SEB House View

6 April 2022

SEB

Overview

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Market and Fair Value Indicators

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Asset Class and Sector Views

Markets moves according to new facts

Investment Regime: War and risks

- The present dynamics playing out in the market are challenging the regime and it is a natural reflex to either try to take positions on the back of war and politics or to just reduce exposures heavily as matters are complex and extremely worrying
- However, we prefer to take investment decisions based on facts of what we see in macro data and market moves – i.e. the levels and trends
- We see that we are now exiting from the Covid period with rather decent growth, above trend outlook, and momentarily high inflation
  - But the war has, increased the downside risks for growth and high inflation
- Markets have responded correspondingly – lifting bond yields substantially
  - Here it's important to point out that yields adjusted for inflation are still in negative territory – so as some investors argue, TINA is still very much alive
  - Markets are also expecting central banks to move more aggressively, with eight rate hikes this year. The question here is if markets are too hawkish
- The market narratives are quite divided now:
  - Some analysts make the call for near recession while others are still bullish
  - The important thing here is to look at what data is saying
- The recent data in March is the first data for the war period, and it is quite decent, probably slightly better than expected
- We are seeing a slowdown in macro, but levels and orders are still good
  - This is probably the major reason why markets are strong
  - The other reason being that most players conclude that equity markets can live with gradually higher rates and as equities is the best place to be with slightly higher long-term inflation

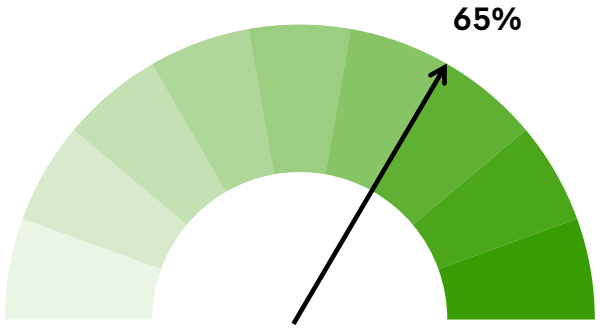
Risk utilization: We stay at 65%

- One important reason to stay with a positive view on risk and markets is the fact that the general growth picture is rather decent although it is not accelerating
  - But all in all equites will perform better than bonds in this inflationary environment

Investment Regime

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

Speedometer



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).

Investment Regime: Growth will most likely persist

The world will continue to grow, albeit at a slower pace

It's important to remember that even as today's new world is challenging the world is entering the post-covid period. Growth over trend was the forecast most research houses had penciled in for 2022, but it is likely closer to trend now after downward adjustments have been made. We can expect increased fiscal stimulus in China and Europe that will help to mitigate the negative impact on growth from the war in Ukraine. The conclusion is that we will still see solid growth going forward.

Central banks have a more challenging environment

There is no doubt that the oil situation challenges inflation forecasts. The question is how aggressively central banks will act. The FED will raise rates soon, but its likely that ECB will act with caution. In general, monetary policy will hold focus on maintaining growth without letting inflation loose and challenge growth. Today, wage growth in the US has been rising, but we may be approaching a peak. This points towards the possibility of a slightly lower inflation rate post covid as bottlenecks may ease. And if the supply of oil picks up globally the risks will diminish in the second half of 2022.

Fiscal spending is on its way

The set up for fiscal spending has shifted. China's economy contracted in March and it will need to add more stimulus to achieve its 5.5% growth target for 2022. In Europe we will see increased military and fiscal spending as the outlook has shifted considerably

Earnings forecasts are good, but we remain wary of downside risks

As long as we continue to expect good growth the picture will be reasonably benign. Previous earnings season has indicated that companies have coped well with challenges in rising prices and bottlenecks, but we are more cautious now as we approach the earnings for Q1 22.

Macro Good post Covid growth Q2 is a new starting point...	• 2022 GDP forecasts are positive, but have been adjusted down due to inflation issues stemming from the war • The inflation/growth balance is floating • Commodities and new supply issues will affect inflation
Central banks A decisive road to normality, with care	• FED tone has shifted to focus on inflation • Several rate hikes on the horizon, but probably on a careful path • Long-term yields will likely move upwards from here
Politics A new situation. China support will rise	• We are getting a new set of fiscal measures to meet the Russia/Ukraine situation • The Chinese government will likely support the economy with more stimulus
Corporates Managing risks; earnings forecasts are so far good	• Earnings will likely stay strong, but price pressures is still a risk • As yields may now rise we monitor multiple expansions • Inflationary pressures from commodities is a risk factor

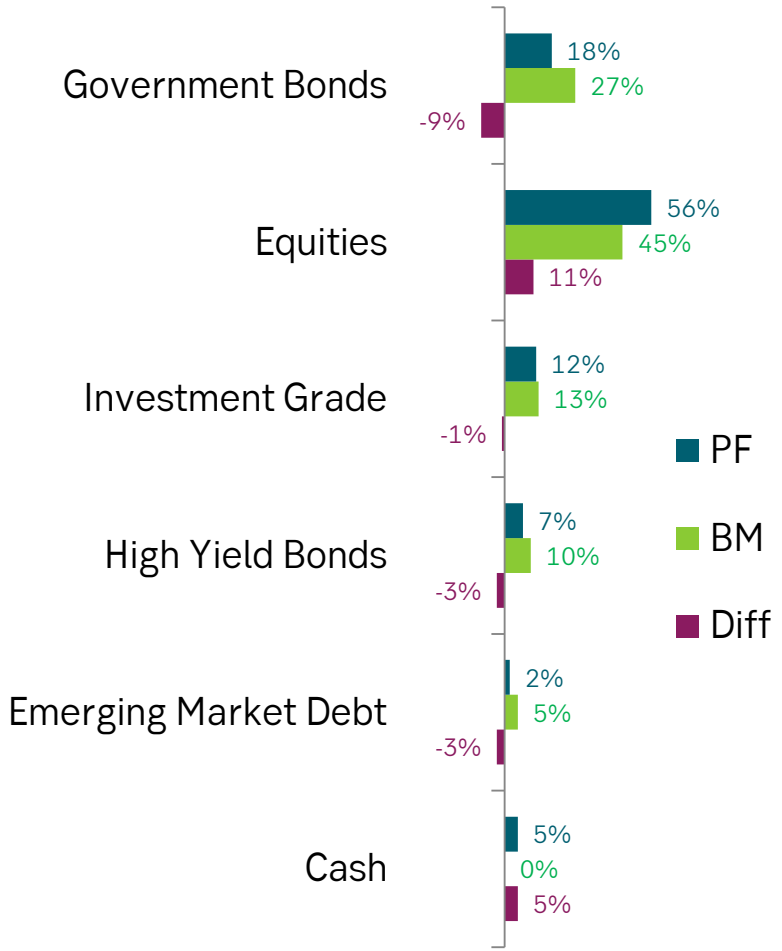
RISKS Persistent inflation | FED policy mistake | Weaker earnings | War escalation

Asset Allocation

More facts on the table, still worrying but more manageable, we stay invested

- We are slowly getting a better grip on the effects of the war as sanctions are set
- Commodity prices has for now stabilized and bond yields reached higher levels
- From this position markets will probably be driven by day-to-day data deliveries and as of now most of the data is decent
- The US yield curve has flattened and can be seen as a sign of an upcoming recession
  - Our view is that yields are distorted by central banks and we now pay less attention to this
  - We expect markets to overall perform well for the next 12 months after the flattening
- We have seen a set of downward revisions of growth forecasts, which is usually not a good sign, but as markets have already priced this in, we expect it remain fairly stable
  - As a result we note that EPS forecasts have lost momentum, but levels are still far better than bond yields; and given the uncertainty, daily macro data is probably more important for sentiment
- Two challenges for risk-taking is how the consumer acts and how the general activity level is
  - Recent macro data was generally solid, which gives support to markets and takes some concern off the table in the short term
- Future inflation expectations are stilly important as they affect consumers
  - A gradual fading of inflation is crucial and we expect figures to gradually diminish
- Bond markets have corrected and the present levels shall probably be seen as a pause before they continue higher
- There is a contradiction in market today, at the same time as some talk about recession markets discount quite substantial FED hikes, FED does also in the dots
- Bond yields will likely continue upwards given the increased activity in fiscal policies, the slow tightening in monetary policy and the general inflation risk which we note is not a bond friendly environment

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 hold an overweight to the defensive US region

- The US economy is the least affected by the war, albeit some of the sector composition is affected by higher interest rates
- US is often considered a risk-off region leading to stronger USD and a flight to safety
- There is also a risk or possibility that the signal sent from the yield curve will later be beneficiary for growth stocks even if it probably is a bit too early at this stage
- The discussion on the yield curve is important:
  - History tell us that equity markets perform rather well as central banks hike rates and markets peak well after the curve has inverted. A strong economy drives earnings even if PE contract as we come closer to a slower growth phase
- The macro outlook is still quite decent and PMI's are well over 50

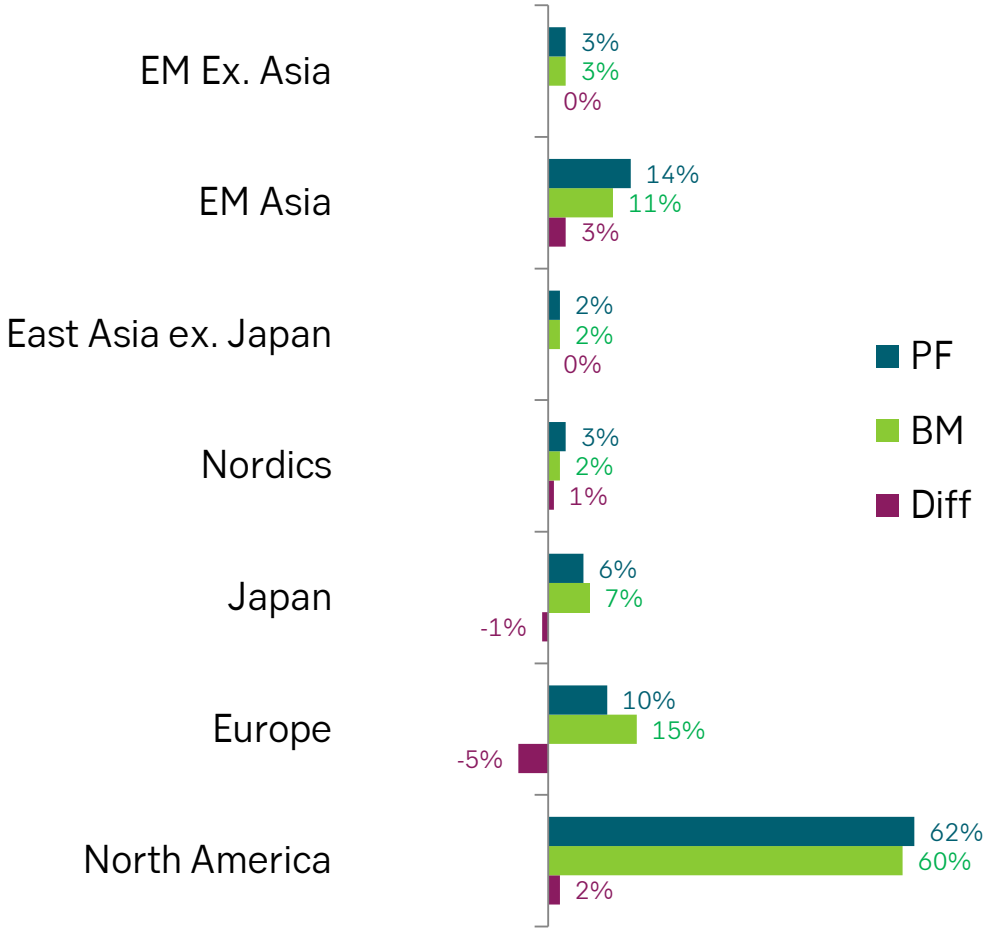
Europe is still in a tricky position, so we prefer to keep our underweight to the region

- Consumer sentiment has taken quite a hit, but macro leading indicators are still at good levels
  - The dependency of oil and natural gas is well documented and sets risk for consumer sentiment and inflation. There is also a more marked trade dependency
- In the long run the industry composition of Europe is possibly quite good in an environment with higher inflation
  - Europe is more of a value region than the US, but given the current ambiguous sentiment, its probably too early to enter that position

Asia remains attractive as China moves ahead with supporting the economy

- We like EM Asia, but it is challenged by a loss of confidence due to Covid lockdowns – but the determination of the policy framework in China should be supportive
  - The Chinese strategy when it comes to growth is positive as there is an ambition to increase growth and lift GDP growth to 5.5% in 2022
- EM ex Asia is to a large extent commodity producers in South America
  - They are in an interesting position, but a strong USD and ESG considerations makes the region not attractive enough

Regional equity positioning



Benchmark is MSCI All Country

Sector allocation

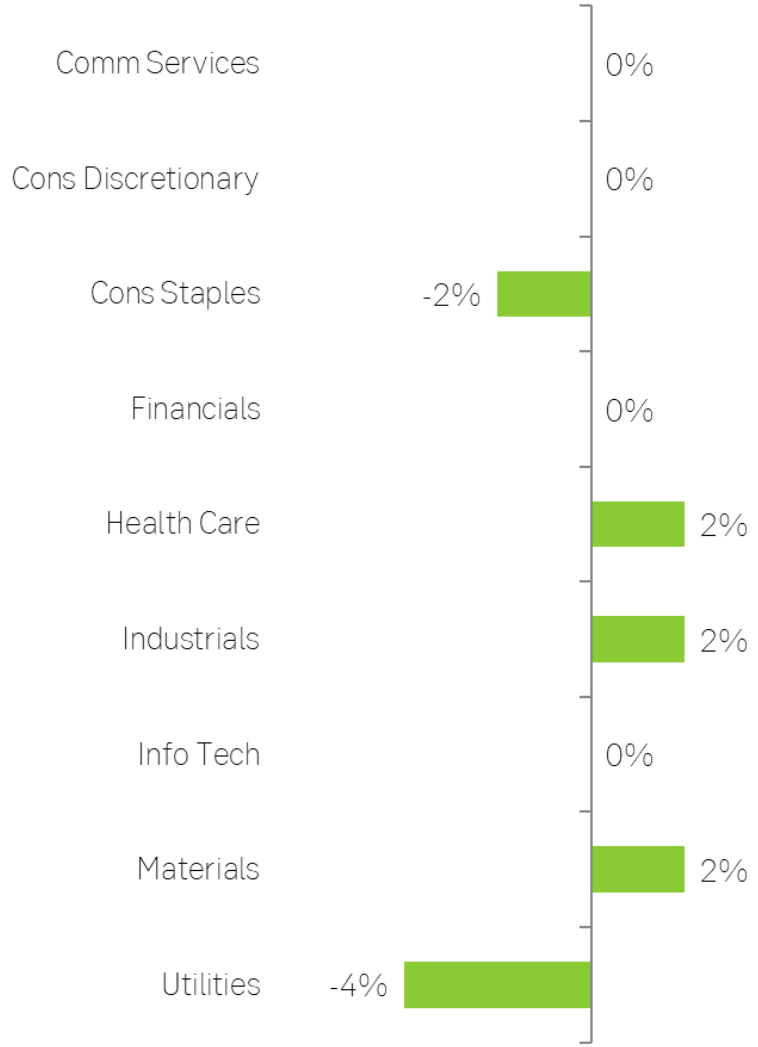
The world is in a phase of decent growth, high inflation and higher bond yields

- We need to focus on the higher risk of inflation and what that means for different sectors – pricing is a comparative advantage,
- Another thing that carries our thinking is that we will have good global growth levels and consumption in the service sector will drive activity higher
- Materials and Industrials has strong earnings growth and benefits from the ability to raise prices in case of rising inflation
- Materials can benefit from higher demand and prices
  - We have seen strong upward earnings revisions which should benefit the sector
  - The sector has also some control over prices but the sanctions on Russia can create some opportunities
- Industrials are also in a good position in this inflationary environment
  - Traditional industries are often in a position to lift prices and respond to new volumes
    - There is a likelihood that we will see more capex in the commodity space that will create demand for Industrials
- Health Care remains attractive as it has defensive characteristics and an aging-population is a positive long-term trend

Our strategy reflects our view that growth will still be an important fact

- The direction of bond yields will be upwards as soon as the situation in Ukraine becomes more stable
- Higher inflation will persist for a while leading us to have a negative outlook for bond proxy sectors
  - Utilities and Consumer Staples correlate with bonds and will find it hard to perform in an inflationary environment
  - They are also low growth sectors which makes them less interesting in the long run

Sector positioning



Risks to the investment regime

Higher commodity prices threaten the growth outlook due to inflation remaining elevated for longer

- Recent US inflation readings remain high due to higher commodity prices
- The difficulty here is that rising energy prices due to the war in Ukraine is not something global central banks can control
  - Rather we have seen governments add fiscal stimulus to support households and recent releases of oil from strategic reserves
- Our base case is that supply constraints will ease moving forward, which can propel inflation to subside from recent elevated levels
  - But the as long as energy prices remain volatile, the question is how long before inflation figures can subdue to a more consistent level?

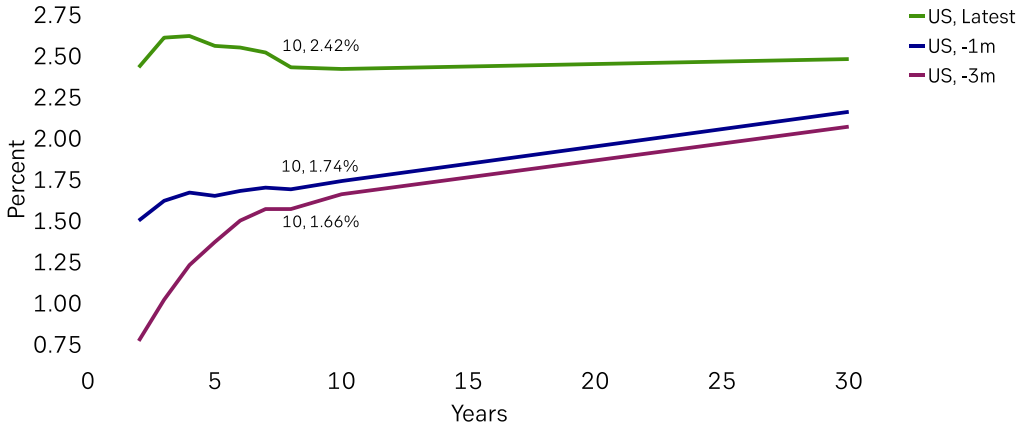
Bond markets pricing in a faster rate hike than the Fed

- The Fed Chairman has signaled a much more hawkish tilt which propelled short-term rates to move swiftly upwards
  - Now the yield curve is partially inverted as short-term yields have moved swiftly upwards
  - However, as the Fed will likely move ahead with quantitative tightening, we will probably see a return to an upward sloping curve
- The rate market has been highly volatile in March, but at the same time the equity market has seen reduced volatility and more stabilization
- However, the risk is that pent-up inflationary pressures may be built into expectations and may affect consumption

Disappoints in the forthcoming earnings season

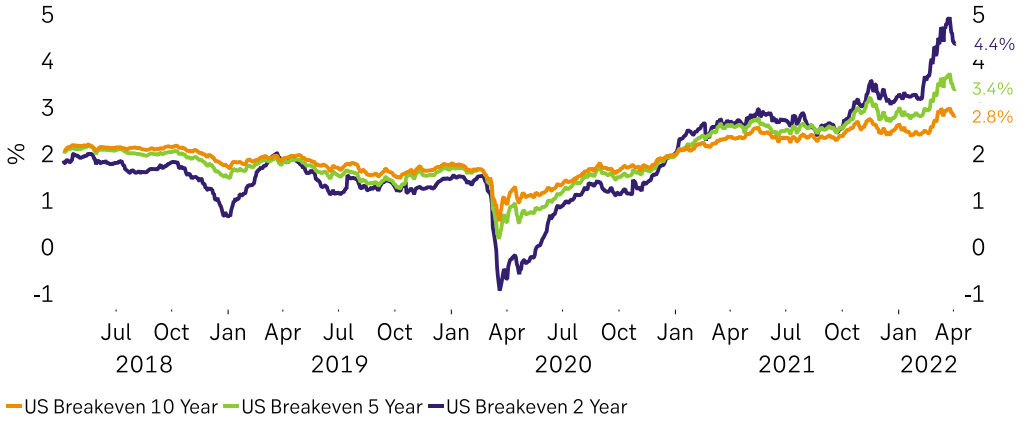
- As we now enter the first quarter earnings season, we may see earnings revised to the downside due to rising costs from input prices
  - This could transfer into weaker future earnings growth for 2022 and 2023

Figure 1: The yield curve has partially inverted signaling that the bond market is more worried about the economic outlook



Source: Macrobond, SEB

Figure 2: Inflation expectations have moved to the upside since the breakout of war in Ukraine. Inflation is expected to remain high in the short-term



Source: Macrobond, SEB

Return Estimates

Figure 1: 12 month forward looking return expectations

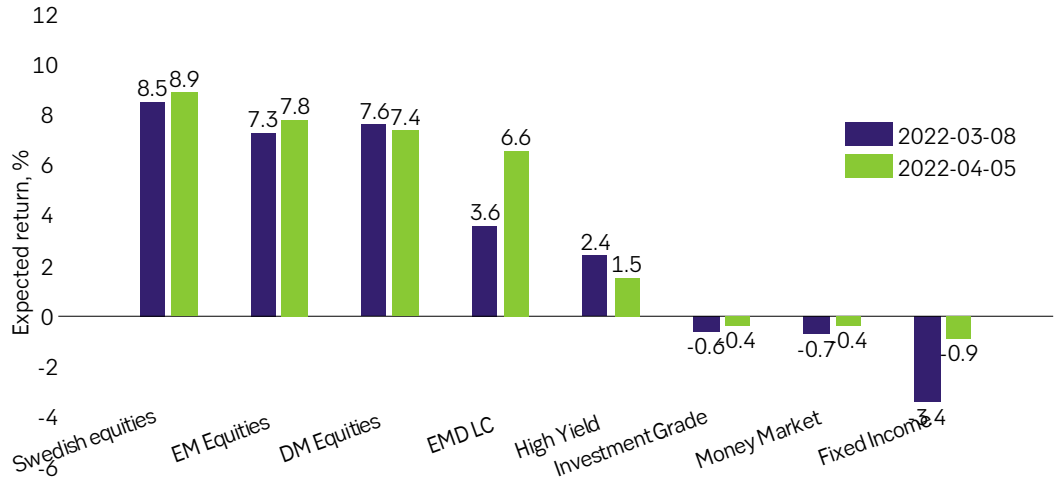


Figure 2: 12 month forward looking return expectations for equities and bonds

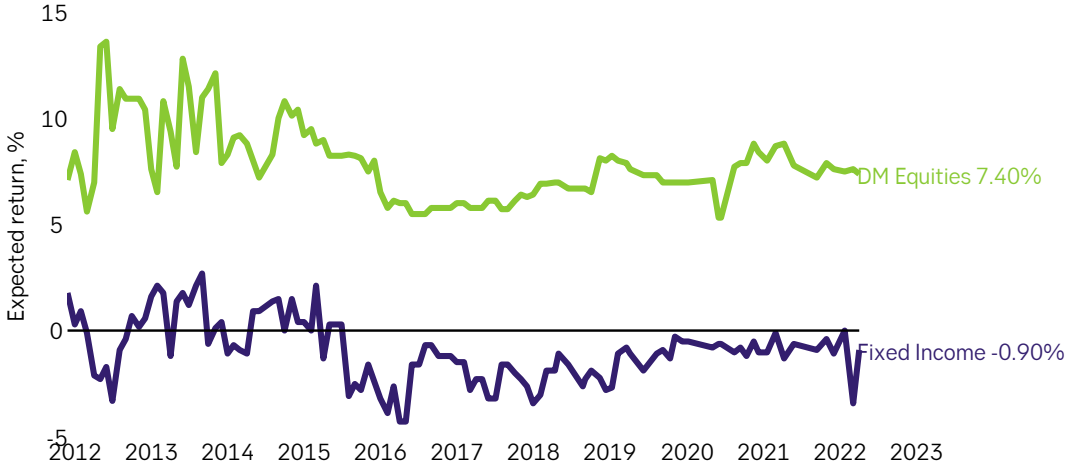


Figure 3: Absolute expected returns

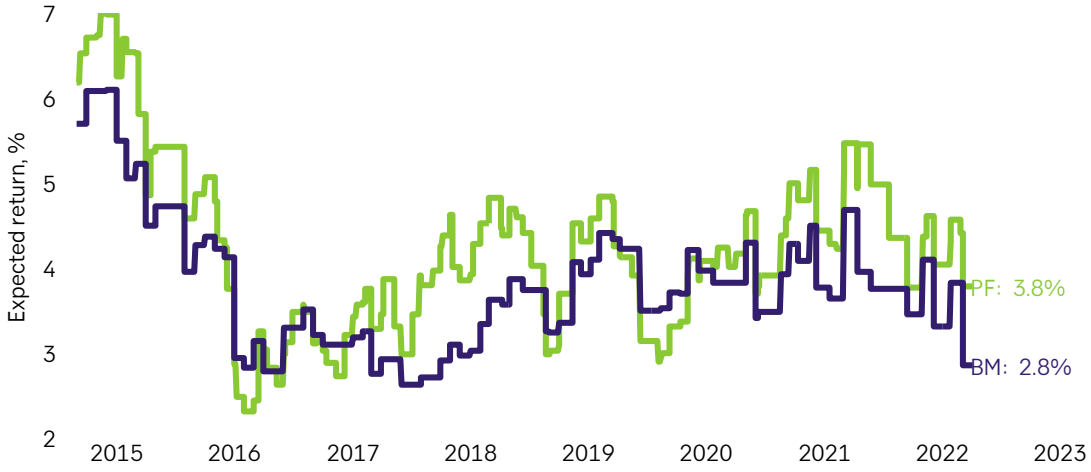
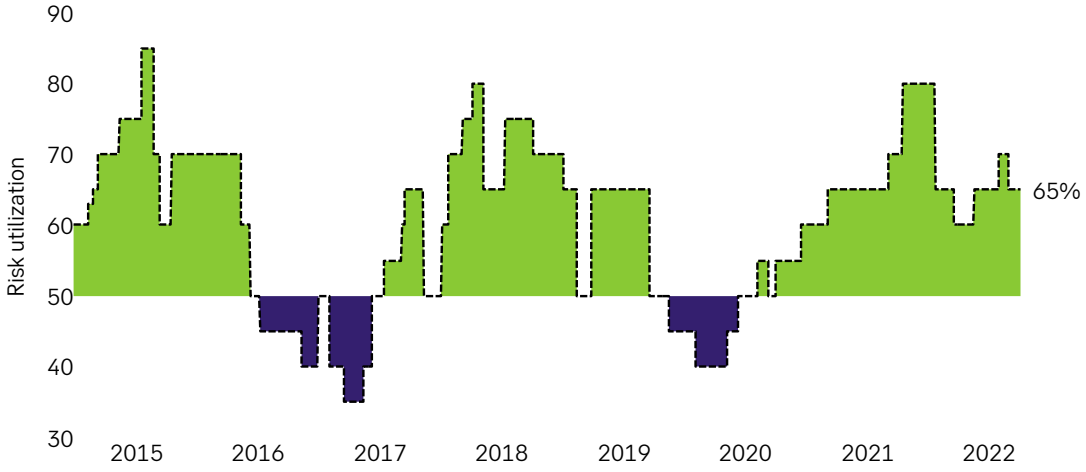


Figure 4: Risk utilization since inception



Historical House View Allocation

Figure 1: Equities

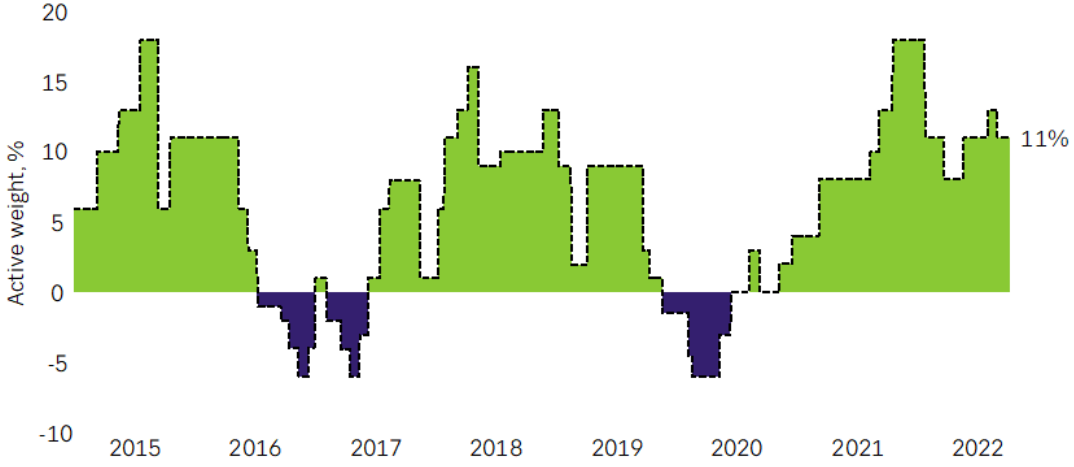


Figure 2: High Yield

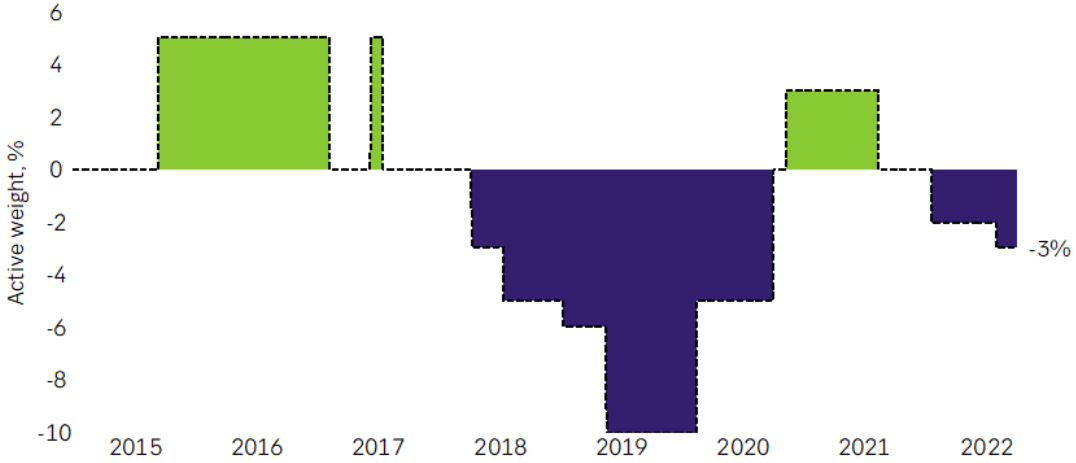


Figure 3: Emerging Market Debt

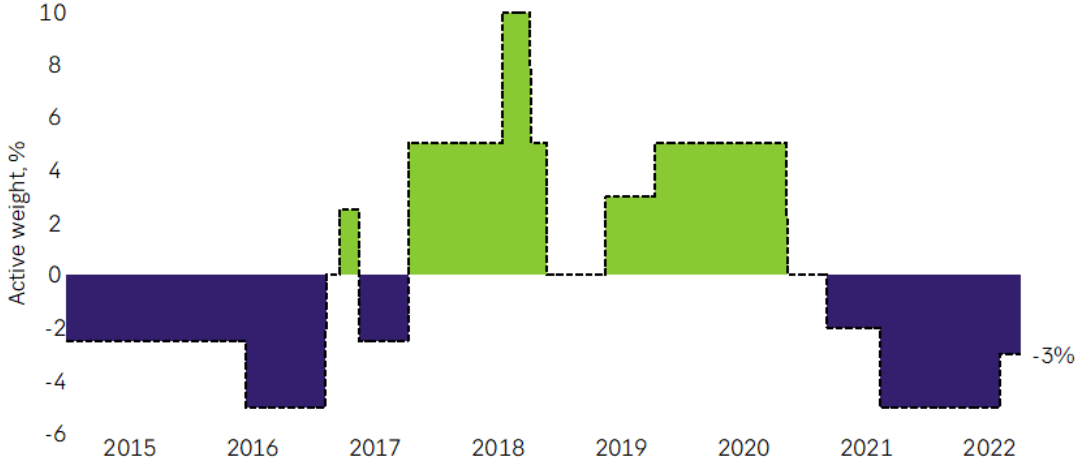
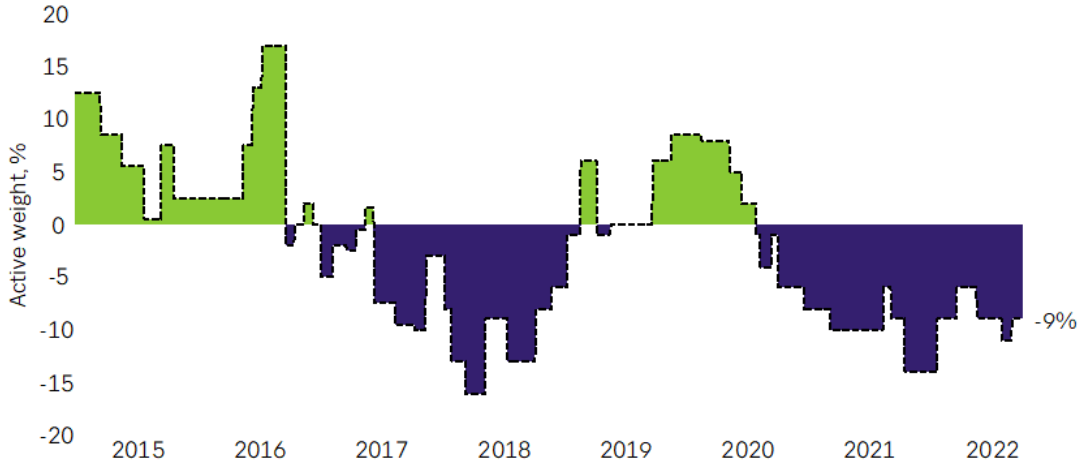


Figure 4: Fixed Income*



* 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

The war in Ukraine is still an important variable, but the factor has faded in importance in our risk-taking decision as markets now focus more on central banks policies and the upcoming earnings season

- Markets have come up since the invasion in Ukraine started, but peace talks have yet been meaningful and risk of further escalation remains

Central Banks have turned more hawkish – markets are pricing in a lot of hikes

- Markets are focusing on central banks policies as the Fed tone has turned hawkish
  - Markets are expecting a 50 bps hike at the next meeting in May
- The ECB's rhetoric has turned more hawkish in an effort to fight surging inflation in Europe

Macro data is still robust, especially in the US, but the outlook is a bit less optimistic

- We are now more neutral on the macro outlook due to renewed lockdowns in China which has a bigger impact on the global economy
  - And as long as the war in Ukraine and corresponding sanctions stay in place, we are more wary of the inflationary outlook

Earnings has increased in importance as we enter the earnings season

- We expect overall earnings to remain positive as we expect companies to have pricing power, but we are now more wary of the upcoming seasons than before
  - Rising input costs and supply chain disruptions may have had negative effects on companies earnings and growth forecasts

On a 3-6M horizon the House View Committee holds a positive view on risky assets and we prefer to remain slightly overweight to equities

- In our view, the biggest risks for equities in the next months is sustained high inflation as central banks go on a tightening cycle which can deter economic growth
  - The war in Ukraine is still the biggest tail risk in case of an escalation

Figure 1: Central Banks is the most important variable in our risk taking as they tighten monetary policy. Earnings has risen in importance as we enter the earnings season

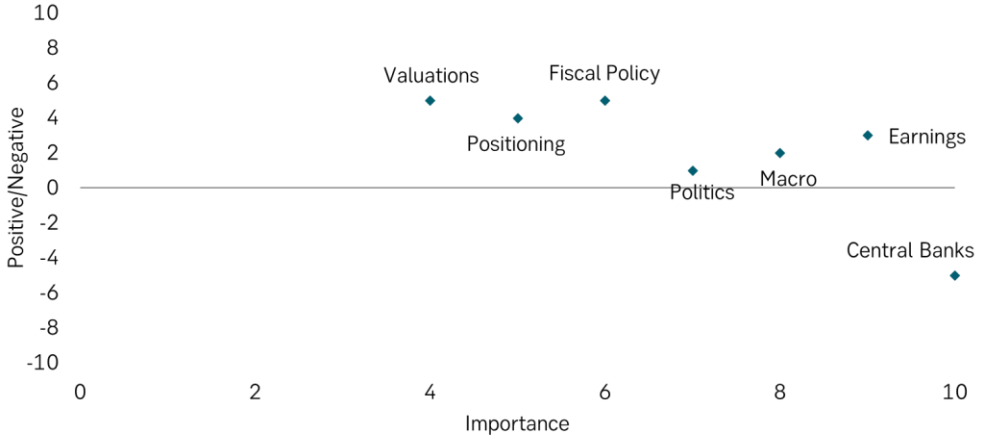
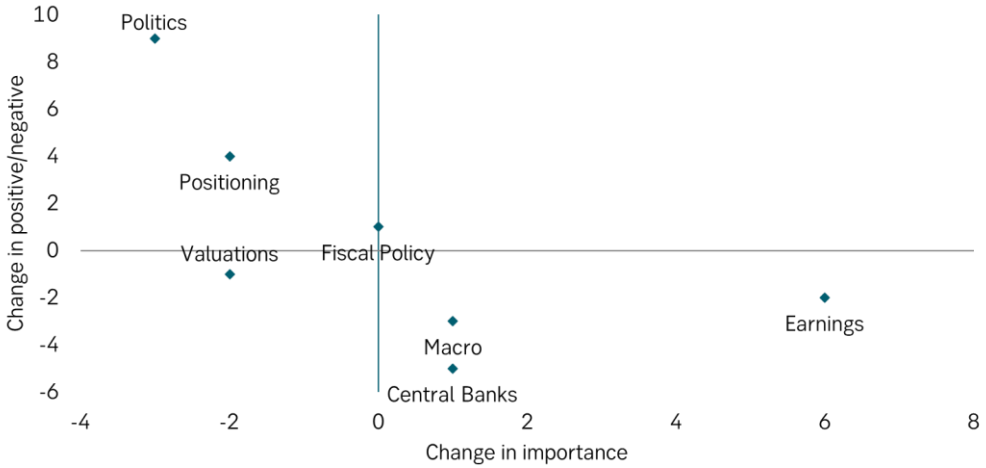


Figure 2: Politics has fallen in importance as the war in Ukraine is fading to the background. We are less positive on macro, but the factor remains an important variable



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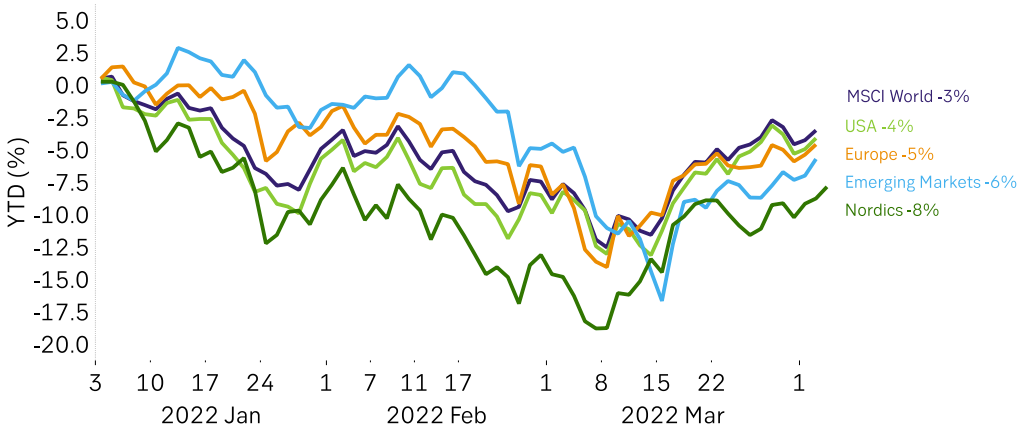
Developments in the Markets

Equities rebounded in March to levels before Russia launched its invasion of Ukraine
Equity markets rallied despite expectations of a tighter monetary policy from the Federal Reserve, lockdowns in China, as well as downward revisions on GDP forecasts, particularly in Europe. The rebound came partly on the back of suggestions that Russia and Ukraine had made progress in negotiations of a ceasefire as well as a pledge from the Chinese to introduce a range of policies favourable to the market. Market volatility declined over the course of March and the VIX futures curve is now signalling that investors are less worried about the short-term uncertainties than they were a month ago. The moves in the rate market have been much greater as the Fed Chairman stated that the central bank would move rapidly towards tighter monetary policy. But while the government bond market suffered in March, the equity market has remained quite complacent throughout the month. The rally in equities can thus also be explained by the outflow from the bond market into the equity market. Commodity markets were volatile throughout the month with oil prices moving swiftly. News on the US plans to boost supplies of LNG to Europe, as well as Russia's plans to stop supplying gas to countries unless they pay in roubles, have been triggers of volatility in raw materials.

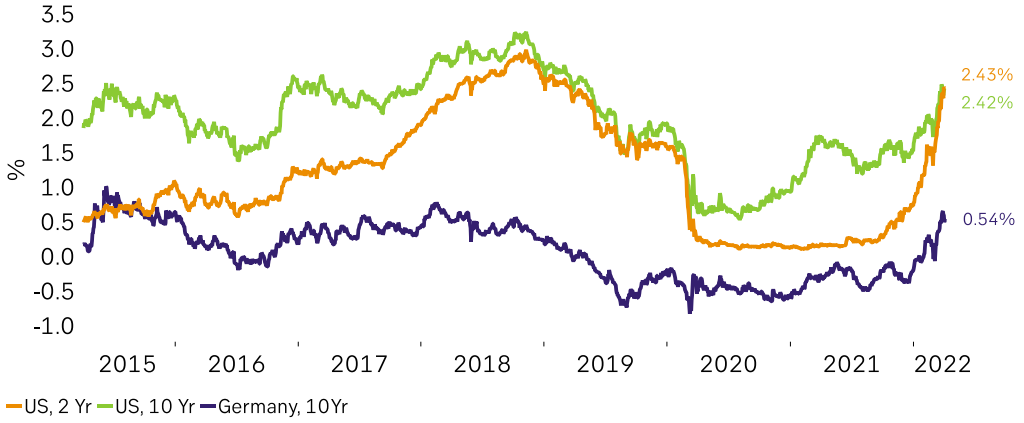
The Fed lifted its policy rate by 25 bps and projected six more rate hikes this year
The Fed started its cycle of rate rises this year and are projecting further rate hikes for next year. The Chairman stated that the US economy is in strong shape and stressed now the need to combat inflation. According to the Chairman, the bank can confidently bring down inflation without causing a recession. The concern for the market has been that the economic effects from the war in Ukraine can heighten the risks of commodity inflation and lead to higher input prices which can in turn impact companies profits. Yields on US Treasuries rose swiftly as markets priced in a tighter monetary policy. In particular we saw strong upward moves in the short end of the curve, which led to a partial inversion of the yield curve. Markets are currently pricing in roughly eight more 25 bps hikes this year, with a probable 50 bps hike at the next Fed meeting. Inflation expectations have risen as there are some signals that some of the forces driving inflation are out of the Fed's control.

Figure 1: Global equities recovered since the breakout of war in late February as negotiations between Ukraine and Russia continued



Source: Macrobond, SEB

Figure 2: We saw yields move swiftly upwards as markets priced in around 8 hikes for 2022. In particular we saw the 2 Yr yield climb swiftly



Source: Macrobond, SEB

Economy – Developed Markets

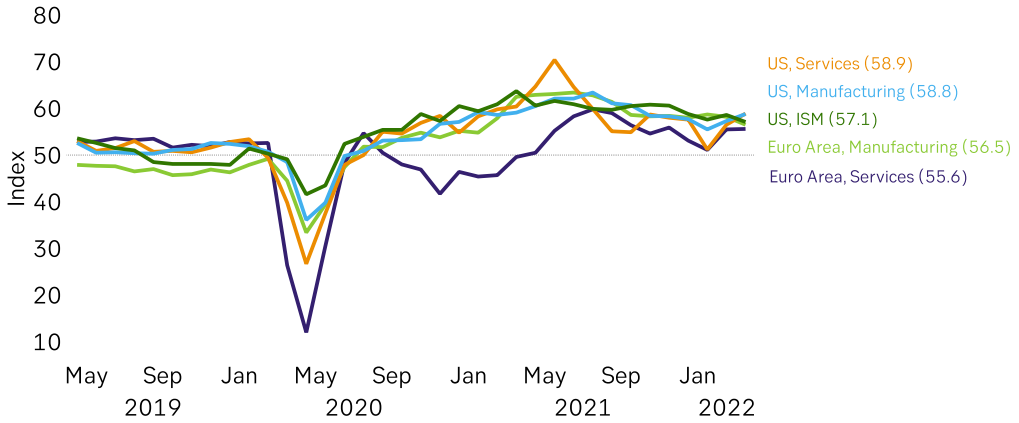
Strong macro data in the US: strong labor market, households and businesses

- US manufacturing activity moderated in March, but remained still at strong levels
  - The sector remains in a demand-driven environment, although we saw weaker new orders and backlogs and improvements in customer inventories
  - The supply-side was more mixed, with prices paid ratcheting higher, while the employment indicator signaled improvements
    - Capacity constraints may begin to moderate as the labor shortage problems are fading and supplier delivery times are easing
    - Inventories are also improving, indicating that companies are better equipped to meet the strong demand
- The labor market in the US continued to add jobs in March signaling that the Fed can go through with hiking rates this year without raising unemployment
  - Higher inflation, less household savings and solid wage growth have contributed to a robust recovery in the labor market
  - Average hourly earnings rose, but inflation is outpacing wage growth, thus denting on consumers demand
    - US inflation-adjusted spending declined in March signaling that spending on goods has moderated given that disposable personal income is also cooler
  - Although labor participation rate picked up it is not yet back at pre-pandemic levels, but this may be due to lingering early retirements
- The main risks for the US economy is a global slowdown and elevated inflationary pressures from the war in Ukraine

Worsening supply shortages and soaring costs due to the Russian invasion of Ukraine dented on Europe's manufacturing rebound

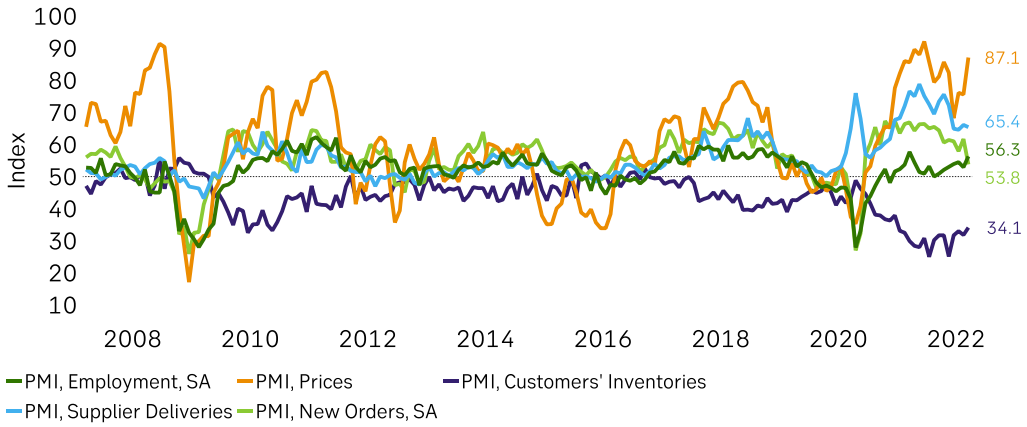
- Although macro data remained at strong levels, we saw a slowdown in March
- The ECB surprised the market with a more hawkish tone at its latest meeting as it announced an acceleration of winding down its asset-purchases program
  - Energy prices have soared and have particularly hit the European economy

Figure 1: US macro indicators are still at stable expansionary levels as economic fundamentals remain resilient. European PMI:s were more mixed



Source: Macrobond, SEB

Figure 2: The US employment component improved due to better wages and easing of virus-restrictions. However, the prices component showed input prices rising once again



Source: Macrobond, SEB

Economy – Emerging Markets

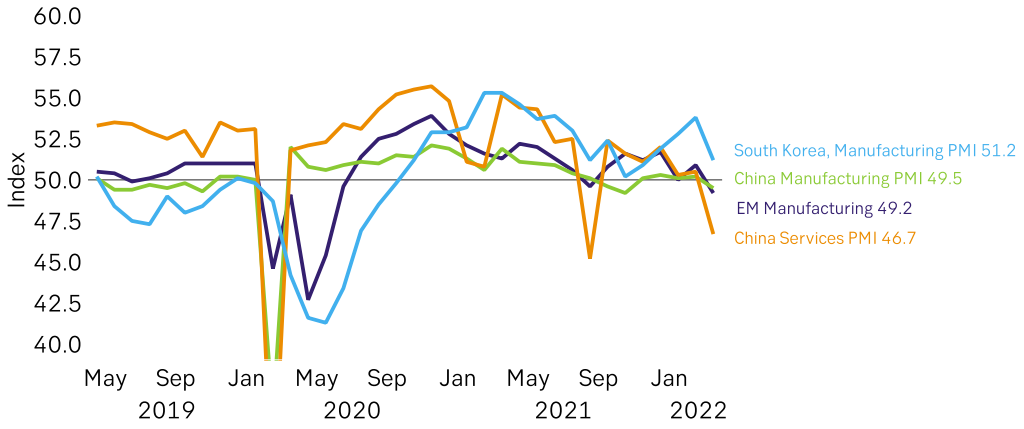
EM macro indicators faltered in March due to ripple effects from the war in Ukraine

- Supply disruptions and rising energy costs hit the manufacturing sector of the region, which can have significant spill-over effects on the global economy
  - External demand for Asia's production weakened which was evident from the drop of South Korea's new export orders
- Latin America macro data slid on tightening of financial conditions as well as the risks of rising inflation due to higher commodity prices
- Central banks in the region will probably push towards a hiking path, with the exception for China which is moving towards easing its monetary policy

Covid lockdowns dented on economic activity in March which signals that the government and PBOC will have to step up to support the economy

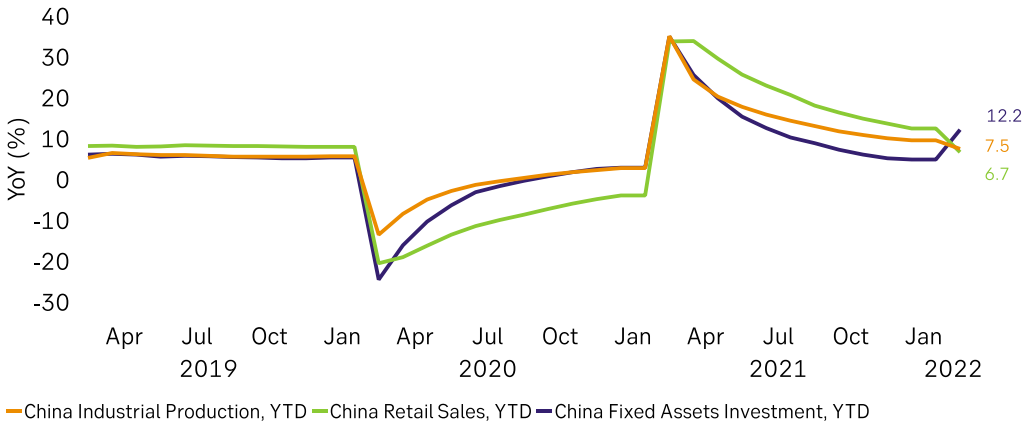
- Both the Caixin and the official manufacturing PMI fell into contraction as Covid restrictions and the war in Ukraine added to the concerns
  - In particular we saw a drop in new export orders and business sentiment due to lockdown in Shenzhen and Shanghai
  - Rising energy costs has also dented on external demand for Chinese goods due to global reduced spending power
- The service sector also plunged due to the latest covid breakout, but this hints that the Chinese may go ahead with further investments in infrastructure as well as the PBOC cutting interest rates and lowering the RRR
- Although hard data showed that industrial production, retail sales and investments were resilient in first months of the year, the risks to the outlook are to the downside
  - Retail sales and investments accelerated in the first two months thanks to the governments policy support at the start of the year
- The PBOC will likely move ahead with an easing cycle in the next quarters
  - Credit conditions indicators are signaling towards further easing
  - And Chinese inflation figures, both CPI and PPI, are moderating which can add further support towards the easing cycle of the PBOC

Figure 1: EM indicators for manufacturing slipped into contraction in March. Lockdowns in China dented on activity, particularly on the service sector



Source: Macrobond, SEB

Figure 2: Chinese hard data was strong at the start of the year. But risks from abroad indicate that government and central bank support will have to step in



Source: Macrobond, SEB

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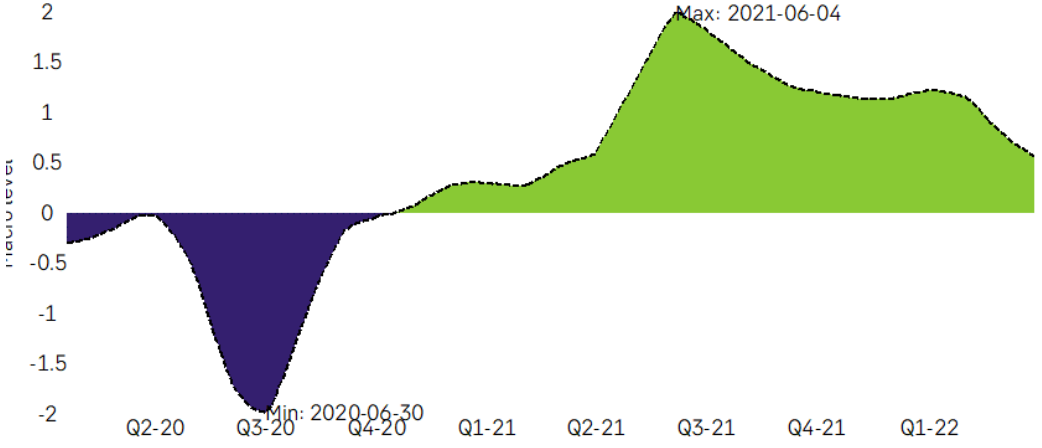
SEB House View – US Macro Status

US macro data remains solid as the labor market recovers

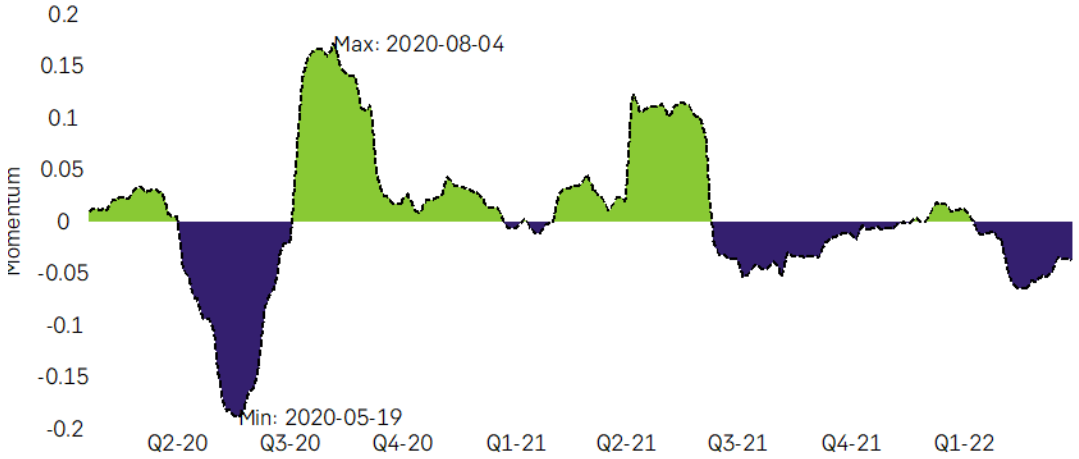
- Markit's PMI:s for manufacturing and services surprised to the upside in March.
  - Supported by pent-up demand, fewer restrictions and less supply bottlenecks
  - Demand increased on back of rising backlogs and new orders
  - Employment expanded and allowed firms to increase output
- However, we note that Markit's PMI:s diverged with ISM figures which were still overall solid, but surprised to the downside due to lower demand components
- Conference Board Consumer Confidence beat expectations in March
  - Negative impact of inflation on US consumers have been smaller than expected
  - Higher prices are testing the resilience of consumers, with lower-than-expected advanced retail sales showing early signs of slowing consumer spending
  - With shrinking savings and subdued personal disposable incomes, strong wage growth is needed to offset higher prices
- We will likely see continued strong momentum in labor markets as more companies hire more workers

Figure 1: US macro level is still strongly positive, but momentum is fading



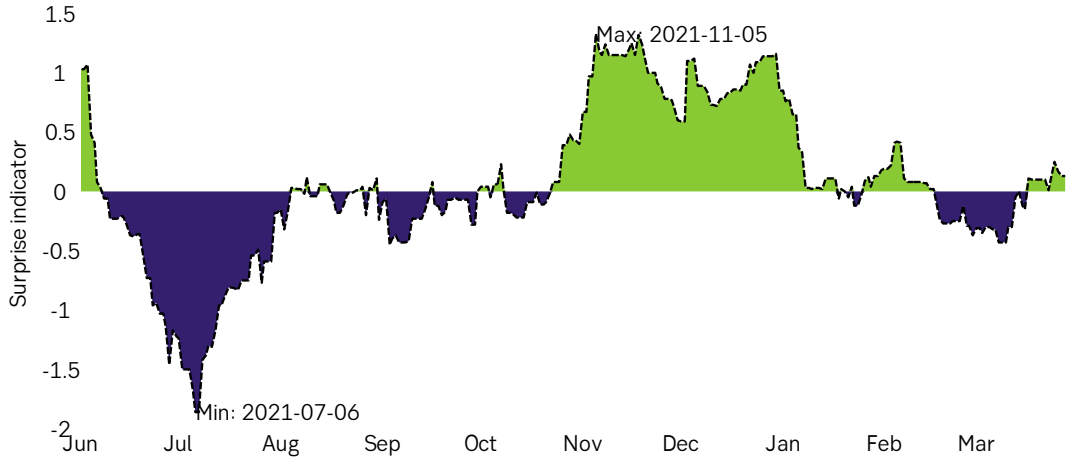
Source: SEB House View

Figure 2: Momentum is negative, but appears now to improve gradually



Source: SEB House View

Figure 3: Our surprise indicator has now surprised to the upside



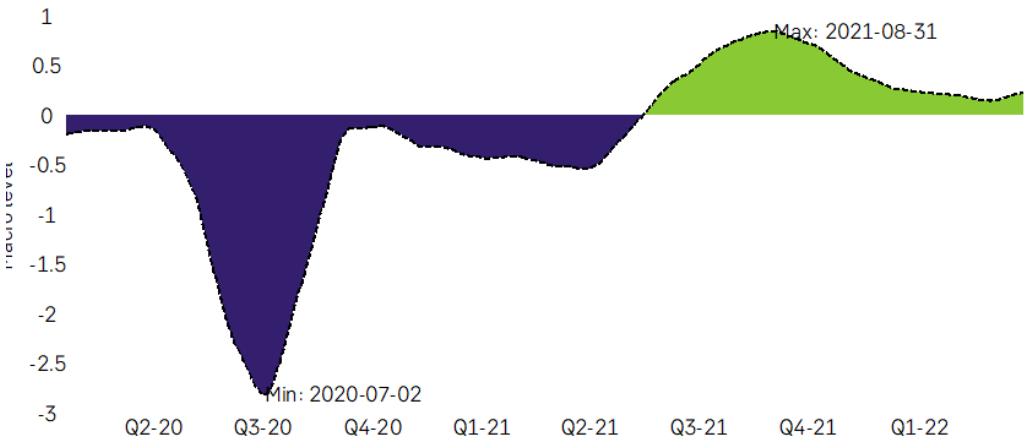
Source: SEB House View

SEB House View – EU Macro Status

The war in Ukraine has made consumers less optimistic about the future

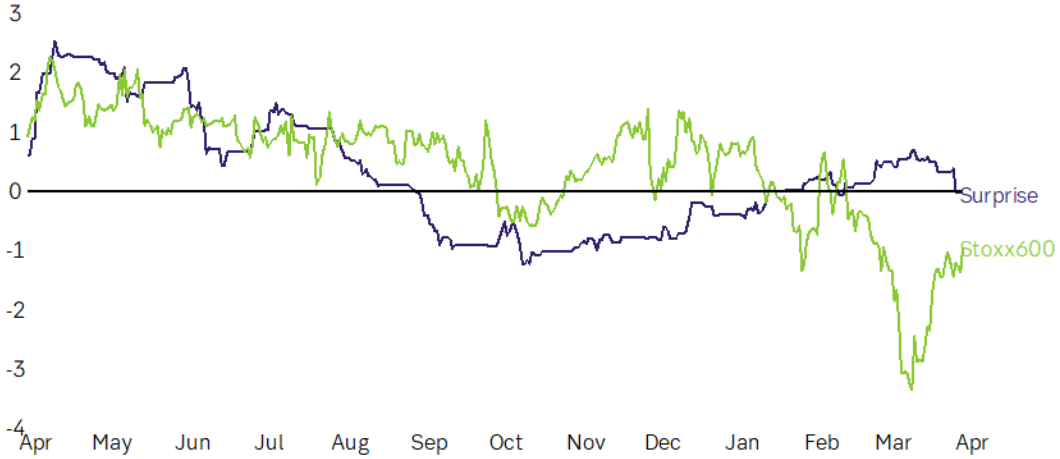
- Overall economic sentiment in the EU slowed, but macro still surprised to the upside
  - Consumer confidence disappointed due to the war and high inflation expectations
    - It will likely continue to decline as inflation stays elevated in the near-term
- Business confidence in the manufacturing sector moderated, whereas services beat expectations, likely due to omicron receding and stronger demand for services
  - Services will likely come in at higher levels than manufacturing moving forward as the demand for services increases
- Several European countries have announced fiscal stimulus, amid growth risks from higher inflation and geopolitics, so we can expect a more accommodative fiscal policy
- However, 2Y yields have widened, possibly signaling financial stress in Europe
  - This is likely due to the war and inflation combined with hawkish ECB expectations
    - ECB's key rate was unchanged at the last meeting, but investors are now expecting five hikes in 2022 and will look for new guidance at its next meeting

Figure 1: European macro level has slightly increased from last month's fall



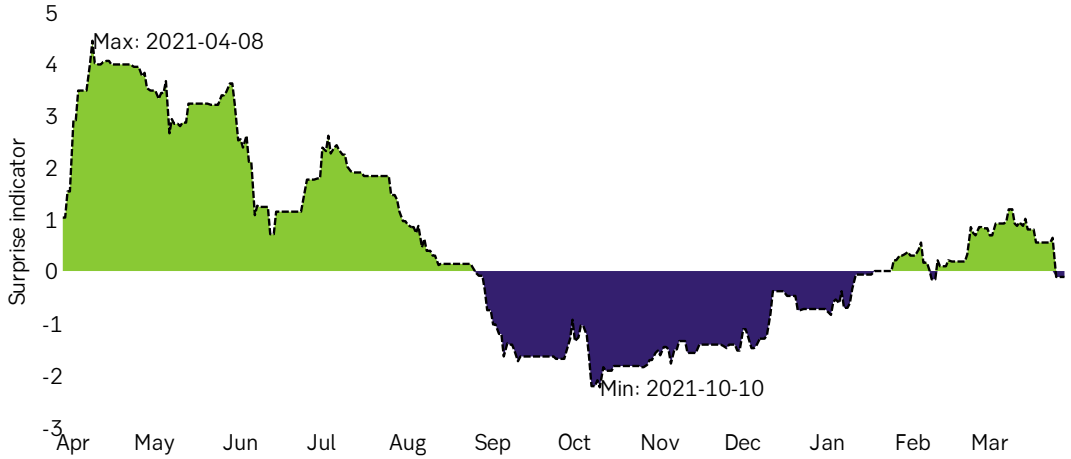
Source: SEB House View

Figure 2 Wary outlook for European stocks as macro surprises have turned negative



Source: SEB House View

Figure 3: Our surprise indicator is now negative, but Bloomberg's indicator is significantly lower



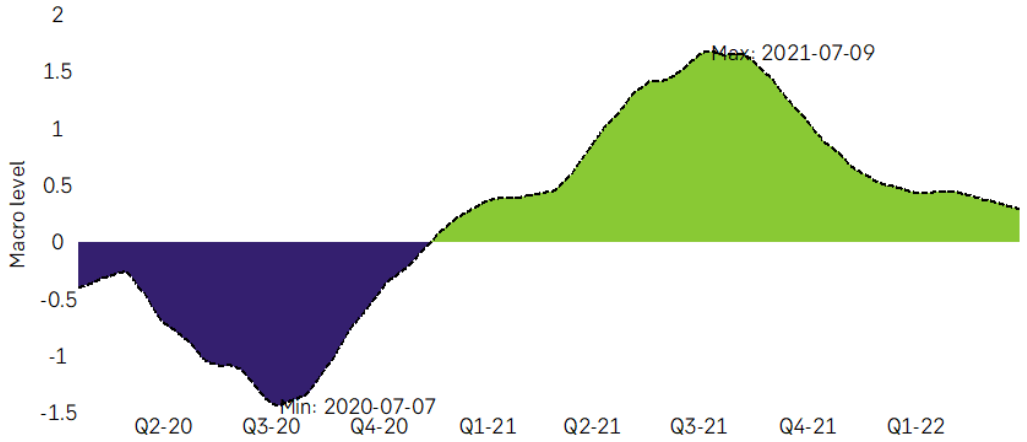
Source: SEB House View

SEB House View – EM Macro Status

The Chinese economy contracted for the first time since 2020, on the back of omicron outbreaks and lockdowns

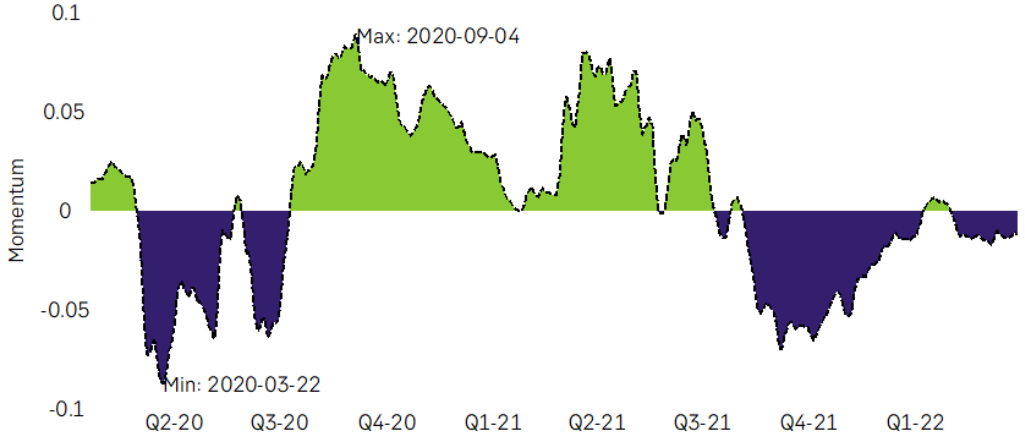
- Industrial production in China for January-February came in far above estimates, driven mainly by an increase in manufacturing output
  - The Chinese economy gained momentum in the first two months, as the effects from earlier policy support in infrastructure and property sector kicked in
- However, PMI:s for manufacturing and services both disappointed in March
  - Both sectors contracted as a surge in omicron cases led to new lockdowns
    - PMIs in April are likely to weaken since additional lockdowns came in late March
- Amid omicron, a weak property sector and global pressures from the Ukraine war, China will need more economic support to reach its 5.5% growth target for 2022
  - The government has announced plans for new policies to stabilize the economy
  - The PBOC kept its one-year MLF rate at its last meeting, but it will likely cut both key rates and the RRR at its next meeting in order to support the economy

Figure 1: EM macro level remained positive despite new omicron cases and lockdowns



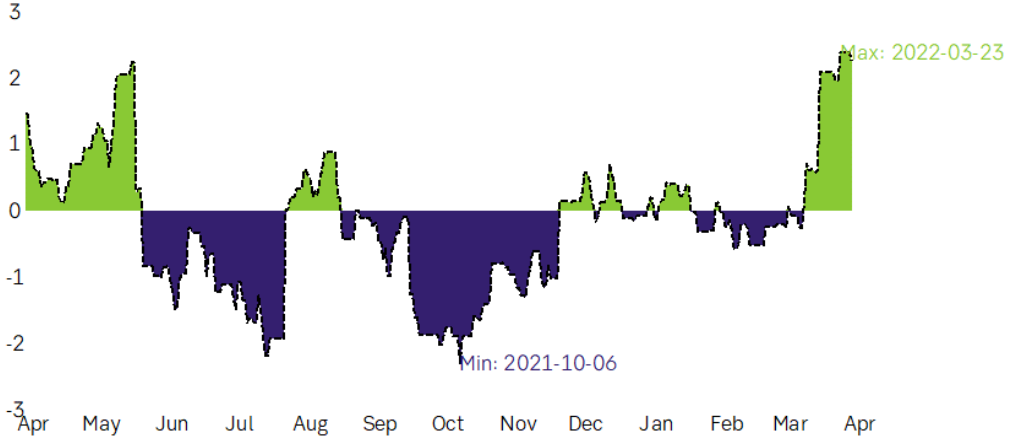
Source: SEB House View

Figure 2: Momentum remains negative as demand from overseas has diminished



Source: SEB House View

Figure 3: EM macro data surprised to the upside due to stimulus boost from China



Source: SEB House View

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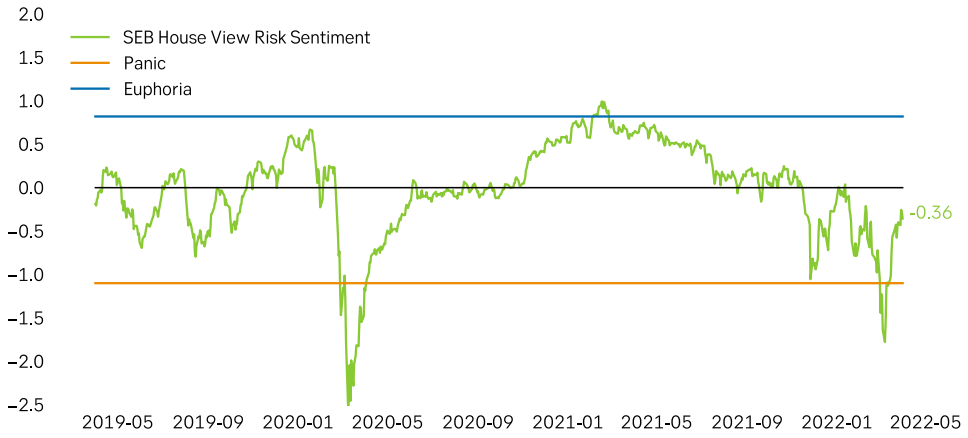
SEB House View – Risk Indicator

The Risk Indicator has rebounded, but is still not at its neutral level

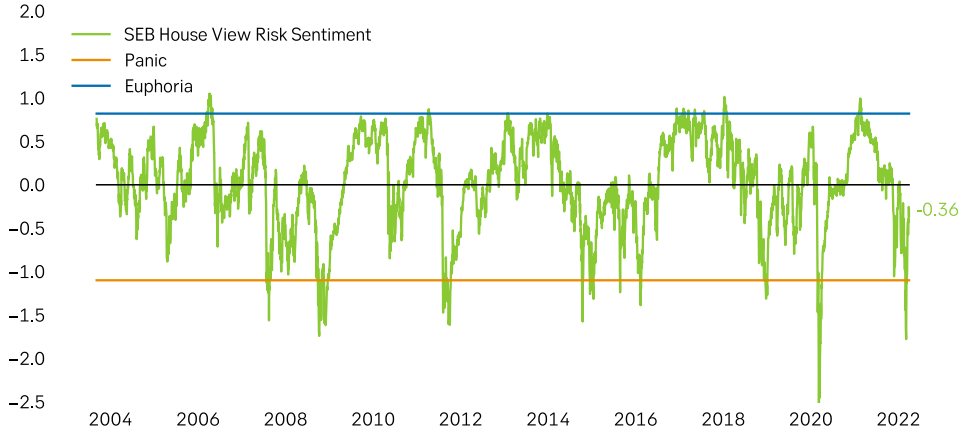
- Our risk indicator moved towards the neutral state and is no longer in panic territory
  - Bonds, in terms of rising Treasury and Bund yields, contributed to the rebound in risk sentiment
  - Risk sentiment also improved because of the relief rally in risky assets and drop in volatility for equities and bonds
    - The VIX index has fallen back from its peak in March, following the invasion of Ukraine
  - Credit spreads have tightened and are now below pre-invasion levels, which also contributed to higher risk appetite
- However, our indicator is still negative and can deteriorate should the war escalate, recessionary risks increase, or financial conditions tighten

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



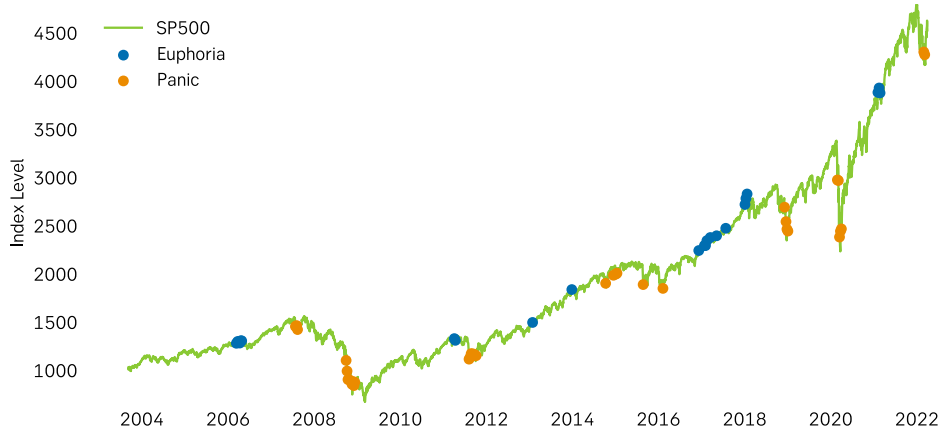
Source: SEB House View

Figure 1: SEB House View Risk Indicator



Source: SEB House View

Figure 3: Extreme states plotted on SP500



Source: SEB House View

In Focus: The yield curve & recession risks

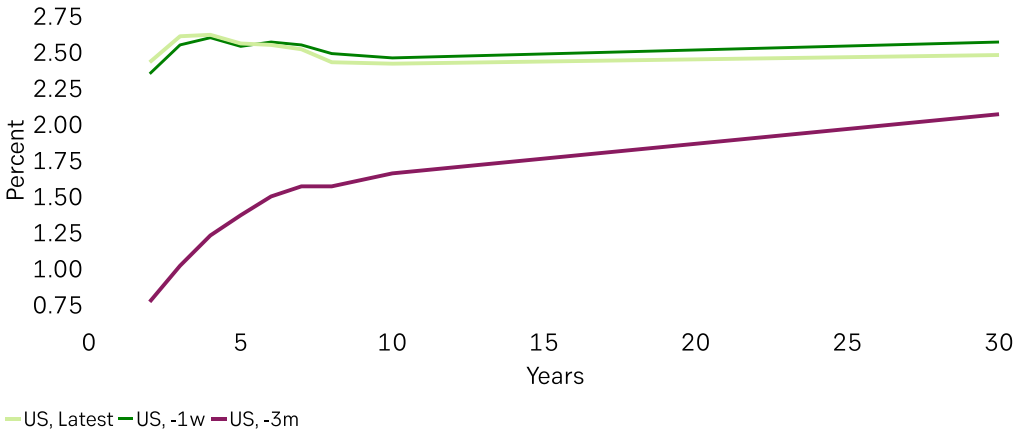
The yield curve inverted following one of the fastest flattening on record

- The US yield curve inverted for the first time since 2019, as the spread between the 10Y and 2Y government bond yields turned negative
- The curve has been flattening sharply since the FOMC meeting in March and the Fed's hawkish pivot in response to record-high inflation, which pushed 2Y yields higher than 10Y yields
  - It has also led markets to aggressively price in around eight rate hikes for 2022
  - The Fed has not yet begun reducing its massive balance sheet, which Powell stated could start in May
- Normally, the curve flattens when the Fed is tightening and conversely the curve steepens during quantitative easing
  - However, this time around things are different as the curve started to flatten during the last period of quantitative easing even before tightening has begun
    - Similarly, the curve flattened during the past decade of quantitative easing
    - We could see the same opposite behavior of the curve when tightening starts in May than what would normally be expected

Real yields are still negative because of high inflation

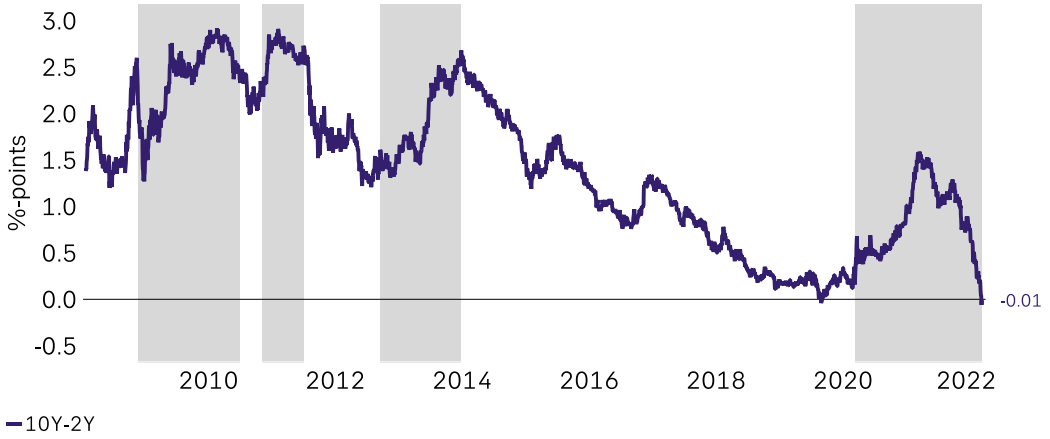
- Strong demand during Covid as well as higher commodity prices after the invasion, has kept inflation high and real yields negative, although nominal rates are rising
- Real yields will likely stay negative in the near-term, due to breakeven inflation staying elevated coupled with gradual increases in nominal rates
  - The Fed's dot plot is less hawkish than the market's expectations for eight hikes in 2022
    - We expect rates to increase at a slower pace than the market is expecting as the Fed may be cautious of raising rates too aggressively, which could cause an economic slowdown and in the worst-case stagflation

Figure 1: The US yield curve has partially inverted as markets are front-loading their expectations of an aggressive Fed in the short-term



Source: Macrobond, SEB

Figure 2: The US yield curve usually steepens during QE (grey areas), but as short-term yields have risen more than long-term yields we have seen an inversions



Source: Macrobond, SEB

In Focus: The yield curve & recession risks

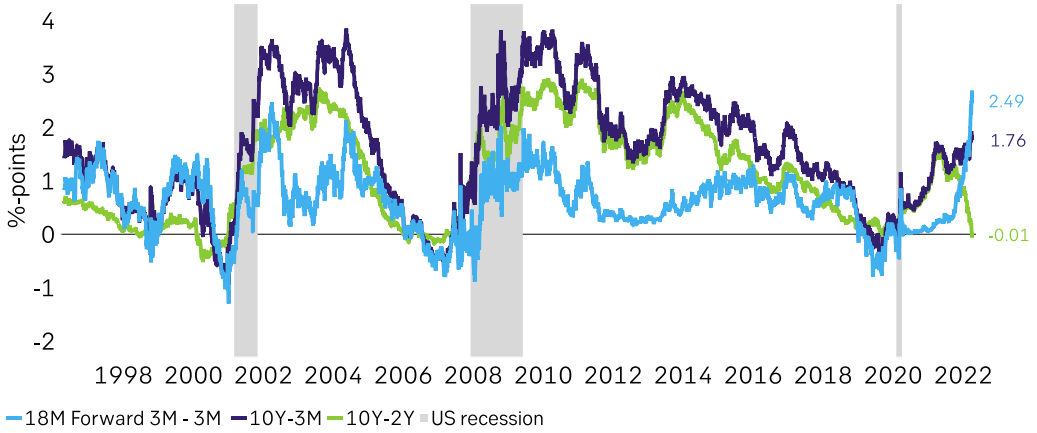
Recent yield curve inversion fuels fears that we may be heading into a recession

- The US yield curve has partially inverted as the 2Y yield increased more than the 10Y yield
- On the contrary, the 10Y-3M spread, another leading recession indicator, has not inverted, but instead steepened
  - Historically, these yield spreads have been reliable signals for recessions, but the curve is likely distorted after a decade of quantitative easing and ultra-low rates
  - From signal to actual recession, with a lead/lag time between 1 and 2 years, equities have tended to outperform bonds, further strengthening our view to maintain an overweight in stocks and underweight bonds
- The Fed has introduced a new recession indicator, which compares the 18-month Forward 3M yield with the spot 3M yield, motivated by that markets are generally better at predicting future recessions
  - The Fed's new favorite measure has not inverted, which casts doubt on whether the economic growth will turn negative at all

Financial conditions, real rates and credit spreads paint a different picture

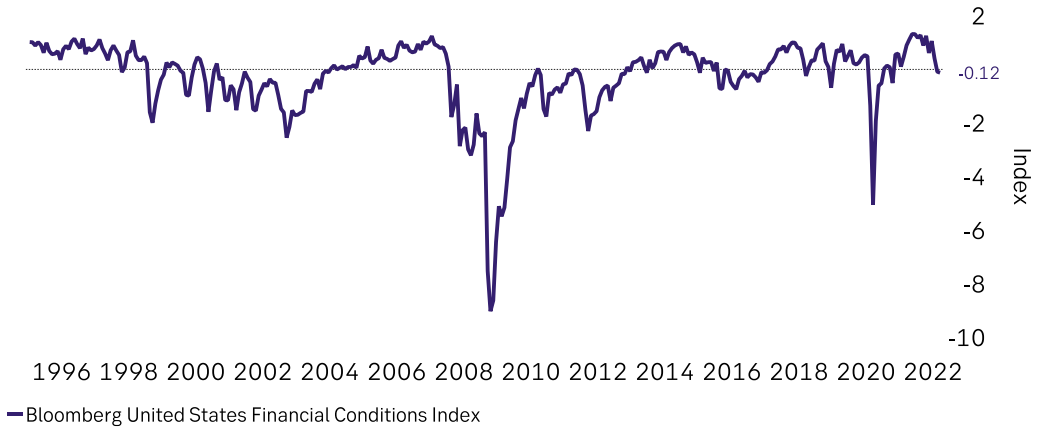
- Financial conditions in the US have tightened relative to pre-crisis norms, on the back of higher commodity prices, rate hikes and geopolitics
  - The index is merely -0,2 standard deviations from its historical mean and further negative impact from commodity prices and geopolitics is likely limited
    - However, there is a risk of tighter conditions as the Fed sharply increases rates
- Real rates are usually positive during recessions, but are currently below zero and still accommodative
- Credit spreads first widened this year, due to policy normalization and geopolitical risks, but have tightened in the past weeks, suggesting that financial stress is likely limited
- In addition, the US business outlook remains optimistic

Figure 1: The 10Y-2Y spread has been a good signal for predicting recessions in the past, but given the new regime we expect that the predictability of the spread has diminished



Source: Macrobond, SEB

Figure 2: US financial conditions has tightened, but is nowhere near conditions during GFC and Covid



Source: Macrobond, SEB

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Developed Market Equities – 12M Outlook

Our 12 month outlook for developed market equities is overall positive, but we remain wary of the heightened uncertainties stemming from inflation risks

Although macroeconomic data is showing a strong recovery from the coronavirus induced recession, which will likely continue as economic activity continues to normalize, the downside risks stemming from prolonged elevated inflation has risen the uncertainty for markets. That is, we are now at an inflection point as inflation will likely remain elevated for longer in 2022 and central banks will have to balance the task of containing inflation whilst also supporting the economy.

Nonetheless, we still expect developed market equities to deliver risk-adjusted returns in excess of developed market government bonds

That is, strong demand and an improving labor market will benefit the asset class. And although rates are expected to rise this year, the tightening monetary policy will in our view not dent the recovery. So as rates gradually rise and government bonds come out of favor, developed market equities maintain its relative attractiveness i.e., the TINA effect.

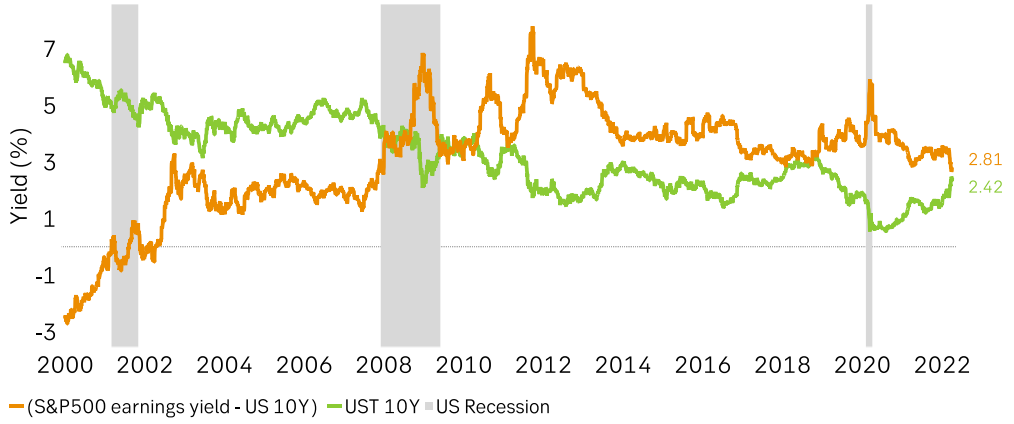
2022 will favor companies that can raise prices despite inflationary pressures and maintain good profit margins

We still expect supply constraints to ease from the coronavirus related restrictions, which should meet the gains in demand. However, given recent geopolitical tensions and rising commodity prices, downside risks have risen of higher-for-longer-inflation. With this in mind, we expect companies that can handle higher input prices to be the winners of 2022. That is, the low yield environment which we have had for years, will not be enough for companies this year.

12M Fwd P/E multiples are now trading at pre-pandemic levels

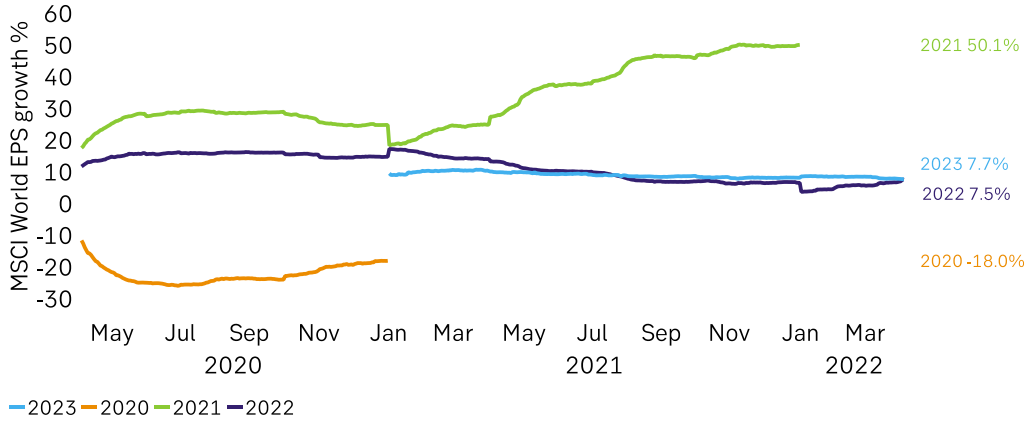
The recent downturn in markets has meant that valuations are now trading at a much more sanguine level. In case the recent geopolitical tensions has a shorter duration, we could see multiples again expand

Figure 1: The spread between US forward earnings yield and the 10Y yield has tightened. Rising yields has dented on the potential for equities, but more so on bonds



Source: Macrobond, SEB

Figure 2: EPS growth forecasts remain at decent levels as the market expects continued recovery in the global economy



Source: Macrobond, SEB

Emerging Market Equities – 12M Outlook

We expect Emerging Market Equities to deliver positive returns over the next 12 months

The growth premium of EM markets relative to DM markets can accelerate in 2022 as inflation and commodity prices will likely remain elevated in this new evolving phase. That is, we see an upside risk for nominal GDP in these regions and can expect further positive earnings revisions. Emerging markets have historically correlated with oil price rallies which in this case would benefit the asset class. The reopening trade is yet not fully priced in for the region and should benefit EM. As long as the global economic outlook remains buoyant, we expect the asset class to outperform bonds.

Policy support in China will likely benefit the asset class for the next 12 months

We expect China to boost consumption and investments through supportive monetary and fiscal policies. The PBOC is at a different starting point than DM central banks and can support the economy with stimulating monetary policy.

The direction of the dollar will determine the performance of EM equities

Given that US rates are expected to rise we could see the US dollar rise which would put negative pressures on EM equities. But on the flip side, a wider current account deficit in the US as well as overall negative real rates can put negative pressures on the dollar.

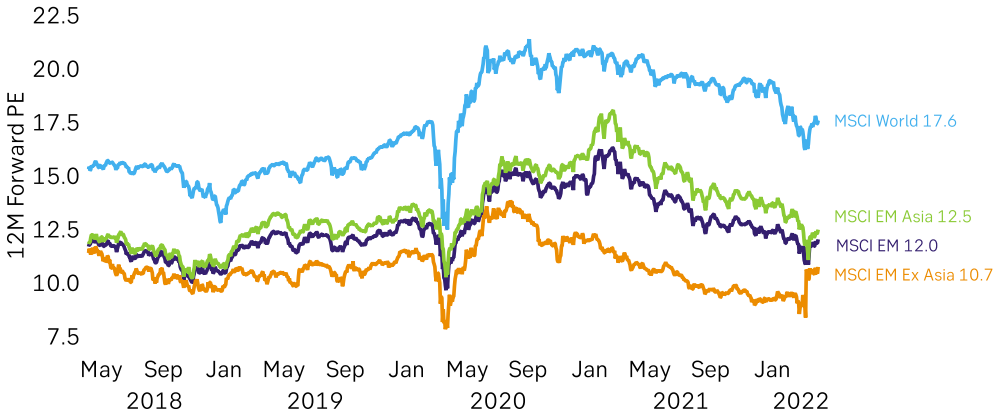
Price levels in EM equities remain attractive relative to DM equities

EM valuation has traded cheaper due to a multitude of challenges last year: zero Covid strategy, property sector adjustment, power rationing and a regulatory adjustment to the corporate profit share. Global investors are still relatively underweight EM after a weak 2021. But we expect to see a turnaround in 2022.

Equity risk premia in the region will likely diminish in 2022

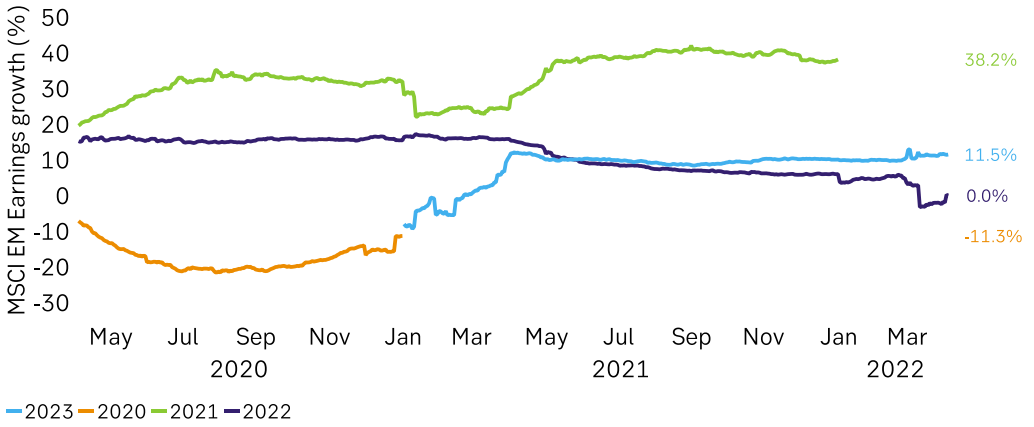
Although all the potential risks are perhaps not fully priced in EM markets, the surprise factor has diminished drastically

Figure 1: Emerging market equities can now come into favor as an inflationary environment with higher commodity prices could benefit EM regions



Source: Macrobond, SEB

Figure 2: In our view EPS estimates for 2022 are too low. We expect the reopening of countries in the EM, together with strong external demand to support the asset class



Source: Macrobond, SEB

Corporate Bonds – 12M Outlook

Over a 12-month horizon we prefer Equities over High Yield bonds and Investment Grade bonds and continue to hold an underweight to these corporate bonds

The relative attractiveness of High Yield and Investment Grade bonds to equities has diminished given that risk-adjusted potential remains weak. Credit spreads have recently widened due to increased uncertainty from the war in Ukraine and sanctions on Russia. Moving forward, spread widening is still a risk in this inflationary environment, while the risk-reward for equities is higher.

Corporate bonds can see withdrawals due to rising rates, slowing growth and escalating geopolitical tensions

Investment Grade Bonds can still offer a decent return and some protection against the volatility of stocks, but the potential has considerably decreased as duration is now longer. The risks of rising rates in combination with the uncertainty posed by the war in Ukraine can further weigh on corporate debt.

We expect credit profiles to improve as activity normalizes

In particular, bonds that have been most affected by COVID-19 and been lagging in the recovery – such as travel companies. However, we remain wary of the risks from geopolitics, supply-chain disruptions and a slower economic recovery

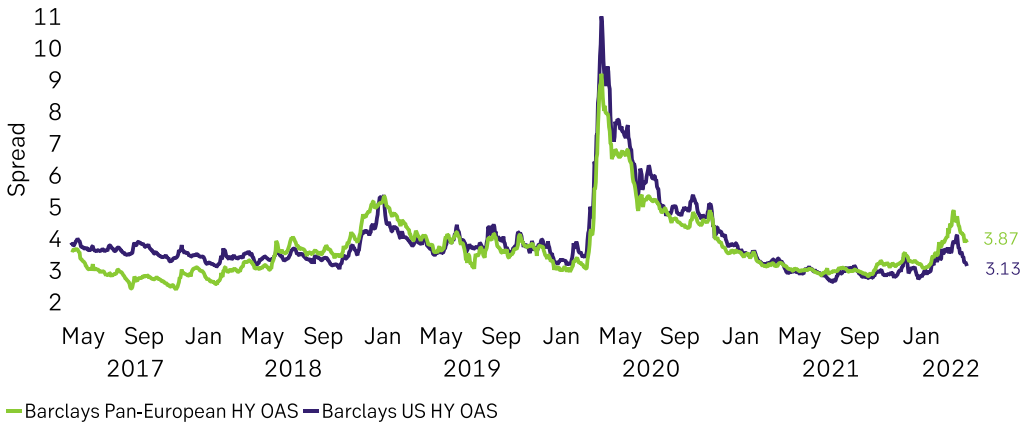
Liquidity in the market can get more challenged

Recently we have seen financial conditions deteriorate due to the war in Ukraine. The Treasury curve has recently flattened as bond markets are more cautious on the outlook. That is, with a tightening monetary policy ahead we could see further volatility onwards.

We expect default rates to stay low moving forward

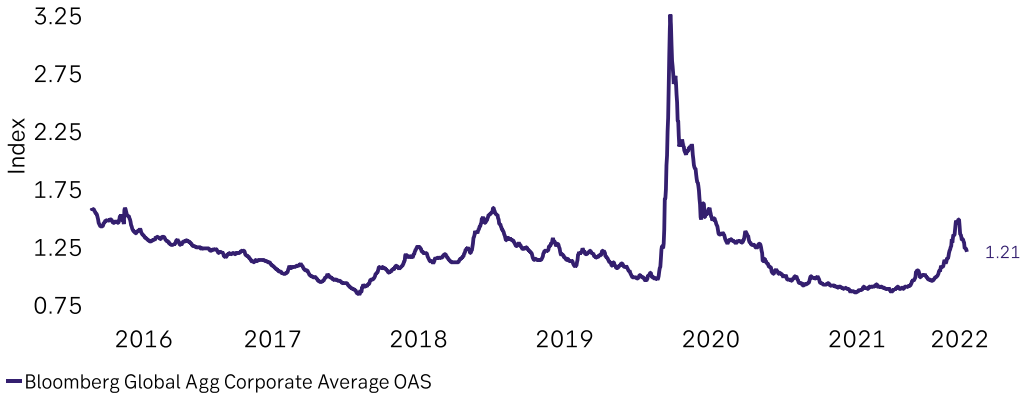
As we are as of today at an expansionary phase of the cycle, we expect it is unlikely that default risks will be priced aggressively. However, with elevated inflation the downside risks have increased

Figure 1: HY spreads widened particularly in Europe due to the war in Ukraine. In our view there is still further risks of spread widening in case the situation deteriorates



Source: Macrobond, SEB

Figure 2: The spread on Investment Grade bonds also rose as the corporate bond market priced in further uncertainty



Source: Macrobond, SEB

Government Bonds – 12M Outlook

We hold an underweight to Government Bonds in favor of Equities

Treasury yields are likely to remain at lower historical levels as the FED shifts policy. Markets are expecting the Fed to hike rates aggressively in 2022 and to continue its hiking path in 2023. Over the next 12 months we expect the long-end of the curve to gradually rise while the short-end will rise at a slower rate as the Fed will likely calibrate the rate hikes carefully. As such, we expect now a steepening of the yield curve and continued outflows from government bonds into equities. Moreover, given the low yields and high prices for government bonds, the asset class provides less risk diversification potential in the portfolio than previously held.

Real yields can remain negative even as nominal yields pick up as inflation breakeven remain high

The US yield curve has flattened considerably over the last month as markets priced in a more aggressive Fed policy in the short term. The US 10Y inflation breakeven has remained rather stable, but at elevated levels. Given these moves, we have seen real yields rise, but yet remain at negative territory. Real yields can rise from these levels without worrying markets. But while a gradual rise in real yields reflects the fact that the economy is improving, a fast rise in real yields may spark volatility for equity investors. Nevertheless, we expect that moderately elevated inflation, together with rising nominal yields, will keep real yields below zero for the coming months. As such the low real yield environment will keep a lid on the potential return for government bonds.

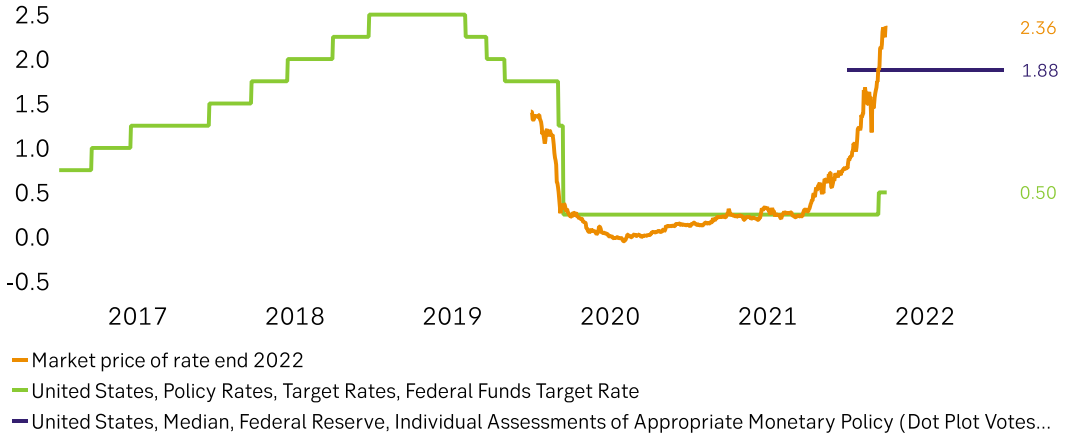
Over the long-term government yields will remained capped due to increased fiscal debt in developed markets

The enormous monetary and fiscal stimulus has allowed for central banks and governments balance sheets to balloon. Therefore, in order to fund the current national debt levels governments are likely to maintain interest rates at low levels for a very long time. We could also see an increase in taxes in order to reduce debt levels, but a hike in tax rates or cuts in government expenditure are not very likely in the near term.

Figure 1: Real yields have moved upwards but remain negative. Treasuries are thus expected to underperform over the year

Source: Macrobond, SEB

Figure 2: The Fed raised its rate in March. Markets are pricing in at least eight more hikes for 2022, while the Fed:s dot plot is projecting only six more hikes for 2022



Source: Macrobond, SEB

Region Overview

Regional equity positioning

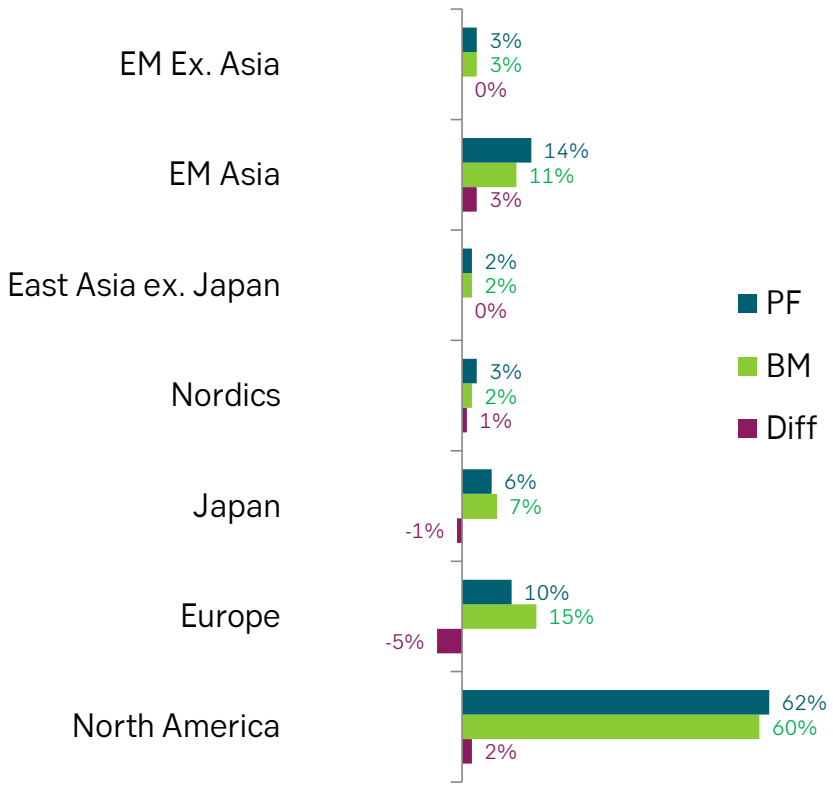
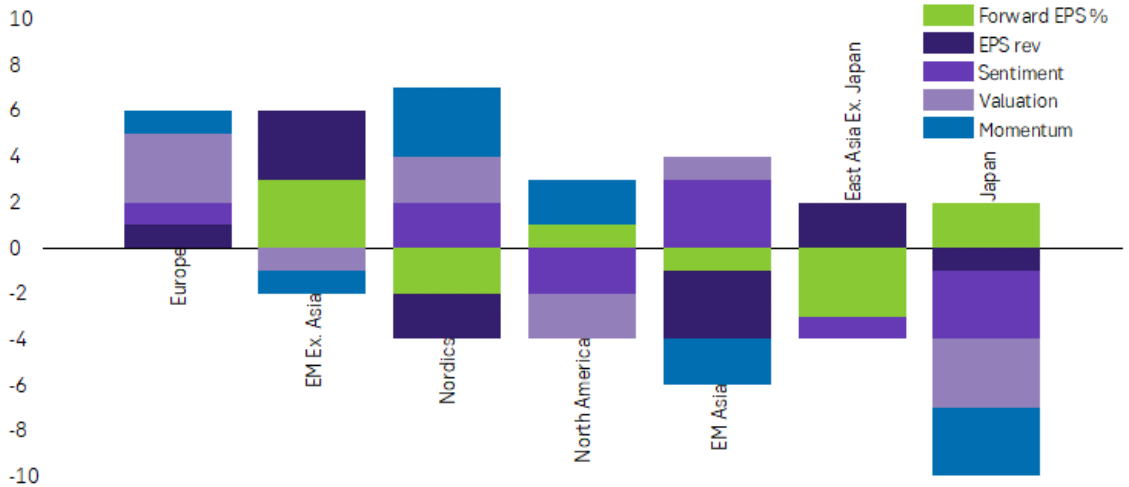


Figure 1: SEB House View region score*



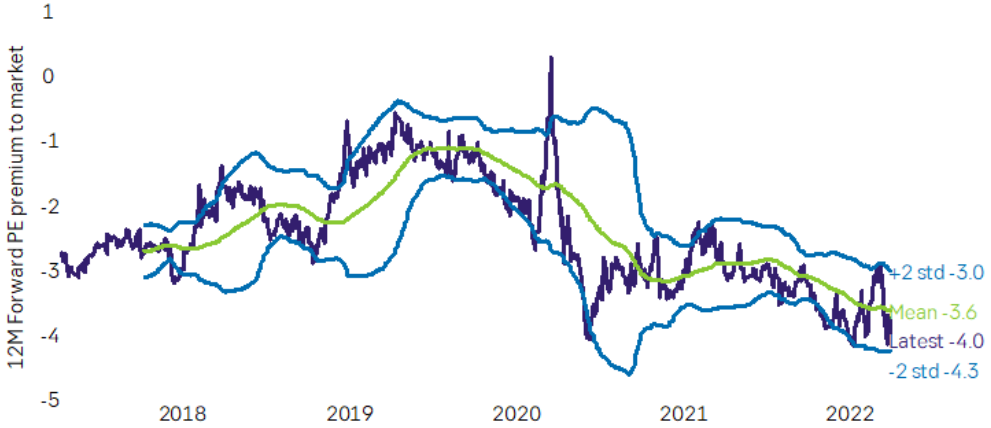
* Ranked by total score with highest score starting from left

EM Asia – Overweight

Omicron has slowed growth in the Chinese economy, but in response EM Asia will likely benefit from huge stimulus and significant monetary policy from China that supports demand and loosens financial conditions

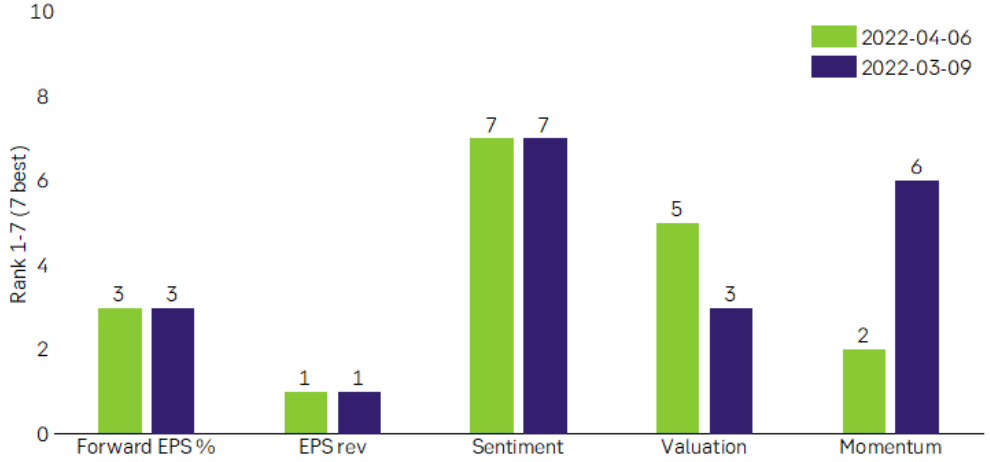
- The Chinese economy contracted in March, as new covid cases led to lockdowns and disruptions in industrial output
  - The government will now stimulate the economy and the PBOC is expected to cut rates in April, which should strengthen demand and boost growth
- Other Asian central banks, are expected to start policy normalization, which is a signal of future economic strength
- Commodity prices are expected to rise further, which will benefit exporting countries in the region
- Sentiment is attractive in our regional model and EM Asia equities look oversold
- The risk to regional growth comes from weaker global growth and external demand
  - However, an accommodative policy stance is viable for central banks if needed, since inflation is relatively low in this region

Figure 1: Standardized relative valuation – Current constituents



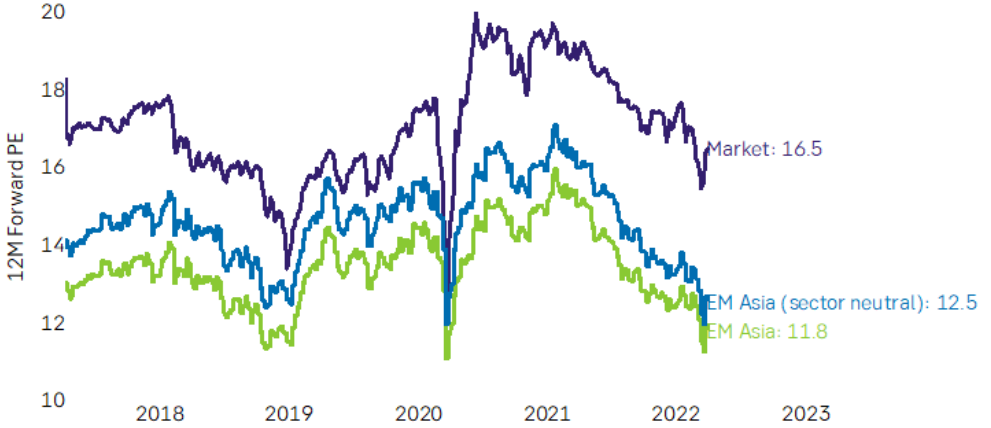
Source: SEB House View

Figure 2: Contribution to House View Region Score



Source: SEB House View

Figure 3: Absolute valuations – Current constituents



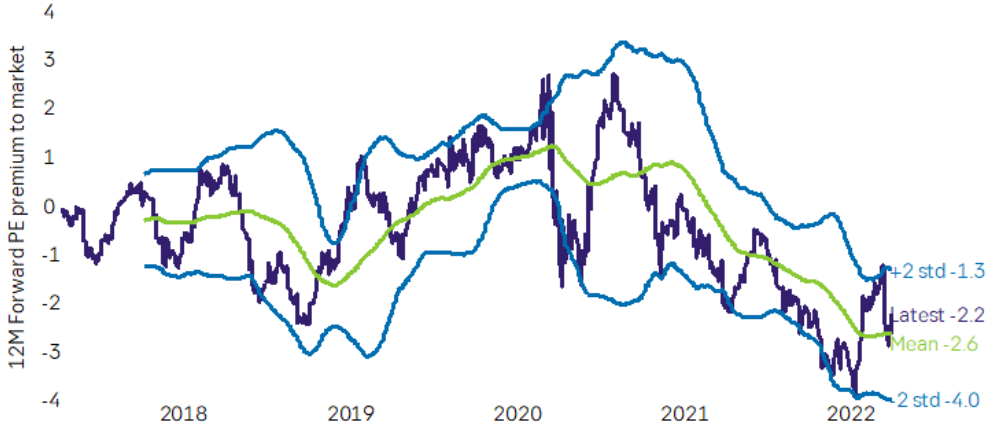
Source: SEB House View

EM Ex Asia – Neutral

Higher prices has historically benefitted EM Ex Asia, but could hurt consumption

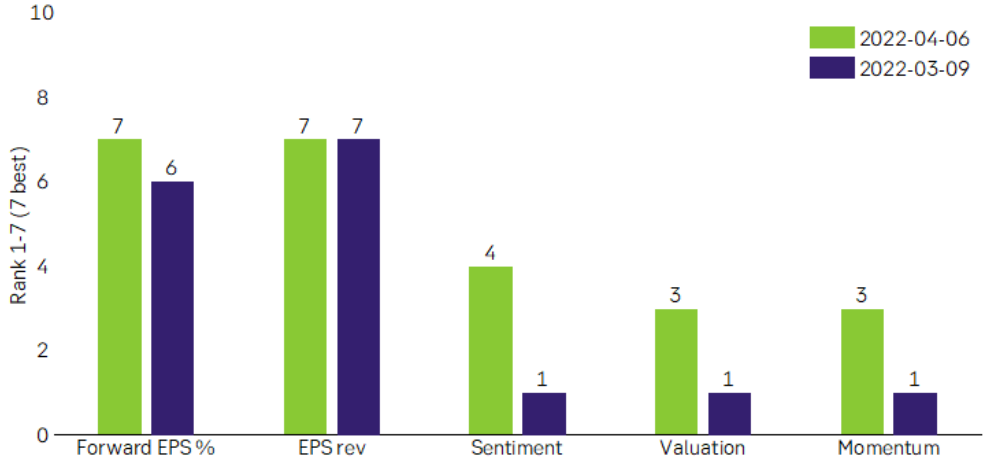
- Retail sales in Brazil fell in January year-on-year, but declined less than expected
  - The country has yet to recover from the pandemic amid high inflation and rates
  - Retail sales grew between January and December, led by personal and household products and pharmaceutical goods
- Higher prices for food and energy, which is a large part of personal spending in the region, has become a main concern
  - Cloth and appliance sales fell month-on-month, inferring that inflation is taking a toll on consumer purchasing power, which will likely weaken overall demand, as house holds are forced to focus on necessities
- Rates will likely remain high in the region as central banks fight inflation, which should weigh on consumption and investments
- Nevertheless, the region has historically worked as an inflation hedge and currently scores higher than other regions on EPS growth and revisions

Figure 1: Standardized relative valuation – Current constituents



Source: SEB House View

Figure 2: Contribution to House View Region Score



Source: SEB House View

Figure 3: Absolute valuations – Current constituents

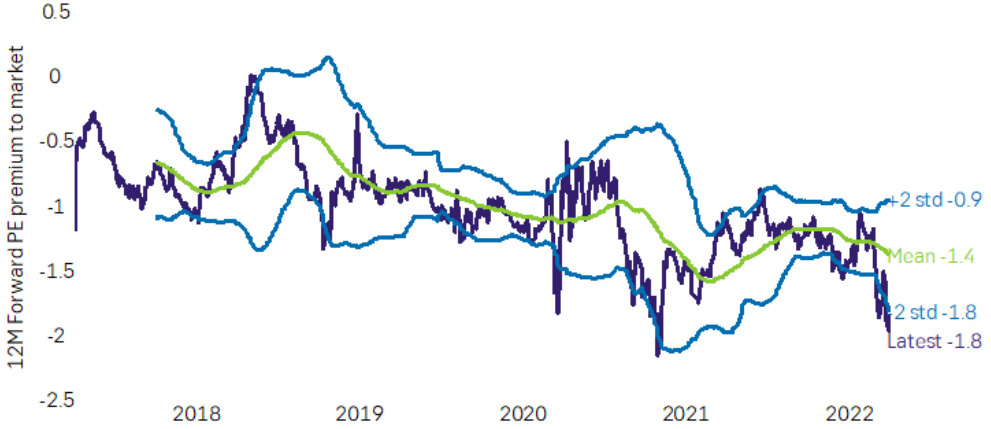
Source: SEB House View

Europe – Underweight

Europe faces higher inflation and risks from the war in Ukraine

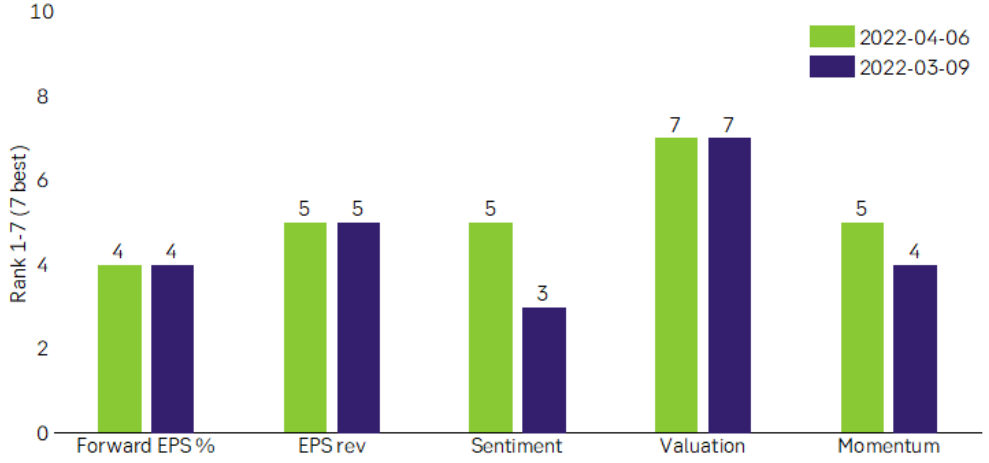
- Consumer and industrial confidence fell in the EU, because of the war and rising inflation and added to the overall negative surprise
  - Increasingly pessimistic consumers spends less money which should hurt earnings
  - The war in Ukraine has had a larger impact on consumers in Europe than in the US, which is neither dependent on Russian energy supplies or in the proximity
- On the bright side, the services sector surprised to the upside on strong demand amid a reopening from covid restrictions
  - However, any escalation of the war will likely abrupt the recovery in service sectors like tourism, travel, leisure and hospitality
- Valuations in Europe are lower than in other regions, but a more hawkish ECB is expected which should put downward pressures on valuations going forward
  - We note that in our model the region has a high score due to the low valuation

Figure 1: Standardized relative valuation – Current constituents



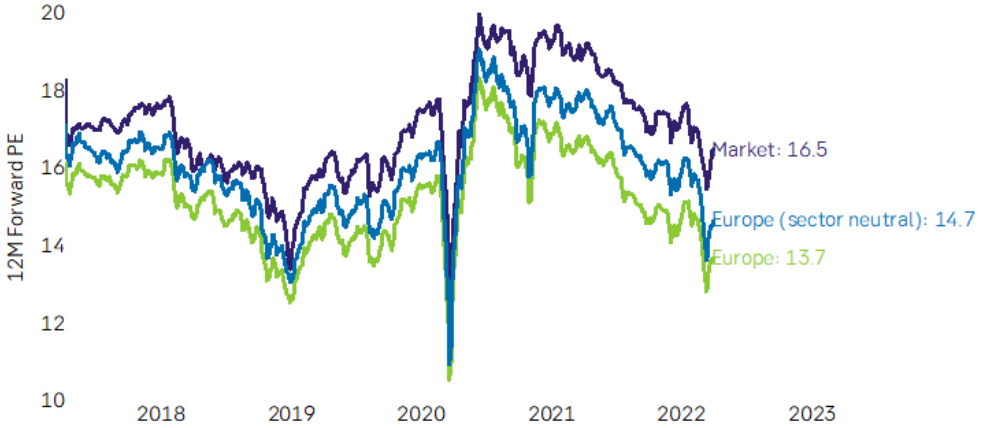
Source: SEB House View

Figure 2: Contribution to House View Region Score



Source: SEB House View

Figure 3: Absolute valuations – Current constituents



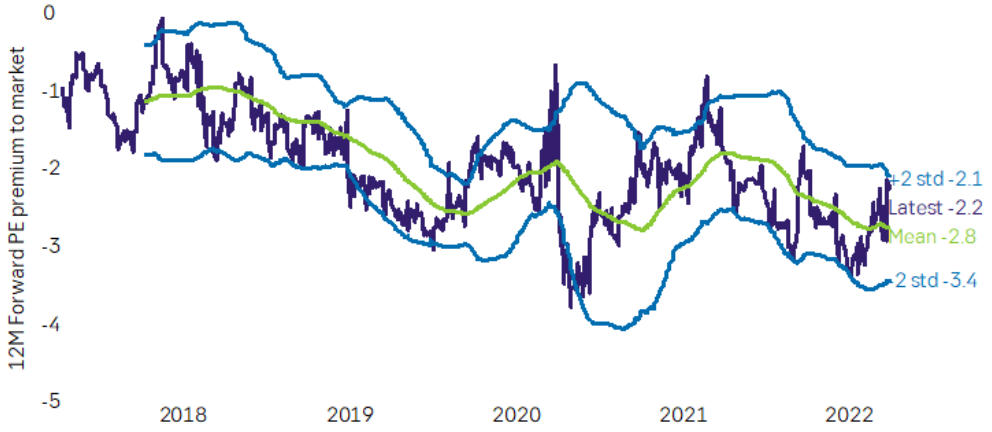
Source: SEB House View

Japan – Underweight

Higher import costs will likely curb the economic recovery and pressure margins

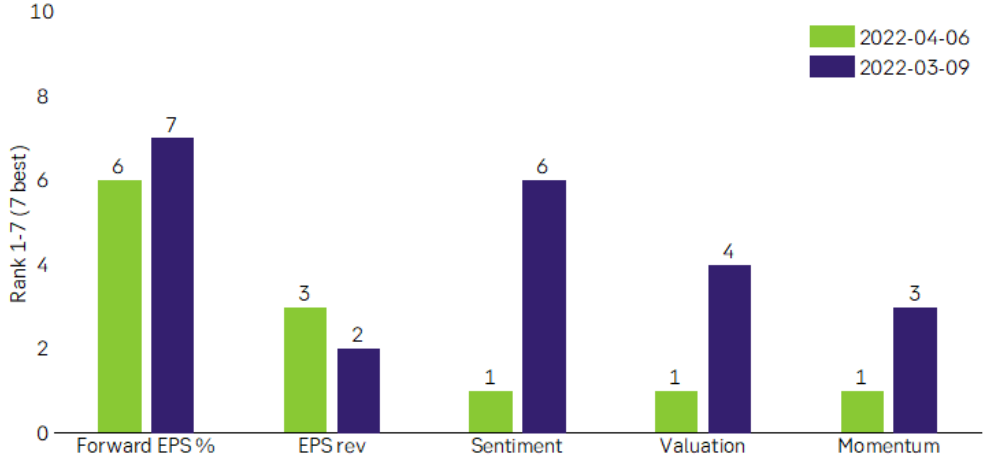
- Industrial production, led by autos, increased in February for the first time in three months, albeit at a smaller pace than expected
  - Factory output has suffered as omicron-related restrictions and lack of semiconductors have put a drag on activity
  - Economists expect that Japan's economy shrank in Q1 and industrial output is closely followed as the economy needs strong production to lift its GDP growth
    - Production has been slow to recover from omicron, and higher import costs from higher energy prices, will likely have negative impact on Q2 growth
- On the positive side, EPS growth is relatively high compared to other regions, but margins are likely to shrink as companies face higher input costs and slowly rising consumer prices
- The recent weakness in Yen will likely worsen the issue with higher input costs for Japanese companies

Figure 1: Standardized relative valuation – Current constituents



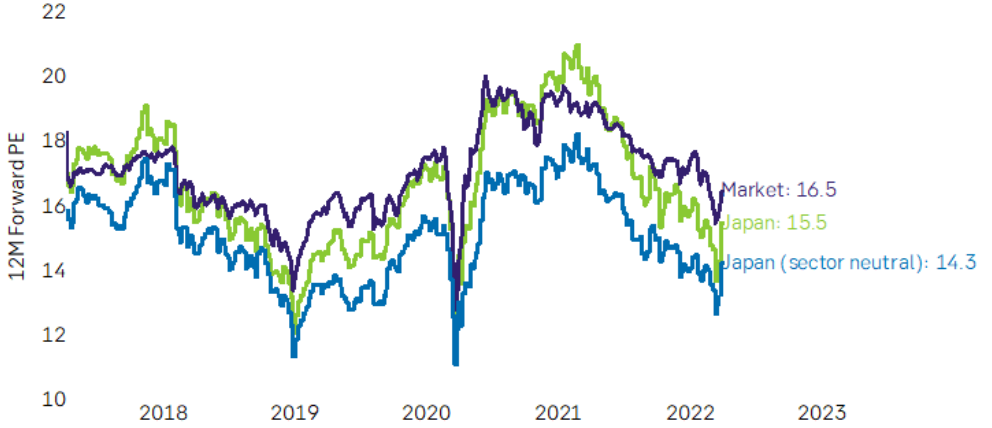
Source: SEB House View

Figure 2: Contribution to House View Region Score



Source: SEB House View

Figure 3: Absolute valuations – Current constituents



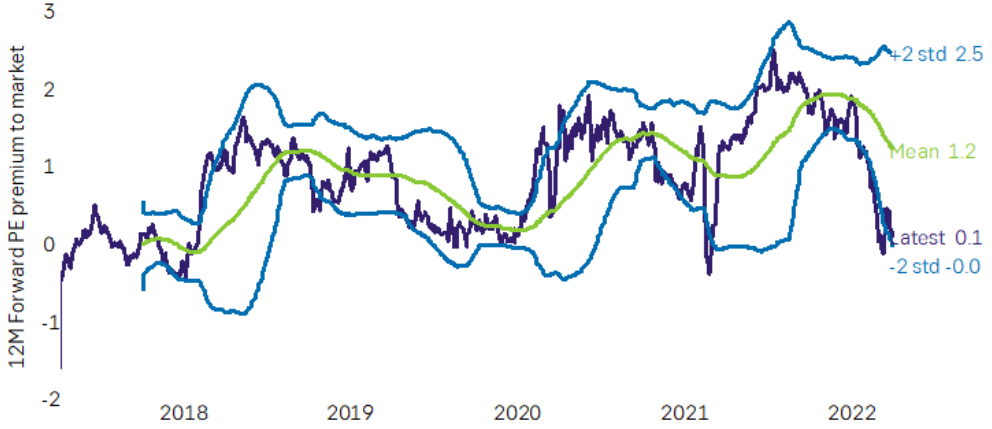
Source: SEB House View

Nordics – Overweight

We like Nordic equities based on a robust growth outlook and cheaper valuations

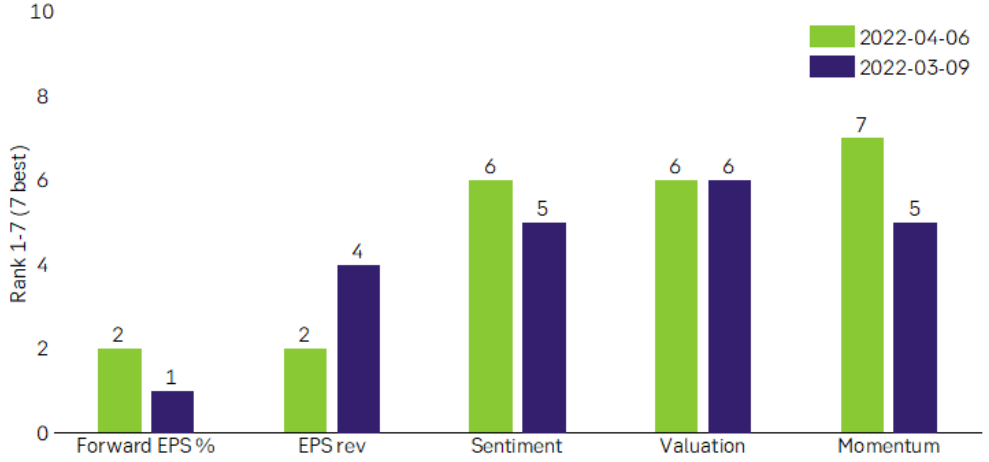
- Headline and underlying inflation in Sweden surprised to the upside in February amid higher prices due to the war
  - The region's low dependence on volatile gas should alleviate inflation pressures
- Nordic macro data is above its 5-year mean, despite negative macro momentum
  - Momentum will likely turn positive in Q2 as the region recently reopened and stronger domestic demand should follow
- The economic outlook for the region still looks stable given a relatively small downward revision to GDP growth for 2022
  - To put it in perspective, we do not expect the Euro area to grow at all this year
- Our model suggests that Nordic equities are currently trading at a discount
- We expect the Riksbank to deliver its first rate hike (25 bps) in December
  - The SEK should weaken in this relatively dovish scenario, since markets are currently pricing in four hikes in 2022, and in turn support the export-heavy region

Figure 1: Standardized relative valuation – Current constituents



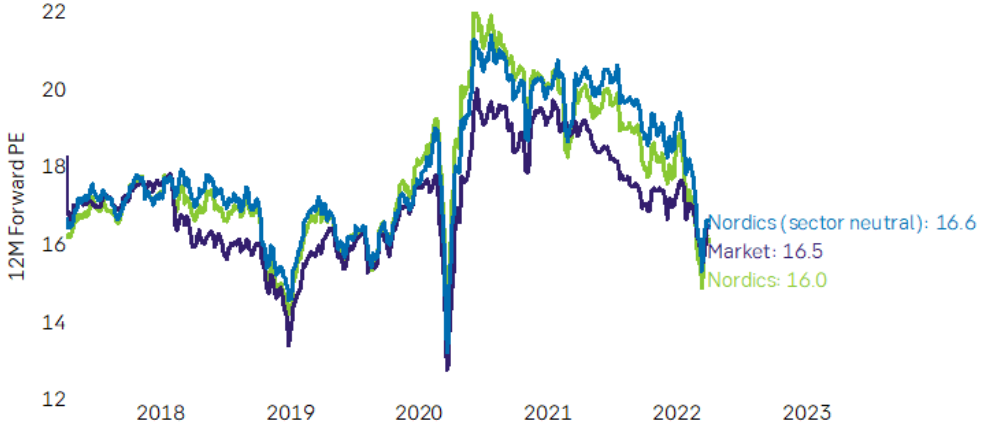
Source: SEB House View

Figure 2: Contribution to House View Region Score



Source: SEB House View

Figure 3: Absolute valuations – Current constituents



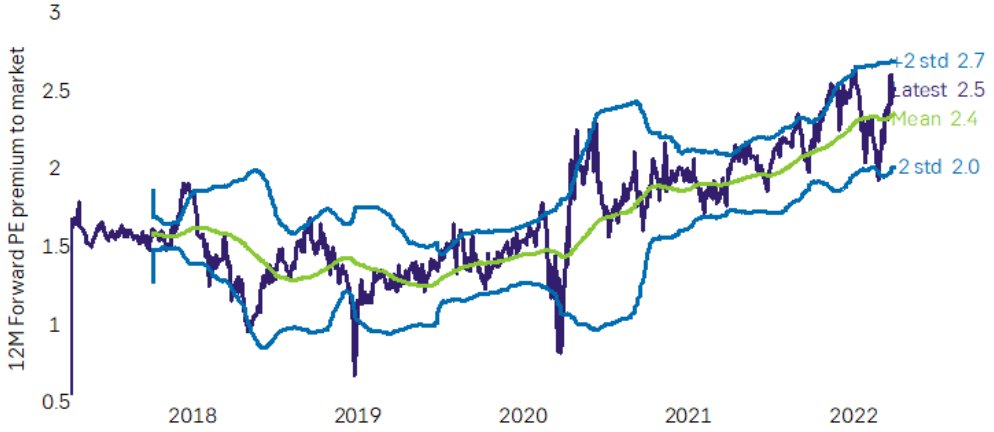
Source: SEB House View

North America – Overweight

US macro and sentiment remain resilient

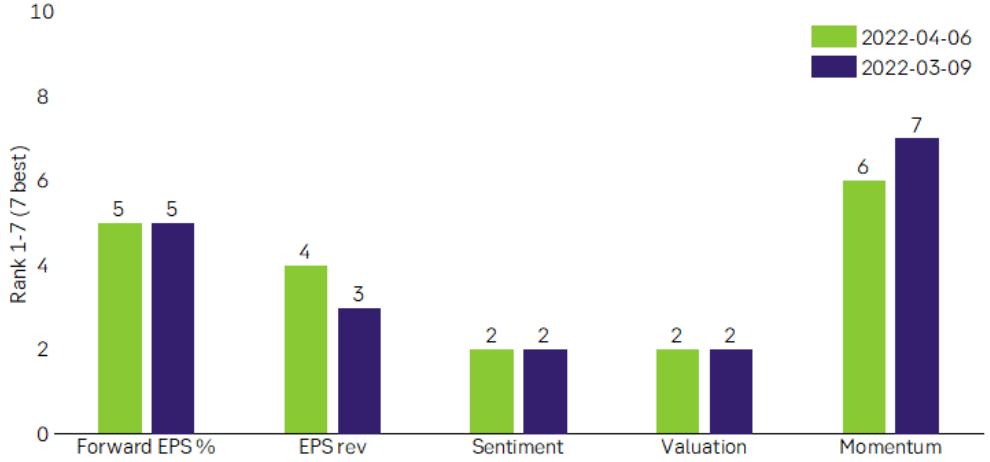
- Consumer confidence has been quite undeterred by the war in Ukraine
  - However, with lower savings as covid stimulus support ends and subdued personal disposable incomes, sustained higher prices will eventually start to hurt sentiment, unless wages continues to increase at a fast pace
- Supply chain bottlenecks are abating which should ease inflationary pressures
- Macro momentum is fading in the US, but macro data is still above its 5-year trend as the labor market, business outlook and PMIs remains strong
- The US is more of a safe-haven for capital than other regions with the war in Europe and new lockdowns in China
  - Momentum could remain high in our regional model as capital flows into the US amid risk-off sentiment in the rest of the world
- Recessions risks are currently low although the yield curve recently inverted
  - But a very hawkish Fed and tighter conditions would increase slowdown risks

Figure 1: Standardized relative valuation – Current constituents



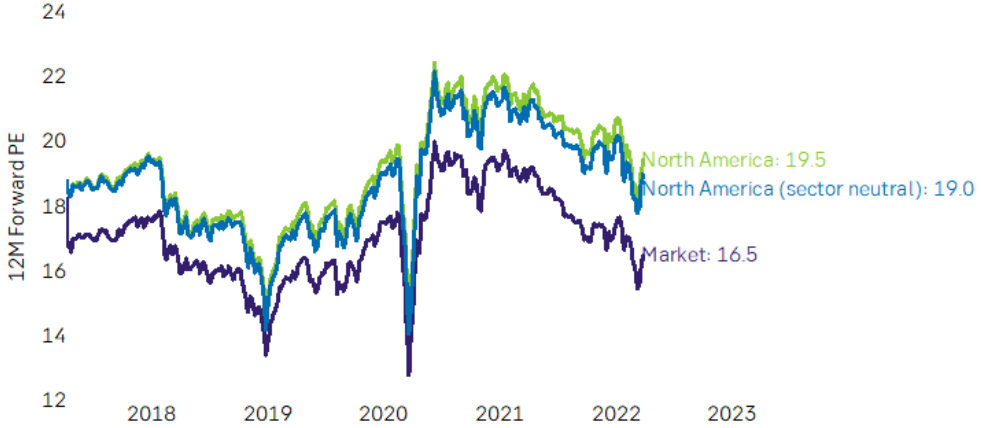
Source: SEB House View

Figure 2: Contribution to House View Region Score



Source: SEB House View

Figure 3: Absolute valuations – Current constituents



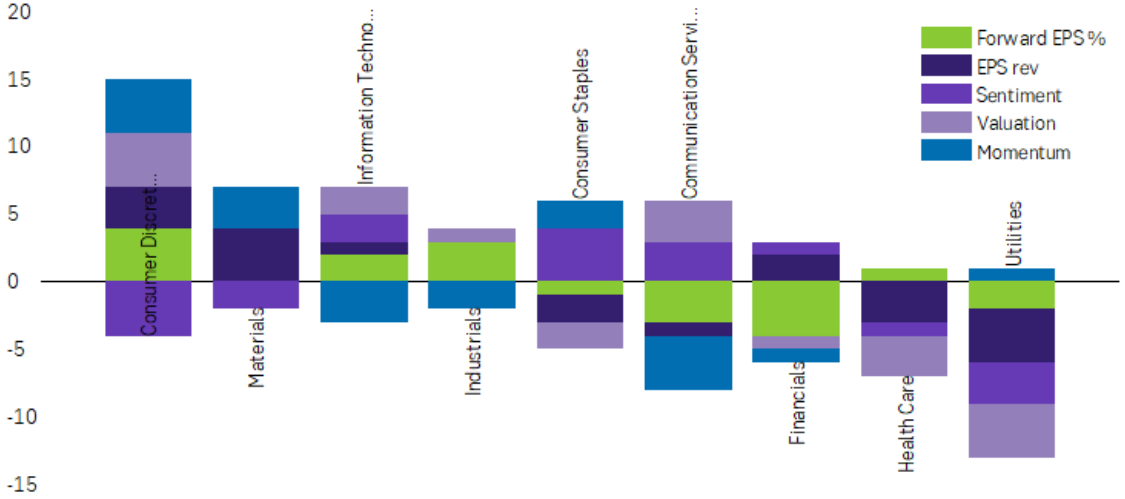
Source: SEB House View

Sector Overview

Sector	UW	N	OW
Communication Services		N	
Consumer Discretionary		N	
Consumer Staples	UW		
Financials		N	
Health Care			OW
Industrials			OW
Information Technology		N	
Materials			OW
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 last months positioning.

Figure 1: SEB House View sector score



Source: SEB House View

Overweight – Materials, Health Care and Industrials

Materials can gain from imposed metal sanctions on Russia

- A large part of the sector could see stronger metal prices following sanctions on Russian metal exports, but recent Chinese slowdown could weigh on metal prices
- Earnings revisions are attractive relative to other sectors

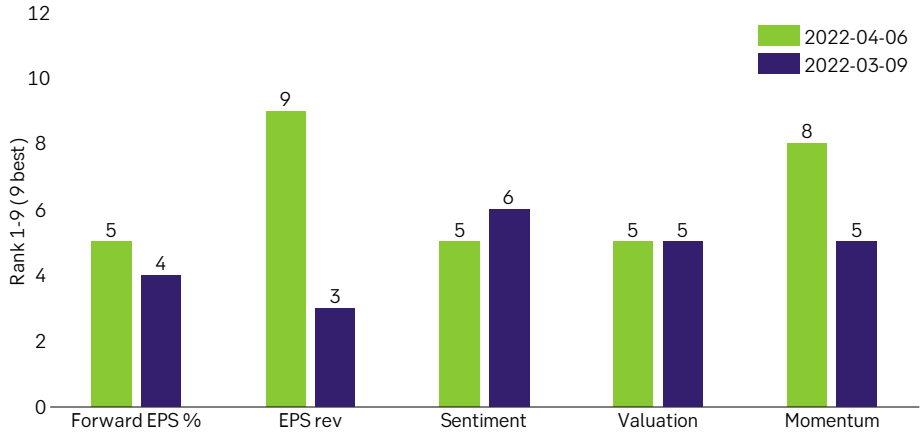
Industrials could benefit from government spending and strong forward EPS growth

- Industries within the sector should benefit from increased military spending, especially in EU, and from infrastructure investments in China to stimulate growth

Health Care looks cheap and the aging population is a positive long-term trend

- The sector is a defensive play amid inflation, normalization and geopolitical risks
- An aging global population is a positive long-term trend with increased demand for healthcare, e.g. medical care, facilities and drugs

Figure 1: Materials have seen strong upward EPS revisions the last month

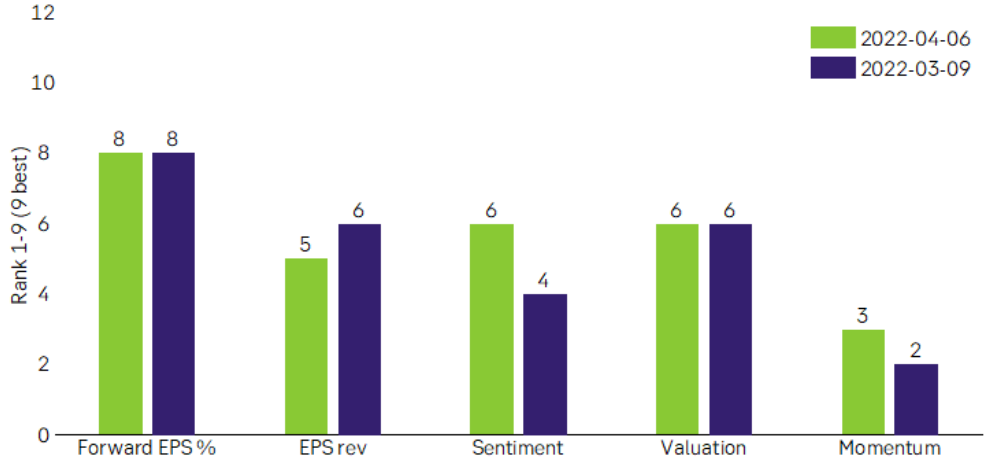


Source: SEB House View

Figure 2: Relative Health Care valuations are still attractive despite PE expansion

Source: SEB House View

Figure 3: Industrials maintains strong forward EPS growth



Source: SEB House View

Underweight – Consumer Staples and Utilities

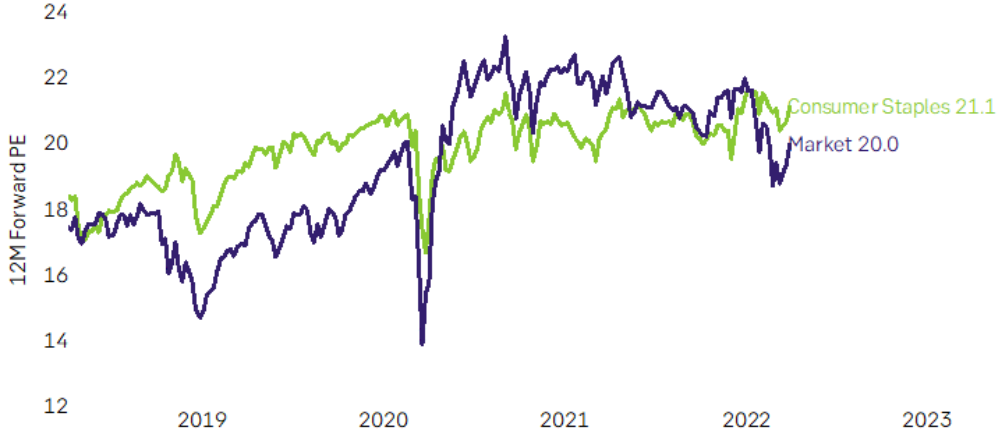
We remain underweight in Consumer Staples

- We believe it will continue to be out of favour as investors are more inclined to buy sectors that offers better earnings growth, sometimes also at a lower valuation
- The Fed and ECB have turned more hawkish and rate hikes are planned for this year – the sector remains inversely correlated to bonds
- With input costs likely to rise, due to rising raw materials, the sector will come under pressure, and the defensive play is less appealing as volatility appears to come down

The outlook for Utilities remains weak considering the new environment

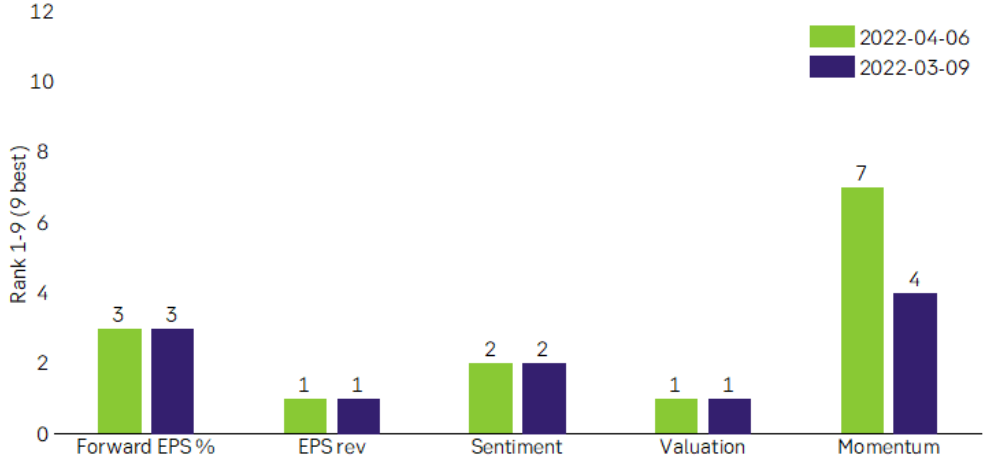
- Fundamentals are weak and the market is more likely to turn out of the sector
- Our view on treasuries is clear: yields are more likely to move up than down.
  - On the margin this will be negative for the bond proxy sector where predictable cash flows are discounted based on long dated yields
- Utilities have outperformed most sectors since the invasion of Ukraine and trade at a premium against the market, despite a weak earnings outlook

Figure 1: Consumer Staples continues to trade at higher levels than the overall market



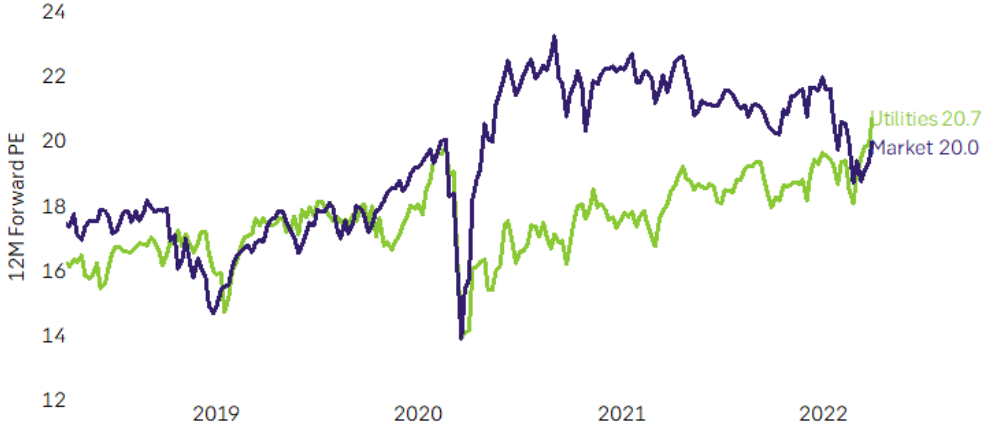
Source: SEB House View

Figure 2: Utilities still scores the lowest in our House View Sector model



Source: SEB House View

Figure 3: Utilities absolute valuations are now higher than the overall market



Source: SEB House View

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