May 2020

Investment Outlook

Summary

Restart after sudden halt?

In the last issue of *Investment Outlook* (published in February), we predicted unexpected news and dramatic fluctuations in financial markets. This proved more correct than we would have wished. The COVID-19 crisis is having – and will continue to have – a major impact on economic growth, the functioning of economies and financial market performance, but our forecasts indicate that the unusually deep low point of the downturn is near.

We expect a deep recession in 2020 and a relatively strong rebound next year. This forecast assumes that a gradual normalisation will occur as restrictions are lifted, starting this spring and summer, and that the spread of the novel coronavirus will fade. But there is considerable uncertainty.

Corporate earnings forecasts are still being adjusted lower – on a global basis, we now foresee earnings 20 per cent lower than last year – compared to the 10 per cent increase predicted a few months ago – and the number of defaults is expected to climb sharply. However, markets have already accepted the fact that in terms of earnings, 2020 is a lost year.

Central bank and government support justifies higher credit risk

In a relative perspective, we are somewhat more positive towards credit risk than equity risk, due to supportive bond purchases by central banks and capital injections by governments into the corporate sector, aimed at avoiding bankruptcies. We thus have a favourable view of corporate bonds, especially those with higher risk (high yield, HY), which often deliver returns that surpass those of the stock market during recovery phases.

Low interest rates prop up the stock market

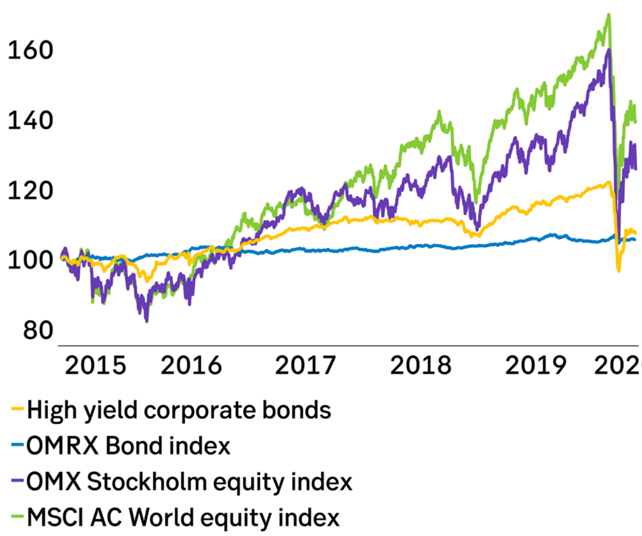
For those who believe in a faster-than-expected recovery in growth and earnings, the greatest potential is in equities. But SEB's main scenario also strongly suggests that the market may be prepared to discount earnings further in the future. That may help prices rise in this otherwise bleak environment. However, because of the rapid upturn in share prices, further weak economic statistics may create new investor uncertainty and stock market dips over the next few months, a common pattern in major downturns. However, the TINA – There Is No Alternative – argument suggests that any decline will quickly attract buyers who lack good alternatives to equities. If this growth scenario holds, the stock market has probably already bottomed out.

Investment areas with potential

As usual, in this May issue of *Investment Outlook* we are presenting some theme articles about current trends. The first provides an in-depth look at renewable energy, a vital element of our shift towards a more sustainable society. We hope and trust that the expected stimulus measures aimed at supporting the rebuilding of the economy after today's deep crisis will also be "green" in nature, reinforcing our view that sustainable investments can both benefit society and generate future returns.

Our second theme article is also energy-related. On pages 24-25 in the report, we examine recent dramatic oil price developments due to plummeting demand and tensions between petroleum-producing countries.

How different asset classes have performed



Source: Bloomberg/Macrobond

The chart shows returns for the past 5 years on the broad MSCI AC World equity index, Sweden's OMX equity index and OMRX bond index and the Pan-European High Yield Index currency-hedged to SEK.

Global equities

- Due to lockdowns in many countries, corporate earnings will suffer widespread declines this year, but recover strongly in 2021.
- More than half the stock market decline has now been recovered thanks to large stimulus measures, which has led to high valuations based on projected 2021 earnings.
- Continued tug-of-war between large stimulus packages, low interest rates/yields and downgraded earnings forecasts.
- Small businesses are attractive from a valuation perspective.

Nordic equities

- Panic in markets = share sell-offs, but often for very limited periods.
- Dramatic cyclical weakening will lead to major downward revisions in earnings forecasts.
- The oil crisis affects many companies, but there are also winners in this crisis.
- After mixed Q1 corporate reports, there is continued great uncertainty.
- There is a unique opportunity for a more sustainable restart, but will people heed the call for a "new green deal" to speed up the recovery after the COVID-19 crisis?

Fixed income investments

- The "whatever it takes" strategy of central banks is slowing the upward trend in long-term government bond yields due to historically large budget deficits.
- Negative expected returns on government bonds are driving investors towards riskier fixed income investments.
- High yield bonds often perform as well as equities after a sharp decline, but at lower risk.

Return expectations, %, next 12 months (SEK)

Equities	Return	Risk
Advanced economies	7.1	18.3
Emerging markets (local currencies)	7.2	17.6
Sweden	7.3	18.0
Fixed income investments	**Return**	**Risk**
Government bonds	-0.8	1.5
Corporate bonds, investment grade (Europe, IG)	3.1	6.8
Corporate bonds, high yield (Europe/US 50/50, HY)	6.2	10.5
Emerging market debt (local currencies, EMD)	5.8	10.7
Alternative investments	**Return**	**Risk**
Hedge funds	3.5	7.0

Source: SEB, forecasts May 2020

Alternative investments

- High volatility and short, powerful market movements pose difficulties for trend-following hedge fund strategies.
- Macro fund managers with limited risk-taking have shown fairly stable performance amid turbulence.
- Extreme stock market volatility, along with any net exposure, is hampering equity long/short funds.
- Diversification will limit volatility somewhat for multi-strategy hedge funds in 2020-2021.

For more details, read the full report, which you can find it at seb.se/investmentoutlookreport

There we also provide you with extra reading in the form of two interesting theme articles:

- Renewable energy – Fresh start or sudden stop?
- Oil – Divergent strategies, collapsing demand behind price crash

Our experts, Chief Strategist Johan Javeus and Investment Strategist Johan Hagbarth, also summarise our view in a video on seb.se/investmentoutlookreport

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