SEB

SEB House View

6 March 2024

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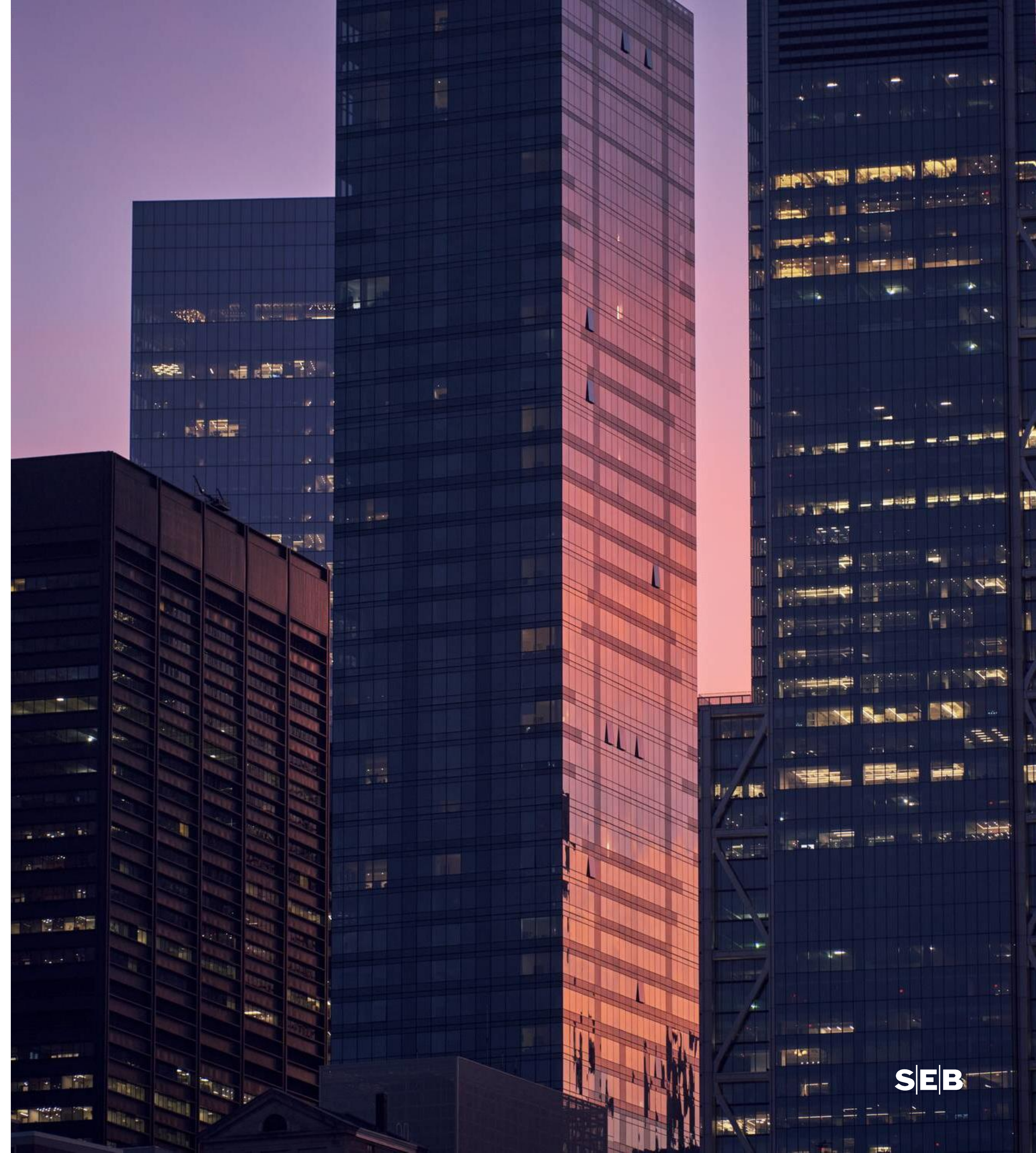


The rally continues, the risk for a correction increases

Strong tech earnings outweigh rising interest rates and a push back of policy easing. A cyclical pick-up is expected as PMI bounce higher.

- US equities have gained in 16 of the past 18 weeks which hasn't happened since 1971. Simultaneously rates have reduced Fed expectations.
  - Risk appetite remains strong as Q4 earnings reports show 73% of S&P 500 companies beat expectations. On average EPS was 4.1% better than expectations. 64% of companies reported revenue above expectations.
  - Magnificent 7 continues to drive the overall market although cracks begin to appear beneath the surface, regarding individual performance.
  - We still think the probability for a US recession remains low, but as US growth continues to surprise on the upside, the risk for a more substantial downturn later in this cycle may increase as the Fed may have to postpone policy easing. Hence (too) good data may be interpreted as bad for markets.
  - European growth prospects are improving albeit from a very weak level, revisions are likely to offer a small boost against the relatively bearish sentiment towards the region. Wages remain a problem for rate cuts.
  - The outlook for Emerging markets remains weak, for China in particular, but markets are priced accordingly
- As regards central bank policy, which is the key driver for risk appetite, rate cuts have been postponed for good reasons in the US (strong growth) and bad reasons in Europe (elevated wage pressure despite lackluster growth)
  - We expect the ECB to start cutting rates in June (potentially already in April).
  - Strong supply side developments in the US (rising labor force and improving productivity) increases the room for growth near trend and lower inflation
- Risks to our main scenario are centered on US economic reacceleration with sticky wage inflation and tight(er) Fed policy
- We keep our pro-risk position and risk utilization at 60% for now

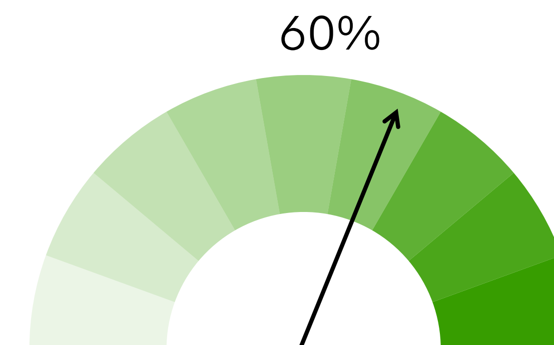
Investment Regime

Our regime-based framework defines the major characteristics of the investment regime

Strong growth may postpone rate cuts	Undervalued small caps	Earnings continue to grow in 2024
Elevated wage growth in Europe	Soft landing remains our main scenario	Weakness in China, but with tentative signs of support
Risk: Rising geopolitical risks		Risk: A "no landing" in the US

Speedometer

60%



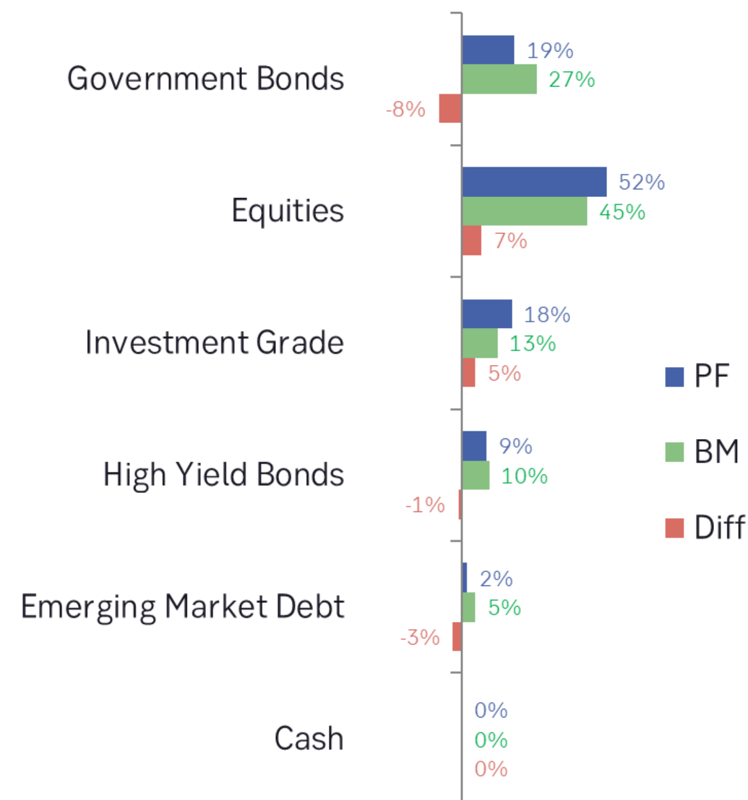
The speedometer controls to what extent the portfolios should utilize their risk budgets. It is connected to the model portfolio (page 4) which at all times utilizes its risk budget in-line with the speedometer. In a very general sense it can be interpreted as equities on/off (with 50% being neutral).

Asset Allocation

Equities continue to outperform as interest rates are repricing the outlook for rapid rate cuts. Credit spreads remains tight and the case for further significant tightening is weak.

- We maintain our overweight in Equities, again noting that valuation in some markets are elevated
  - Our strategy continues to hold a soft landing as the most likely scenario where unemployment rises very gradually and where lower inflation enables central banks to cut rates in Q2 24
  - Low equity risk premium argues against increasing risk utilization
- Bonds continue to offer good returns indicating the importance of balancing portfolios
  - Rising yields in Q1 2024 increase the attractiveness of bonds, but the prospect of substantially lower bond yields is weak bar a recession. A changing equity-bond correlation increases the prospect for risk diversification
  - A hard landing and recession would surely see bond returns provide a cushion against falling equity prices
- We remain underweight in Government Bonds, but note that the combination of rising bond yields and tight credit spreads make the case for UW Bonds vs OW Credit weaker now.
- Our slight underweight in High Yield bonds is a small risk-reward statement
  - Spreads are tight and risk-reward is not great adding to HY
- We keep our underweight to Emerging Market Debt, bonds have rallied and are approaching record tight spread levels just below 300 basis points
  - Rapid Fed rate cuts and a weaker USD in 2024 could take us into the range 200-300 bps.

Model Portfolio



Long only portfolio. Yearly VaR(95%) ex. mean between 7% and 21%.No restrictions on the individual asset classes. The weights are set manually by the House View committee; i.e. they are not based upon an optimization model.

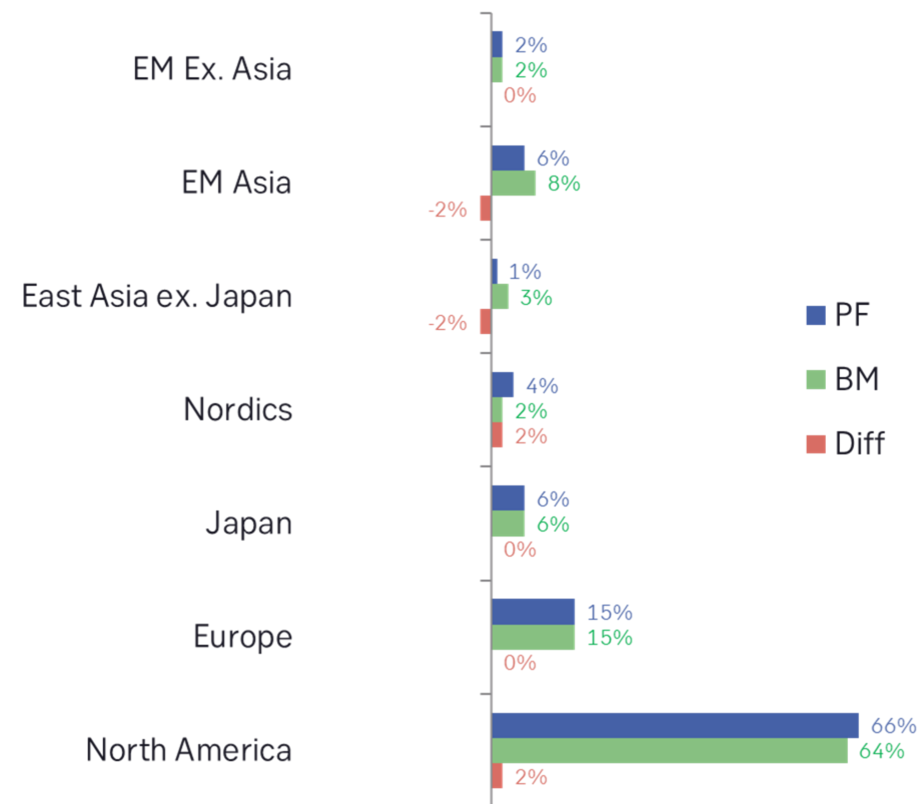
Regional equity allocation

We prefer to stay overweighted in the US. The Q4 earnings season highlighted US leadership, justifying the high valuations of the S&P 500. Tech earnings have driven global equities higher, despite less impressive EPS growth outside the US

- We continue to focus on assets in innovation and growth
- The historical rather extreme valuation gap between the US and the rest of the world rests on continued strong growth momentum in the US
- A downgrade to the tech sector could be a negative catalyst, while the US election outcome is another risk, given Donald Trump's the protectionist stance

- We maintain our neutral stance to Europe which has worked well since the last House View update
  - European growth is improving slowly, earnings expectations and investor sentiment/positioning remains muted setting the stage for positive surprises, valuation is slightly below historical averages
  - We expect the ECB to start cutting rates in June, but the timing remains uncertain
- We also maintain our overweight to the Nordic market
  - The Riksbank was surprisingly dovish at the February meeting. Rate cuts will benefit interest rate-sensitive sectors including our tilt towards small-cap stocks
  - A backdrop of rising PMIs may help business cycle-sensitive markets like Sweden
- EM Asia remains undervalued, but China suffers from structural headwinds
  - Our regional model signals that EM equities are trading at attractive valuations, and it prefers to raise the allocation to EM
  - A tactical bounce occurred in February, but problems in the real estate sector, deflation, elevated debt levels, tech competition and the threat of Trump import tariffs are barriers to a more sustained rally
- We upgrade Japan to neutral from underweight by reducing our exposure to East Asia ex-Japan, as corporate governance reforms and solid earnings will likely spur positive momentum going forward

Regional equity positioning



Benchmark is MSCI All Country. Benchmark weights updated by September 2023. Portfolio weights have been adjusted accordingly to keep our active weights unchanged.

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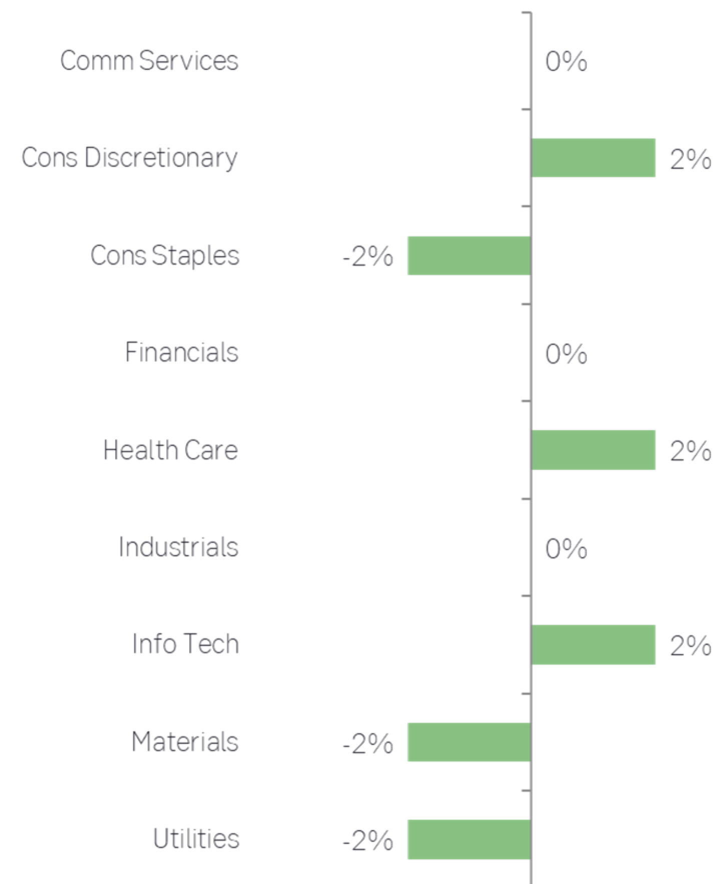
Sector allocation

We keep a less cyclical, but still growth and quality positive position

- We prefer to keep our overweight to Health Care
  - The sector has shown strong momentum, with earnings growing faster-than-expected, supporting our stance
  - Health Care has historically performed well in periods of falling inflation and is less sensitive to rate changes, providing some stability
  - Health Care's defensive characteristics should be beneficial in late-cycle phases
- We maintain our overweight in Consumer Discretionary, supported by a strong job market and consumer spending
  - Earnings have remained strong, surpassing forecasts, boosted by strong consumer spending, supported by a strong job market and real wage growth
  - That said, there are some risks over the horizon with decreasing household savings and high price levels
- We keep our overweight to IT as AI and rate cuts should boost the sector
  - IT had very strong Q4 earnings – we anticipate strong earnings growth ahead
  - AI trends and anticipated rate cuts later this year should support the sector
  - Moreover, IT provides downside protection due to its less cyclical nature
- We keep our underweight in Consumer Staples, Utilities and Materials
  - Consumer Staples should underperform amid a strong economy and job market, however, it may gain appeal if economic conditions deteriorate
  - Utilities tend to perform better during a weaker economy and with falling yields, yet with current weak momentum and better growth potential in other sectors, we maintain a slight underweight
  - We stay underweighted in Materials due its weak earnings growth and high cyclicality, considering that we are approaching economic slowdown.



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Risks to the investment regime

US growth reaccelerating increasing the odds for a hard landing down the line

- Looser financial conditions (equities and spreads), tight labor market, increasing real wages, continuous fiscal deficit (6-7% GDP) can again lead to higher than expected US growth for 2024 as also indicated by the recently accurate Atlanta Fed GDPNow model
- This "no landing"-scenario would likely lead to a more hawkish response from the Fed and ultimately increase the risk of running too tight in the future. Higher bond yields and the fears about debt-sustainability can also re-emerge in this scenario.

Surprise downturn in growth due to lagged effects from tighter monetary policy

- As indicated above, we see that risks are currently tilted towards a higher growth picture. However, we do not exclude the possibility of negative growth surprises due to for example lags in tighter monetary policy.

Escalation of geopolitical tensions

- Europe-bound vessels have continued to re-route around the Cape of Good Hope, increasing the risk of a pickup in goods inflation as the situation continues in to its fifth month. However, we do note a slight downturn in shipping rates recently indicating some resilience in supply chains.
- Russia-Ukraine continues to be a worry with Russia recently advancing and conquering the city of Avdiivka. Meanwhile further US support for Ukraine is stuck in Congress, increasing the probability of further Russian advancement and potential of escalation.

US regional bank risks have shot up again

- NY Community Bancorp recently reported a large surprise loss related to their commercial real estate exposures. On the bright side, CRE-exposures are largely centered in smaller banks and the magnitude currently is seemingly smaller than last year's treasury holdings –related stress. We do note this nevertheless and view it as a possible risk to the very positive sentiment in the financial markets currently.

Figure 1: US Growth outlook: GDP expands above trend

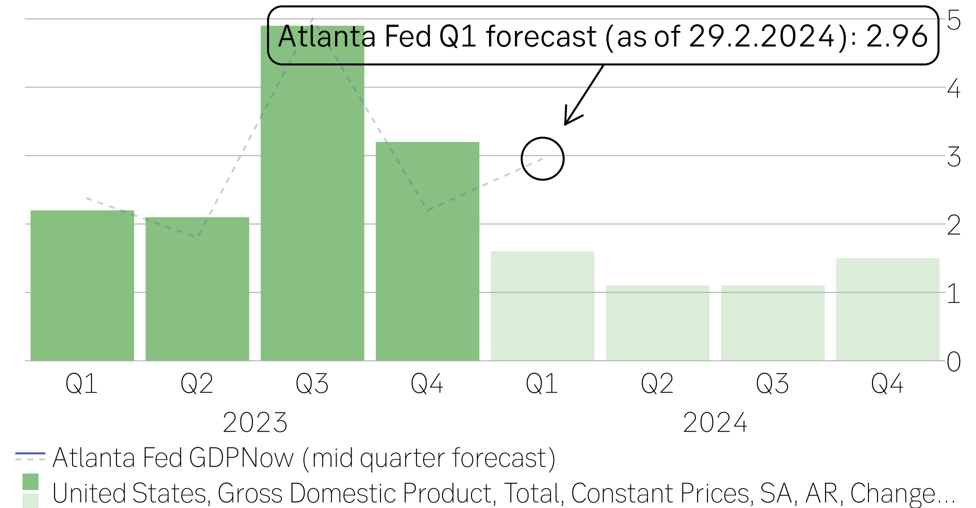


Figure 2: Shipping rates slightly down recently

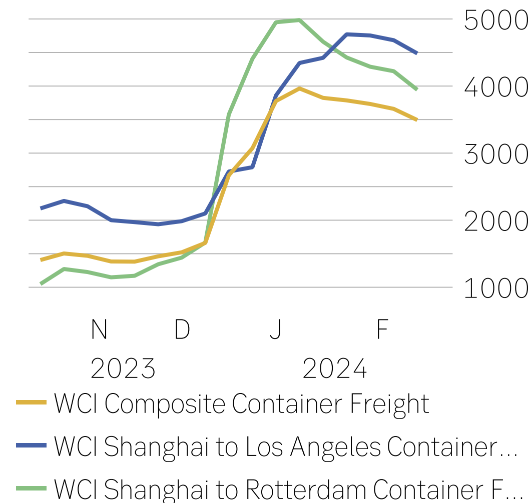
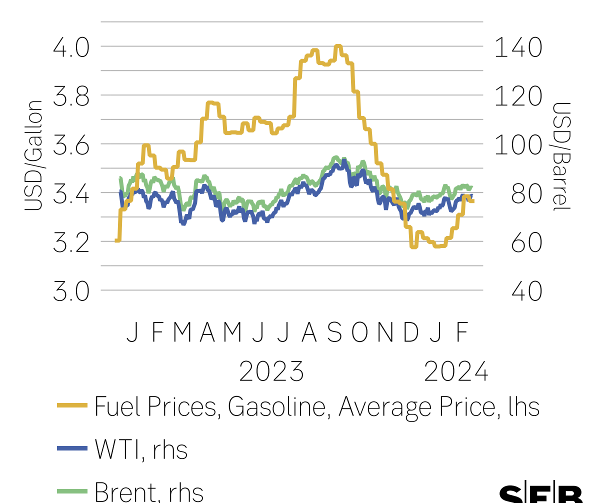


Figure 3: No shocks in energy prices



Sources: SEB, Bloomberg, Macrobond

Return Estimates

Figure 1: 12 month forward looking return expectations

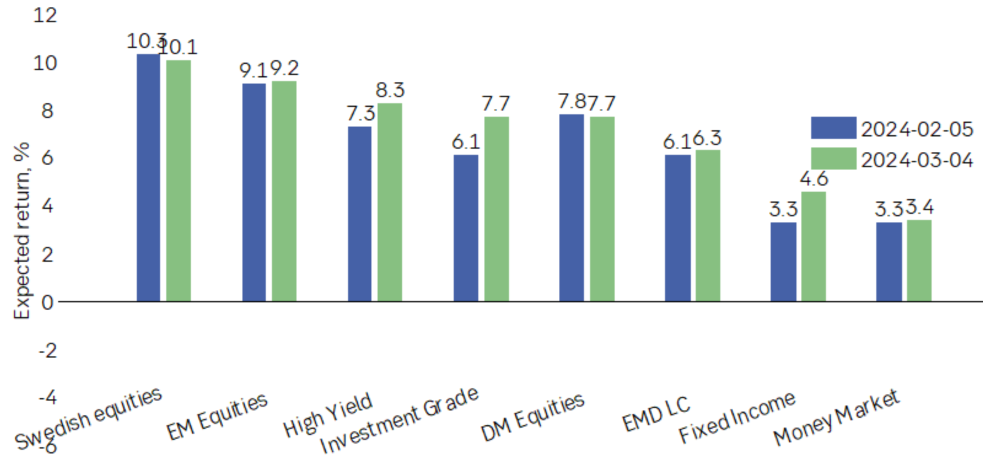


Figure 2: 12 month forward looking return expectations for equities and bonds

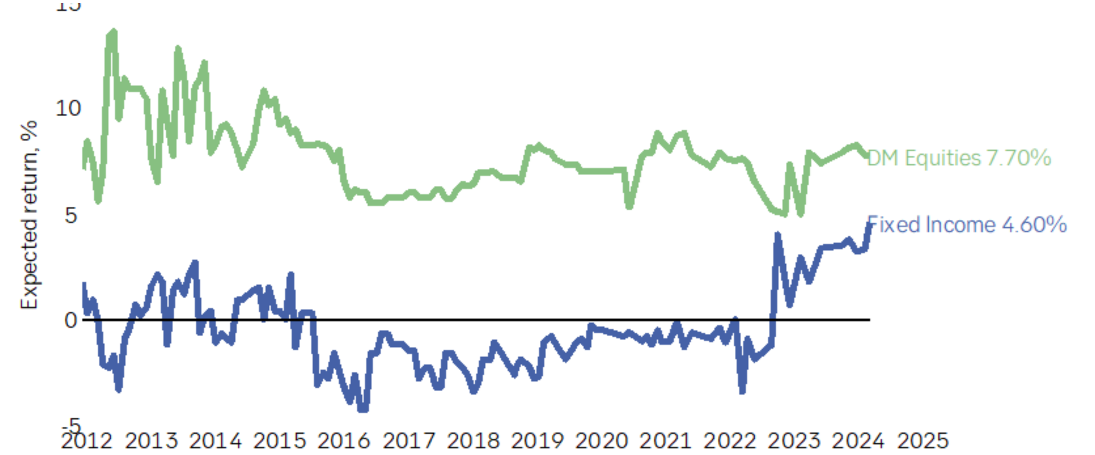


Figure 3: Absolute expected returns

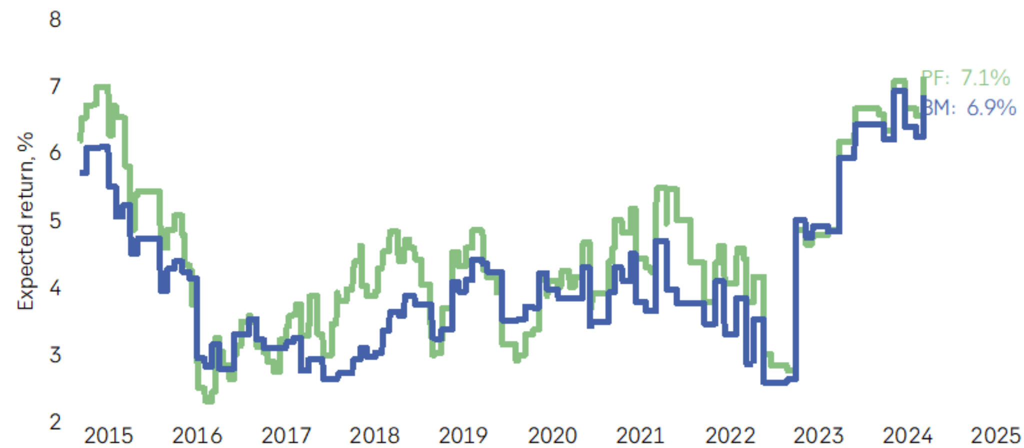
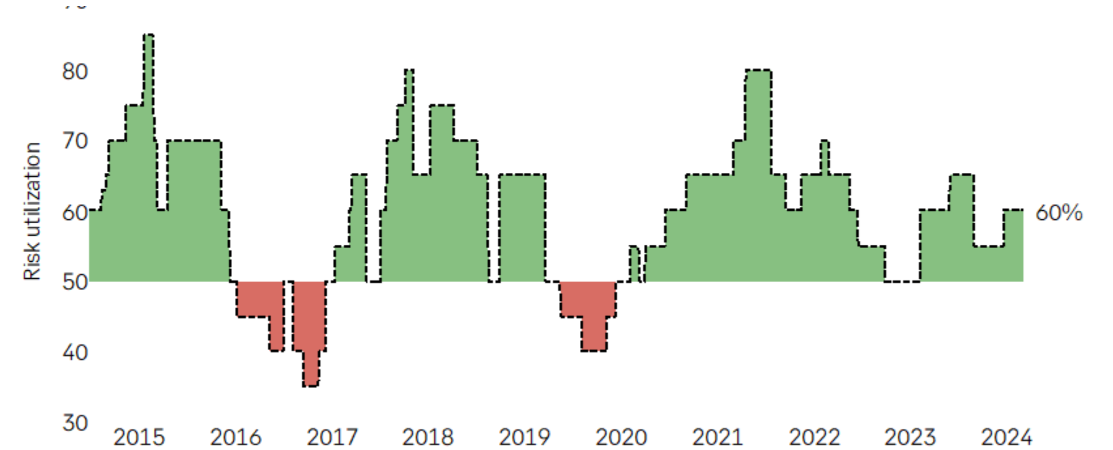


Figure 4: Risk utilization since inception



Historical House View Allocation

Figure 1: Equities

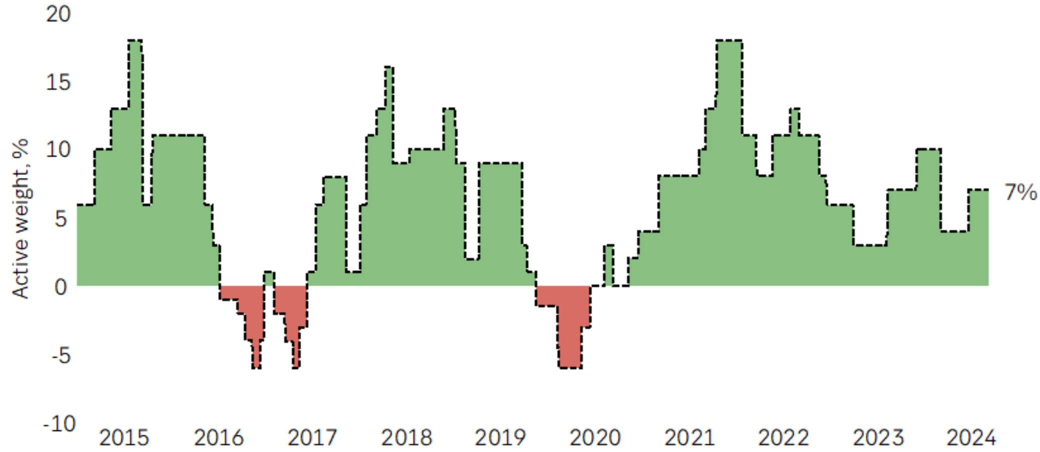


Figure 2: High Yield

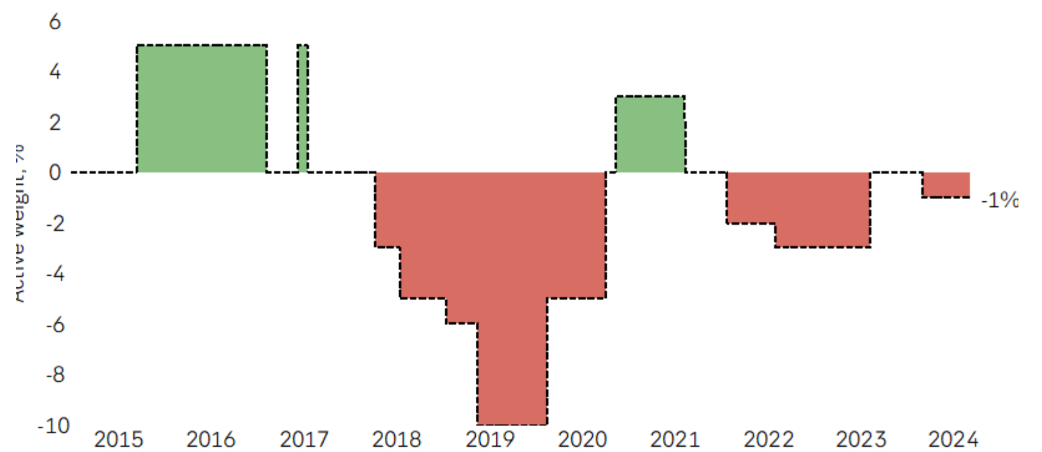


Figure 3: Emerging Market Debt

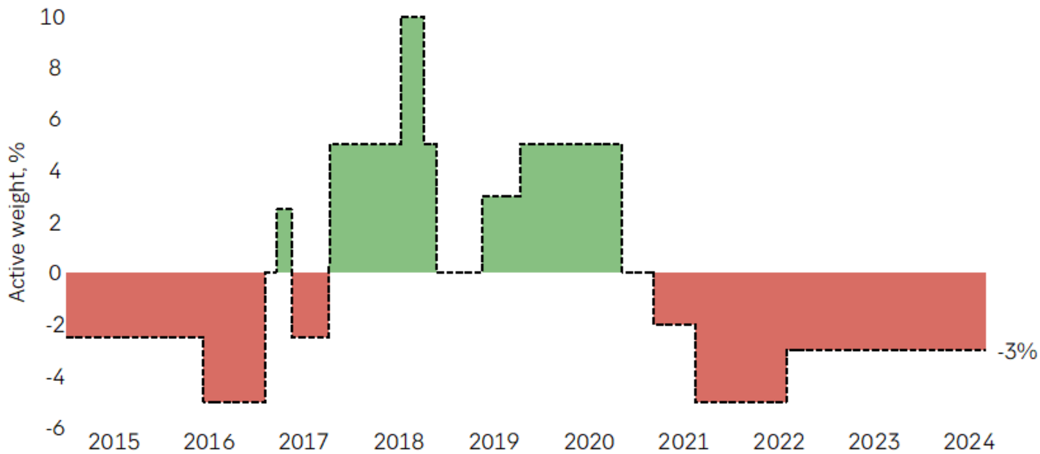
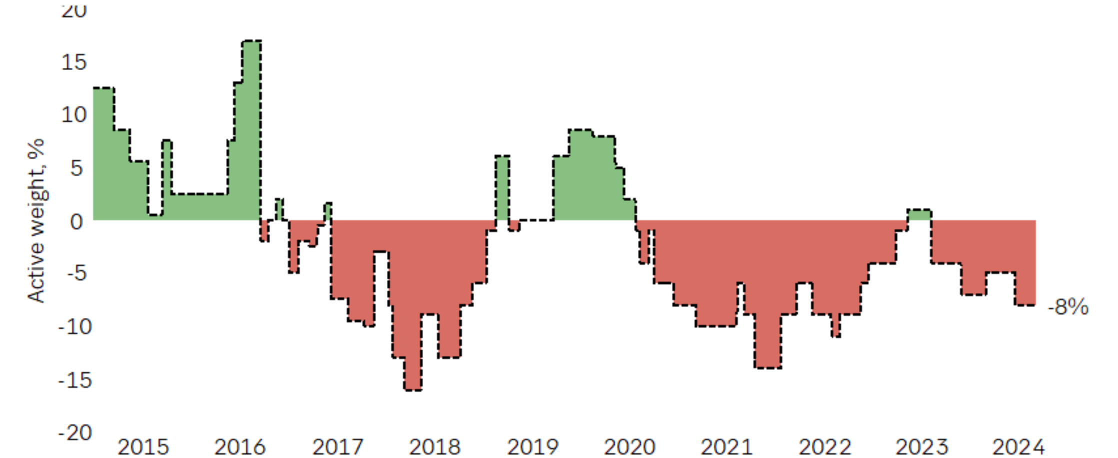


Figure 4: Fixed Income*



* The 2014-2015 combined overweight to equities and fixed income was financed by an underweight to Investment Grade, Commodities, and EMD.

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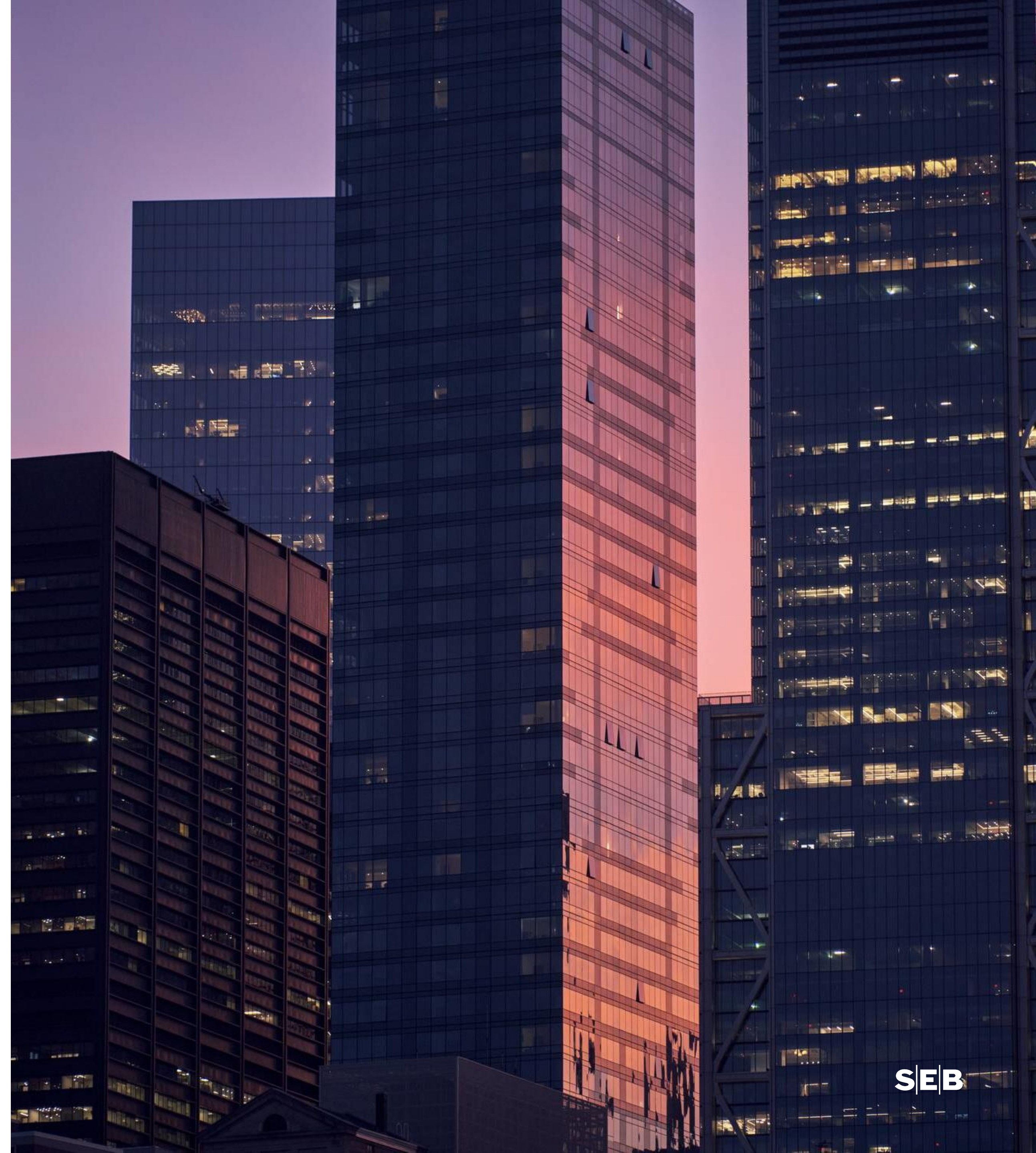


House View decision variables

Macro conditions and central banks continue to be the most important factors for our tactical risk-taking, and are viewed as slightly positive for risk assets

- Macro data has increased in importance since our last House View meeting, with attention shifting from earnings to inflation and activity data
  - Macro conditions have been supportive for risk assets, with many equity markets have continued to make new highs and credit spreads trading near record lows
  - Looking ahead, there are tentative signs of improvement in global manufacturing PMIs, which usually tend to benefit more cyclical assets and markets
- Central banks remain central to our tactical asset allocation, with market sentiment being highly focused on the timing of interest rate cuts
  - Markets have quickly pared their bets on early rate cuts in Q1, with higher US inflation data contributing to that shift, along with pushback from policymakers
  - That said, central banks are slightly positive for equities, in our view. We anticipate rate cuts over the coming months which should support risk assets
- Going forward, central banks and inflation data will be equally important
  - Upcoming central bank rate decisions and especially the FED's SEP, will be key
  - Central banks' data-dependency also means economic data will remain a market focus, with the hope that February's data will show more favorable readings following January's higher inflation numbers
- SEB House View prefers to maintain risk utilization at 60% as we expect favorable macro conditions to continue to support risk assets
  - Macro data has continued to support our base case scenario of a soft-landing, suggesting a low recession risk, keeping our outlook on equities positive
  - In our view, equities are likely to benefit the most from solid growth and lower inflation, and are more likely to rise in this environment

Figure 1: Central banks and macro data continue to be the most important factors for our tactical risk-taking

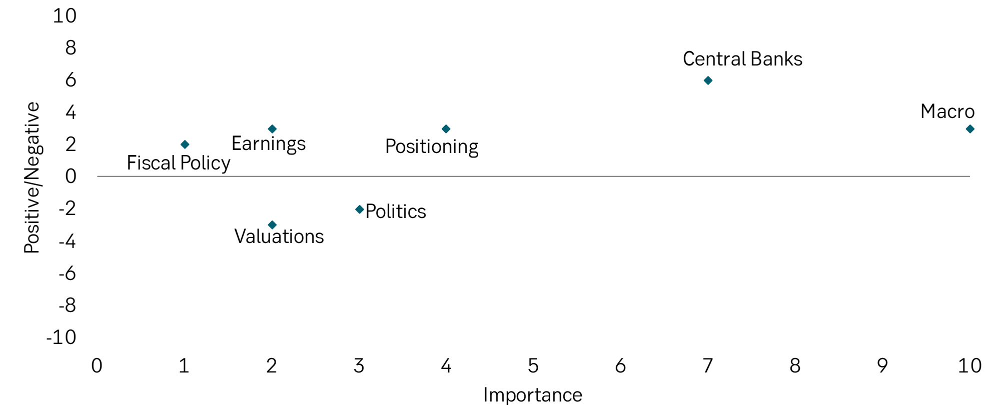
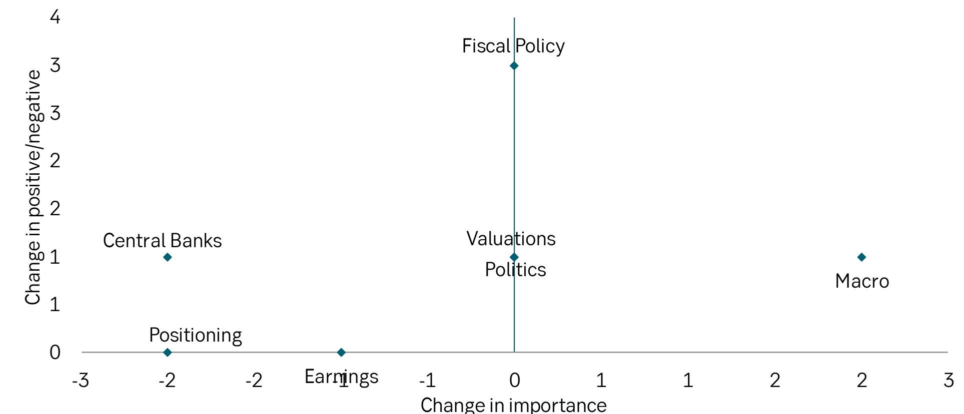


Figure 2: Macro and central banks have become more slightly more positive for equities, in our view, while earnings have become less important as the earnings season comes to an end



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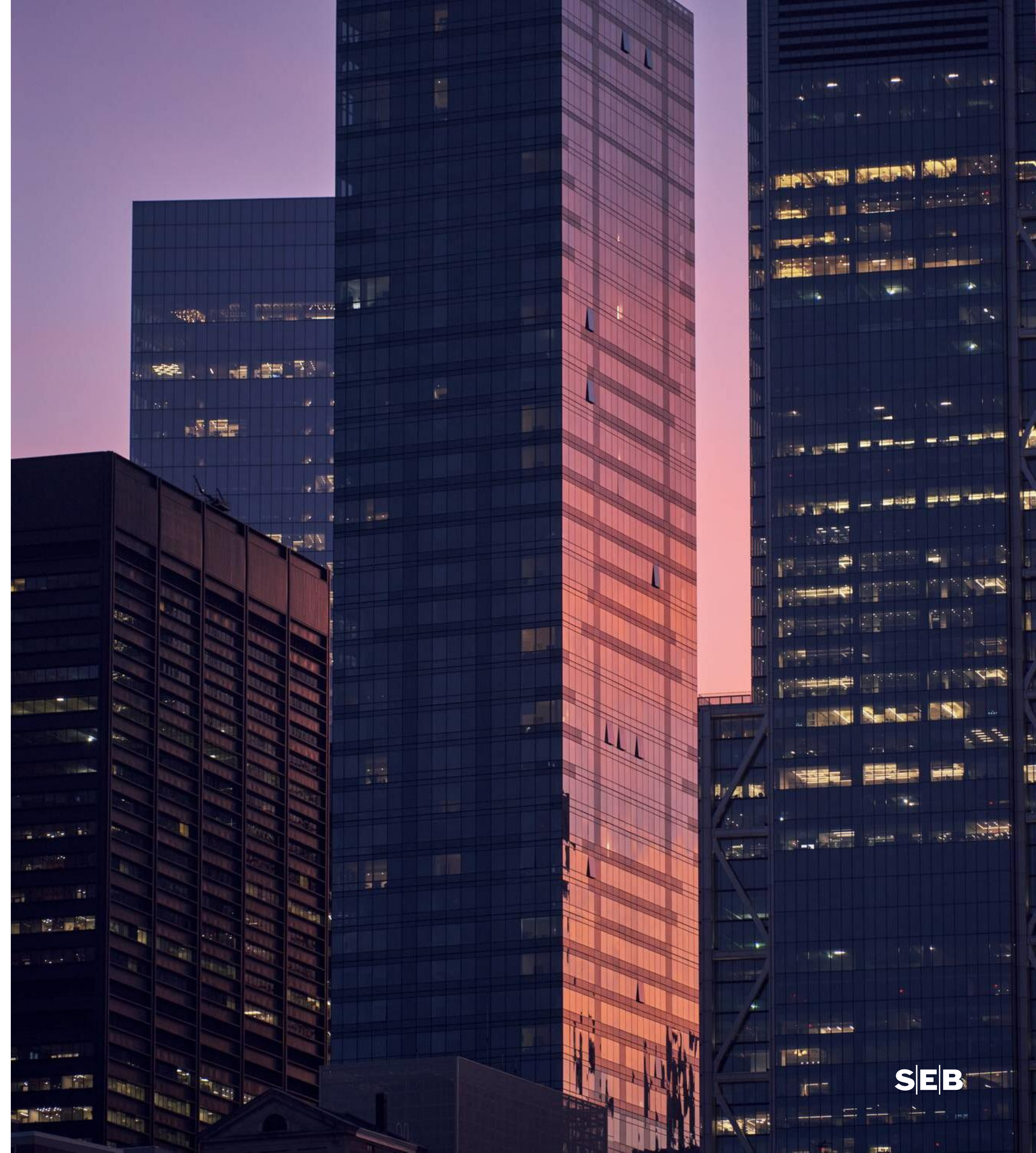
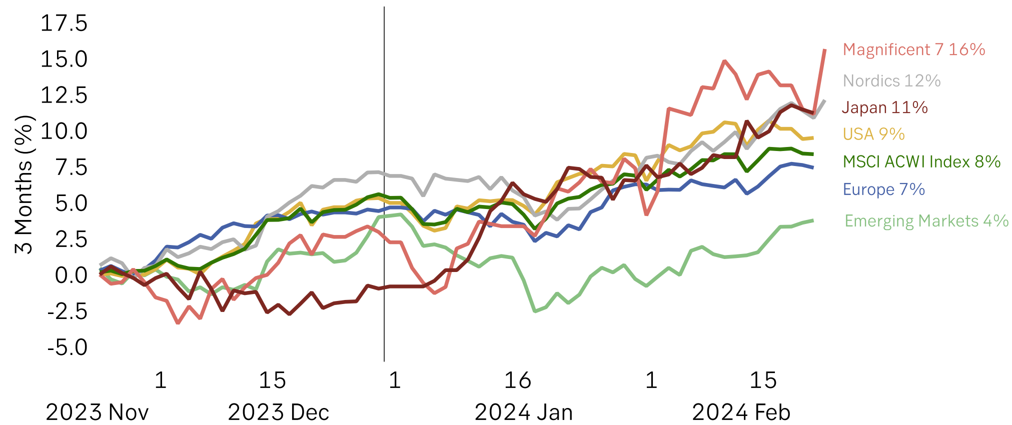


Developments in the Markets

Equities continues to rally, AI narrative persists, while government bonds continue to decline on inflation signals

Figure 1: The global equity rally gained pace in February, led by the Magnificent 7, Japanese and Nordic equities. European and Japanese equities also hit new all-time highs.

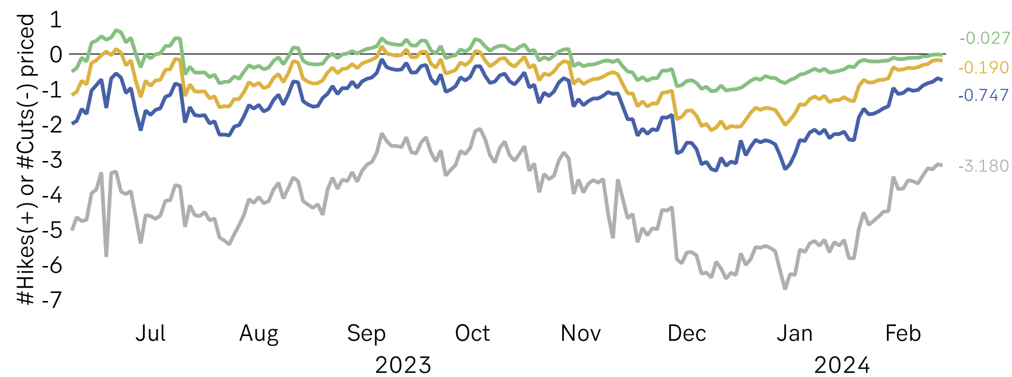


Source: Macrobond, SEB

Figure 2: Treasury yields have continued to climb amid a tougher backdrop for bonds which have seen upside inflation surprises and cautious Fed minutes about lowering rates too soon

Source: Macrobond, SEB

Figure 3: Discouraging US inflation prints and Fed rhetoric have forced markets to price out the likelihood of a Fed rate cut in March, in contrast to earlier bets of a 25-bps cut.



Source: Macrobond, SEB

Figure 4: Nvidia's share price soared after reporting upbeat Q4 earnings, reinforcing the narrative that AI's strength will persist, buoying broader stock market sentiment

Source: Macrobond, SEB

Developments in the Markets

Risky assets have remained robust in the face of rising inflation expectations, bond yields and volatility

Figure 1: Crude oil prices have seen some gains in 2024, likely driven by improving fundamentals rather than risk premium for a wider military conflict in the Middle East

Figure 2: US inflation expectations, as gauged by breakeven rates, are on the rise, in line with inflation in the US showing signs of rebounding and the increase in oil prices

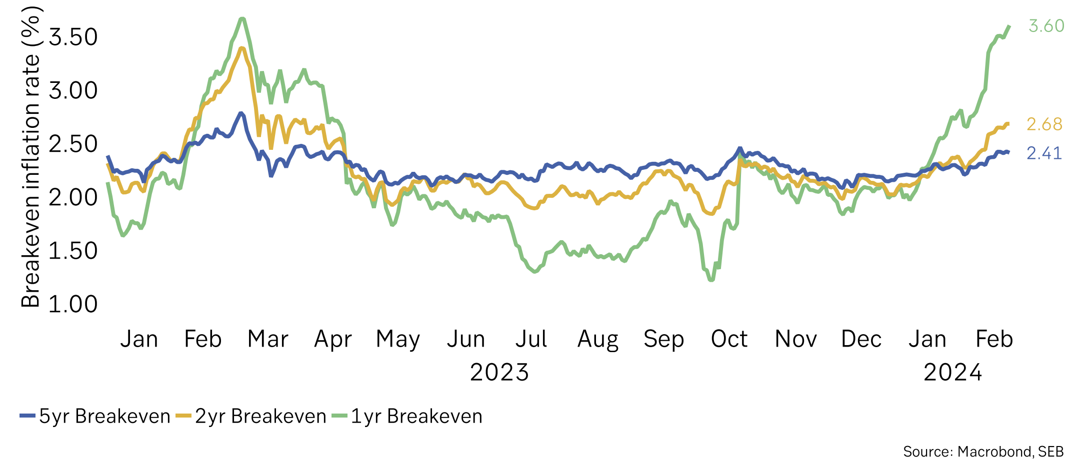


Figure 3: US bond and stock market volatility have risen lately amid renewed concerns about higher-for-longer rates in the US after higher-than-expected inflation prints

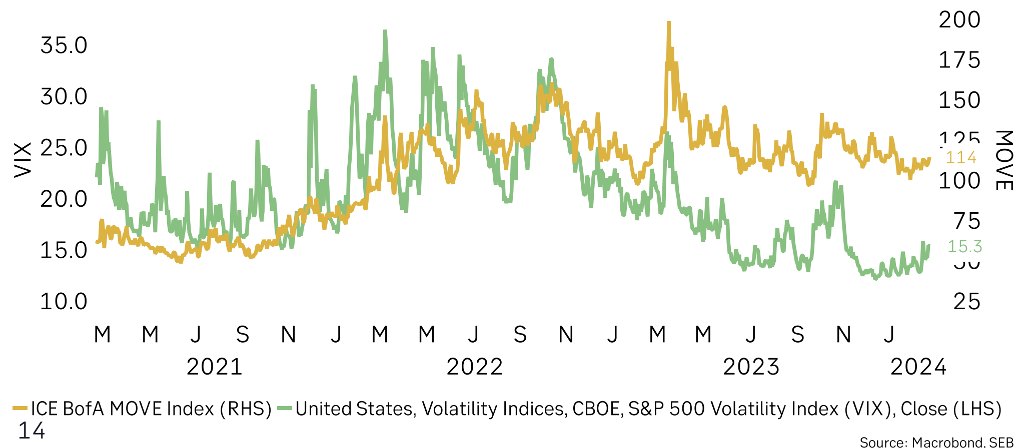


Figure 4: Risk assets have remained robust in the face of increasing bond yields, especially corporate bonds, whose credit spreads have stayed near historically low levels

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Economy – Developed Markets

US consumer price index rose more than expected in January, pushing consensus expectations of a first Fed rate cut from April to June

- Core PCE inflation, the Fed's key inflation metric, surged to a 0.4% m/m in January as expected, up from a 0.1% increase in December.
- Powell's preferred inflation measure "supercore" PCE inflation – core services excluding housing rents – accelerated to 0.6% m/m. Both the core and supercore readings were largely driven by portfolio management, OER, and hospital services
  - The uptick in the core and supercore PCE inflation are unwelcome news for the Fed as it suggests a bumpy path ahead toward achieving the 2% inflation target
  - That said, we think the Fed will view January's inflation reports with caution due to seasonality issues and possible one-off factors at work. We expect inflation to decline in the coming months due to softer demand
- US core retail sales, excluding autos and gas, saw their biggest drop in almost a year in January, hinting at a post-holiday pullback in consumer spending
  - Despite the weak report, a sharp decrease in future consumer spending is not inevitable, in our view, thanks to the stabilizing effect of a solid US labor market
- January FOMC minutes showed that officials are cautious about easing monetary policy too swiftly and preferring a data-driven approach. January's high inflation readings makes a Fed rate cut in March improbable but is also unlikely to change the view of FOMC participants.
- The eurozone averted a recession last year with a flat growth reading in Q4, however, the growth outlook for the region remains soft, particularly in Germany
- The European Commission recently cut its 2024 growth forecasts for the eurozone and EU, expecting a faster decline in inflation than previously forecasted
- Euro area inflation slowed in February on an annual basis, but both the headline and core CPI inflation eased less than expected. We expect the disinflation trend to continue, prompting the ECB to start lower rates by June.

Figure 1: Core PCE inflation, the Fed's preferred inflation gauge, eased to 2.8% y/y in January, while the monthly figure rose to 0.4%, both in line with expectations.

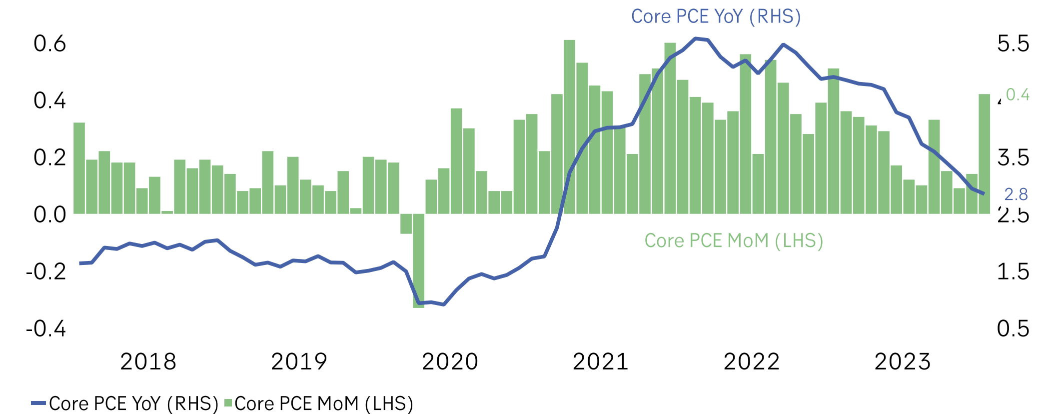
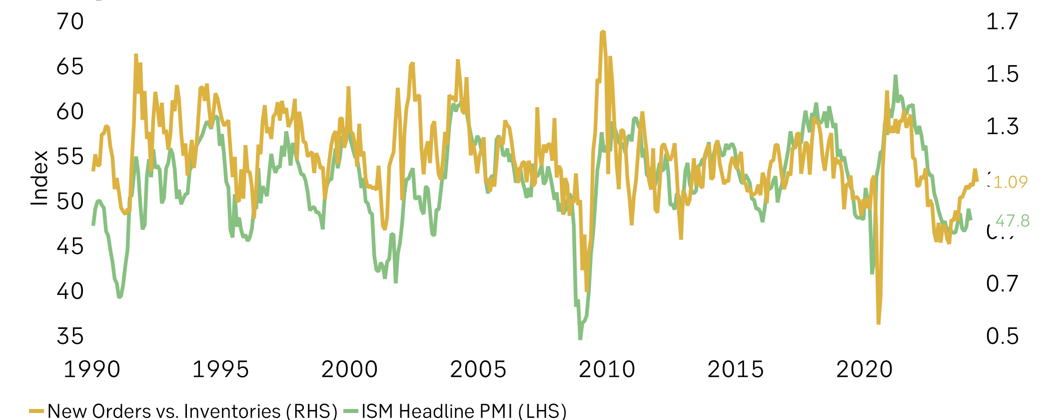


Figure 2: The ISM manufacturing PMI unexpectedly fell in February (47.8), but the rising new orders/inventory ratio signals that US manufacturing activity should improve in the coming months...



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Economy – Emerging Markets

China continues to ramp up support, but it seems to be more targeted towards the stock market than the real economy (Table 1)

- Chinese growth forecasts for 2024 have continued to be modest by historical standards, driven primarily by the uncertainty and slowdown in the real estate sector and its impacts on the economy as a whole (debt overhang, lower consumer & business confidence+demand)
- February manufacturing PMIs inched down slightly and still remain in contraction territory for the fifth consecutive month (49.1), although possibly impacted by the shorter month due to the Lunar New Year (LNY) holiday
- Non-manufacturing PMIs did rebound and beat expectations, however (51.4) driven by an increase in the services component. The stronger than expected services PMI is likely impacted by the LNY which has generally beat expectations in the key travel and spending measures
- Thus far the support measures and positive LNY-data have had a meaningful positive impact on the stock market (CSI 300 up 13% from the February lows), but it remains to be seen how long-lasting the impacts will eventually be as they do not address the structural problems in the economy

Meanwhile India continues to outpace China (Figure 1)

- India's economy grew by 7.0% in 2023, significantly beating China's 5.2% and it is expected to continue going forward
- India's structural outlook continues to outpace China due to better demographics, rising middle class, structural need for new infrastructure and housing
- India is also preparing for general elections in May, but it is expected that the ruling party (BJP/Modi) prevails due to strong results in state elections in December

Figure 1: India continues to outshine China in GDP growth

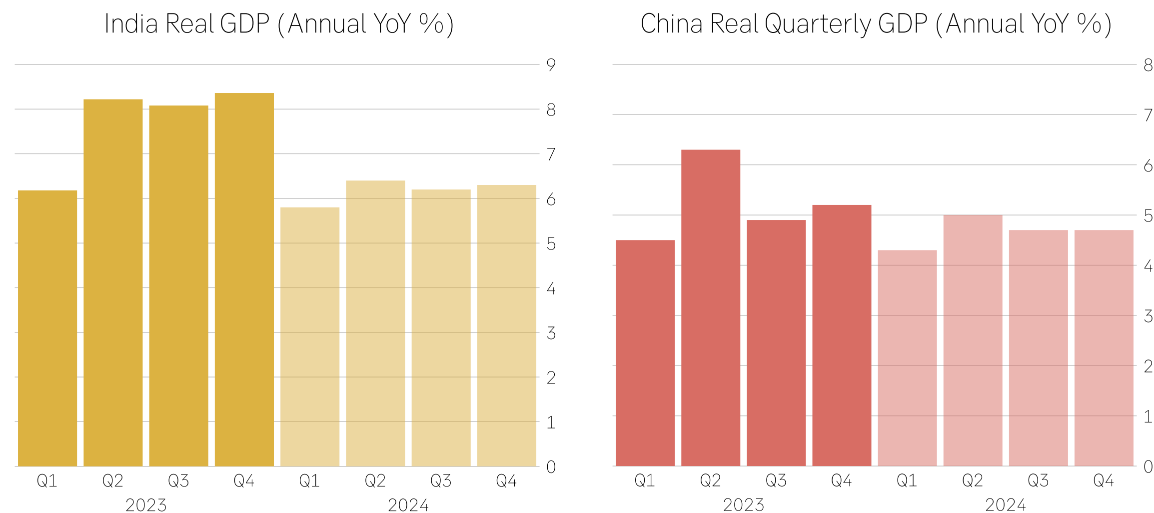

Table 1: China's efforts in 2024 have thus far had more to do with the stock market than solving the economy's underlying problems

Measure	Target
Crackdown on quant funds (21.2)	Stock market
Cut 5y loan prime rate (mortgages) by 25bps (20.2.)	Real economy
Replaced chair of the securities regulator (7.2.)	Stock market
Stock lending (shorting) ban (6.2.)	Stock market
Sovereign wealth fund buying stocks/ETFs (6.2.)	Stock market
Cut the reverse requirement by 50bps (24.1.)	Real economy
Considering mobilizing SOEs to purchase stocks (22.1)	Stock market

Sources: SEB, Bloomberg, Macrobond

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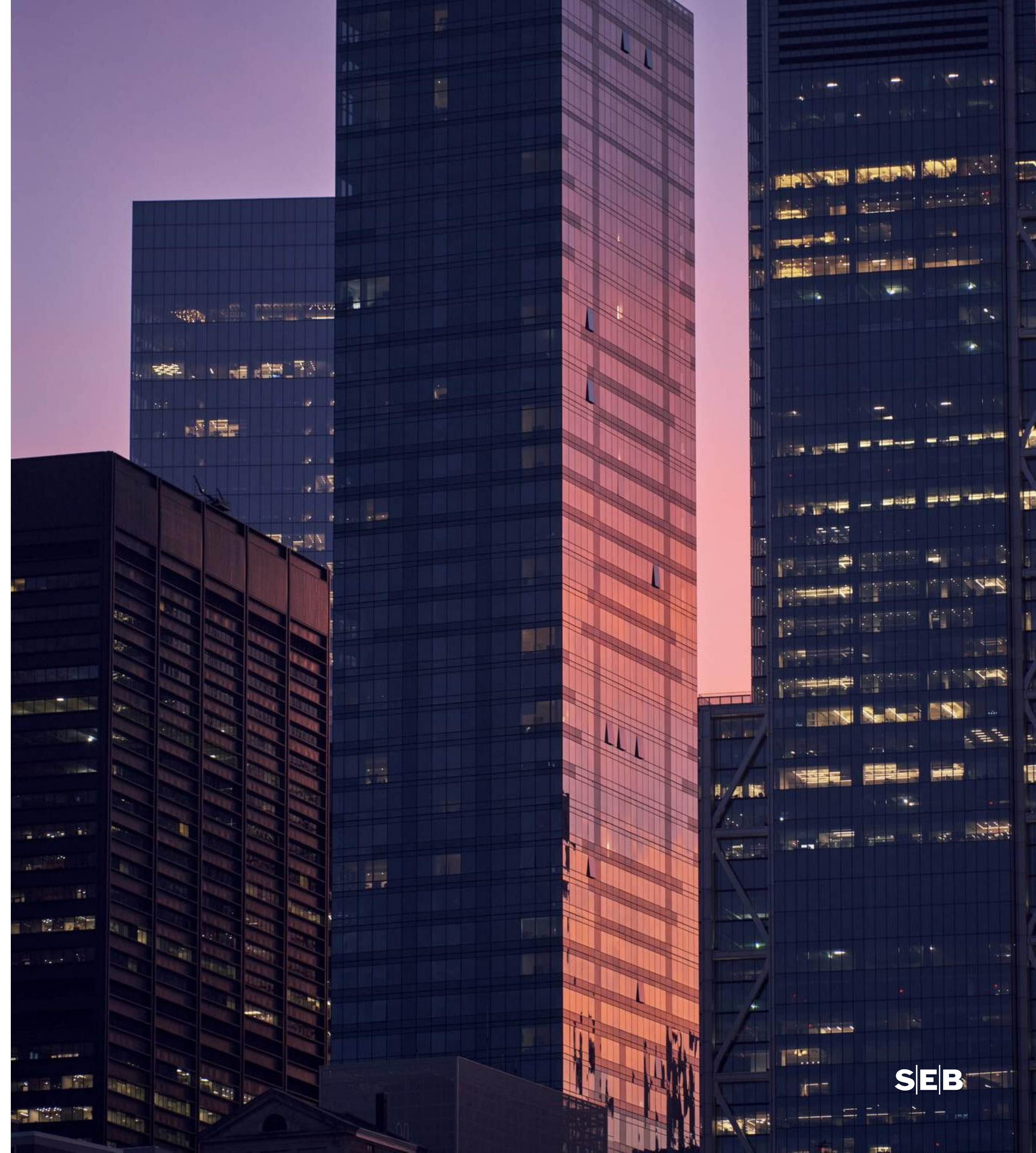
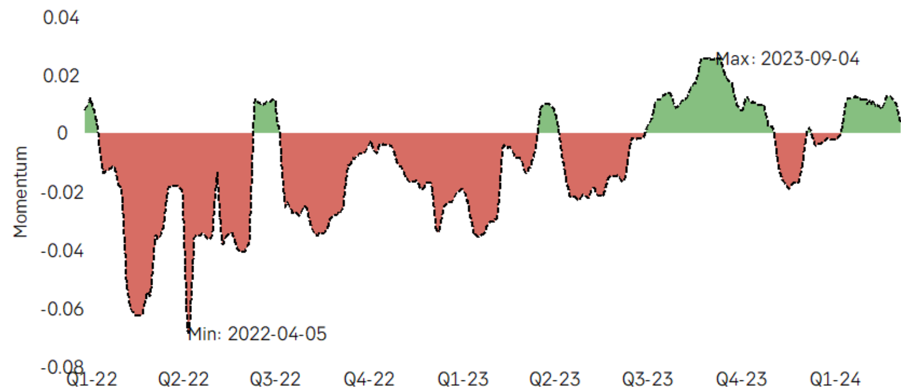


SEB House View – US Macro Status

Our US macro surprise indicator fell earlier this month, driven by lower consumer confidence and a drop in housing starts

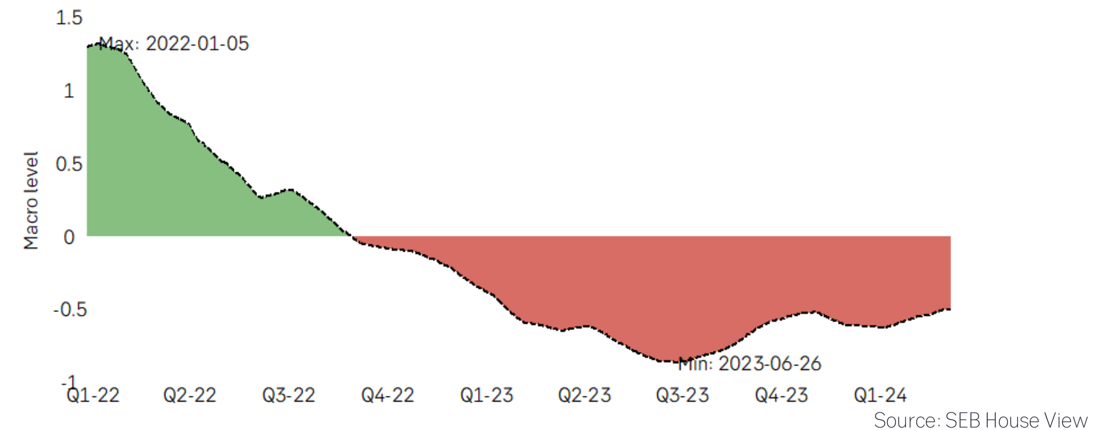
- February saw an unexpected drop in the Conference Board's consumer sentiment index, reflecting growing pessimism about business and job markets
  - More consumers calling jobs hard to get increased compared to the prior month, while the number of consumers saying jobs are plentiful declined, indicating a cooling labor market
- Despite the Philly Fed's manufacturing index rising unexpectedly in February to 5.2, it was not enough to maintain a positive surprise indicator
- Hard data—housing starts, retail sales, durable goods, factory orders and manufacturing output—has shown notable weakness in recent weeks
- That said, other indicators show a growing divergence with soft data showing more momentum than hard data – which has historically been good for equities

Figure 1: US macro momentum saw a slight uptick in February, driven by a rebound in the Philly Fed's manufacturing index which unexpectedly jumped to 5.2



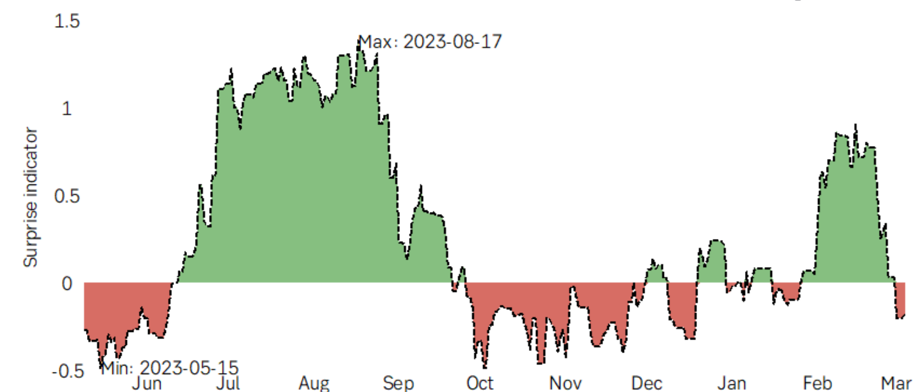
Source: SEB House View

Figure 2: Subpar sentiment in small business, manufacturing, and services sectors drags US macro data below its historical average



Source: SEB House View

Figure 3: US macro surprises turned negative earlier this month, due to an unexpected drop in the Conference Board's consumer confidence index and housing starts



Source: SEB House View

SEB House View – EU Macro Status

Germany's economic weakness persists as weak data and sentiment delay recovery hopes

- German industrial output fell more than expected in December, led by declines in chemicals and construction, highlighting ongoing economic weakness
- Germany retail sales also disappointed as they unexpectedly fell in December, declining twice as fast as the previous month, as consumer demand was pressured by high inflation and interest rates
- GfK consumer confidence indicator also deteriorated far below forecasts in February to an eleven-month low, staying at depressed levels, due to reported declines in income expectations, propensity to buy and economic prospects
- German composite PMI unexpectedly fell in February, showing an increase in the rate of contraction of economic activity, led by a big drop in the manufacturing sector amid lower output and new orders

Figure 2: The EU's economic recovery has stalled, with persistent weakness in data, notably from Germany

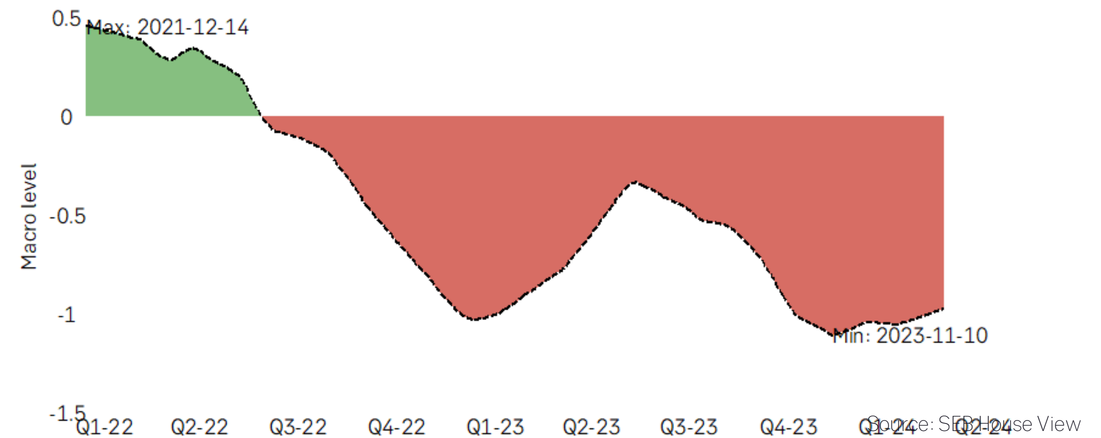


Figure 1: EU macro momentum has stayed positive despite overall weak data, buoyed by a surprising jump in German factory orders in December

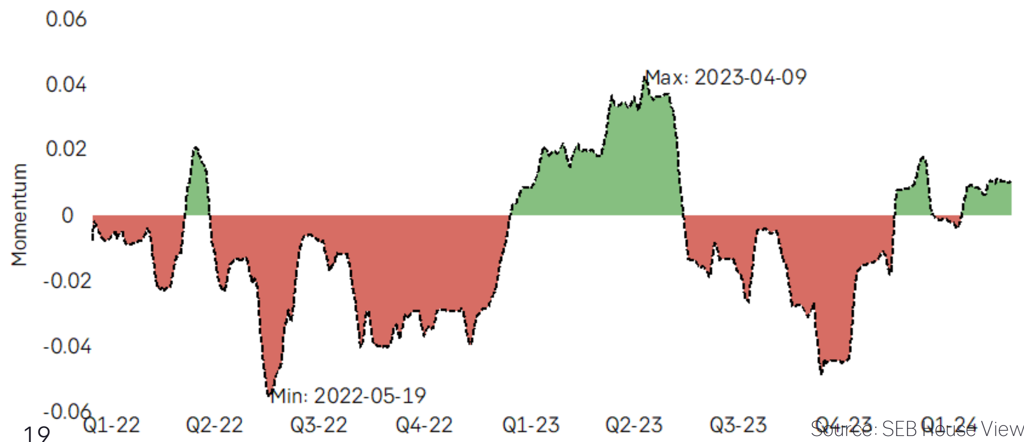
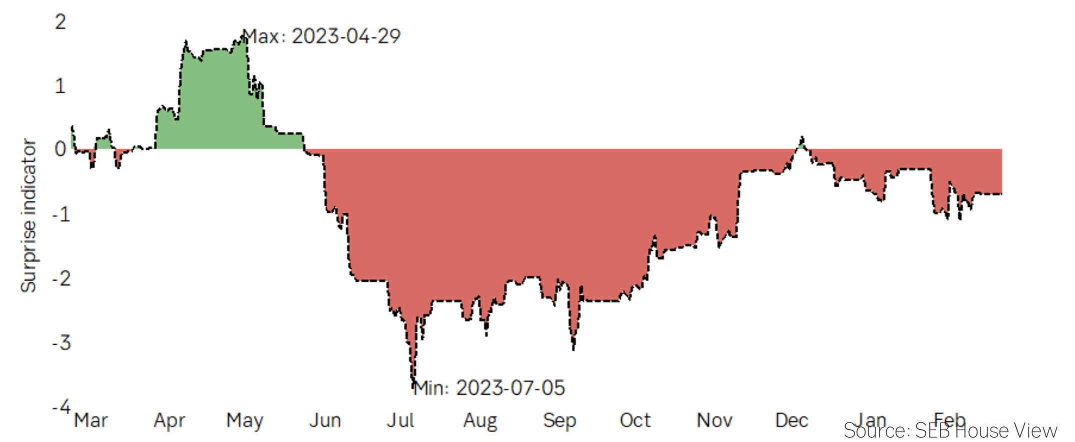


Figure 3: Negative economic data surprises, largely driven by disappointing German figures, have reduced expectations, lowering the bar for positive surprises going forward



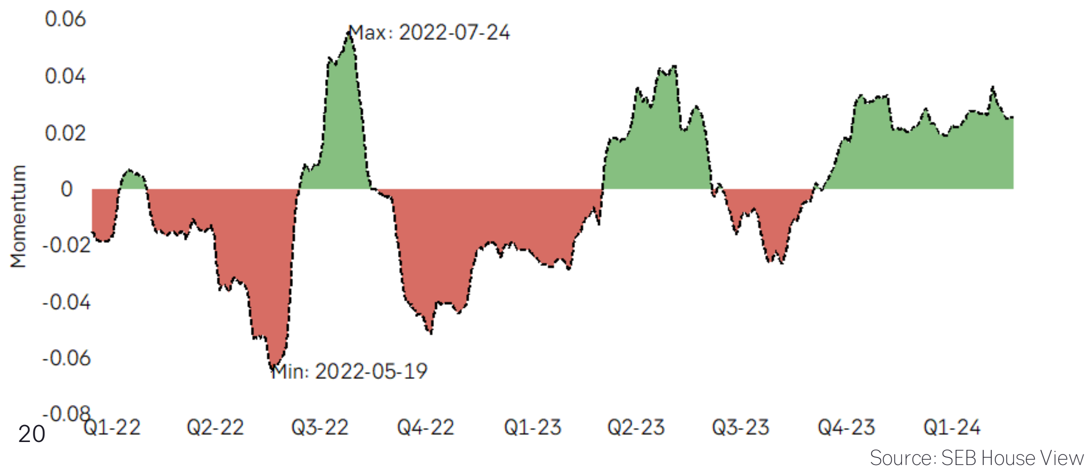
SEB

SEB House View – EM Macro Status

EM macro data has continued to see positive momentum, driven by improving Asian exports and Brazil manufacturing activity data

- Brazil industrial output unexpectedly grew in December, surpassing forecasts, driven by a surge in durable goods, finishing above pre-pandemic levels
- South Korean exports in January rose more than expected, marking a fourth consecutive month of growth, fueled by semiconductor sales and a rebound in sales to China. This reinforces signs of an economic recovery, but a global slowdown remains a risk
- Taiwan's exports grew year-on-year in January, with a notable increase from the previous month's gain driven by IT and communication product sales, yet fell short of expectations
- China's January activity data offered no positive surprises, with the Caixin Manufacturing PMI on target at 50 and the Services PMI unexpectedly falling

Figure 1: EM macro data maintained upward momentum in February, fueled by improving exports in Asia and an increase in Brazil Manufacturing PMI



Source: SEB House View

Figure 2: Our EM macro level indicator returned to positive territory last month, slightly above its trend, boosted by robust growth in Asian exports and Brazil manufacturing activity

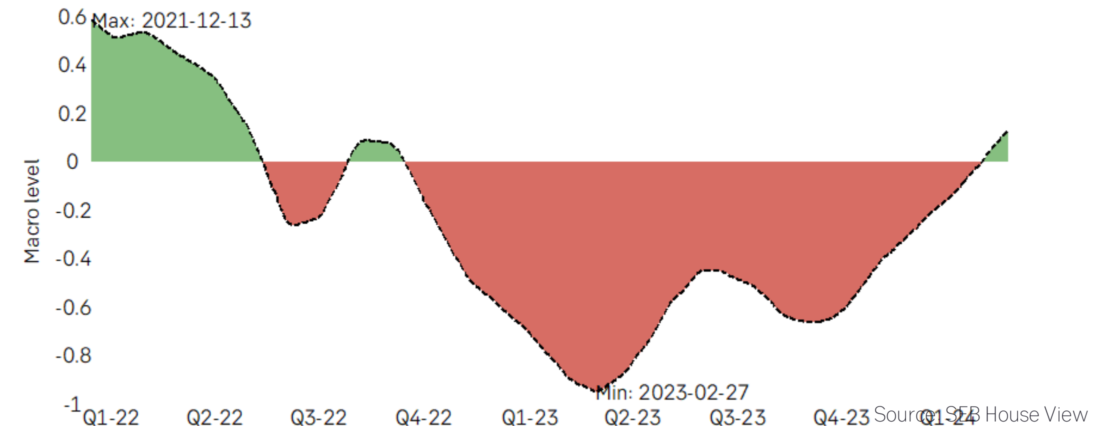
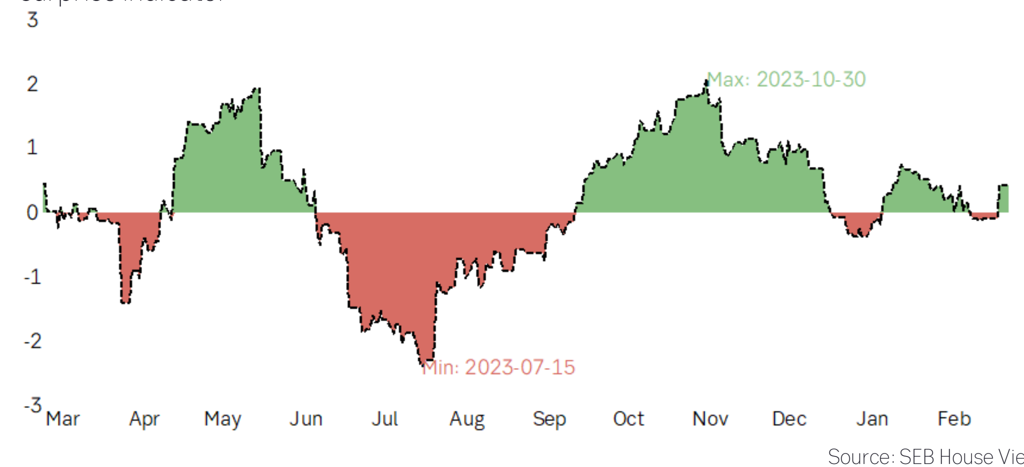


Figure 3: EM economic surprises bounced back into the positive in February, buoyed by growth in industrial output from Brazil and surging exports from South Korea, lifting our aggregate macro surprise indicator



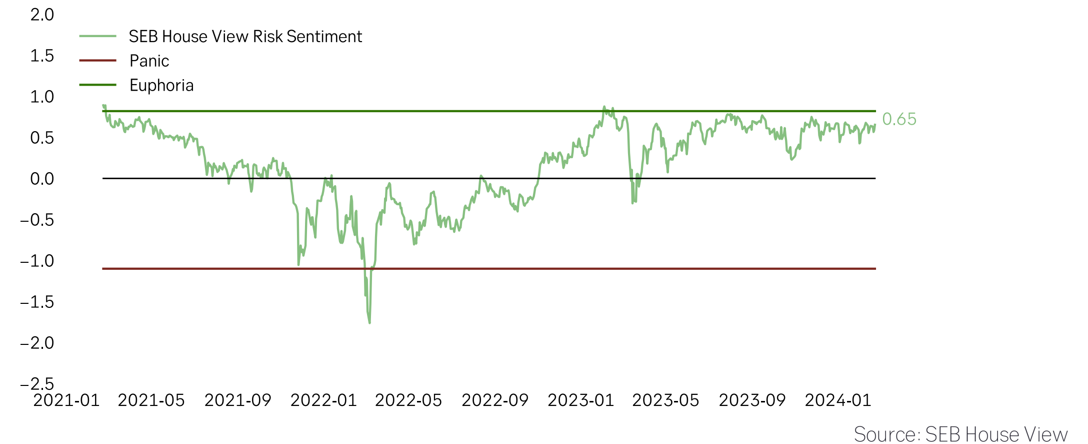
Source: SEB House View

SEB House View – Risk Indicator

Since our last House View meeting, risk appetite become even more bullish, supported by resilient macro conditions and positive earnings season in the US

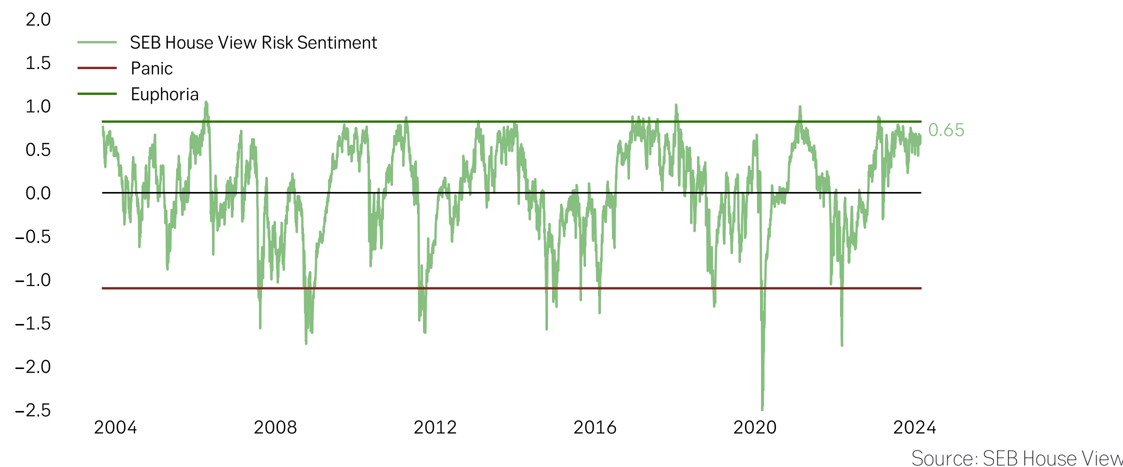
- Risk assets have stood strong amidst higher bond yields and central banks' pushback against expectations of early rate cuts
- Robust macro data and a positive US earnings season, highlighted by Nvidia's very strong results, have further supported bullish sentiment in the market
- Record highs in equity markets across the US, Europe, and Japan, coupled with tight credit spreads, reflect this optimism
- Market sentiment is expected to stay bullish in the near-term, supported by data confirming a soft-landing scenario, with a potential to broaden out if the macro-outlook stays positive and there is a shift into risk assets and less-owned equity segments

Figure 2: SEB House View Risk Indicator – Short Time Horizon



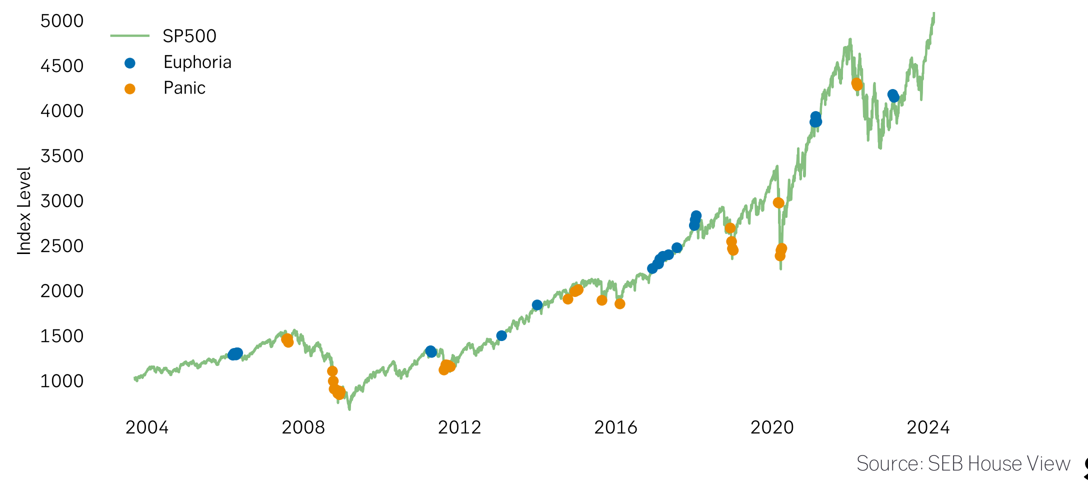
Source: SEB House View

Figure 1: SEB House View Risk Indicator



Source: SEB House View

Figure 3: Extreme states plotted on the S&P 500



Source: SEB House View

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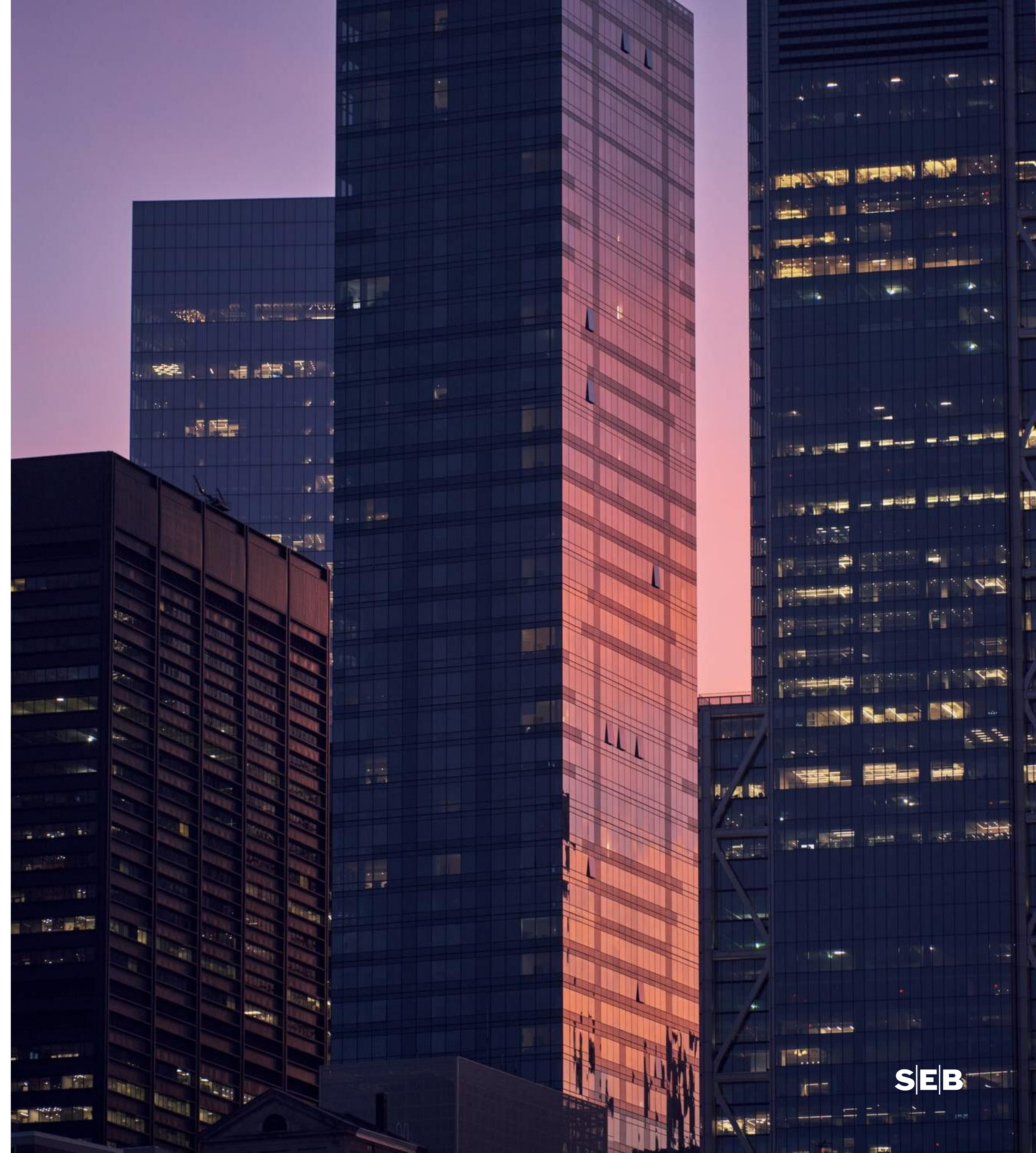


In Focus: China

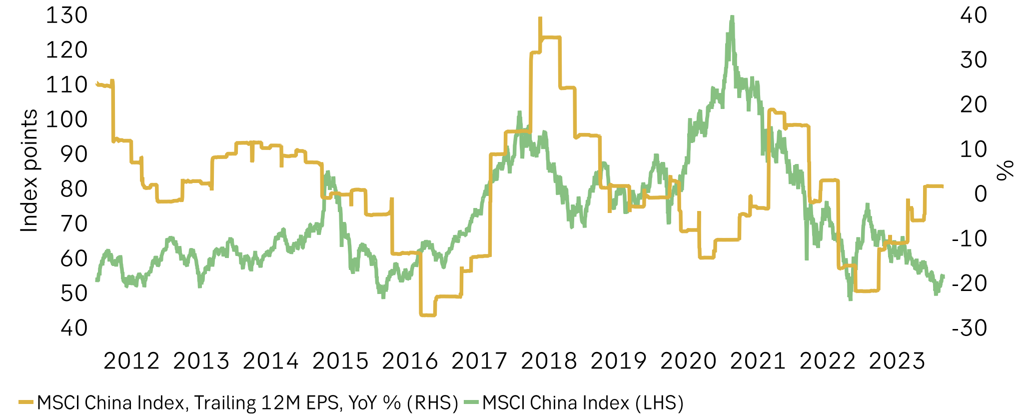
We remain cautious on Chinese stocks, awaiting strong drivers to sustain the recent market rally

Last month, Chinese equities experienced an uptick, buoyed by encouraging January credit data, better-than-expected Lunar New Year spending figures, and a series of government interventions, mostly targeting its stock market. However, the potential for these measures to drive a durable equity market rally remains uncertain. Instead, we think more sustained and aggressive stimulus measures, beyond the recent 25 basis point reduction in the loan prime rate, would be a more persuasive sign of commitment and could act as a substantial catalyst for markets.

While timing the market is notoriously challenging, we are holding out for more definitive signs of a turnaround in EPS, before adopting a constructive stance on China. Improvements in Chinese credit and monetary data indicators, like the jump in January's M1 money supply—a key leading indicator to Chinese business activity and EPS growth—may be early signals of such a turnaround. That said, we think it is premature to declare this the start of a sustained upward trend.

Nevertheless, we think caution is still warranted given ongoing geopolitical tensions, persistent policy uncertainty, and a continuing slump in China's real estate market. In light of these challenges and despite some unexpected positive economic data recently, our preference is to maintain our underweight to Chinese equities, until a substantial positive driver appears, such as the continuance of a strong monetary stimulus

Figure 1: The earnings contraction in China is slowing, but we await clearer signals on an EPS recovery before turning more constructive on Chinese equities.



Source: Macrobond, SEB

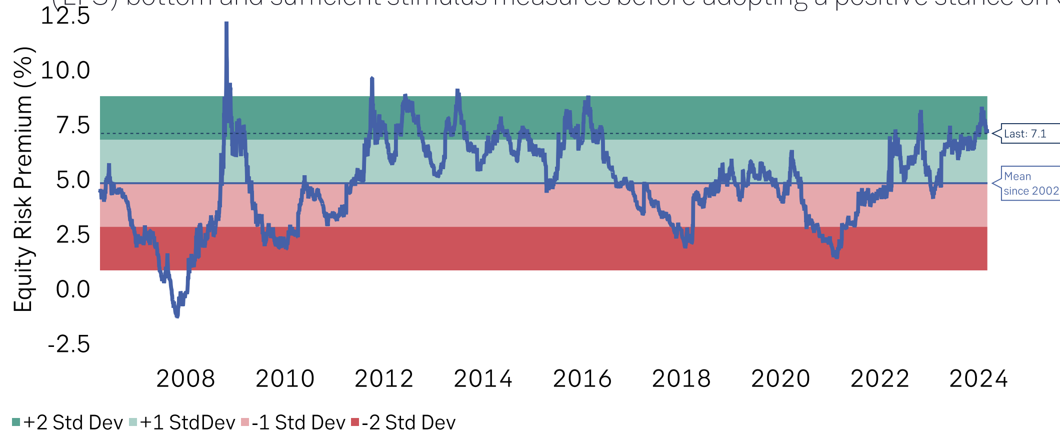
Figure 2: January saw a sharp increase in M1 money supply – a key indicator of Chinese growth and EPS trends. However, data prints around Chinese New Year should be viewed with caution, and additional data is required to confirm if this is a new trend

Source: Macrobond, SEB

SEB

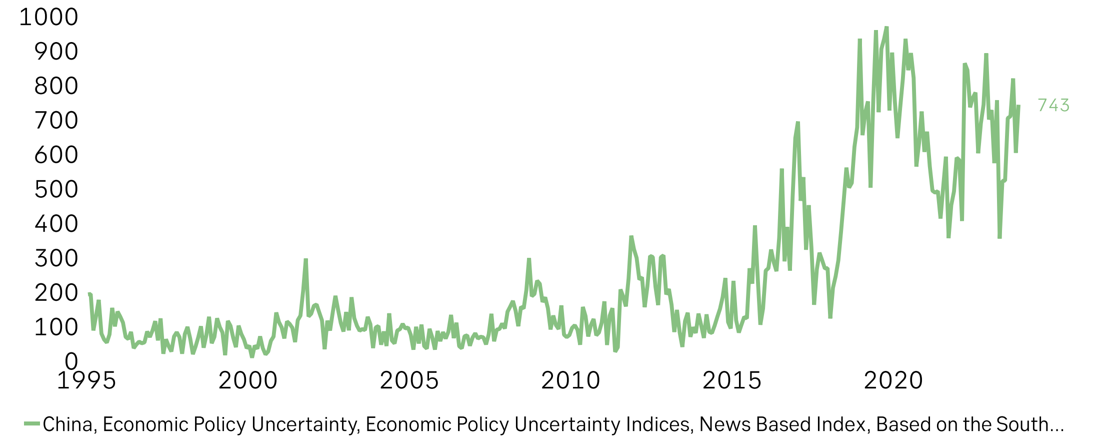
In Focus: China

Figure 1: Chinese equity risk premium is high. Stock valuations are at multi-year lows, suggesting markets have factored in its gloomy outlook. However, we await clearer signs of a (EPS) bottom and sufficient stimulus measures before adopting a positive stance on China



Source: Macrobond, SEB

Figure 2: Uncertainty in China's policies has risen sharply. Despite attempts to boost the economy and stock market, policymakers are still behind the curve. A significant concern on the horizon is the risk of a potential trade war with the US

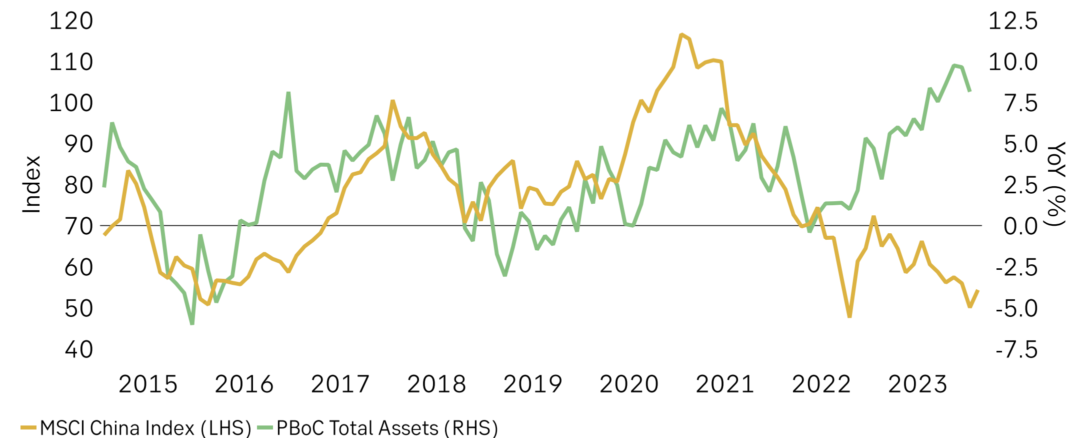


Source: Macrobond, SEB

Figure 3: The PBoC recently reduced its 5-year loan prime rate by 25 basis points, exceeding the anticipated 10-bp cut. While it is a move in the right direction, it will take a lot more to boost China's sluggish housing market

Source: Macrobond, SEB

Figure 4: Continued support from China's central bank would likely go a long way, as balance sheet expansion have led to a strong stock market performance in the past



Source: Macrobond, SEB

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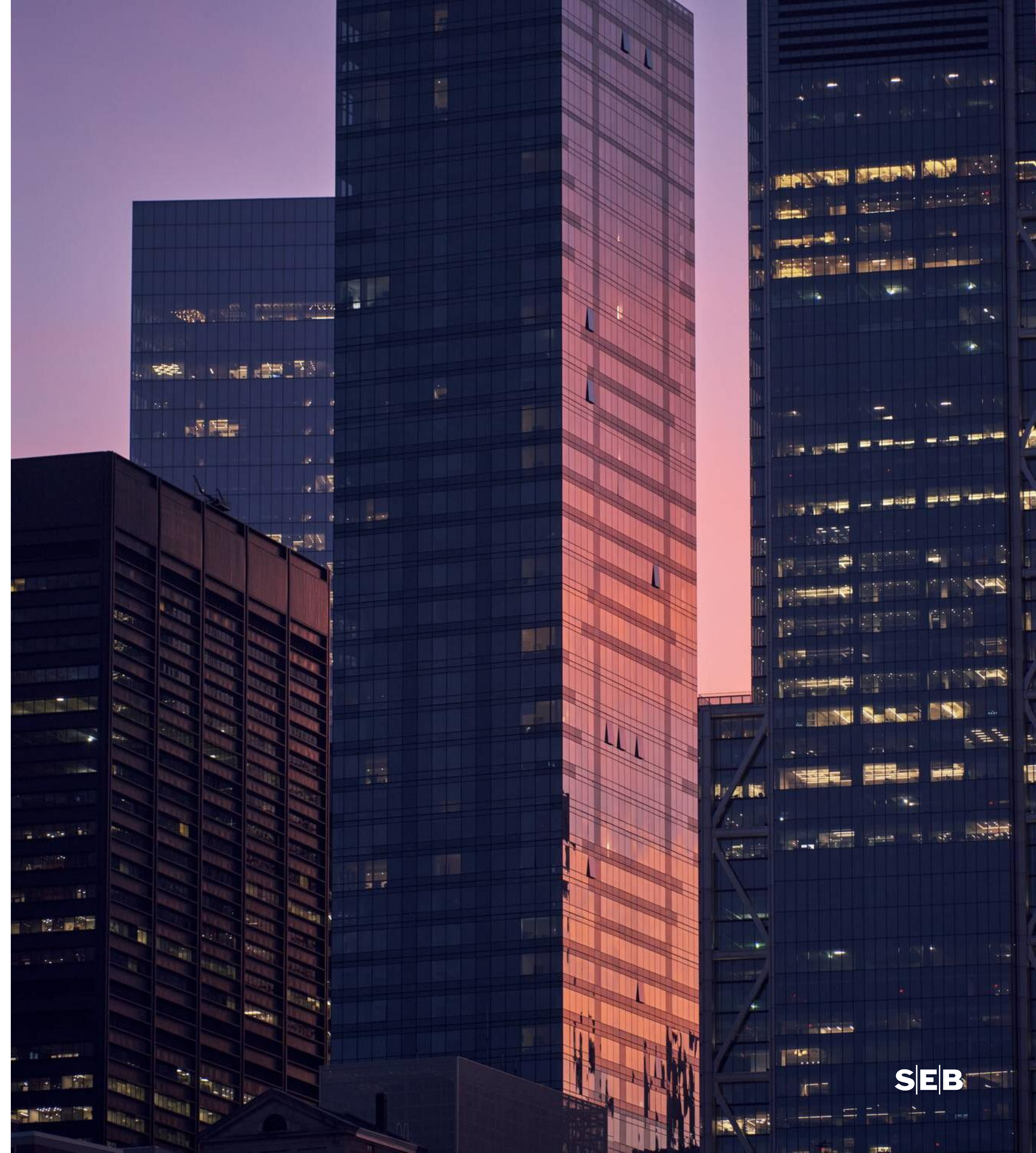


Developed Market Equities – 12M Outlook

Our 12-month outlook for developed market equities is a bit more cautious, but still positive given that we expect a soft-landing scenario

Developed market central banks will likely go ahead with rate cuts this year, which in a soft-landing for the economy, will be supportive for equities on a strategic horizon. We anticipate a moderation in inflation and as a result, DM yields will likely fall a bit further, buoying DM equity valuations. Historically, equities have performed well between the last Fed rate hike and first Fed rate cut, with additional upside after the first rate cut, supporting our 12-month outlook for equities.

A 'soft landing' remains our base case scenario, but the risk of downside growth may heighten in an environment of higher for longer rates

We expect inflation to normalize without inducing a recession. Labor markets in the US and Europe have remained strong despite rising interest rates. That said, the lagged effects from tighter monetary policy should lead to tightening credit conditions, exerting downward pressure on growth. A mild recession remains a risk to our outlook as factors supportive of growth, such as excess savings and fiscal stimulus from governments start to wane.

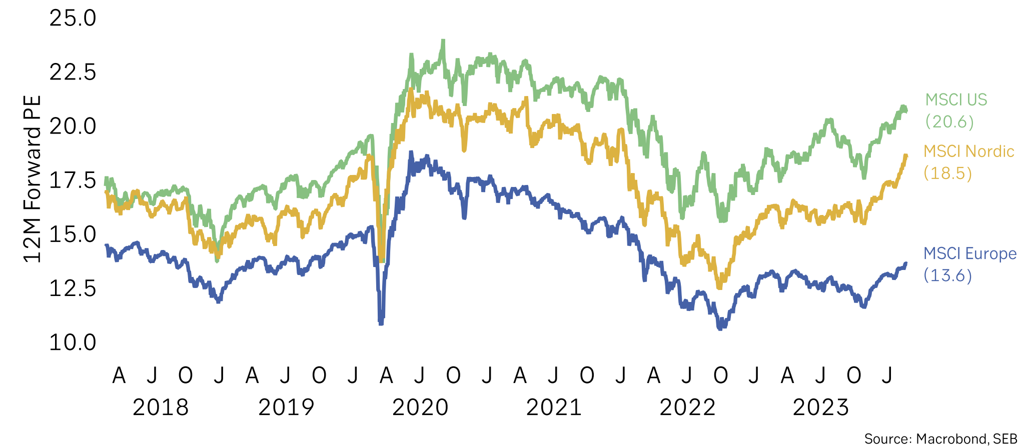
2024 earnings growth in the US is expected to improve after a dismal 2023

European equities trade at a historically wide discount compared to US equities. US equities could continue to rally this year due to expansion in multiples as central banks start to cut rates. We expect US equities to be driven also by better earnings growth which can lead to a positive performance of US equities.

Small-caps have lagged large caps, but may have upside potential going forward

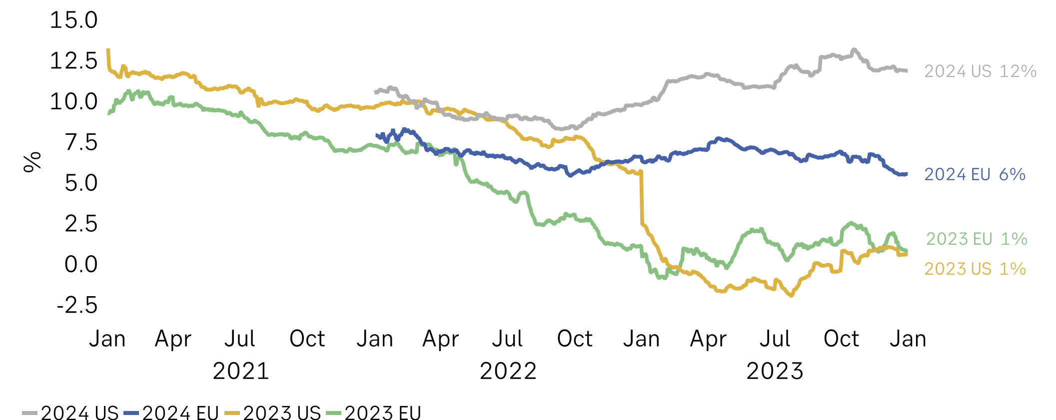
Small-cap stocks have underperformed large-cap stocks last year and appear attractive due to their inexpensive valuations. Small-caps may be poised for outperformance when central banks initiate rate cuts.

Figure 1: We have seen an uptick in valuations lately. As the Fed starts to loosen monetary policy in 2024, we could potentially see some further expansion in multiples



Source: Macrobond, SEB

Figure 2: SPX bottom-up EPS growth is expected to improve in 2024 after a dismal 2023



Source: Macrobond, SEB

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Emerging Market Equities – 12M Outlook

On a tactical horizon we prefer to keep a cautious position due to political risks and a weak property market. But over a 12-month horizon we could turn constructive on EM equities after a dismal 2023, which should be supported by a weaker USD, looser global monetary policy and low positioning overall in the region.

Lower interest rates should boost demand and drive growth higher over the next 6-12 months. The EM region is projected to grow more rapidly than DM countries. Improvements in Asian exports also suggest better EM macro momentum ahead. Exports from South Korea and Taiwan, bellwethers for global trade, have gradually improved and show signs of a potential rebound in external demand

China faces economic and demographic challenges

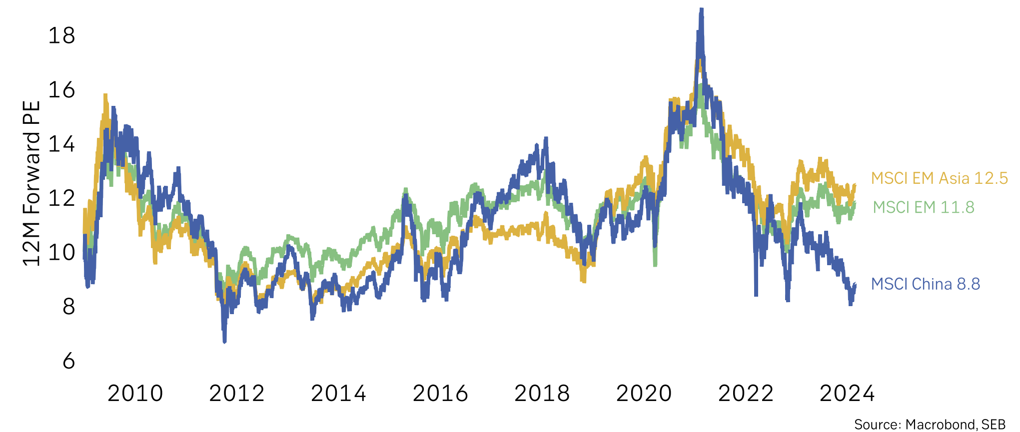
Investors are still overall bearish on China due to economic disappointments, a declining property market, and geopolitical challenges, leading to a de-rating of Chinese equities. Although China has rolled out targeted stimulus measures in recent months, their effectiveness remains uncertain, and aggressive fiscal stimulus may be limited due to China's high public debt.

On the upside, Chinese equities have already priced in the negative news via a de-rating and could be close to a turnaround. Furthermore, the low valuations can limit further downside risks and provide a cushion against external negative shocks. Moreover, China's growth prospects still surpass developed markets, despite the downturn in the property sector, one of its key growth drivers.

The strong USD trend will likely begin to fade, supporting EM equities

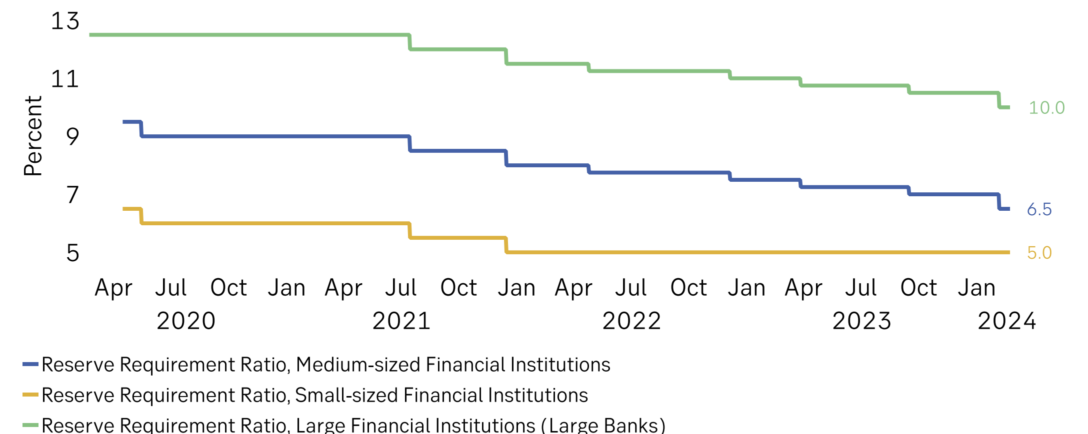
We think the USD should weaken as recession fears fade due to resilient US hard data. Easing monetary policy should put downward pressure on the USD and a weaker US dollar should support EM equities.

Figure 1: Easing monetary policy should support EM growth and EM equities which could reaccelerate given the low valuations



Source: Macrobond, SEB

Figure 2: China has rolled out several stimulus measures, such as cutting its RRR rate, to support the stock market. The question remains if these measures are enough for a turnaround



Source: Macrobond, SEB

Corporate Bonds – 12M Outlook

Corporate bonds should benefit from lower rates and tighter spreads

In a soft landing/goldilocks scenario, declining interest rates amid gradual monetary easing should benefit both corporate and government bonds. Nevertheless, corporate bonds should outperform government bonds as government bond yields drop modestly, while credit spreads have better running yield.

In the case of a soft-landing scenario, high-yield corporate bonds could outperform their IG counterparts, but on a tactical horizon we prefer to keep a slight underweight given that risks of widening spreads are not over

In a soft-landing scenario characterized by stable growth and increased risk appetite, high-yield corporate bonds are poised to outperform investment-grade bonds. Given their higher spreads compared to investment-grade bonds, high-yield bonds should become more appealing, especially as concerns about a potential recession diminish. As expectations for corporate earnings improve and default rates remain relatively low, we can expect HY credit spreads to tighten.

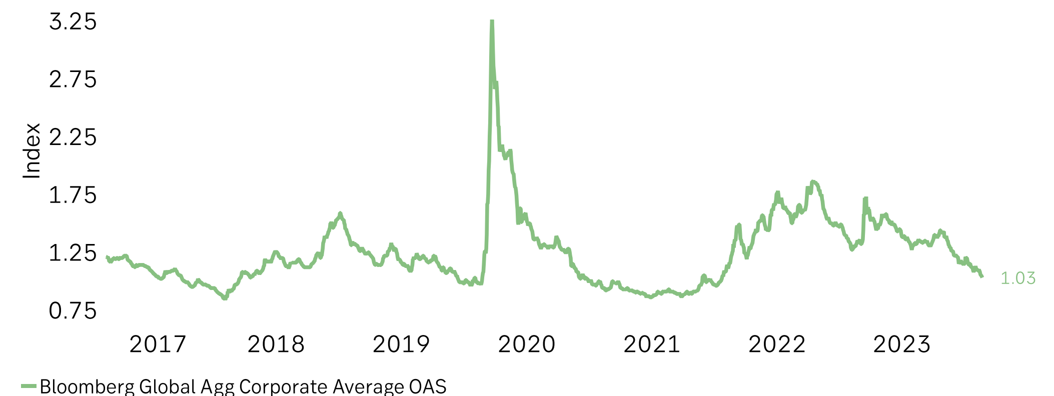
Downside risks to our 12-month outlook

Having said that, the uncertainty for the next 12 months is still on the background, given the various macroeconomic scenarios that could play out. There are downside risks to our base case scenario and outlook. One such risk is that inflation proves to be more persistent than anticipated, prompting central banks to maintain higher for longer rates until something breaks in the economy. Additionally, there is a possibility that economic growth unexpectedly turns sharply lower, causing a deeper downturn and prompts aggressive rate cuts from central banks. In both scenarios, IG credit spreads are anticipated to broaden modestly, while HY spreads widen significantly due to rising default rates, resulting in that high yields bonds underperforms safer investment grade bonds.

Figure 1: HY spreads may still tighten further in a 'soft-landing'/'goldilocks' scenario where rates decline and default rates remain low. However, risks of widening spreads are not over

Source: Macrobond, SEB

Figure 2: IG bonds can also have a good performance next year as risk appetite improves and recession fears diminish. But risks of widening spreads cannot be disregarded



Source: Macrobond, SEB

SEB

Government Bonds – 12M Outlook

Government bonds will likely have positive returns on a 12-month horizon given expected global rate cuts

Labor markets are in relatively good shape, which should slow wage growth and inflation. As inflation eases, we expect central banks to lower rates which should lead to a decrease in government bond yields over the next 12 months.

Given that bond yields are still at historically elevated levels, there is plenty of room for a positive rally in case of several rate cuts

Easing monetary policy should boost both bond and stock prices. However, with reasonable growth and subdued inflation, equities might benefit more than government bonds. As interest rates decline, we expect EPS expectations to climb due to a resilient economy. Falling government bond yields also renders equities comparatively more appealing compared to bonds.

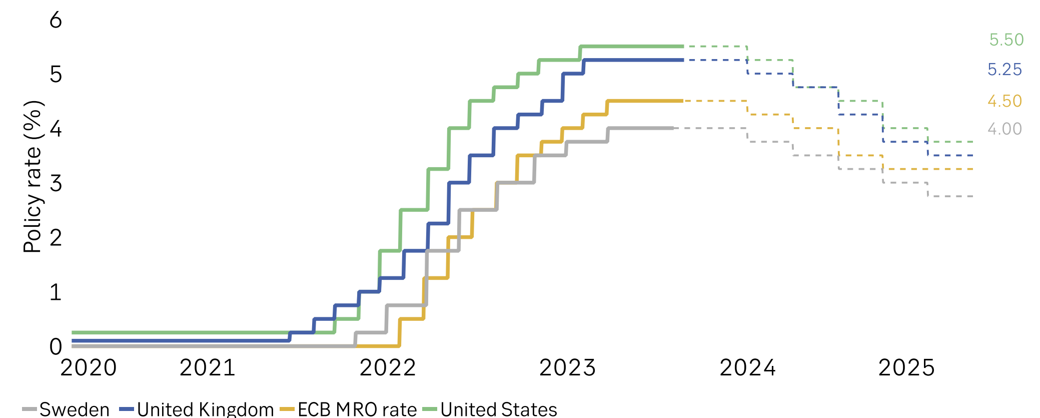
Sticky inflation and oil supply shocks could cause bond yields to rise further

However, there are many scenarios and factors that could prevent or postpone a bond rally. Persistent strength in US consumer spending and labor markets could sustain core inflation, which might compel the Fed to tighten further, driving bond yields upwards. Actions like OPEC further tightening the oil supply could be a catalyst. A surge in global commodity prices would pose an upside risk for inflation and thus bond yields. Rising inflation would likely deter central banks from cutting rates, pushing forward rate cuts expectations. Additionally, China's recovery could gain pace due to numerous new stimulus measures introduced, increasing demand for commodities and exerting upward pressure on commodity prices.

Figure 1: Real yields are in positive territory, but we expect real and nominal yields to decline as central banks start to cut interest rates

Source: Macrobond, SEB

Figure 2: Central banks are expected to cut rates this year, which would benefit bonds and stocks. Forecasters are expecting a couple of rate cuts in 2024 and to continue in 2025



Source: Macrobond, SEB

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Region Overview

Regional equity positioning

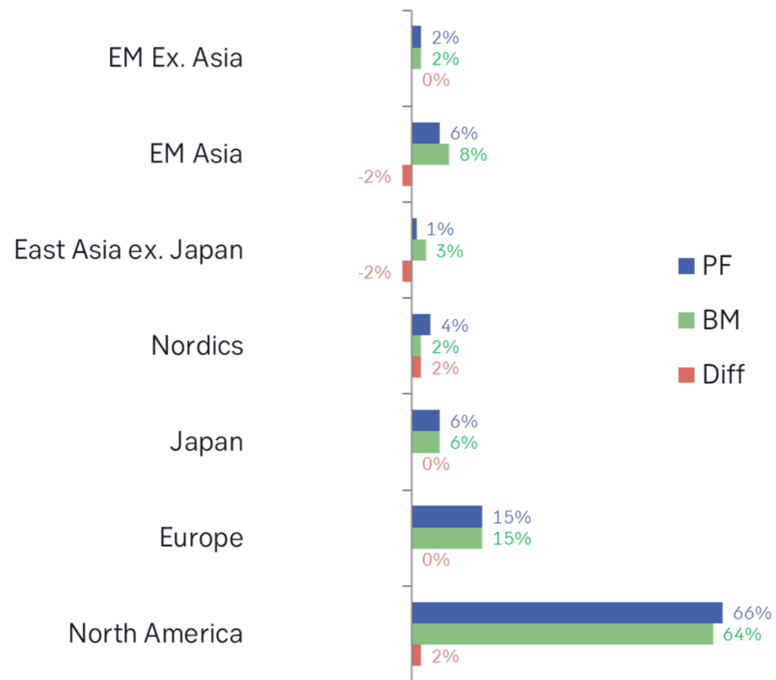
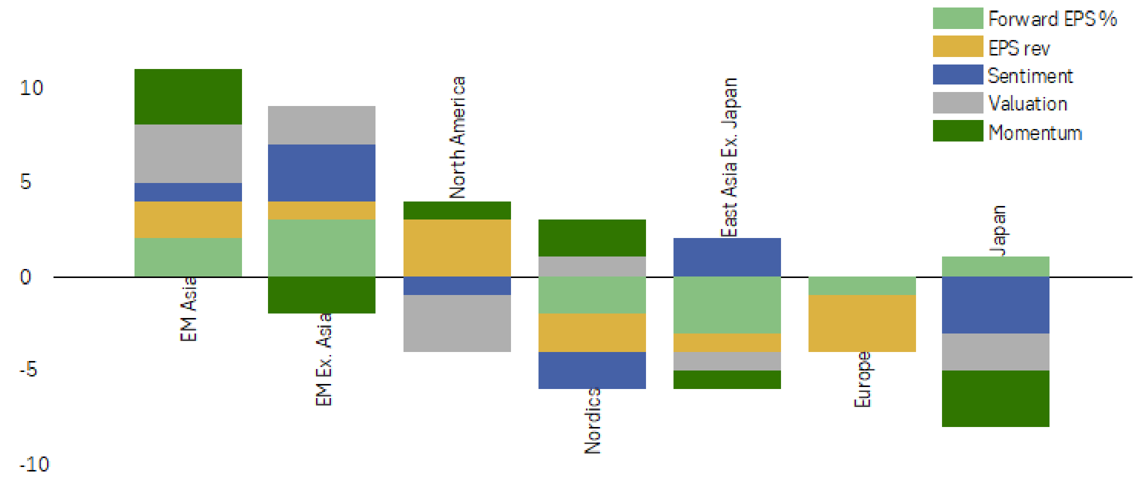


Figure 1: SEB House View region score*



* Ranked by total score with highest score starting from left

SEB

EM Asia – Underweight

Despite recent improvements in macro data, we prefer to stay underweighted until a catalyst of optimism for China emerges

- EM Asia achieves the highest rank in our regional equity model due to attractive valuations, strong momentum and robust consensus EPS growth
- Chinese equities surged last month on upbeat credit and CNY spending data, and supportive government measures, mostly targeting its stock market. However, the durability of these boosts for the market is uncertain…
- …and we think caution is still warranted due to ongoing geopolitical risks, China's elevated policy uncertainty and weak housing sector
- Before turning more constructive on Chinese equities, we would like to see sustained and sufficiently aggressive stimulus measures from Beijing and clearer signs of an EPS recovery

Figure 2: Standardized relative valuation – Current constituents

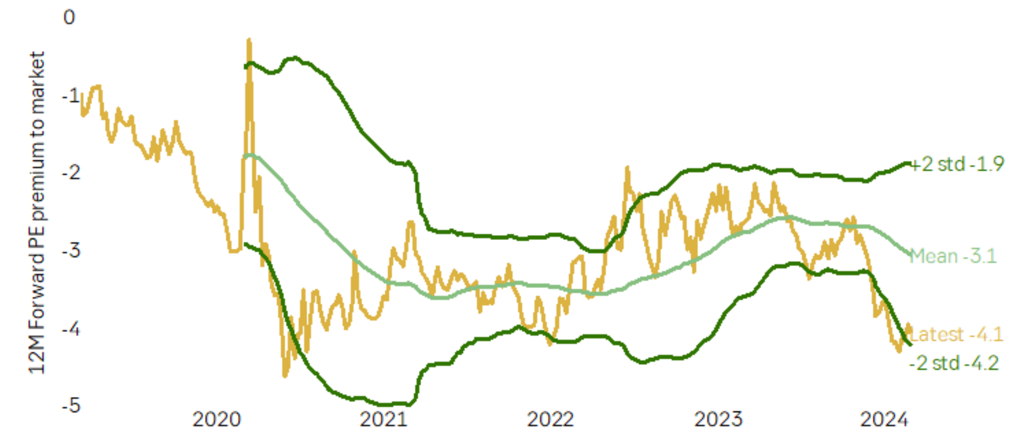
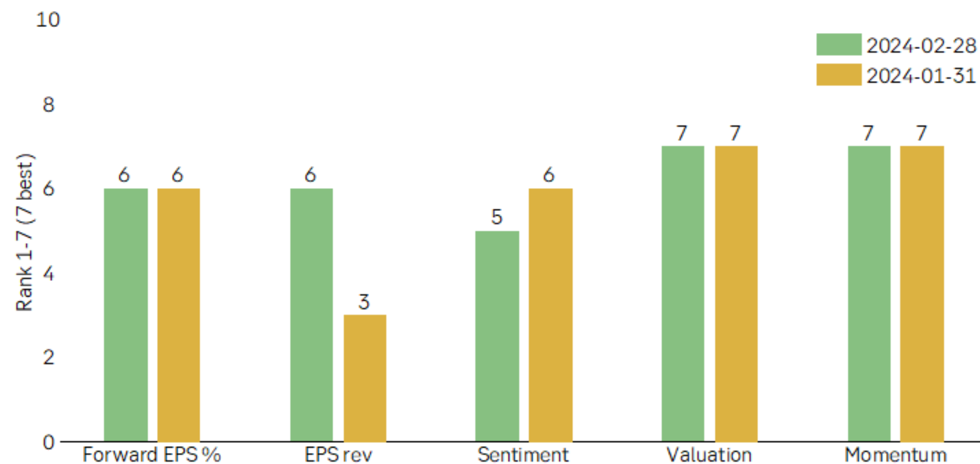


Figure 1: Contribution to House View Region Score



Source: SEB House View

Figure 3: Absolute valuations – Current constituents

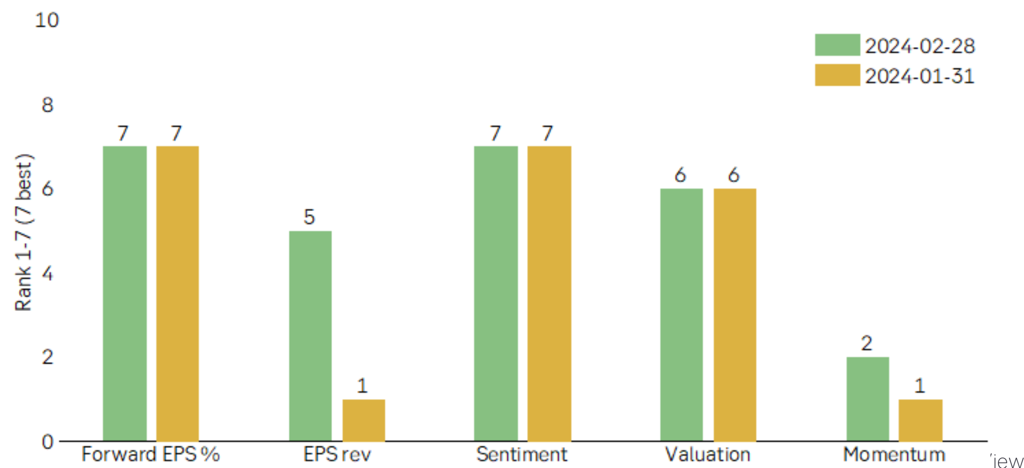
Source: SEB House View

EM Ex Asia – Neutral

We prefer to maintain a neutral stance on Em Ex Asia as tepid momentum is likely to continue, pending signs of a global manufacturing recovery

- EM Ex. Asia achieves a high score in our regional model, due to a solid EPS outlook, positive sentiment and low valuations. However, the region's price momentum is tepid, trailing behind developed markets over the last six months
- A further broadening of the equity rally beyond the US, and EM catching up globally, likely hinges on falling yields, improved growth outside the US, and a global manufacturing rebound
- There are early signs of a global manufacturing recovery, highlighted by rising global manufacturing PMI and new orders, yet this trend awaits confirmation
- Rate cuts in the region should support growth and extend this positive trend
- Risks include a weaker China, stronger USD, lower oil prices, rising geopolitical tensions and a global slowdown, which may favor safer regions like the US

Figure 1: Contribution to House View Region Score



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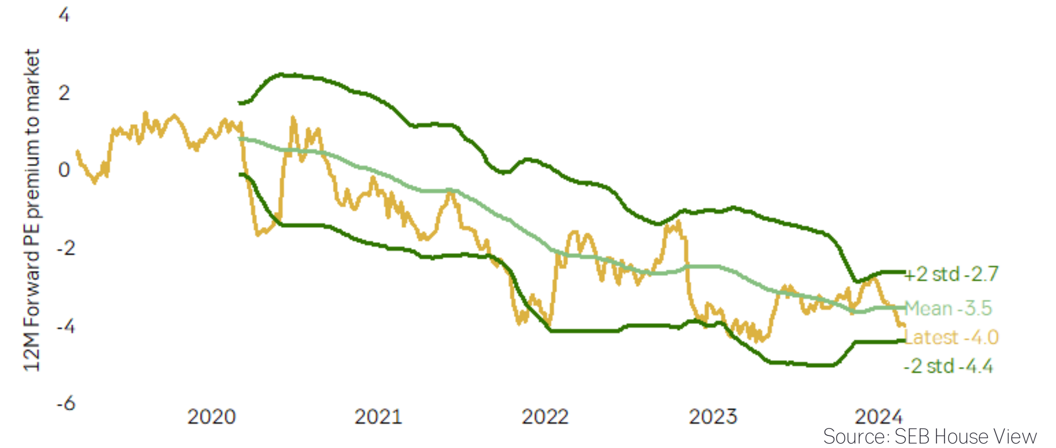

Source: SEB House View

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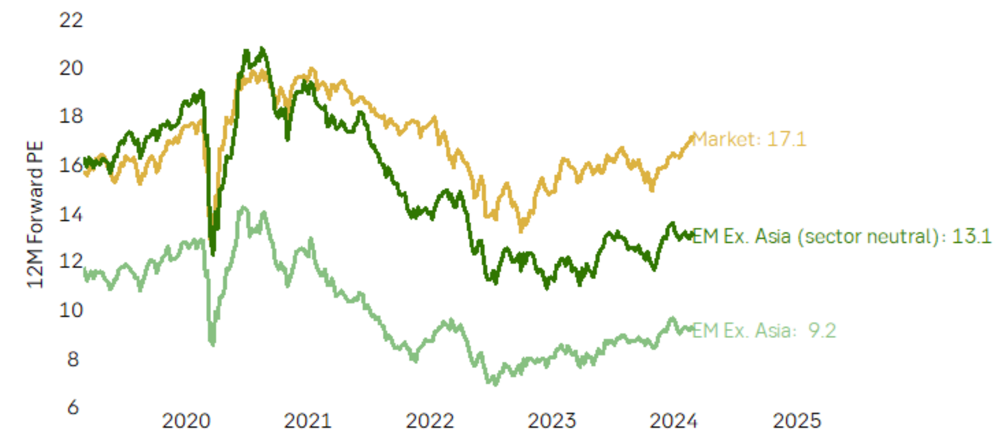

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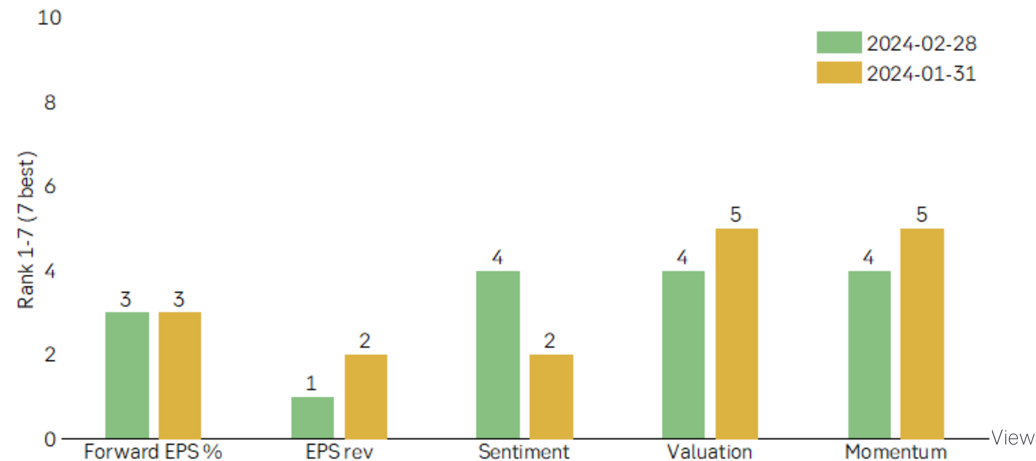
Europe – Neutral

We prefer to stay neutral on European equities due to a soft growth outlook and elevated uncertainty, amid rising geopolitical risks and a weak China

- Sticky inflation data and ECB's cautious stance on early rate cuts have shifted our expectation of a first rate cut from March to June, in line with consensus
- The region continues to rank relatively low on scores for forward EPS growth, with disappointing earnings reports leading to negative EPS revisions. That said, markets have set fairly low EPS expectations, which should provide a buffer for any further downgrades and setting a low bar for positive surprises.
- Our economists predict 0.5% growth for 2024, matching consensus and our soft-landing scenario. However, we anticipate a slow recovery as PMIs only show minor improvements
- A more constructive stance on Europe hinges on an improved growth outlook and clearer timeline of ECB rate-cuts, likely to emerge post-spring wage talks

Figure 1: Contribution to House View Region Score



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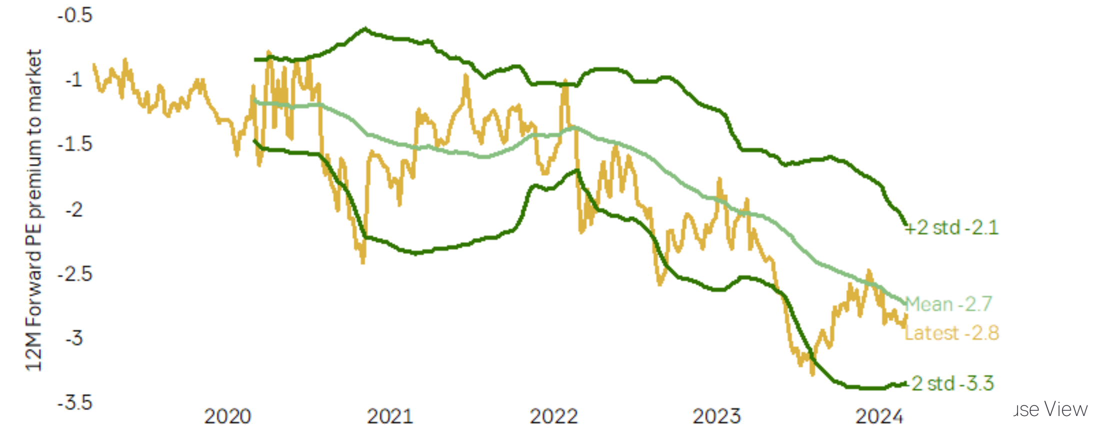

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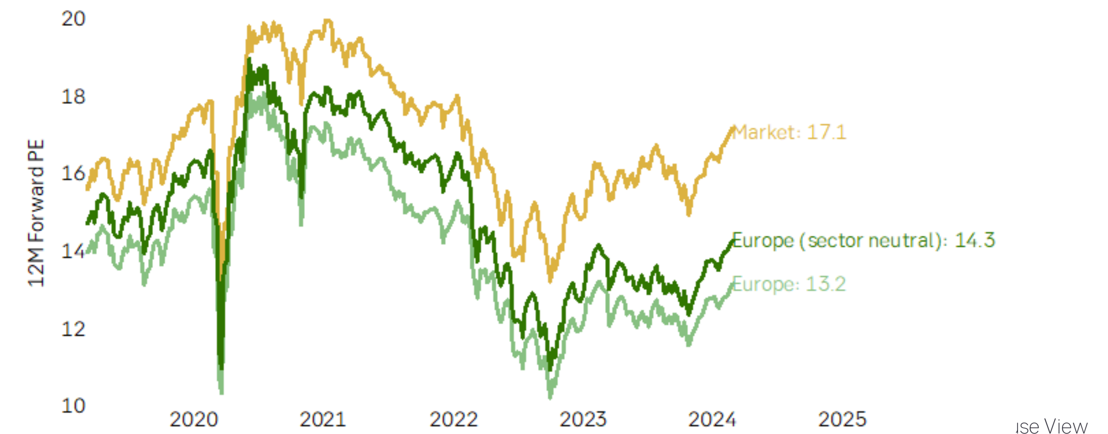
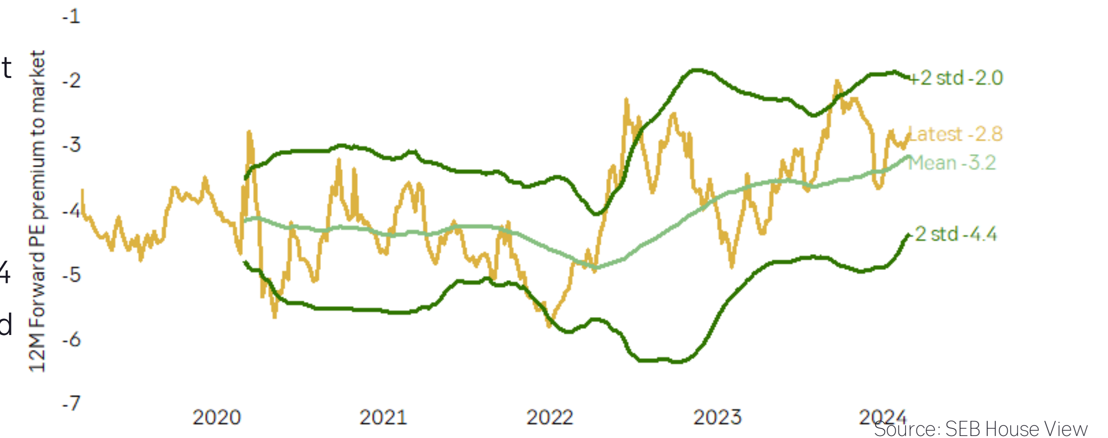


Japan – Neutral

We upgrade Japanese equities to a neutral stance due to resilient earnings and potential for further upside ahead

- We choose to upgrade Japan to a neutral stance from underweight based on robust earnings growth and changes in corporate governance, with potential for further market gains despite the recent rally
- Japan's economy unexpectedly entered a technical recession last year, after two consecutive quarters of negative growth, however, these numbers could still be revised. Our economists still forecast the Japanese economy to grow 1.2% in 2024
- A U.S and European soft-landing and a potential turn in global manufacturing should be supportive for cyclical markets and regions, such as Japan.
- Having said that, we remain wary about potential headwinds from the BoJ's anticipated policy shift in the spring, e.g. rising yields and a stronger JPY. The extent of the impact remains to be seen, but will likely depend on the pace of normalization

Figure 2: Standardized relative valuation – Current constituents



Source: SEB House View

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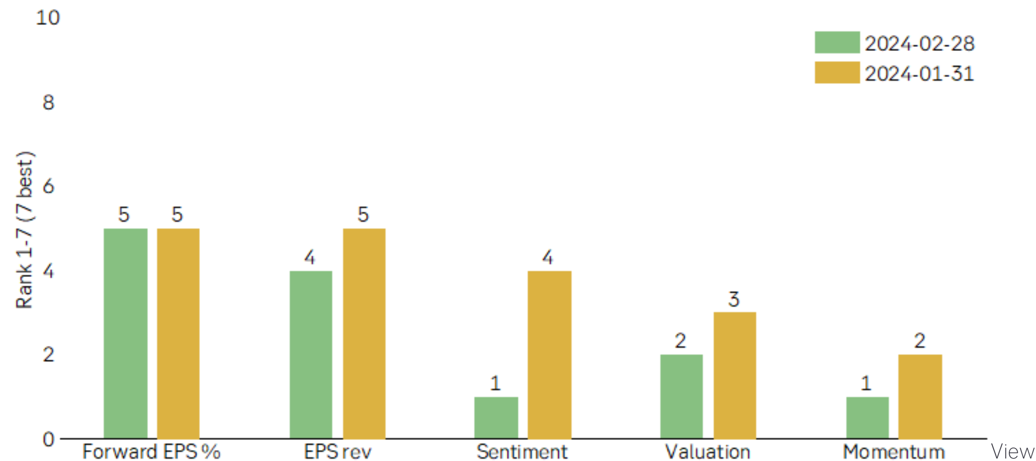

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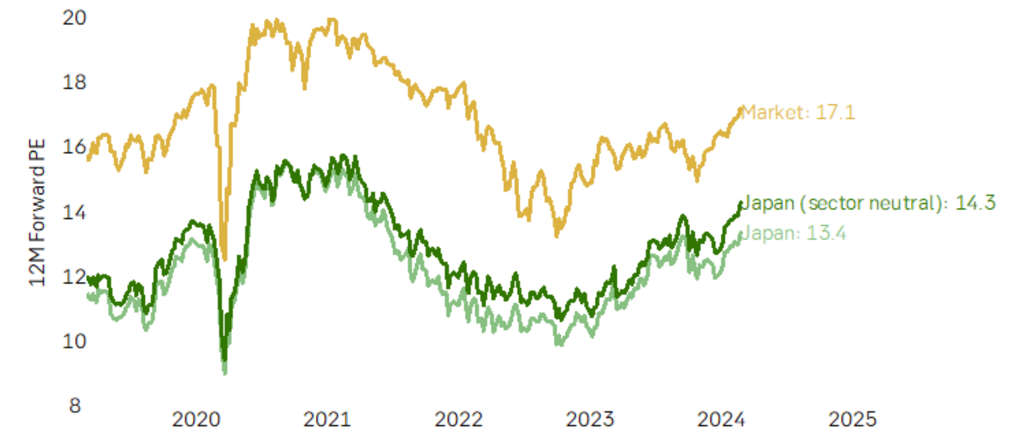
Figure 3: Absolute valuations – Current constituents



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Nordics – Overweight

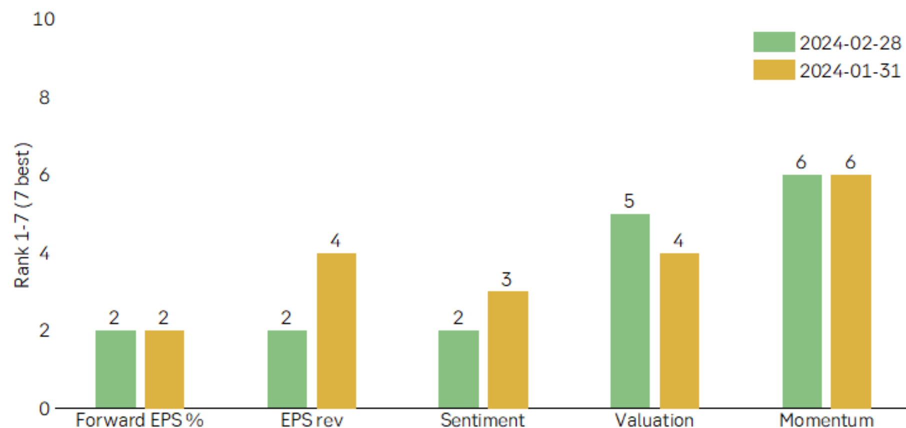
We remain overweight in the Nordics, anticipating the region's strong momentum to persist, bolstered by anticipated rate cuts and an improved growth outlook

- The Nordics scores high in our regional model for both positive momentum and low valuations. We expect this year's strong momentum to continue, driven by rate cuts and an improved growth outlook
- While the region's earnings growth outlook remains weak, low expectations set the stage for positive surprises with any uptick in growth
- JP Morgan's Global Manufacturing PMI is on the rise, hinting at an uplift in global growth, which should be beneficial for more cyclical regions, like Sweden
- The surprisingly dovish stance from the Riksbank at their February meeting suggests a potential rate cut by mid-2024 if inflation declines swiftly. Rate cuts would benefit interest-rate sensitive sectors, including our tilt towards small-cap stocks

Figure 2: Standardized relative valuation – Current constituents

ıse View

Figure 1: Contribution to House View Region Score



Source: SEB House View

Figure 3: Absolute valuations – Current constituents

Source: SEB House View

North America – Overweight

We maintain our overweight position in US stocks, supported by strong earnings and the potential for a soft landing that typically boosts equities

- The US scores high in our regional model on upward EPS revisions and strong momentum, following an overall solid earnings season
- The region ranks low on high valuations, however, the US equity premium is warranted right now, in our view, by their strong earnings and defensive qualities amid a global slowdown and geopolitical tensions
- We anticipate that the Fed will be able to cut reduce rates this year without triggering a recession, a scenario historically favorable for US stock performance, though the timing is uncertain…
- Having said that, potential also lies in regions like EM or Europe where lower valuations present a catch-up opportunity, especially if we see stronger earnings or earlier-than-expected central bank cuts in those regions

Figure 2: Standardized relative valuation – Current constituents

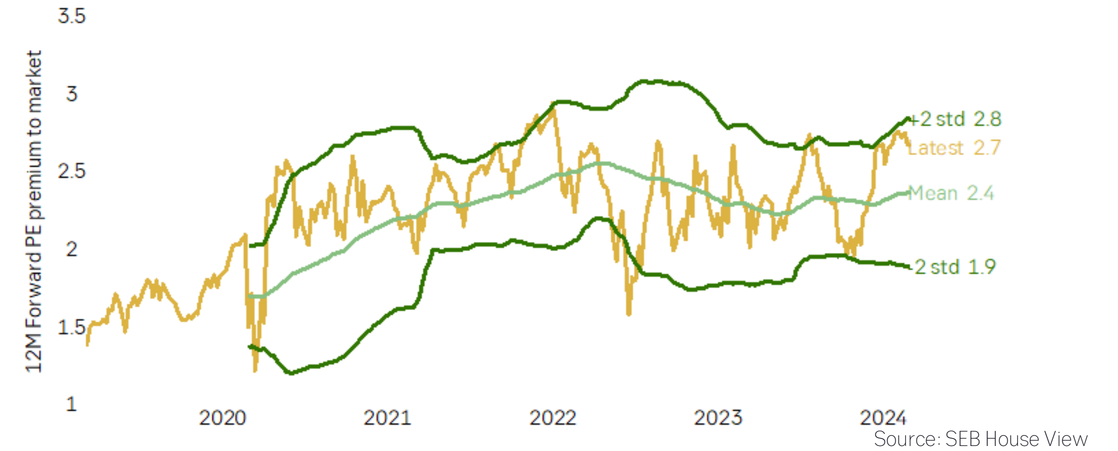


Figure 1: Contribution to House View Region Score

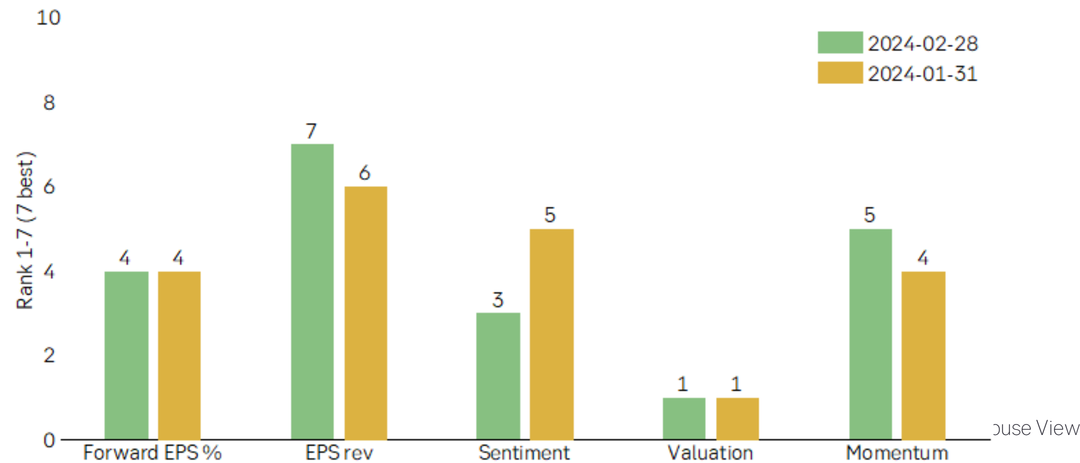
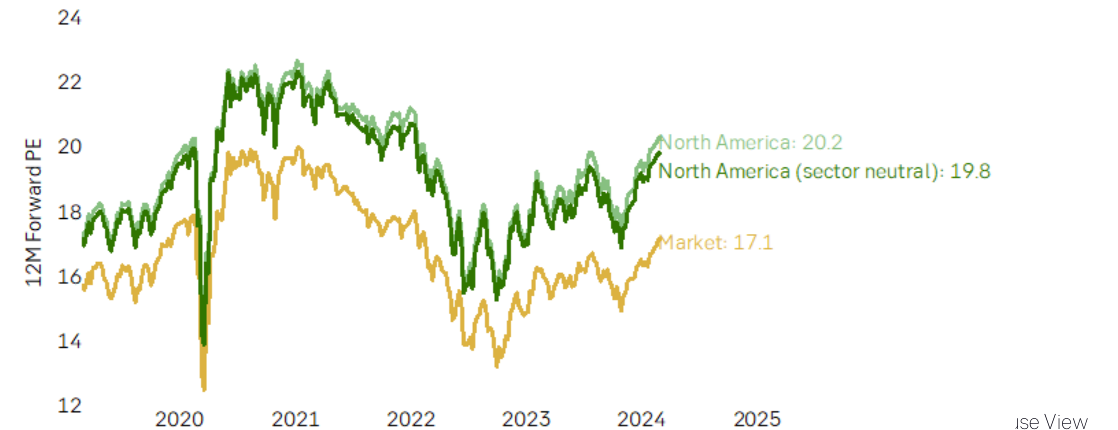


Figure 3: Absolute valuations – Current constituents



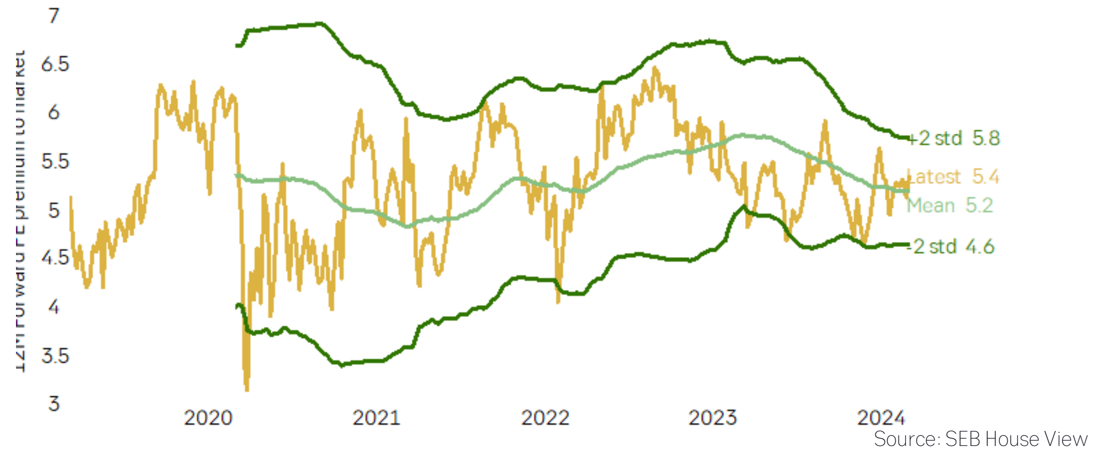
SEB

East Asia Ex Japan – Underweight

We chose to increase our underweight to East Asia Ex Japan, due to its bleak EPS outlook, while being heavily exposed to developments in China

- 12M Forward earnings are dismal while earnings revisions have deteriorated
- The region mostly consists of Australia, which is heavily exposed to China's economy which remains challenging
- The region's momentum has improved since early in the year, but is still trailing most of the other regions
- **Therefore, we prefer to increase our underweight to the region**

Figure 2: Standardized relative valuation – Current constituents



Source: SEB House View

Figure 1: Contribution to House View Region Score

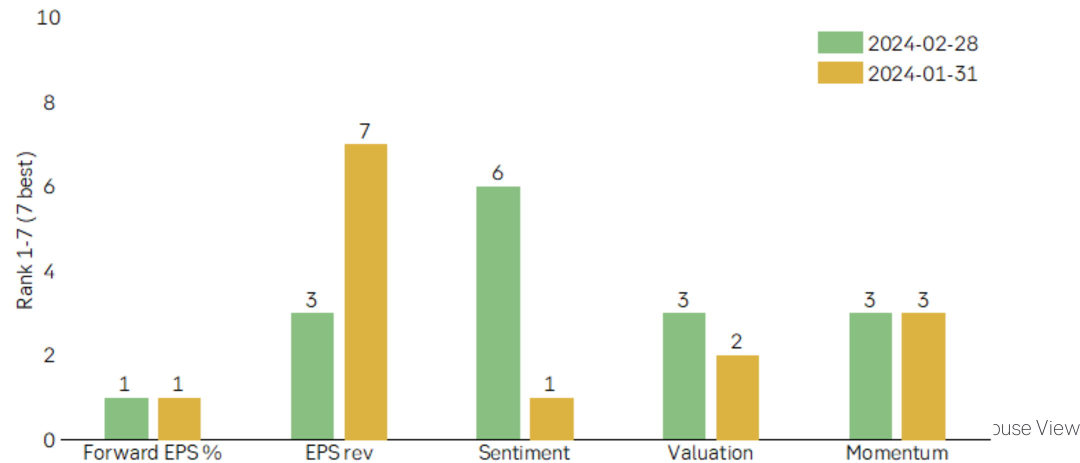
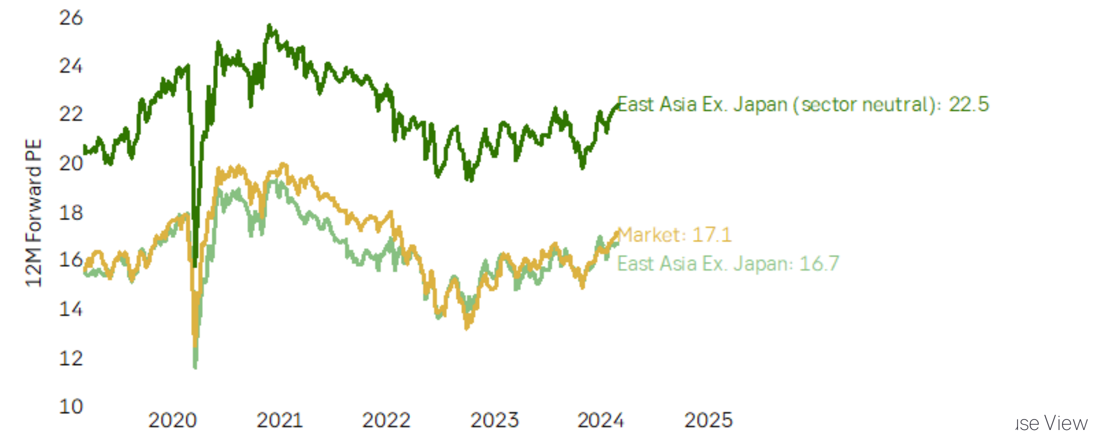


Figure 3: Absolute valuations – Current constituents



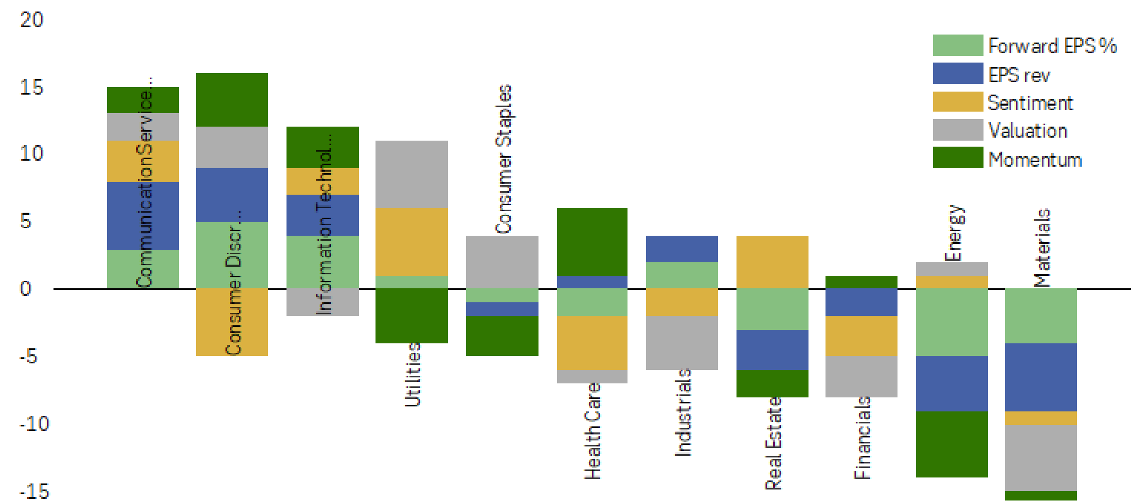
SEB

Sector Overview

Sector	UW	N	OW
Communication Services		N	
Consumer Discretionary			OW
Consumer Staples	UW		
Financials		N	
Health Care		N	OW
Industrials		N	(OW)
Information Technology			OW
Materials	UW		
Utilities	UW		

* We do not take views on Energy or Real Estate. The former is too much of an oil call and the latter is too small a sector. (X) Indicates previous positioning.

Figure 1: SEB House View sector score



Source: SEB House View

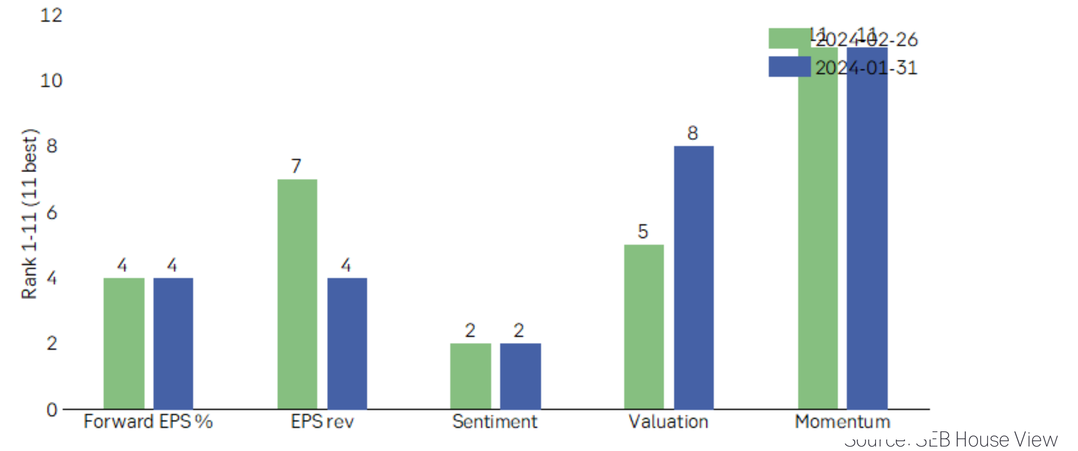
SEB

Overweight – IT, Consumer Discretionary and Health Care

We prefer to hold sectors with a solid earnings outlook and the Healthcare sector due to its defensive characteristics in a late-cycle environment

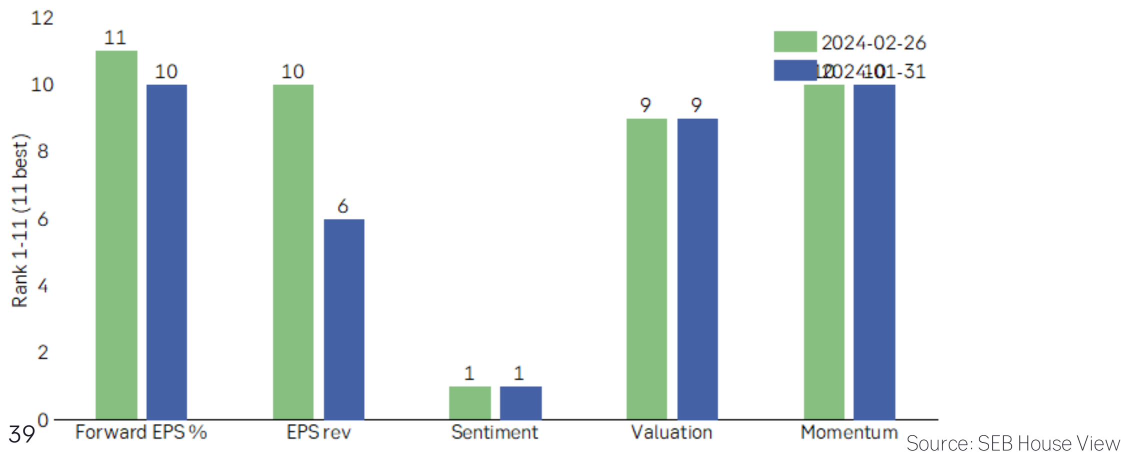
- Health Care has experienced strong positive momentum and upbeat earnings surprises, supporting our constructive stance. The sector has historically performed strongly during disinflation periods and is less volatile for rate swings
- We keep our overweight to Consumer Discretionary, for the time being, as earnings continue to outgrow forecasts. Consumer spending is still strong, being supported by a steady labor market, however, with decreasing household savings and high prices there are some risks over a longer horizon
- We keep our overweight to IT as we anticipate strong earnings growth ahead. We also expect rate cuts and the AI trend to be supportive for the sector. IT also provides downside protection due to its less cyclical nature

Figure 2: Our sector model has continued to signal strong momentum for Health Care as we enter late cycle and positive earnings surprises. The sector has historically outperformed during periods of declining inflation



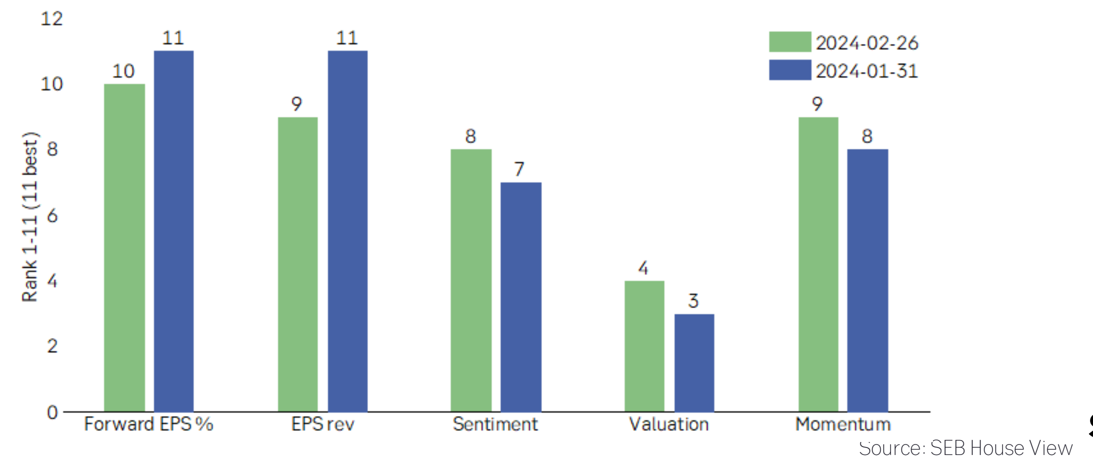
Source: SEB House View

Figure 1: The earnings growth outlook for Consumer Discretionary remains strong



Source: SEB House View

Figure 3: IT earnings have continued to surprise positively, and the growth outlook is solid



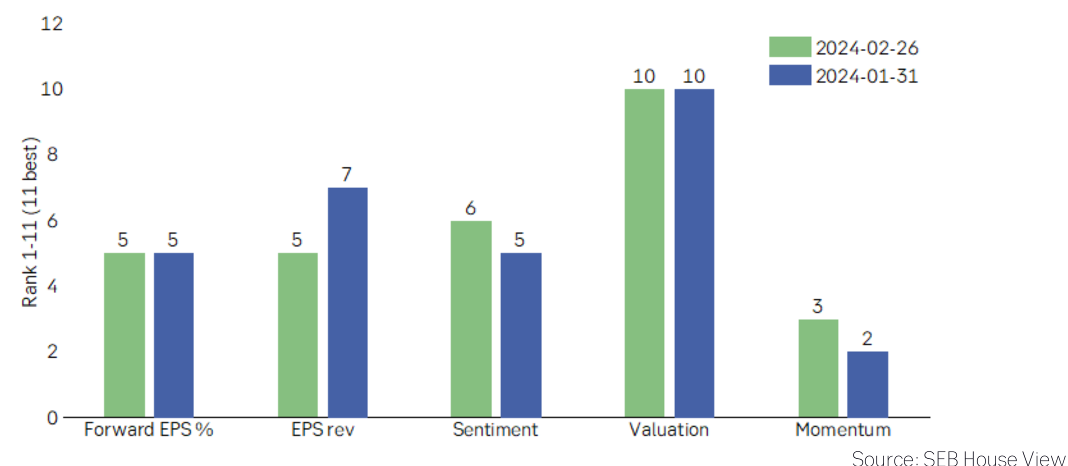
Source: SEB House View

Underweight – Consumer Staples, Utilities and Materials

We remain underweighted in Consumer Staples, Utilities and Materials for the time being as fundamentals are still not there to justify a change in allocation

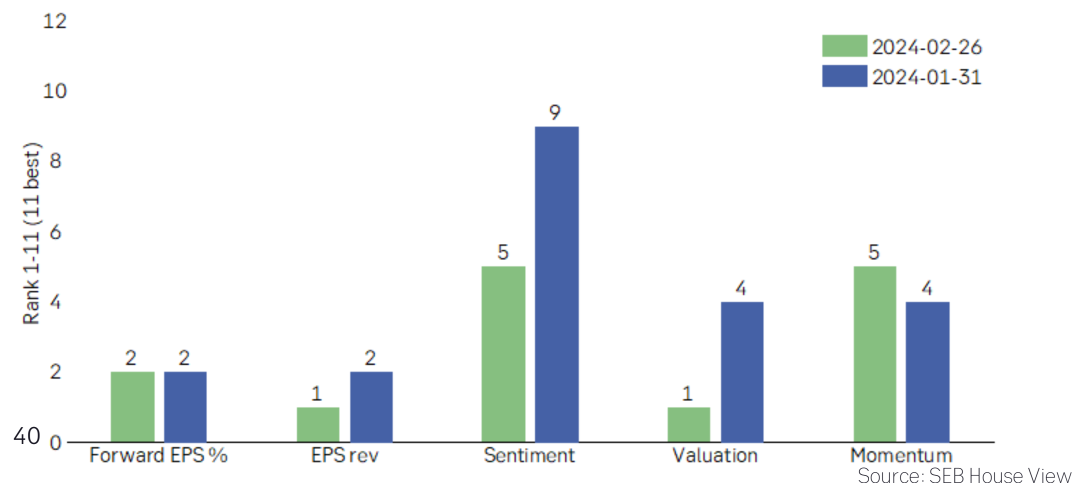
- Consumer Staples will likely underperform relative other sectors as long as the cycle holds up strongly. In case of a stronger downturn in macro indicators, the sector could become more attractive given low valuations
- Utilities is also a sector that performs well during a weaker economy and as yields fall, but momentum has yet turned, and we see better growth opportunities elsewhere. We prefer to keep our slight underweight to Utilities
- We hold our underweight in Materials given the muted earnings growth outlook and considering that we are entering a slowdown in the economy. Demand for materials will likely remain subdued as rates are weighing on durable goods and manufacturing surveys are still signaling a contraction in business activity

Figure 2: Consumer Staples still has a weak earnings outlook for 2024, but could potentially become more interesting as we enter the late cycle



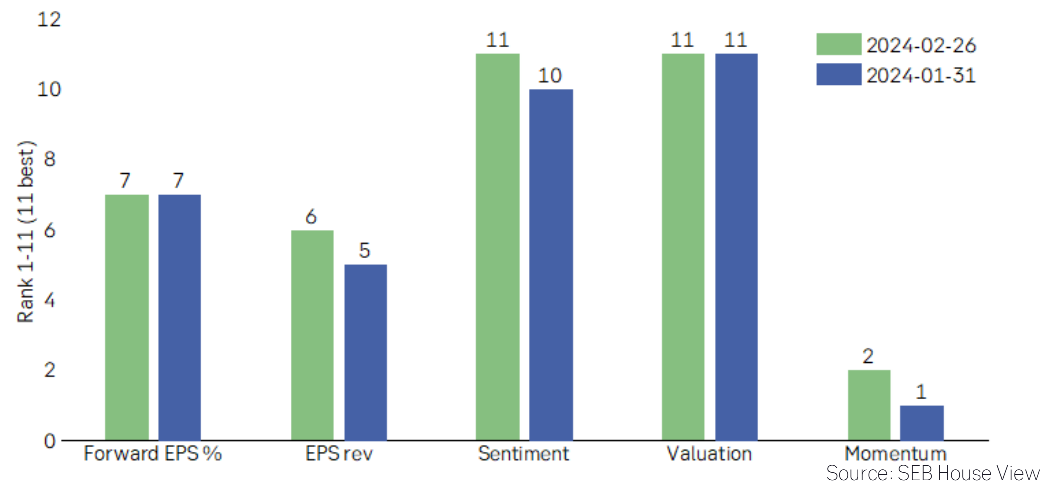
Source: SEB House View

Figure 1: Materials continues to score low on earnings growth and negative EPS revisions



Source: SEB House View

Figure 3: Momentum for utilities has remained negative



Source: SEB House View

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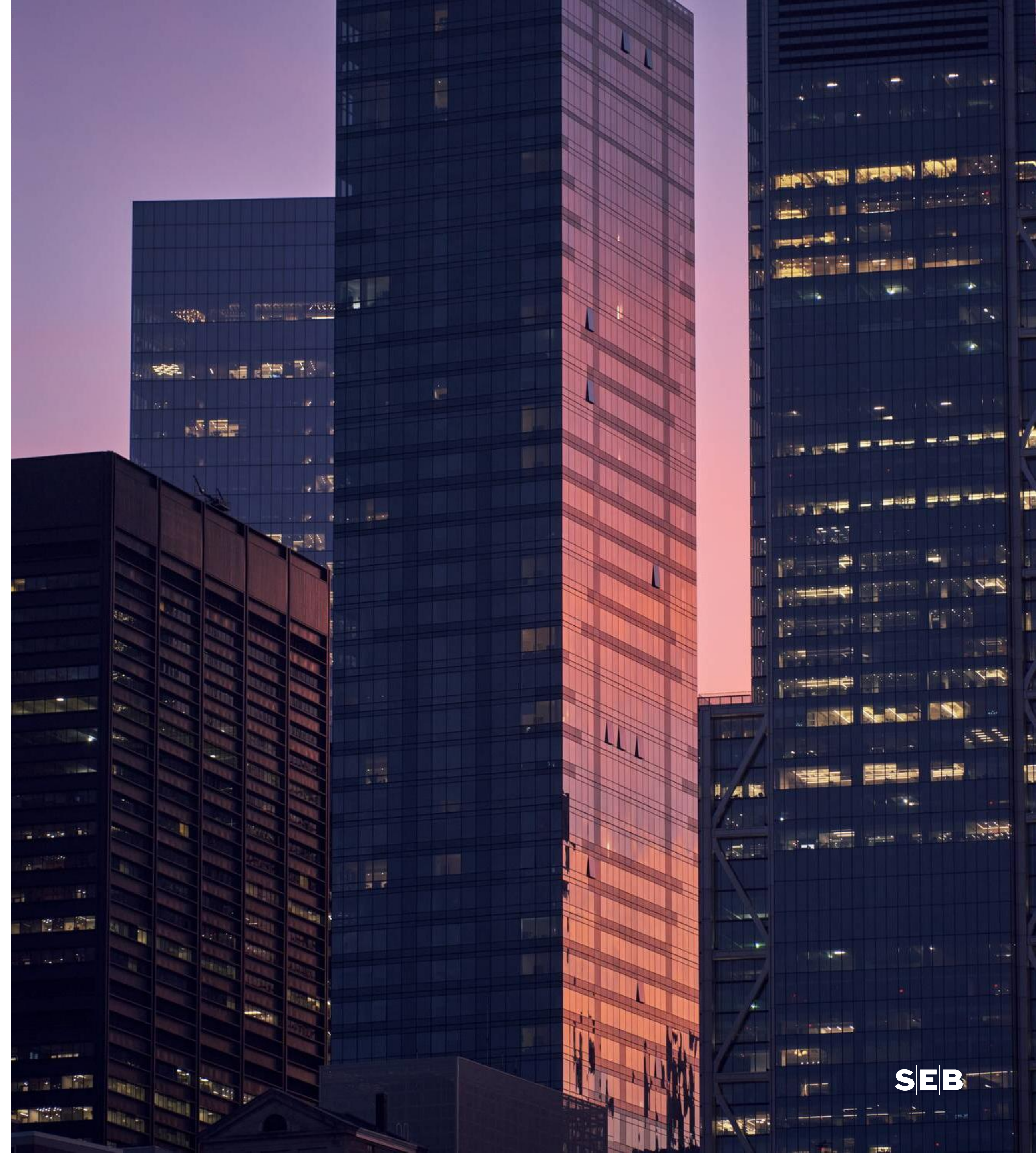

US Inflation Heatmap

US Inflation Indicators

Heatmap based on rolling 10-year Z-scores. Actual data releases are shown below.

	2/2024	1/2024	12/2023	11/2023	10/2023	9/2023	8/2023	7/2023	6/2023	5/2023	4/2023	3/2023	2/2023	1/2023	12/2022	11/2022	10/2022	9/2022	8/2022	7/2022	6/2022	5/2022	4/2022	3/2022	2/2022
Economic Measures																									
Trimmed-Mean CPI		3,7	3,8	3,9	4,1	6,05	4,5	4,8	5,0	5,5	6,0	6,1	6,4	6,5	6,6	6,6	6,9	7,2	7,1	6,9	6,9	6,5	6,2	6,1	5,9
Core CPI		3,9	3,9	4,0	4,0	4,1	4,3	4,7	4,8	5,3	5,5	5,6	5,5	5,6	5,7	6,0	6,3	6,6	6,3	5,9	5,9	6,0	6,2	6,5	6,4
Core PCE		2,8	2,9	3,2	3,4	3,6	3,7	4,2	4,3	4,7	4,8	4,8	4,8	4,9	4,9	5,1	5,3	5,5	5,2	5,0	5,2	5,1	5,3	5,5	5,6
CPI		3,1	3,4	3,1	3,2	3,7	3,7	3,2	3,0	4,0	4,9	5,0	6,0	6,4	6,5	7,1	7,7	8,2	8,3	8,5	9,1	8,6	8,3	8,5	7,9
PPI		-1,1	-0,1	-1,1	-0,4	2,3	2,1	-1,0	-3,1	-0,9	2,6	3,0	6,3	8,8	8,9	10,5	11,2	11,6	12,8	15,3	18,3	16,8	15,7	15,3	13,7
Sentiment																									
Michigan Expected Inflation 12M	4,6	4,6	4,5	6,1	6,3	5,3	5,6	5,0	5,2	6,3	6,6	5,5	5,9	5,8	6,6	7,3	7,3	6,4	6,5	8,2	8,2	7,4	8,2	8,0	6,0
Conf Board Expected Inflation 12M	5,2	5,3	5,5	5,7	5,9	5,7	5,7	5,7	5,8	6,1	6,2	6,3	6,2	6,7	6,6	7,1	6,9	6,8	7,0	7,4	7,9	7,5	7,5	7,9	7,1
ISM Manufacturing Prices Paid	52,5	52,9	45,2	49,9	45,1	43,8	48,4	42,6	41,8	44,2	53,2	49,2	51,3	44,5	39,4	43,0	46,6	51,7	52,5	60,0	78,5	82,2	84,6	87,1	75,6
ISM Manufacturing Supplier Deliveries	50,1	49,1	47,0	46,2	47,7	46,4	48,6	46,1	45,7	43,5	44,6	44,8	45,2	45,6	45,1	47,2	46,8	52,4	55,1	55,2	57,3	65,7	67,2	65,4	66,1
NFIB Higher Prices		22,0	25,0	25,0	30,0	29,0	27,0	25,0	29,0	32,0	33,0	37,0	38,0	42,0	43,0	51,0	50,0	51,0	53,0	56,0	63,0	65,0	63,0	66,0	64,0
Commodities																									
CRB Raw Industrials	-2,6	-6,6	-4,6	-5,3	-1,6	-2,2	-7,9	-7,5	-11,0	-16,5	-17,7	-17,6	-14,2	-8,5	-12,1	-11,8	-14,8	-8,4	-1,8	-2,5	1,6	9,3	17,4	20,3	18,2
Metals	-14,7	-21,0	-13,7	-14,7	-4,4	0,6	-7,7	-6,5	-10,0	-23,5	-22,5	-25,3	-17,4	-1,3	-3,2	-2,7	-13,2	-8,7	-1,5	-2,6	3,0	15,6	27,9	46,5	29,4
Agriculture	-14,2	-13,0	-9,3	-4,1	-2,3	-6,5	-3,0	3,7	-4,2	-16,2	-13,4	-8,7	-7,0	6,6	12,4	15,1	13,3	19,4	20,9	17,0	21,4	34,1	31,6	46,4	35,6
Energy	-14,3	-14,1	-25,6	-29,1	-19,0	-17,1	-35,4	-35,0	-35,1	-45,7	-36,6	-31,7	-14,5	2,7	30,3	56,4	28,0	31,5	91,3	79,3	80,2	121,2	103,0	88,4	60,4
Wages																									
Hourly wages		4,5	4,3	4,3	4,3	4,5	4,5	4,7	4,7	4,6	4,7	4,6	4,7	4,6	4,9	5,1	5,0	5,1	5,4	5,5	5,4	5,6	5,8	5,9	5,3
Inflation components																									
Shelter CPI		6,2	6,3	6,7	6,8	7,1	7,3	7,7	7,8	8,1	8,1	8,1	7,6	7,8	7,5	7,1	6,9	6,7	6,3	5,8	5,5	5,1	4,8	4,5	4,1
Electricity CPI		3,8	3,3	3,4	2,4	2,6	2,2	3,1	5,4	6,1	8,5	10,1	10,6	11,6	14,3	13,8	14,2	15,5	15,8	15,4	13,8	12,2	11,1	11,0	8,8
Car Rental CPI		-14,1	-11,9	-10,4	-9,5	-8,6	-6,6	-7,0	-12,9	-12,9	-11,7	-9,2	-7,2	2,3	-4,4	-5,7	-3,3	-1,2	-5,8	-11,9	-8,4	-1,4	9,7	23,2	14,9
Recreation CPI		5,3	5,6	4,8	5,7	6,4	6,1	6,2	5,9	5,8	6,4	6,0	6,0	5,7	5,7	5,4	3,9	4,1	4,2	4,5	4,7	4,8	4,4	4,8	4,4
Market Indicators																									
US 5Y Breakeven	2,4	2,3	2,2	2,2	2,4	2,2	2,2	2,3	2,2	2,2	2,2	2,5	2,6	2,4	2,4	2,4	2,6	2,2	2,8	2,8	2,7	3,0	3,3	3,5	3,2
US 5Y/5Y Breakeven	2,3	2,4	2,2	2,2	2,5	2,4	2,3	2,5	2,2	2,3	2,2	2,2	2,2	2,3	2,2	2,1	2,3	2,1	2,4	2,4	2,1	2,3	2,5	2,4	2,2

■ Standard deviations above mean shaded in darker red ■ Close to mean ■ Standard deviations below mean shaded in darker blue

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