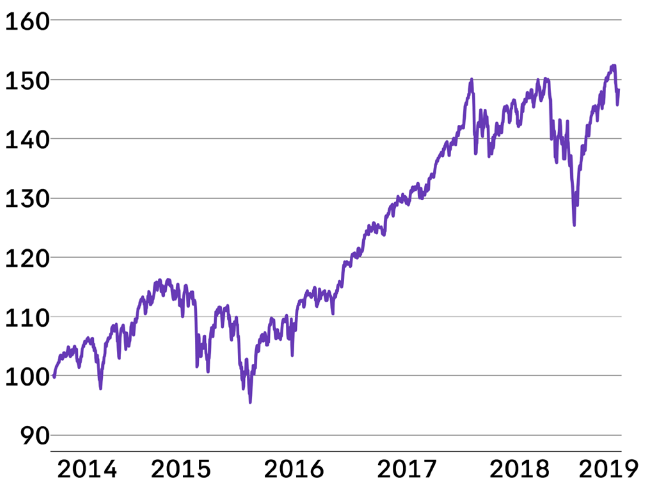
Steeply rising share prices are usually accompanied by strong optimism from financial market players, but not this time around. Both surveys and various risk indicators show that although risk appetite has climbed, it remains at moderate levels. The percentage of cash-equivalent holdings by asset managers is also unusually high, considering recent stock market upturns. Having a large cash position may gradually force asset managers into the stock market, since there is an obvious lack of alternative sources of returns. This may help prolong the upturn, but we expect limited potential gains from current share prices, since earnings have not kept pace with prices. This makes equity valuations more stretched.

Low earnings expectations being surpassed

The first quarter 2019 corporate report season has been stronger than expected. The large downward revisions in earnings forecasts that occurred late in 2018, before the first quarter of 2019, proved overly aggressive. The American report season has surprised on the upside, and sales have been consistent with expectations. Technology giants like Microsoft and Facebook as well as the more consumer goods-oriented Amazon have delivered solid reports, resulting in share price upturns. Health care sector earnings have been another upside surprise. Semiconductor and hardware companies in the information technology (IT) sector are still having a tough time, though. Comments from Intel and Texas Instruments indicate that it will take another several quarters before demand rebounds. Demand from computer centres and China is described as especially weak.

In **Europe**, reports so far have been in line with expectations. Thanks to decent manufacturing activity and weak currencies, industrials were among the sectors that performed well, but the vehicle sector again stood out as the weak link. The hard-pressed European banking sector is showing lower earnings than in 2018, as expected. UBS and Credit Suisse, two Swiss banks, were especially weak and pulled down the

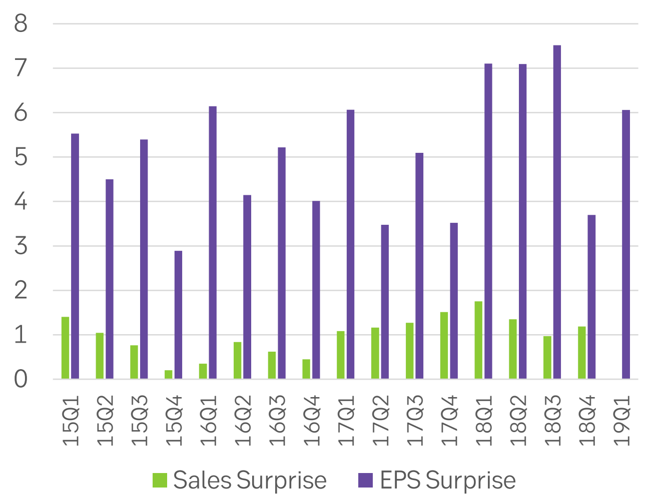
Strong five-year performance by global equities



Source: Bloomberg/Macrobond

The MSCI All Country World Index of equities, including dividends, is currently close to record-high levels.

American companies beat lowered earnings expectations



Source: Bloomberg

Of those companies that have published Q1 2019 reports so far, earnings have surprised on the upside by about 6 per cent, while sales are in line with expectations. If we extrapolate these trends for the remaining corporate reports, it would mean a slight increase in Q1 earnings compared to 2018.

Mediocre rate of earnings growth

Region	P/E ratio, 2019	Rate of earnings growth, %, 2019
United States	17.6	2
Europe	14.1	5
Japan	12.6	-3
EM sphere	12.7	6

Source: Bloomberg

A profitable 2018 is being followed by slower earnings growth in 2019. The US will have especially difficult comparative figures this year after last year's tax-driven earnings explosion, while Europe and the emerging markets sphere will perform better. Historically, the Japanese stock market has had low valuations, but a strong currency and the fading global economic growth rate are pulling down corporate earnings-generating capacity.

sectoral average. These results have not, however, prevented Europe's still low-valued banking shares from climbing along with the market.

In **China**, earnings have surprised on the upside. Looking at the shares in the CSI 300 Index, which represent the Shanghai and Shenzhen stock exchanges, so far these have beaten expectations both in terms of sales and earnings. The CSI 300 is the major index that has risen the most so far this year, but it is still at about the same levels as one year ago.

Despite the trumpets and fanfares in stock markets, we are maintaining our forecast of low single-digit growth in global corporate earnings. Stronger economic growth is needed before earnings projections can be revised upward.

A profitable 2018 is being followed by slower earnings growth in 2019. The US will have especially difficult comparative figures this year after last year's tax-driven earnings explosion, while Europe and the emerging markets sphere will perform better. Historically, the Japanese stock market has had low valuations, but a strong currency and the fading global economic growth rate are pulling down corporate earnings-generating capacity.

Big differences between sectors in earnings and price trends

The most striking difference is the one between the technology and health care sectors. **Technology** has rebounded steeply after its downturn late in 2018 and is the best-performing stock market sector so far this year. Meanwhile its earnings trend is fairly mediocre. Technology sector earnings are even expected to decrease marginally this year, compared to 2018. Apple, the biggest company in the sector, is expected to report a slight earnings downturn despite starting 2019 with a strong first quarter report. Companies that develop and produce semiconductors and components, such as Intel and Texas Instruments, published reports that included a subdued outlook for the rest of the year. Weak demand from China and other markets was cited as one reason. South Korean-based Samsung also presented a weak report and a subdued future outlook. Chinese competition as well as low demand for memory chips and LCD displays were behind Samsung's weak figures. But there is continued cautious optimism about a better second half of 2019. This is also true of investors, who have treated the sector well despite meagre earnings reports.

High share valuations in semiconductors

Source: Bloomberg

Shares in the semiconductor sector are at near-peak levels. The chart shows price/earnings ratios based on a one-year forecast for the MSCI World Index for semiconductors and semiconductor equipment and indicates that the upturn has occurred because of higher valuations.

Sectors in MSCI World Index of equities

Source:MSCI.com/gics ,"Global industry classification standard"

At the end of 2018, companies such as Facebook, Tencent and Alphabet (Google) were reclassified from the "information technology" sector to "communication services".

It is worth noting that the global sectors in the MSCI World Index were reclassified at the end of 2018. Nowadays, for example, Facebook, Tencent and Alphabet (parent of Google) are included in the "communication services" sector. As a result, the technology sector now has lower valuations, but is also more volatile in its earnings.

The **health care sector**, on the other hand, is delivering generally strong reports. Yet the sector is the worst in global stock markets this year. Among the reasons are political worries about how the US health care system will look in the future. Republicans and Democrats agree on the need to bring down costs of medicines, among others, increasing the probability of some kind of reforms.

Democratic presidential candidate Senator Bernie Sanders recently launched his revised "Medicare for All" bill. In practice, it would mean replacing private insurance policies with a government system covering the entire population. The probability of such a reform being enacted is low, but the risk premium for shares in this sector has increased. President Donald Trump has also loudly appealed to pharmaceutical companies to lower prices. We have heard similar rhetoric before, but it has been difficult to push through concrete proposals that would disrupt earnings in the sector. The report season has so far shown solid earnings increases that have also provided upside surprises. The sector is attractive in a longer perspective, since valuations are reasonable and earnings are relatively unaffected by economic cycles, but we must expect the fear of health care reforms to keep these shares down for another while.

The US is the economic engine, but other regions are not far behind

The US stock market has rebounded dramatically since plunging late in 2018. The S&P 500 index actually fell by nearly 20 per cent in local currency from its peak in September to its trough in December. The same index reached an all-time high early in May. Again it has been major technology, consumer goods and media companies that have driven the upturn. Apple, Microsoft and Amazon each have a market capitalisation of nearly USD 1 trillion.

Europe is not far behind the US, with major manufacturing companies having driven share prices higher along with consumer-oriented companies. IT is a relatively small sector in Europe but has performed strongly this year, led by German-based software company SAP and the Dutch semiconductor company ASML, which have both gained more around 35 per cent in local currencies.

Emerging markets are dominated by China, whose domestic stock exchanges have performed strongly. The Shanghai and Shenzhen exchanges plunged in 2018 but have soared to become winners this year. Freer lending and tax cuts have boosted consumer confidence, and perhaps these stimulus measures will help China avoid further economic slumps. Valuations have normalised, so Chinese shares are not notably cheap, as they were at the beginning of 2019.

Japan stands out as a cheap stock market in relation to its own history but has had difficulty attracting investors,

Health care shares are still reasonably valued

Source: Bloomberg/Macrobond

Health care shares have climbed steadily upward in the past five years. The chart shows P/E ratios based on a one-year forecast of the MSCI World Index for the health care sector and indicates that this has not happened because of higher valuations, but instead thanks to earnings increases.

Growth companies have outperformed value companies in the past decade

Source: Bloomberg/Macrobond

The chart shows the stock market performance of growth companies compared to value companies. Value companies are defined as those with low P/E ratios, a high proportion of shareholders' equity compared to market capitalisation and high dividend yields. Value companies with flexible and sustainable business models are especially attractive from an investor perspective.

since global economic forecasts have gradually been adjusted downward. There is often a high correlation between Japanese stock market performance and global economic optimism. In addition, attempts to boost return on equity in Japanese listed companies have not shown results in aggregate level figures – yet.

Time to give value stocks a chance?

Growth companies have continued to deliver rising profits and sales and have been richly rewarded on the world's stock exchanges. Low-valued companies, however, have not attracted investors to the same extent. This is partly because of low interest rates, which make it cheap to wait for earnings further in the future – which has benefited growth companies – but also because many traditional companies have quickly become obsolete due to changed consumption patterns and new innovations. Examples of companies at the cutting edge in their respective industries are Amazon in consumer products, Netflix in media and electric car pioneer Tesla in the auto industry. Traditional companies are being forced to update their business models. Such change takes time and is costly. Meanwhile, earnings growth is suffering, and so are valuations.

These firms are thus classified as "value companies": companies with low P/E ratios, high levels of shareholders' equity in relation to market capitalisation and high dividend yields. There has been a major difference in the performance of these two categories over the past decade. Growth companies have outperformed value companies. If historical patterns repeat themselves, it is time to give value companies a chance. Unpopular shares may be the right ones to invest in. Rarely has the difference in popularity between growth companies and value companies been as wide as now. Low-valued companies that are able and willing to adapt their business models to new market conditions should perform well in the stock market.

Conclusion

Stock markets have performed strongly so far in 2019 and valuations have risen rapidly, but share price increases have far exceeded earnings growth. We thus expect potential upturns from current levels to be limited.

The technology sector stands out as highly valued despite lukewarm earnings reports. In particular, technology companies with high exposure to semiconductors and components can be avoided for another while. At best we may see an improvement during the second half of the year, but the stock market has already discounted this.

Portions of the global stock market look attractive in the long term, however, since valuations are at historically low levels. The Japanese stock market is such an example and is currently being avoided by institutional investors. Valuations are attractive and the trend towards more shareholder-friendly governance is continuing. The health care sector is another example that stands out as having historically low valuations. Fear of reforms in the American health care system has created purchase prices that are attractive in the long term. Value companies are also attractive investments. In this category of companies, we should look for low-valued firms that are able and willing to update their business models.

Theme: India

Big challenges, gigantic potential

Despite its notoriously problematic bureaucracy, nepotism and corruption, India is the fastest growing major economy in the world. Clear progress is being made in the fight against corruption and in reducing bureaucracy, especially under Narendra Modi's government since 2014. At this writing, it is not clear whether Modi still has the voters' confidence to govern the country after the parliamentary election now under way. Regardless of the outcome, the Indian stock market is attractive, with a number of rapidly growing sectors and well-run companies. Meanwhile, valuations are relatively high, the country's dependence on oil imports is a cause for concern and there is an elevated political risk in a short-term perspective.

Great progress from a low level

India is the world's third largest economy (according to purchasing power parities, PPP) and the fastest growing among the Group of 20 (G20) countries. It continues to climb quickly up the World Bank's ranking of countries in terms of "ease of doing business". All of the world's countries are ranked based on 41 different parameters and the challenges that companies in each country face as a result of regulatory requirements, legal compliance and transparency, taxes, available infrastructure, credit and more. This year, India moved up 23 places on the list to 77th place. Just two years ago, it was in 122nd place. Apart from India, only the tiny country of Djibouti (with one million inhabitants in the Horn of Africa) managed to make such substantial gains in the ranking two years in a row. The World Bank identifies no fewer than 14 major reforms in India that have made it easier for companies to do business there over the past two years.

Being ranked 77th among the 190 countries examined by the World Bank may not be the most flattering ranking as such, especially not relative to China, which is still much farther ahead in 46th place. But India is moving in the right direction, having now passed countries such as South Africa (82) and Brazil (109). Prior to Narendra Modi's landslide victory in the 2014 election, India was ranked 134th.

Economic growth, despite everything, ranks at the top internationally

Key macroeconomic figures, per cent	2019F	2020F
GDP growth	7.3	7.5
Inflation, CPI	3.9	4.2
Public sector, % of GDP	27	27
Budget deficit (adjusted), % of GDP	6.9	6.6
Current account, % of GDP	-2.5	-2.4

Source: International Monetary Fund. F = Forecast

India is large but poor in an international comparison

	India	US	China
Population, million	1,339	326	1,386
Land mass, thousands of sq km	3,287	9,832	9,563
GDP, USD billion	3,260	22,200	15,470
GDP per capita in USD (PPP)	8,480	64,770	19,520
Urban population, % of total	34	82	58

Source: World Bank, IMF

Reforms are driving growth

Perhaps the most important economic reform of all was the introduction of a national goods and services tax (GST) in 2017. This eliminated the country's extremely inefficient excise duty system for domestic products and improved transparency for both government authorities and companies with respect to business transactions and tax payments. It also helped to force faster digitisation of companies' administration and payments. A new Insolvency and Bankruptcy Code is another of the significant reforms that have improved efficiency. The national biometrically-based identification system has also sharply boosted the digitisation of services and dramatically reduced corruption.

India's infrastructure is also rapidly improving from an internationally low standard. That is true of traditional physical infrastructure such as roads and power grids as well as digital infrastructure. About 40 per cent of the population uses the internet, and almost everyone has access to a mobile phone and a bank account.

Will Modi retain voters' confidence?

However, not everyone has a positive view of developments in India. Western investors and analysts think it is unquestionably positive to have reforms that improve legal compliance and force large parts of the country's underground economy to either comply with laws – start paying taxes – or disappear. But many voters in the country have lost their income as a result. Furthermore, the so-called currency (or "demonetisation") reform in late 2016 has few supporters. At that time, all old bank notes were replaced by new ones overnight, and large denominations were completely eliminated in a poorly prepared process. The cost of this reform was far too large in terms of disrupted business opportunities to offset what was apparently a negligible direct impact on the underground economy. However, it indirectly helped speed up development of the country's electronic payment infrastructure.

GDP is growing rapidly, but so is population

Former workers in the underground economy are not the only people who are disappointed; the "good times" that Modi promised have not materialised. Although India is the world's fastest growing economy of significant size, GDP growth of more than 7 per cent is not enough to satisfy the rapidly increasing working-age population.

Yet India has one of the world's highest GDP growth rates

It is also apparent in the electoral campaign now under way that the country's economic success is not enough to ensure Modi's re-election. Modi, who calls himself India's "watchman"(Chowkidar Narendra Modi), has focused more and more forcefully on security policy issues and returned to the Bharatiya Janata Party (BJP)'s Hindu nationalist roots. The country's conflict with Pakistan has heated up again, helping to sharpen this focus. That plays into the BJP's hands in the short term but at the same time risks further intensifying the polarisation between the country's Hindu majority (almost 80 per cent of the population) and its minorities, with Muslims constituting the single largest group. Religion and caste play a subordinate or insignificant role in India's modern business world but are still very important in social contexts. Tensions between different religious groups have increased in recent years, although Modi and the BJP in other contexts assert their secular agenda.

"...900 million voters will elect a new government..."

India is the world's largest democracy, and nearly 900 million voters will now elect a new federal government in seven rounds, held on different dates in different states over several weeks in April and May, with the results being announced in late May. Opinion polls indicate that Modi's BJP-led National Democratic Alliance (NDA) will be able to form a government again this time, but with far fewer votes than in the 2014 election. However, financial analysts and economists specialising in India are convinced that, almost regardless of the election outcome, the country will carry on with reforms to promote economic growth – a trend that has actually been fairly clear since the country's 1991 economic crisis, regardless of the government in power. It is also noteworthy that India has a relatively strong and independent (although painfully slow) court system, an independent central bank and state governments that wield a great deal of power.

Megatrends are fuelling growth

However, the strong economic growth in India is being driven by more than just reforms. The population is young and expanding, and is moving at a rapid pace into cities, where incomes are on average far higher than in rural areas. Despite a relatively low level of development in rural areas, rapid digitisation is also under way there, with major efficiency gains as a result. Economic growth could also get a significant boost from rapid credit expansion, since private sector borrowings are low and important conditions needed for the wider availability of credit are now in place.

Only 34 per cent of the Indian population lives in cities, compared to 58 per cent in China and 82 per cent in the US, and there is an enormous difference between urban and rural areas. The income of city dwellers averages 6 times higher than that of rural dwellers in India. As urbanisation rises from a low level in international terms, the caste system provides unique incentives for continued urbanisation in India. In cities, there are government ministers, business executives and university vice-chancellors who in villages would never get anything but the lowest-paid and dirtiest jobs and would be social outcasts.

From the rice paddy to the cyber age

India's population is being catapulted almost literally straight from the rice paddy into the cyber age, where biometric identification is used for both voting and receiving pensions and other government benefits electronically in bank accounts accessed by mobile phones with an internet connection. The country is also a large and growing exporter of services, with everything from customer service call centres to advanced development of artificial intelligence provided by big consultancy firms. Last year, the six largest IT consultancies listed on India's domestic stock market generated operating income of more than USD 15 billion, on a par with total earnings for all mechanical engineering companies in the Nordic countries, to provide a regional comparison.

The Indian private sector, both companies and households, has a low level of debt in international terms. Debt is even lower if we ignore a few major companies with a focus on infrastructure investments, which previously were able to borrow large amounts from state-owned banks, due more to political connections than sound credit assessments. Lending to small and medium-size companies as a share of GDP is only about one sixth of the volume in China, and the country's total mortgage debt is equivalent to only 10 per cent of GDP. A combination of factors – the drafting and implementation of India's new Insolvency and Bankruptcy Code, improved transparency of companies' cash flow as a result of the national goods and services tax reform, and many years of work to recapitalise state-owned banks and force all commercial banks to acknowledge and clean up bad loans – has laid the foundation for faster credit expansion going forward. A number of international investment banks with operations in India expect accelerating credit growth in the years ahead.

Oil dependency – an Achilles' heel

One great cause for concern when investing in India, which investors need to take into account regardless of what party is in government, is the country's heavy dependence on imported oil and the vulnerability this entails.

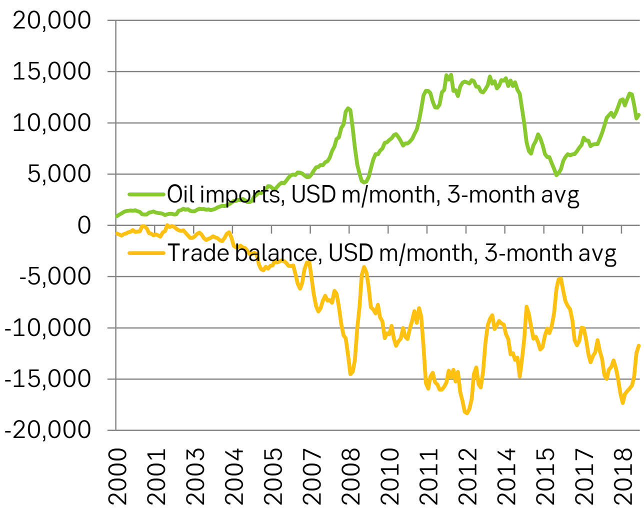
The cost of India's oil imports corresponds to 3-4 per cent of GDP on a net basis. The country's oil expenditures account for virtually its entire trade deficit, and persistent trade deficits are perhaps the most significant macroeconomic imbalance for India. Expensive oil imports restrict the government's ability to implement more stimulative fiscal policy, for instance by investing more in infrastructure that improves productivity, health and education.

Food and oil prices cause high inflation

Unlike the West, India has chronically high inflation instead of inflation that is too low – a widespread problem in Europe and Japan, for instance. The most important source of inflation in India is food, but the second most important factor, after failed harvests, is the effects of fluctuating oil prices. This forces the central bank at times to pursue a more restrictive monetary policy than would otherwise have been desirable.

Statistical analyses of earnings growth for Indian listed companies also indicate a clear inverse correlation with the oil price trend, with cheaper oil – all other things being equal – tending to produce faster earnings growth and vice versa. That is hardly surprising, since India has a small domestic oil industry. Indian oil companies work primarily in oil refining and petrochemicals, while consumer companies and financial institutions with exposure to the domestic economy and household consumption have a significant presence.

Costly oil imports weigh down Indian economy



Source: Bloomberg

The chart shows the value of India's monthly oil imports and its trade deficit (3-month moving average) in USD million. The country's exposure to and dependence on oil imports are clearly apparent.

An investment in the Indian stock market over a period of less than five years should thus be associated with a neutral to negative view of oil prices. Otherwise there are probably better investment alternatives.

Pollution – can India afford not to address it?

India tops most lists that attempt to rank countries by their environmental problems, which is hardly encouraging. The ten cities in the world with the most air pollution are all in northern India. Simply by living in the capital, Delhi, and breathing air outdoors, non-smokers are subject to about the same lung cancer risk as if they were smokers. In all kinds of offices, at companies and government agencies, there are instruments that measure particulate matter in the atmosphere, both indoors and outdoors, and air quality is as natural a feature of weather forecasts as the temperature. People who can afford it often evacuate their families from cities during the autumn and winter months, when pollution is at its worst.

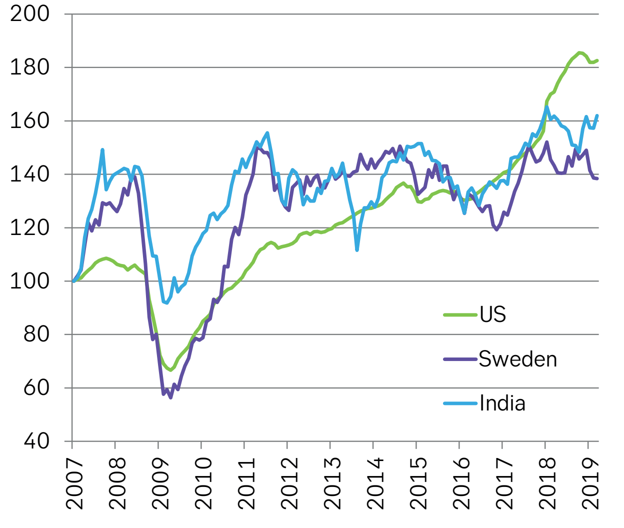
Roughly half of all people who die prematurely from illnesses related to air pollution – an estimated 1.8 million – die in India. According to the British medical journal *The Lancet*, 77 per cent of the people in (what will soon be) the world's most populated country will be exposed to air pollution that exceeds World Health Organisation (WHO) guideline levels. During periods when pollution is at its worst, particulate matter in Delhi is 70 times higher than the guideline levels.

Not only is the air dirty, but waste management in many places is non-existent, and rubbish of all kinds is deposited alongside streets and roads and floats in poisoned rivers, both sacred rivers and more ordinary waterways. Some 90 per cent of the estimated 8 million tonnes of plastic waste that pour into the world's oceans each year come from the world's ten most polluted rivers, the Ganges being one of them.

Still, there is hope. In this year's election campaign, environmental pollution has taken a place on political leaders' agendas in a completely different way than in 2014. For many voters, economic issues are more pressing. While the percentage of Indians living in extreme poverty is falling steadily and today is estimated to be only about 5 per cent of the population, nevertheless a full 40 per cent of all children under 5 are short for their age, which can be an indication of chronic malnutrition. However, for the expanding middle class, there is a clear link between pollution and poor health.

India also has fantastic opportunities to make use of modern energy sources such as solar power and bio-based fuels. Most vehicles sold in the country are two-wheeled, and in China, for example, two-wheelers are now mostly electric. Improved waste recycling could also enable large-scale production of biogas, renewable diesel or second-generation ethanol. The combination of India's great dependence on oil imports, high oil expenditures and good potential to produce energy from the sun and biomass should constitute an irresistible attraction for the country's political leaders to capitalise on. Problems with the environment, public health, inflation and the trade balance are directly linked to oil, although the country's domestic coal industry is an even worse environmental culprit. However, there are many problems standing in the way, in particular the country's poor relations with China (which is far ahead in both battery technology and solar

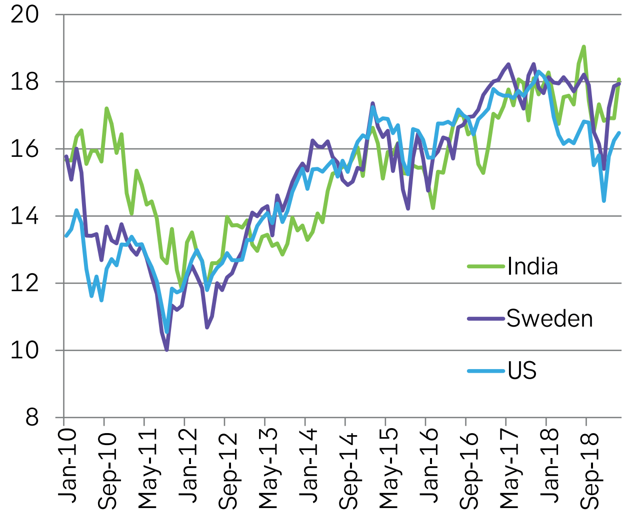
Mediocre earnings growth, but signs of better times ahead



Source: Bloomberg

The chart shows indexed earnings growth in US dollars for the largest listed companies in the US (S&P 500), Sweden (Stockholm Benchmark) and India (Nifty).

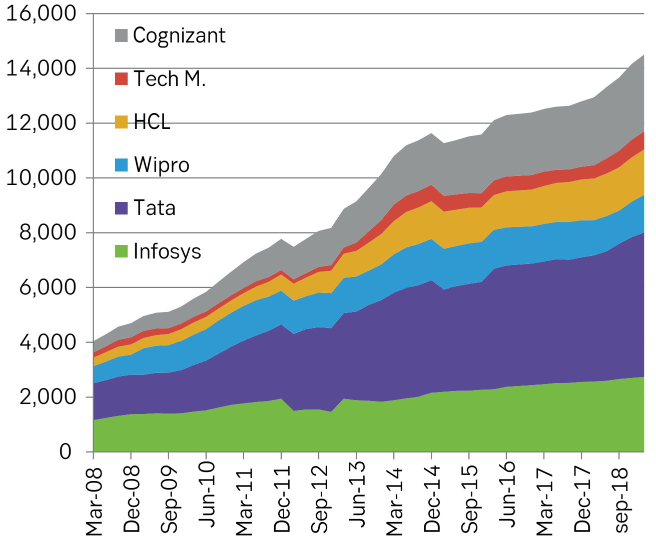
High valuations require better earnings growth going forward



Source: Bloomberg

The chart shows the 12-month forward consensus P/E ratios for the largest listed companies in the US (S&P 500), Sweden (Stockholm Benchmark) and India (Nifty).

IT consultancies, a successful export industry in India



Source: Bloomberg/Macrobond

The bar chart shows aggregate earnings in USD million on a rolling 12-month basis for the six largest Indian listed IT consultancies.

panels), limited resources for capital-intensive investments in renewable energy sources and an outdated domestic motor vehicle industry.

So far, there is still a lack of political will; for example, Swedish companies involved in investments to produce biogas-fuelled vehicles in India have met with limited success.

The stock market is attractive despite high valuations

Earnings growth for Indian listed companies has been mediocre in recent years, especially if earnings are translated into a hard currency like the US dollar. But conditions are in place for a significant acceleration. In recent years, earnings have been held back by a number of transitory factors, such as bank credit losses (related to India's Insolvency and Bankruptcy Code, more stringent accounting rules and a political will to clean up state-controlled institutions), currency reform and the national goods and services tax (whose long-term advantages are sizeable and obvious despite teething problems, which had a negative short-term economic impact in 2017).

Valuations are high, especially compared to emerging markets in general. However, sectoral valuations vary considerably. Consumer goods companies are trading at extremely high earnings multiples in an international comparison. Indian export companies in the IT and commodities sectors are valued more in line with those sectors internationally – for good reason, since they do not primarily offer exposure to India's fast-growing domestic economy.

For banks and financial companies, it is important to distinguish between inefficient state-owned banks and private, often rapidly growing, modern institutions. The financial sector, like consumer goods companies, offers direct and significant exposure to domestic economic growth, with greater cyclical and political risks but with far more modest earnings multiples.

The Indian financial market is relatively well-developed, and many large listed companies have a reputation for being well-run according to international standards. Unfortunately, it is difficult to invest directly in Indian equities on the country's domestic stock exchanges. Unlike with China, for example, there is only a quite limited range of Indian shares listed on US or other Western stock markets. The sector that is easiest to invest directly in is large IT consultancies, nearly all of which are listed in the US. However, the fast-growing and exciting private financial and banking sector only has a few names listed internationally, and the range of medium-sized high-growth companies available other than on Mumbai's stock market is basically non-existent.

Conclusion

The Indian stock market is attractive, given its rapid economic growth, potential for robust earnings growth, and less dependence on the general economic trend and commodity prices compared to many other EM stock markets. At the same time, the country is quite vulnerable because of its dependence on imported oil. Share prices are relatively high, as is political risk at the moment, but this risk could soon be reduced significantly. We are attracted primarily by the private financial sector and IT consultancies with international operations.

Nordic equities

Nordic stock market valuations are neutral

After stock markets got off to a strong start in 2019, driven by diminishing worries about economic growth, more dovish monetary policies and hopes of reduced trade policy conflicts, we see a clear risk of a correction following new comments by Donald Trump that are critical of free trade. Investors appear to have been lulled into a partly false sense of security. Underlying the strong performance of stock market indices are major differences between sectors. A weak Swedish krona is bolstering the Stockholm exchange this year, but is this beneficial in a long-term perspective? In terms of earnings-neutral multiples, valuations are in the mid-range for the past five years, making them neither appealing nor unappealing. Finland offers attractive valuations and generous dividend yields. All in all, we have a neutral to negative view of Nordic stock markets for the rest of this year, while the outcome of ongoing trade talks between the US and China is critical to whether we will lean in a positive or negative direction.

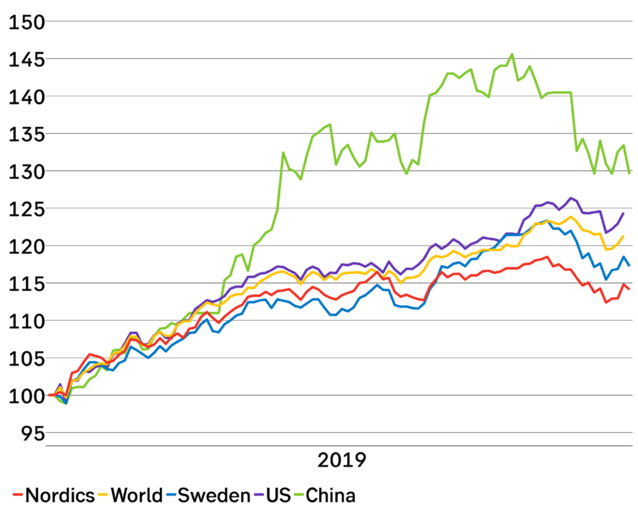
China has led this year's stock market upswing

Stock markets have turned in a surprisingly strong performance so far this year. As of mid-May, the VINX Nordic Index showed a 12 per cent return since the start of the year, and calculated in Swedish kronor the upswing was over 17 per cent. For the Stockholm exchange (part of Nasdaq OMX Nordic) – which has also been bolstered by the weak krona – the upturn was 18 per cent. Winners due to the weak krona, led by exporters, greatly outweigh losers, mainly the retail sector.

Despite the extra boost from the weaker krona, the gains on the Stockholm exchange cannot compare to the rally on China's Shanghai and Shenzhen exchanges, which have led major stock exchanges this year. The upswing so far this year for the CSI 300, consisting of the 300 biggest equities in Shanghai and Shenzhen, best sums this up – 37 per cent in Chinese yuan terms, which corresponds to 46 per cent in kronor (at this year's peak on April 19; by mid-May they were still up a strong 21 per cent in CNY and 30 per cent in SEK). The stock market rally in China has been driven by a combination of stimulative monetary and fiscal policy, an easing of economic growth worries and greater hopes of a mutually beneficial trade agreement between the US and China. As recently as late 2018, many people feared an escalating trade war. That was a strong factor contributing to the negative stock market sentiment at the time. The trend this year is a mirror image of the decline in late 2018 and is not limited to Chinese equities; Nordic companies with a great dependence on the Chinese market, primarily large manufacturers, have also been strongly affected by swings in market sentiment.

Judging from the implicit volatility of the US equity options index – the VIX index, which is often used as an indicator of market nervousness – investors have apparently been lulled by the same calm that prevailed in the summer of 2018. The question is whether the market will turn out to be as treacherous now as then. Certainly, surveys indicate that institutional investors are still positioned relatively cautiously in the stock market, but at the same time hedge funds are rumoured to have made major investments in low-volatility products in the US. An extreme exposure to such instruments, which needed to be unwound quickly, is believed to have contributed significantly to the sharp stock market correction in February 2018.

China has led the global stock market rally in 2019



Source: Bloomberg/Macrobond

The chart shows the share price index in Swedish kronor for the largest listed companies in China (CSI 300), the US (S&P 500), Sweden (OMXS30), the Nordics (VINX) and the MSCI AC World Index. The Chinese stock market has outperformed the West this year, mirroring the pattern in 2018. Hopes of improved relations between the US and China have played a crucial role in improving investor sentiment. This has also affected Nordic companies with a large exposure to the Chinese market.

On May 5, Donald Trump threatened to suspend negotiations with China, raise tariffs on Chinese imports to 25 per cent and sharply increase the number of goods subject to punitive duties. This surprising announcement was a great disappointment to investors in the West. At this writing, it is uncertain what the outcome will be, but there is quite clearly a greater risk of a breakdown in negotiations on a new trade agreement between the US and China. In our view, an escalating trade war would have a somewhat negative impact on economic growth and a very negative impact on investor sentiment. As of late April, the market had probably factored in an agreement that would promote growth in share prices.

A weak krona benefits the Stockholm exchange

The Swedish krona recently traded at its lowest level in 10 years against the euro. Compared to the US dollar, the krona is now at its lowest level since 2002. For multinational companies on the Stockholm exchange, this means that earnings generated outside Sweden, all other things being equal, are worth more calculated in Swedish kronor. For exporters with high costs in Swedish kronor and revenue in other currencies, the effect is much more positive. This is true of everything from paper mills and mines to the telecom, vehicle and engineering industries. Losers are above all the retail sector, primarily durable goods such as clothing, electronics or other goods made in Asia or elsewhere in Europe and sold in Sweden. Companies that are winners due to the weak krona have a large weighting on the Stockholm exchange, while losers have an insignificant weighting. Manufacturing, IT, basic materials and health care, which all benefit from a weak krona, together have almost a 50 per cent weighting. Losers in the retail sector and the media together have scarcely a 5 per cent weighting; excluding H&M, whose revenue in Sweden is an insignificant 4 per cent, they constitute less than 2 per cent of market capitalisation.

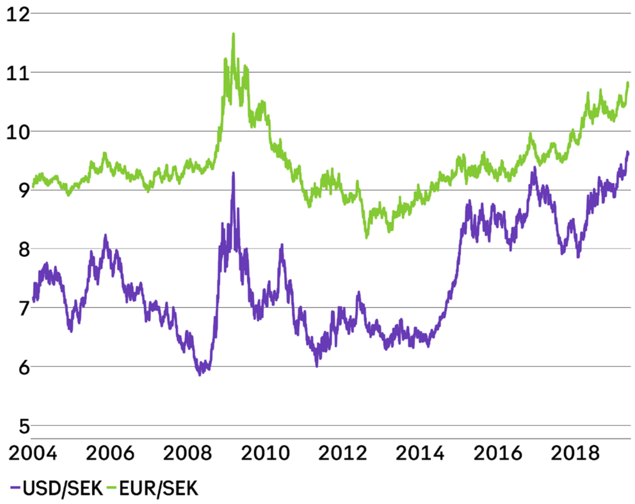
In the short term, the weak krona will no doubt have a positive impact on stock market performance, but investors probably do not fully expect the krona to be as weak as it is today over the long term. Even if it does remain as weak as it is now, there is also a great risk that the positive effect will diminish over time, since cost inflation also tends to accelerate. Some of Sweden's exporters believe that a strong krona could help put more pressure on them to make efficiency improvements, which in the long run may benefit their competitiveness.

Better risk-weighted potential in forest products than industrials

Regardless of the nature and pace of the deceleration now under way, and the ongoing trade negotiations between the US and China, we find the recent substantial difference in share price performance for different cyclical sectors remarkable.

Both the industrials and forest product sectors are cyclical – in other words, highly dependent on global economic developments. In both cases, there are important factors suggesting that improved profitability over the past decade is due at least to some extent to sustained improvements. This is expected to contribute to higher profitability troughs in the next economic downturn, no matter whether that comes sooner or later.

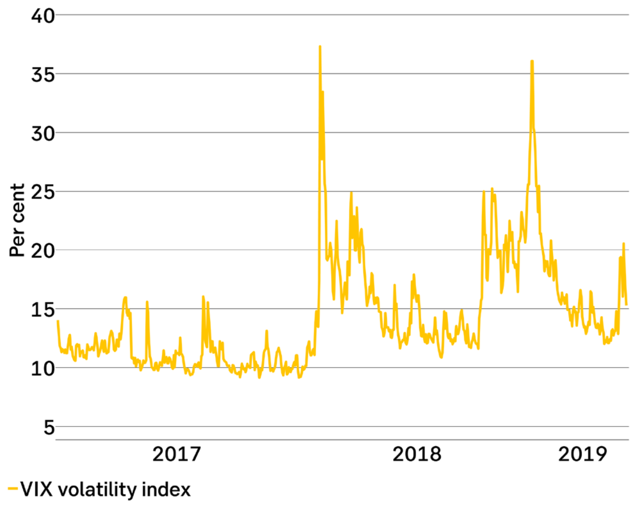
The krona has weakened dramatically since 2013 – benefiting the Stockholm exchange



Source: Bloomberg/Macrobond

The chart shows the exchange rate for the Swedish krona against the euro and the US dollar. A sharp, steady krona depreciation since 2013 has inflated the value of earnings generated abroad and boosted the competitiveness of exporters. Winners due to the weak krona have a far greater weighting on the stock market than losers, which are primarily in the retail sector.

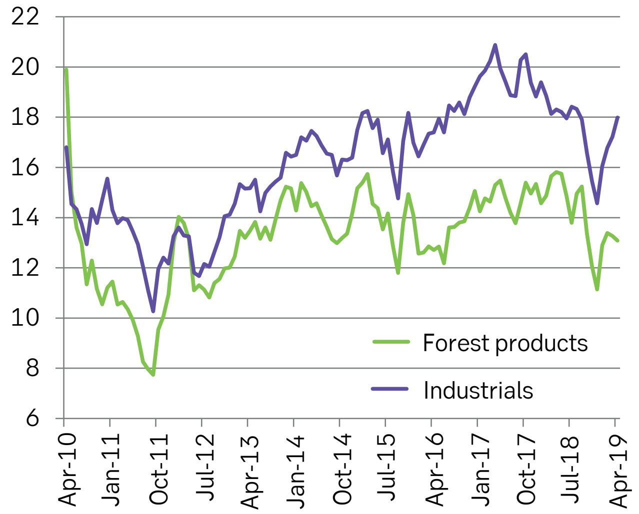
Has the financial market been lulled into a false sense of security?



Source: Bloomberg/Macrobond

The chart shows the VIX index of implicit volatility in the US stock options market, a frequently used measure of nervousness among equity investors. A sharp increase in investor worries, driven by inter-related questions about the strength of the economy and the US trade war, lifted the VIX and pushed down share prices in late autumn 2018, but since the turn of the year market worries have eased significantly and steadily. Surprise over Trump's renewed threats of trade obstacles in May risks re-igniting investor worries again.

Large valuation gap shows diverging investor sentiment towards cyclical sectors

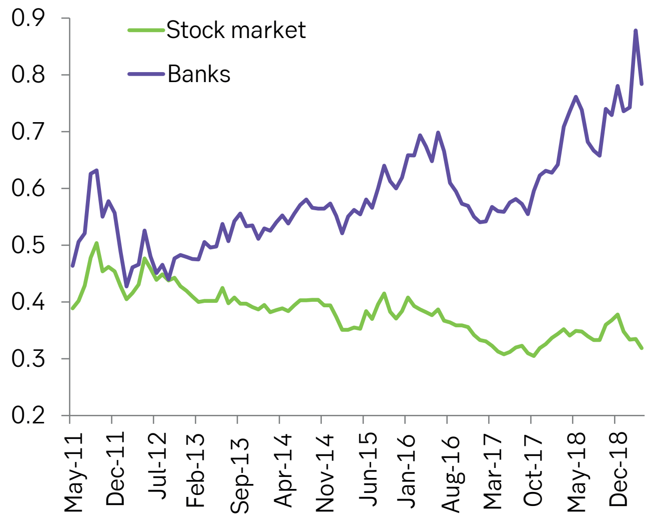


Source: Bloomberg

The chart shows 12-month forward-looking P/E ratios for the Nordic industrials and forest product sectors (unweighted average consensus P/E ratio for major companies that have at least 9 years of history with a comparable structure).

In both sectors, profits are at or near historical highs, but there are a number of indications that some deceleration has already begun in both the industrials and forest product sectors. This is seen, for example, in a sharp drop in factory orders for trucks, a shrinking global market for passenger cars and electronics, and falling prices for paper pulp and some qualities of paper. Normally, a falling purchasing managers' index, as over the past year, is worrisome for cyclical equities, although the correlation is far from perfect. The stock market is often ahead of the curve and far more volatile.

Record-high relative dividend yields for banks that are under pressure



Source: Bloomberg

The chart shows the expected dividend yield for the coming 12 months based on consensus forecasts for the four big banks on the Stockholm exchange (unweighted average), compared to the average for the Stockholm exchange (SBX). These banks are forecast to provide a dividend yield 2.5 times higher than the exchange average; the difference has never been greater than this year. Meanwhile, it is very difficult to estimate the potential costs of any money laundering crime.

Valuations of Nordic industrial equities are almost always higher than those of forest product equities, but the valuation gap has widened substantially in recent months. Forest products are now valued at a P/E ratio five points lower than for industrials, which is an unusually large gap, with the discount doubling in less than a year. Obviously, it is reasonable to expect that a faster, more substantial deceleration in economic growth than expected would put pressure on equities in both sectors, and vice versa – a less dramatic deceleration than expected would benefit both sectors. However, we believe that the relative benefit/risk ratio has become more attractive for forest products recently. The downside is more limited in a negative scenario, while the potential in a more positive scenario has become larger.

Depressed valuations, hard-to-quantify risks

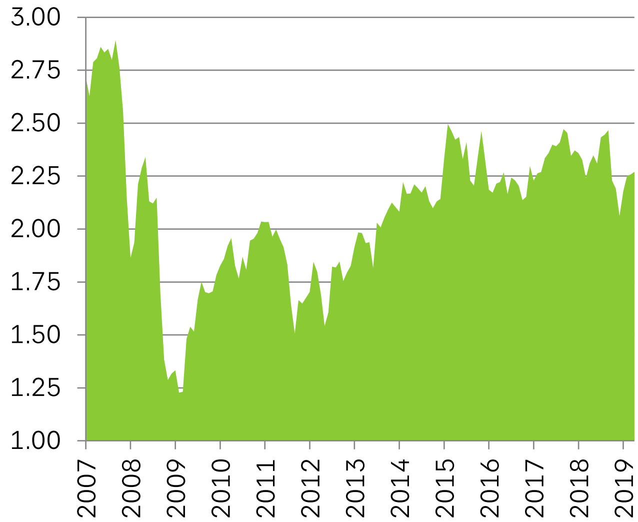
The dividend yield for the Stockholm exchange as a whole is below 3.3 per cent, but for the major banks it is 7.8 per cent (unweighted average). The combination of a very weak relative share price trend for banks, relatively stable overall earnings growth and strong balance sheets that allow generous dividends has produced a much greater difference in dividend yields between the average for banks and for the rest of the exchange. The dividend yield for banks is now 4.5 percentage points higher or 2.5 times the average for the Stockholm exchange. In early 2017, the difference was 2.1 percentage points or 1.6 times.

We find bank valuations and dividend yields attractive, especially in relative terms, but obviously there is an explanation for this and for the somewhat hard-to-quantify risks. The most important explanation for the weak share price trend this year is market worries that the ongoing inquiry into money laundering at Swedbank will expose irregularities similar to those at Danske Bank in Estonia. That in turn would mean a risk that Swedbank, like Danske Bank, will be forced to pay a heavy fine to US authorities. However, it is hard to quantify the probability that this will happen.

Nonetheless, the difference in the average dividend yield for banks including/excluding Swedbank is only 0.2 percentage points, based on the consensus forecast. If we instead use SEB's forecast for the banks we monitor, the average dividend yield is 7 per cent, since we expect Nordea to buy back shares instead of paying its entire dividend in cash.

Other factors that have held back bank shares recently are expectations that upcoming interest rate hikes from Sweden's Riksbank will be further delayed and growing pressure on margins for some products, such as mortgages.

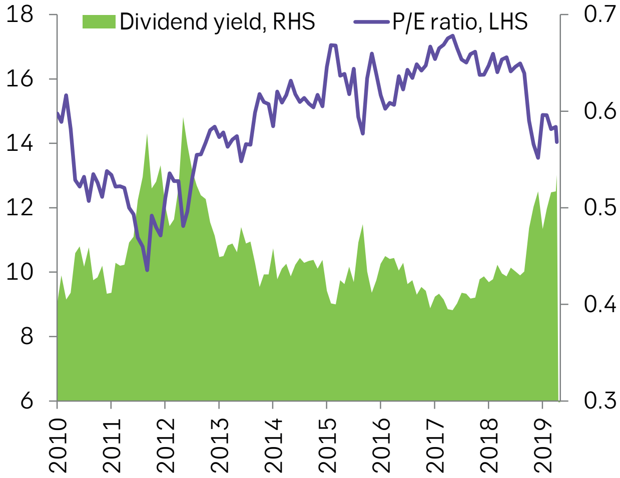
Neutral valuations in the Nordic stock market as a whole



Source: Bloomberg

The chart shows book equity valuations for Nordic listed companies (VINX Index). Earnings-neutral multiples such as equity value (above) and valuation per krona of revenue often provide a better, more cyclically neutral, picture of valuations than earnings-related multiples. Current valuations are in the middle of the relatively narrow range for the past five years, far higher than after the financial crisis and during the euro crisis but far lower than the 2007 peak at the end of the stock market "super cycle".

Attractive valuations and dividend yields on the Helsinki stock exchange



Source: Bloomberg

The chart shows 12-month forward-looking P/E ratios and dividend yields based on consensus forecasts for the HEX25 index of the 25 largest companies on the Helsinki stock exchange. The P/E ratio is near a 6-year low while the dividend yield is the highest since 2012.

Neutral valuations in the Nordic region, but Finland is attractive

At the turn of the year, valuations in the Nordic stock market were clearly attractive from a short-term historical perspective based on virtually every metric. After the spectacular rally during the first four months of 2019, the picture is now more complex. In particular, Finland looks attractive, with a consensus forecast P/E ratio of 14 for the coming 12-month period. Almost the entire increase in the Helsinki index for the year is attributable to higher forward earnings forecasts (a combination of upward revised forecasts and higher earnings). The P/E ratio for the Nordic region as a whole is just below 16, which is near the average for the past five years. As usual, Copenhagen has the highest valuations (almost 19) and Norway the lowest (13). The aggregate forward earnings expectations for companies on the Copenhagen stock exchange have been whittled down continuously for almost two years, while the trend has been more volatile in Sweden and Norway. Earnings forecasts in those markets were initially revised downward significantly around the turn of the year but have now been revised upward, almost back to their original level, while Finland stands out with upward revisions so far this year.

The dividend yield for the Nordic region, 3.9 per cent, is more appealing than that for the Stockholm exchange. The Nordic average is raised by Finland and Norway, where dividend yields are expected to be 5.3 and 5.1 per cent respectively. These are the highest levels since 2012 and far above the average for the past 13 years: 4.5 and 4.2 per cent respectively.

"...valuations are neither unattractive nor attractive..."

If we look at earnings-neutral multiples, the Nordic stock market as a whole is now valued near the middle of the range for the past five years. It is significantly higher than the troughs during the financial crisis and euro crisis, but far lower than at the end of the stock market "super cycle" in 2007. Based on earnings-neutral multiples, valuations are neither unattractive nor attractive but instead relatively neutral.

Summary

Overall, we have a neutral to negative view of the Nordic stock market for the rest of the year, with the outcome of ongoing trade talks between the US and China being crucial to whether we will lean towards a more positive or negative direction. However, valuations in Finland are appealing, and we are finding a more attractive relative risk for forest products compared to industrials among cyclical sectors.

Fixed income investments

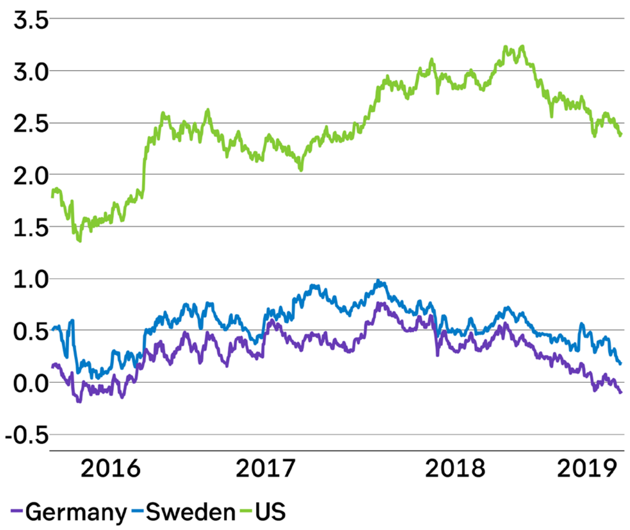
Central banks slow their pace of tightening

The fixed income market got the year off to a strong start following the turbulence seen in late 2018. A clear reversal by the world's central banks has contributed to the continued decline in yields in recent months, despite a recovery in risk appetite. The changed message from central banks about continued monetary stimulus has benefited exposures with both interest rate risk and credit risk. We still prefer having a limited interest rate risk (bonds with short maturities) and see some advantages to credits (corporate bonds), which we hope will enable us to benefit from higher US interest rates and yields, among other things. The Federal Reserve's dovish tone, combined with monetary and fiscal stimulus in China, will enable emerging market bonds to continue their good performance for another while.

Government bonds (excl emerging markets)

After its change in direction around the turn of the year towards a clearly more stimulative monetary policy, the **US Federal Reserve** (Fed) has continued to communicate that its monetary policy is dependent on underlying data and that it does not see itself under any pressure to adjust its interest rate policy in either direction. We share the Fed's view of continued muted inflation pressure and a gradual deceleration in economic activity. That leads us to believe that the most likely scenario is no change in Fed interest rate during 2019 and 2020.

The downturn in bond yields has continued



Source: Bloomberg/ Macrobond.

Central bank actions have led to falling bond yields this year. Fewer interest rate hikes affect our forecasts for 10-year government bond yields, which we have revised downward significantly since the last issue of *Investment Outlook.*

Forecasts for 10-year government bond yields

Market	May 17	Jun 2019	Dec 2019	Dec 2020
US	2.37	2.45	2.25	2.10
Germany	-0.12	0.00	0.15	0.35
Sweden	0.17	0.30	0.40	0.80

Source: SEB, market data May 2019

Given the unexpectedly weak general economic trend, together with restrained central banks around the world, we now also believe that the **European Central Bank** (ECB)'s interest rates will remain at current levels during 2019 and 2020. Given an even more dovish ECB, German 10-year government bond yields will remain near zero. A somewhat better European economy in 2020 may then help German 10-year yields rise to about 0.35 per cent.

The Swedish economy is slowing because of subdued international demand and falling residential construction. Low inflation will force the **Riksbank** to once again delay its next key interest rate hike. The central bank now believes this will occur in late 2019 or early 2020, which is about one quarter later than it announced in February. Our forecast is that the next rate hike, from -0.25 to 0 per cent, will be delayed until July 2020, when inflation will be fairly close to the 2 per cent target. Because our inflation forecast is lower than the Riksbank's, we do not believe it will take further steps after that during 2020-2021.

We prefer government bonds with short maturities

Government bonds today provide a low return while upturns in their yields can further reduce total returns, since there is a negative correlation between yield movements and bond prices. We therefore prefer bonds with short rate fixation periods (short duration = low interest rate risk), where a rise in long-term yields will not have as great a negative impact on bond prices.

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

Central bank communications about continued monetary stimulus have not only benefited exposures with a credit risk, such as corporate bonds. Returns on bonds in both the investment grade (high credit rating) and high yield (low credit rating) categories have also improved, given indirect signals of continued low funding costs and stable credit quality. Credits have seen a well-needed recovery, with credit spreads (yield gaps between government and corporate bonds) in both Europe and the US taking back much of the widening that occurred during the fourth quarter of 2018. There is a strong correlation between economic growth and the risk assigned to credits, which is reflected in credit spreads. Consequently, corporate bonds will be very sensitive to recession signals going forward as well. In light of our cautiously positive growth scenario, we are choosing to keep a relatively high credit risk in our portfolios, although increased uncertainty could lead to sharp movements along the way.

We expect high yield and investment grade corporate bonds to generate better returns than government bonds and hope we can take advantage of the high-yield situation in the credit market. The greatest potential is probably in high yield, thanks to stable growth prospects and the relatively limited sensitivity of high yield bonds to rising interest rates. The fact that central banks are in a holding pattern on interest rate hikes also supports this credits scenario, although the effects will be somewhat more limited than early this year.

Emerging market (EM) bonds

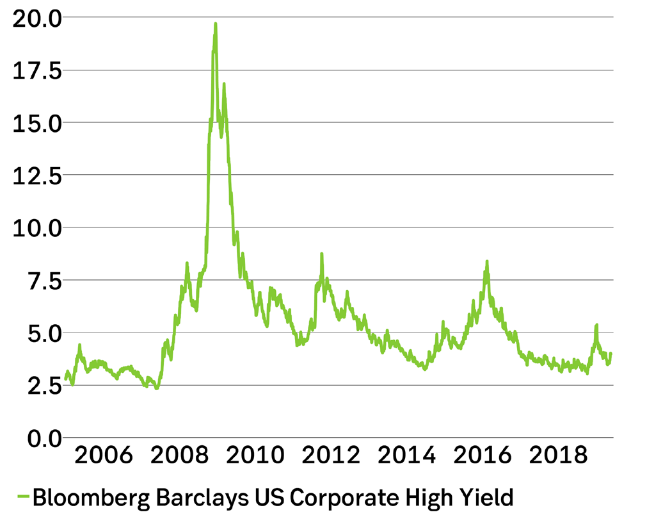
Fixed income investments in emerging markets have performed very well during 2019, driven in part by the good risk climate. Along with higher EM yields compared to more mature markets, a number of EM currencies clearly strengthened during the first few months of the year. The US Federal Reserve's more cautious approach including a delay in interest rate hikes, combined with monetary and fiscal stimulus in China, are positive factors for many emerging markets. All in all, this means good conditions for continued favourable performance for emerging market bonds.

Expected return, next 12 months (in SEK)

Fixed income investments	Return	Risk
Government bonds	-1.3%	1.2%
Corporate bonds, investment grade (IG), Europe	0.9%	2.7%
Corporate bonds, high yield (HY), Europe	3.7%	3.9%
Emerging market (EM) bonds in local currencies	7.0%	8.1%

Source: SEB forecasts, May 2019

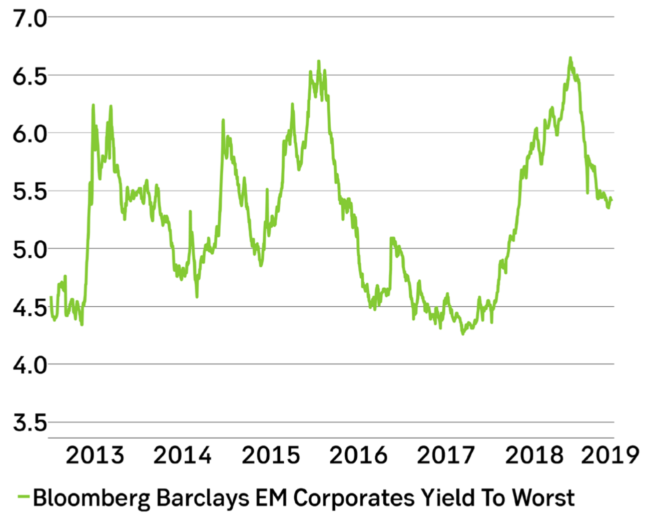
More dovish central banks have narrowed credit spreads



Source: Bloomberg/Macrobond

The spread between high yield corporate bonds and government bonds has narrowed during the year, but provided we are correct in our forecast that a recession will be avoided in the short term, there is still potential in high yield.

Opportunities in emerging markets



Source: Bloomberg/Macrobond

More cautious central banks and the potential for stronger emerging market (EM) currencies should continue to benefit fixed income investments in emerging markets. "Yield to Worst" shows the effective yield in per cent that the investment generates if all bonds are redeemed by the issuer on the earliest date they can be redeemed; in other words, the current average yield is around 5.5 per cent.

Theme: Floating rate notes

Returns on credit risk, but protection from interest rate risk

In recent months, central banks have signalled slower interest rate hikes, which suggests that the low-yield environment we have had for many years will continue for another while.

A low-yield environment makes it difficult for many investors to generate returns on their fixed income holdings; at the same time, a rise in market interest rates can have a negative impact on returns from many regular fixed income investments. For this reason, investors are eyeing other kinds of fixed income assets.

To make this search easier, we start by taking a closer look at two sources of return for a fixed income investment.

Take interest rate risk – but protect against it

Interest rate risk is the risk that interest rates and yields will go up when you own a fixed income investment, since there is an inverse relation between interest rates/yields and bond price movements. Taking an interest rate risk thus works well when interest rates are falling, but when market rates are moving upward, that means worse conditions for fixed income assets in general and for those with long maturities in particular. Fixed income securities with short interest fixation periods are affected less by a rise in long-term yields.

However, investors can protect themselves against interest rate risk by holding floating rate notes (FRN) as part of their portfolio. These notes have a floating rate, or coupon, which is usually adjusted up or down every three months in line with the interest rate trend. This limits interest rate risk because the rate is continuously reset. When the rate is adjusted, the coupon is set in line with, for example, the Stockholm interbank offered rate (Stibor) plus a fixed credit premium. An FRN is thus only affected by short-term market interest rates and the credit premium. As a result, investors are paid for taking a credit risk but are protected on a continuous basis against rising long-term yields. If short-term market interest rates rise, that actually benefits FRNs because their coupon rate gradually rises.

Credit risk, a company risk

The return on a corporate FRN is instead largely based on the company's credit risk. Credit risk is the risk that the company issuing the note will not be able to repay it. Bonds issued by companies with a higher credit risk need to compensate for the higher risk by paying higher coupons on those securities.

Corporate bonds are usually divided into two categories based on creditworthiness.

- Investment grade (IG) bonds have a lower risk and lower coupons, with ratings assigned by the S&P credit rating agency ranging from AAA (the highest) to BBB.
- Bonds with ratings below BBB are called high yield (HY) and have a higher risk and higher coupon.

As mentioned above, credit risk is the risk you take that the company you lend to – via the security – cannot pay the coupon during the loan period or repay the loan principal due to insolvency, or "default". The difference between the yield on a corporate bond and a government bond in the same currency and with the same maturity is called the credit spread. If the risk among companies is expected to increase, the credit spread will widen, since corporate bond investors will then require a higher yield to compensate for the higher risk. On the other hand, if there is a lower expected risk for companies, the same spread will narrow. A thorough analysis and good risk diversification improve the chances of achieving the desired risk/return profile when investing in the credit market.

The Nordic corporate bond market

The range of available Nordic corporate bonds has expanded rapidly in recent years. Due to higher capital requirements, it has become less profitable for banks to issue loans. Meanwhile, many companies see an advantage to being able to fund their activities in other ways than by only using bank loans. The bond supply has also been driven by increased demand. More and more investors have grown tired of low government bond yields and are looking for assets with better return potential. There have thus been large inflows into corporate bond funds.

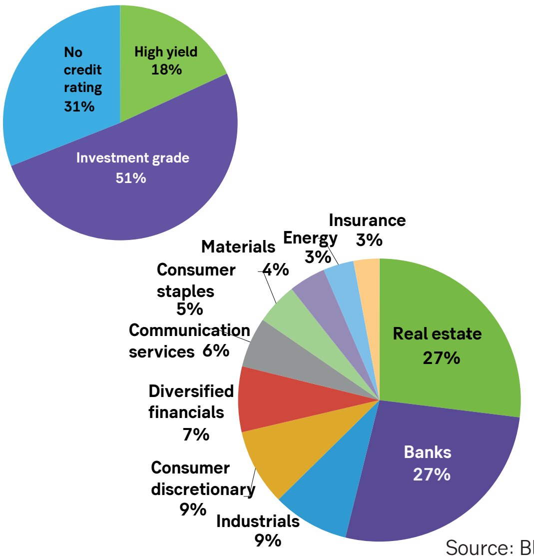
The **Swedish** corporate bond market is generally characterised by well-run companies with healthy balance sheets and good repayment capacity, often of investment grade (IG) quality. Many companies on the Stockholm exchange's large cap list also issue corporate bonds. Volvo, Tele2 and Castellum are examples of companies that frequently issue bonds, and most sectors are represented, although the real estate and banking sectors have the largest bond issuance volumes. However, the Swedish market does not only consist of large caps; there is also an active high yield (HY) market. HY companies are often owned by private equity firms and offer high return potential, but also high risk. Examples of companies in this category are the alarm systems company Verisure and Cabonline, one of the largest Nordic taxi networks.

The **Norwegian** corporate bond market, which has been around for a long time, is well-established. It differs from the Swedish market in that it has fewer large caps and more HY companies. The oil and road haulage sectors are well represented, including companies such as Odfjell and Stolt-Nielsen, but there are also fish farmers and local savings banks.

More and more **Finnish** companies are also taking advantage of the bond market, and the average Finnish bond issuer is a medium-sized manufacturer. More **Danish** companies are using the corporate bond market as well, although issues denominated in DKK are still fairly rare. Vestas (a wind turbine manufacturer) and DSV (a global supplier of transport and logistics services) are examples of Danish companies that issue bonds in euros.

Another characteristic of the Nordic corporate bond market is that many companies (both investment grade and high yield) do not have a rating from a credit rating agency. However, that is not an obstacle for large fund managers, since they conduct their own credit analyses and can also invest in these companies. If a bond has no credit rating, that often gives it a higher return since it includes an additional risk premium. If fund managers can determine that a company will be assigned a better rating or apply for a rating in the future, the company's bonds will often rise in value.

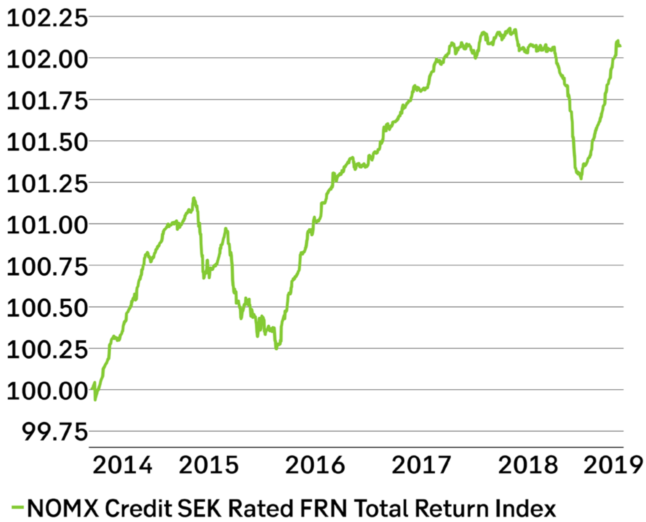
Sector breakdown and average credit rating for the Nordic corporate bond market



Source: Bloomberg

The Nordic corporate bond market consists of many well-run companies with healthy balance sheets. In Sweden, the real estate sector accounts for a large share; in Norway, the oil and road haulage sectors are prominent. A large percentage of companies in the Nordic corporate bond market lack an official credit rating.

Returns on floating rate notes (FRN)



Source: Bloomberg/Macrobond

The chart shows returns for the past five years for the NOMX Credit SEK Rated FRN Total Return Index. Since 2005, the index (which consists solely of investment grade bonds) has only had a negative return during three calendar years. The largest negative return was -3.3 per cent in 2008 in conjunction with the financial crisis, but it took just one year before it was back at pre-crisis levels.

Historically, floating rate notes (FRNs) have offered relatively high returns relative to risk (measured by volatility). Since 2005, the NOMX Credit SEK Rated FRN Index has had a negative return during only three separate calendar years. The largest negative return was -3.3 per cent in 2008 in conjunction with the financial crisis. But it took only one year before the market was back to its pre-crisis levels.

Summary

In a world of historically low yields and interest rates, there is limited potential to find attractive fixed income investments. A fixed income fund that can limit interest rate risk but provide exposure to some degree of credit risk is one possible route to take in order to generate a good risk-adjusted return. A fund like that often has a low risk but still provides return potential and is thus suitable for more cautious investors and more liquid investments.

Contact information

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