February 2021

SEB

Investment Outlook
Summary

More volatility in the rate hiking phase

High inflation is putting pressure on central banks to tighten their monetary stance, but their policies will remain stimulative for some time to come. Economic growth will slow, but from high levels. A tug-of-war between opposing trends will lead to greater volatility, despite continued good fundamentals. We are maintaining a certain overweight in risk assets but expect more modest returns.

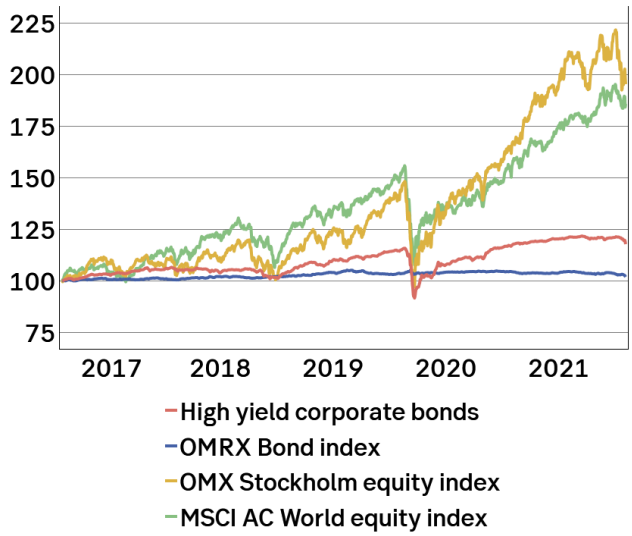
Last year ended with a real spurt on the world's stock exchanges. But as soon as 2022 began, the tone of the capital market changed. Government bond yields began to climb rapidly, after signals from central banks of more powerful shifts in their monetary policies. These shifts are being driven by a high inflation rate combined with low unemployment, that is, by classic overheating tendencies. Investors have responded with reduced risk-taking.

Companies are reporting their fourth quarter results, which are confirming that 2021 was a record year, with aggregate earnings increases of around 50 per cent for Swedish listed companies. Such a profit explosion naturally means that expected earnings increases will be subject to greater uncertainty. This uncertainty mainly centres on the impact of input prices, COVID-19 pandemic effects and slower economic growth rates, and to what extent the corporate sector can compensate for higher inflation. We believe that yearly earnings growth for 2022 and 2023 will end up in the 5-8 per cent range.

Valuations and stock market performance
During 2021, valuations of many Nordic and especially Swedish equities reached levels not seen in 20+ years. Signs of some sobering up after last year's euphoria are already apparent, and we expect continued normalisation in 2022. In our main scenario, last year's winners will continue to lose out in favour of more attractively valued equities, both cyclical and defensive. Stock market performance overall will be a struggle between growing corporate earnings and "multiple contraction" (declining valuations). This will be a challenging environment for much of the Stockholm stock exchange, while conditions in Oslo and Helsinki will be better.

Globally, last year's stock market rallies were more than justified by the profit explosion we saw. Valuations expressed as price/earnings (P/E) ratios actually fell slightly during the year but remain on the high side historically. Today's turbulence may persist for another while, but a clear downturn in COVID-19 transmission, reduced geopolitical tensions and falling inflation – while earnings forecasts remain intact – the growth and interest rate/bond yield outlook still suggests that the stock market year may end on the plus side.

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.

Risks
A weaker economy than we forecast would squeeze corporate earnings. If inflationary forces do not fall as much as we hope, this would put pressure on central banks to keep their current plans intact or tighten their policies even further despite weaker economic conditions. Geopolitical tensions pose a risk that cannot be ignored. For example, a war between Russia and Ukraine would lead to further upward pressure on oil and natural gas prices.

When it comes to risks, we usually think mainly of negative outcomes, but another view may of course be that we are painting an overly negative scenario. Falling inflation and reduced COVID-19 transmission – combined with solid economic growth and continued very low key interest rates – could very well stabilise and reverse the fall in risk appetite that we witnessed early in 2022.

Global equities

- Earnings growth and low rates/yields will support equities
- How the Fed manages the inflation threat will be crucial to stock market performance
- The 2021 profit explosion moderated valuations
- Setbacks in emerging markets will create opportunities

Nordic equities

- Hangover after a period of euphoria
- Struggle between earnings growth and multiple contraction
- Trend shift for equities due to monetary policies
- Big differences between sectors and countries
- Conflict with Russia would lower risk appetite

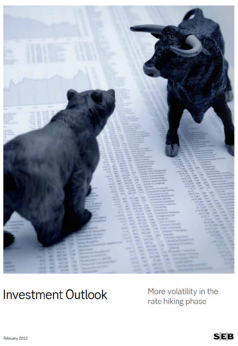
Fixed income investments

- Focus on the clear change in monetary policies
- More key rate hikes and a longer hiking cycle would push long-term yields higher
- High yield bonds still attractive, but less advantageous as interest rates rise and yield spreads narrow

Return expectations, %, next 12 months (SEK)

Equities	Return	Risk
Advanced economies	7.5	15.6
Emerging markets (local currencies)	7.1	14.9
Sweden	8.2	17.6
Fixed income investments	**Return**	**Risk**
Government bonds	-0.2	1.4
Corporate bonds, investment grade (Europe, IG)	1.1	7.1
Corporate bonds, high yield (Europe/US 50/50)	1.5	10.9
Emerging market debt (local currencies, EMD)	5.3	10.6
Alternative investments	**Return**	**Risk**
Hedge funds	3.5	6.0

* 24-month historical realised volatility.
Source: SEB, forecasts February 2022



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

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

- From QE to QT – What happens when monetary policy is tightened?
- The metaverse – Interactivity and immersive experiences
- Emission rights – In 2022 the price will finally make a difference

Our experts Fredrik Öberg and Johan Hagbarth also present our in-depth market view in the form of a video, which is posted on the same web address.

Investment Strategy
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