

Investment Outlook

Back to the future

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Introduction

Back to the future

- Crisis responses, reopening and recovery
- There are risks, but also tools to manage them
- Low rates and yields still give equities an edge, despite high valuations
- Increased use of “green” hydrogen will provide sustainable energy

If you have engaged in the sport of orienteering or have been at sea before the GPS era, you probably recognise that unpleasant feeling of not knowing where you are or where you are going. The world in general – and economists in particular – were in a similar situation last spring, when uncertainty about the COVID-19 pandemic and the impact of the resulting lockdowns was at its greatest.

In recent months we have seen economies reopen, once again giving us a position on a map to help us navigate. But we are still largely sailing in unfamiliar waters, given the unique events we have seen this year.

The world economy is recovering, after bottoming out in the second quarter. The recovery is of course being driven by the reopening of advanced economies, but also by unprecedentedly aggressive crisis responses by governments and central banks. Today's questions about future growth very much centre on whether new virus outbreaks will force public authorities to impose major new lockdowns, whether governments can deliver the promised stimulus packages to jump-start growth and whether household consumption as well as business production and investments will bounce back.

We naturally see risks in all these areas, yet we expect new outbreaks to be met with “smart” lockdowns. We also believe that the necessary stimulus measures will materialise and that consumers want to consume and businesses want to produce. The recovery will thus continue, although because of repercussions from the lockdowns it will take time before we return to pre-pandemic economic growth trends. We also believe that interest rates and bond yields, which are highly important to the stock market, will remain even lower – and for even longer – than we previously expected, in a world where

inflation is defying economic theory by staying relatively low, while central banks continue to fund borrowing needs.

This provides a sound basis for share price increases, although the surge in stock market indices over the past several months means that our bright outlook is already largely priced in. With valuations that have historically only been surpassed during the IT (dotcom) bubble of 20 years ago, the question is: can the rally continue? There are good arguments for accepting higher valuations, especially low interest rates and yields. In our view, the stock market rally is on more solid ground than many observers believe. See the “Nordic equities” section of this *Investment Outlook* for more details.

The knowledge that central banks will not raise interest rates is subduing tendencies towards higher yields. With the risk of negative returns on government bonds, investors must look to corporate bonds for returns to generate returns in the fixed income segment.

We also present two theme articles of a more structural nature. One addresses important efforts to achieve a more sustainable world. We describe how the increased use of “green” hydrogen promises solutions to many of the remaining technical problems in ensuring a sustainable energy supply. Our second theme article assumes that the average age of the world's population will keep rising and that older people will represent an increasing percentage of the total. This will impact consumer behaviour, health care needs, savings and much more. Both theme articles describe opportunities for the long-term investor.

Wishing you enjoyable reading.

Fredrik Öberg, Chief Investment Officer
Investment Strategy

Summary by asset class

The second quarter of 2020 probably marked the low point of the economic crisis due to COVID-19 and the nationwide lockdowns triggered by the pandemic. There is a lingering risk of further acceleration in the spread of infection, and a second wave may well arrive, but we are unlikely to see lockdowns on the same scale as before.

Fiscal and monetary stimulus programmes have contributed greatly to an upward trend for risk assets. Hopefully these measures will also have a significant positive impact on the real economy. We expect a sharp decline in GDP this year, followed by a relatively strong recovery in 2021.

The lockdowns had serious consequences for most businesses, resulting in plummeting Q2 earnings, but still not as much as previously feared. Massive government support measures helped soften these effects, while businesses were quick to cut their costs. It will probably take another six months before we see business earnings growing at the aggregate level, but after that they should pick up speed again, since there is a pent-up need for consumption and production.

Global equities

- Second quarter corporate earnings greatly surpassed the market's low expectations.
- We expect falling earnings growth for two more quarters before the demand situation normalises and earnings growth can rebound.
- We still have a positive view of digitisation-related companies thanks to their superior market positions and structural growth. High valuations are a source of concern.
- Institutional investors have become more optimistic about economic and earnings trends.

Nordic equities

- Record-sized quantitative easing has given financial markets energy; elevated P/E ratios may be long-lasting.
- Quarterly reports surprised very much on the upside; companies are more resilient to the crisis than feared.
- Expensive stocks have become more expensive; low valuations have been a trap for investors in 2020.
- High valuations will affect potential future returns; extensive sector rotation may occur during the coming year.
- Green companies will be the winners of the 2020s, but after the upturn there is a need for selectivity in stock-picking, and the US presidential election will be of major near-term importance.

Fixed income investments

- Today's low rates and yields may be long-lasting, though we expect central banks to allow some rate increases if they coincide with sustained economic recovery.
- Expected negative returns on government bonds are driving investors towards riskier fixed income investments.
- Corporate bonds have recovered sharply. Their future potential is thus lower, but we remain positive towards owning corporate bonds and foresee that they will benefit from aggressive central bank and government stimulus programmes.

On a global basis, we expect earnings to fall by more than 20 per cent this year. We believe most of this decline can be recovered in 2021. Since stock market indices are at or near record levels, this implies that earnings at aggregate level are carrying historically high valuations. We should thus have a longer time perspective in order to justify current share prices. If we look at bond yields, which are extremely low – for both risk-free and investment grade corporate bonds – equities do not appear to carry such high valuations in relative terms.

Although stock markets are in record territory and corporate bonds have approached pre-crisis levels, we choose to maintain a continued overweight in both equities and credits. Gradually improved macroeconomic conditions, low interest rates and yields, continued central bank support and expansionary fiscal policies keep suggesting an overweight in risk assets. High valuations as well as near-term risks – such as a possible second COVID-19 wave, the US presidential election and tense relations between the United States and China – are among the reasons why we are only recommending a slight overweight.

Alternative investments

- Increased market risk appetite helped hedge funds turn in a positive performance.
- Equity long/short funds benefited from a more fundamental environment and a positive quarterly report period.
- Comparatively stable bond yields provided support for macro funds.
- Event-driven funds saw a robust recovery, especially in mergers and acquisitions (M&A) and credits.

Return expectations, %, next 12 months (SEK)

Equities	Return	Risk*
Advanced economies	7.7	18.3
Emerging markets (local currencies)	7.8	18.1
Sweden	7.9	18.3
Fixed income investments	Return	Risk*
Government bonds	-0.3	1.4
Corporate bonds, investment grade (Europe/US 50/50, IG)	1.9	7.0
Corporate bonds, high yield (Europe/US 50/50, HY)	3.8	11.1
Emerging market debt (local currencies, EMD)	5.7	10.4
Alternative investments	Return	Risk*
Hedge funds	3.5	7.0

* 24-month historical volatility

Source: SEB, forecasts Sept 2020

Risk exposure and allocation

We are overweight in equities and corporate bonds

After collapsing in March, risk assets have steadily climbed upward. A balanced portfolio consisting of equities, bonds and alternative investments is now showing a small positive return so far during 2020, although a clear weakening of the US dollar has undermined returns on global equities measured in Swedish kronor.

The stock market slide resulting from COVID-19 hit bottom on March 23. As a result of policy responses from central banks in the form of key interest rate cuts and quantitative easing, as well as enormous stimulus packages launched by governments all over the world, risk assets have quickly recovered. US and Swedish equity indices are now higher than at the beginning of 2020, despite a sharp deterioration in economic conditions and major downgrades in earnings forecasts. Interest rates and bond yields have plunged and credit spreads have narrowed, making it cheaper for companies to fund themselves. Corporate bond purchases by the US Federal Reserve (Fed) and the European Central Bank (ECB) have helped push interest costs down to almost the same low levels as before the virus outbreak.

In line with the general economic trend, global earnings forecasts have been downgraded. Earnings are expected to be more than 20 per cent lower in 2020 than in 2019. Companies with modern business models that enjoy the advantages of digitisation and companies connected to the home have

performed well, while traditional industrials and financials have had a tough time. Large impairment losses in the form of expected (unrealised) loan losses in the banking sector have pulled down aggregate estimates.

On the whole, the second quarter report period turned out to be far stronger than forecast. The trend towards downward adjustments in earnings forecasts has faded and been replaced by upward adjustments. The lifting of various coronavirus-related restrictions and government stimulus measures are making a positive contribution, along with the surprisingly agile response of businesses to the drop in demand. The short-term trend for earnings and macroeconomic conditions is positive, but sequential improvements should dwindle as the world normalises. Next year earnings growth will accelerate thanks to economic recovery and low comparative figures, which the market has already priced in. 2020 will be a lost year for companies, but right now it looks as if the damage will be smaller than we previously feared.

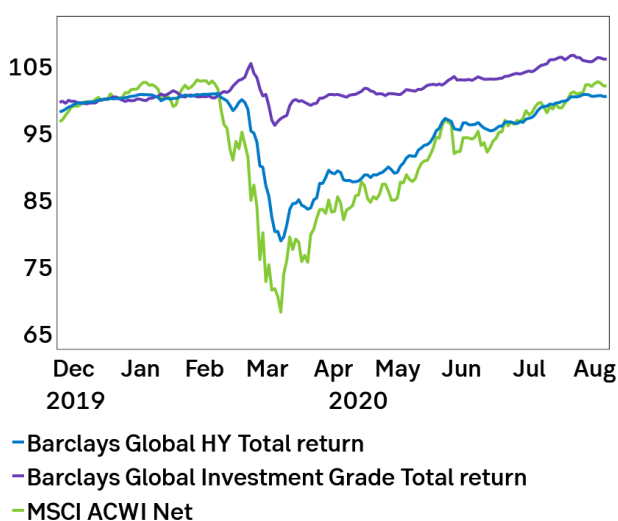
Central banks have pushed down risk-free yields, forcing investors to take risks in order to achieve returns. As a result, corporate bond and equity valuations have soared. Record-low interest rates and a gradually improving economy are favourable for risk assets, but the market has largely already discounted an improvement scenario. The potential compared to current levels is thus more limited than before.

In March we enlarged our allocation to equities after the major stock market slide. In early April we also upweighted our risk via high yield (HY) corporate bonds when funding costs (credit spreads) soared, which has benefited our portfolios. We thus increased our risk during this period. Despite strong market performance, we are maintaining our overweight in equities and corporate credits, since we expect continued low interest rates and a relatively strong economic recovery ahead. Central banks are ensuring continued low interest rates and high risk appetite, and fiscal stimulus will provide support for another while. Valuation parameters are challenging, but a positive trend for equities and rising risk appetite – as well as gradual macroeconomic improvements – will tip the balance in a positive direction.

As for Swedish equities, we have continued to add companies with stable revenues and strong balance sheets. In global equities, we remain overweight in growth companies of a structural nature. We have decreased our holdings in Japan in favour of other Asian countries, where we are now substantially overweight. We are also overweight in small caps whose valuations have not kept up with the rest of the portfolio, but which should perform well in the future.

In fixed income, we remain overweight in corporate bonds, especially in the HY segment as well as in short durations, which thus have low interest rate risk. In order to optimise risk-adjusted returns in the overall portfolio, we hold a broad alternative investment portfolio.

Risk assets back above zero returns



Source: Bloomberg

The chart shows the performance since late 2019 of investment grade bonds (Barclays Global Investment Grade Total return), a global equity index (MSCI ACWI Net) and high yield bonds (Barclays Global High Yield Total return).

Macro and other market drivers

Recovery in a complex environment

At the time that the May issue of *Investment Outlook* was being written, there was almost total uncertainty about the impact of the COVID-19 pandemic and the resulting lockdowns, how soon reopening would occur and what the long-term effects would be. Today we know a lot more about this recovery, but great uncertainty remains. This is not only because the economy has been through a kind of shock we had never experienced before, but also because we have seen completely unprecedented crisis responses; it is unclear whether the political ambition to deliver further help and to restart economic growth will turn into concrete actions.

Renewed outbreaks of COVID-19 can, of course, also be added to the list of uncertainties. This risk should not be underestimated, but we believe that future infection outbreaks will be met with “smart” lockdowns that limit their economic impact. We are also approaching the launch of both new virus suppressant medicines and vaccines, so even if this human tragedy unfortunately continues, the economic consequences will probably not be critical.

Labour markets more resilient than expected

In recent months the pandemic has unfolded less favourably than we and many others feared, but the economy has offered upside surprises. Recovery has been faster than expected in advanced economies, especially for private consumption and manufacturing. One important factor is that labour markets have held up better than expected. In the United States, unemployment has fallen in recent months. In Europe, stimulus measures have limited the impact of joblessness. Retail sales are largely back at pre-crisis levels and industrial production has also bounced back, although it has not quite reached previous levels.

Because the downturn has been smaller than previously feared (especially in labour markets), a large proportion of specially earmarked government stimulus money has not been utilised. This will make room for political leaders to launch further stimulus packages, which need not be aimed at crisis management, but can instead focus on getting the economy back up and running. Discussions are under way in the US Congress about another stimulus package totalling USD 1 trillion or more. The Swedish government, too, has declared its ambition to launch a major “restart package” soon, in the range of SEK 100 billion, also a very large figure in relation to the size of the economy.

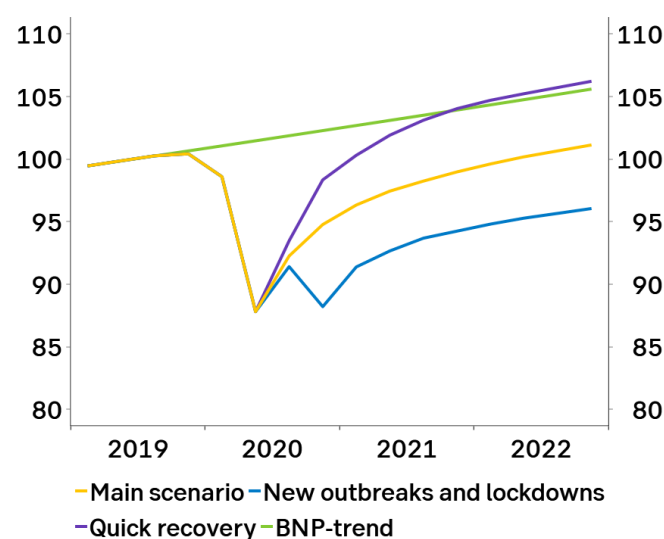
Massive stimulus measures causing some inflation concerns

One important factor behind the rapid recovery has been massive stimulus measures by central banks around the world. In the US, the Federal Reserve (Fed) slashed its key interest rate

to near zero, where other major central banks had already kept their key rates for a long time. Enormous central bank bond purchases have not only continued, but expanded significantly, and in some cases have included corporate bonds. This quantitative easing (QE) supports financial markets and economic growth in various ways, but has created concerns that such a dramatic increase in the money supply will generate inflation, as economists learn at university. We already have some inflation in the system (around 1.5 per cent in major economies), but because of continued globalisation and subdued inflation expectations, we do not expect inflation to climb very much. This, in turn, means that central banks are likely to keep their key rates low for a long time. As long as they continue to buy government bonds, they also serve as a source of funding for future stimulus packages.

One can argue that this funding of central government debt via central banks and the money supply can continue for a long time without problems. If the economy should grow so vigorously that inflation accelerates, central banks will have the opportunity to quickly withdraw funding and reduce the money supply. The long-term effects of the debt build-up remain to be seen and perhaps managed, but that does not disturb the picture for the next couple of years.

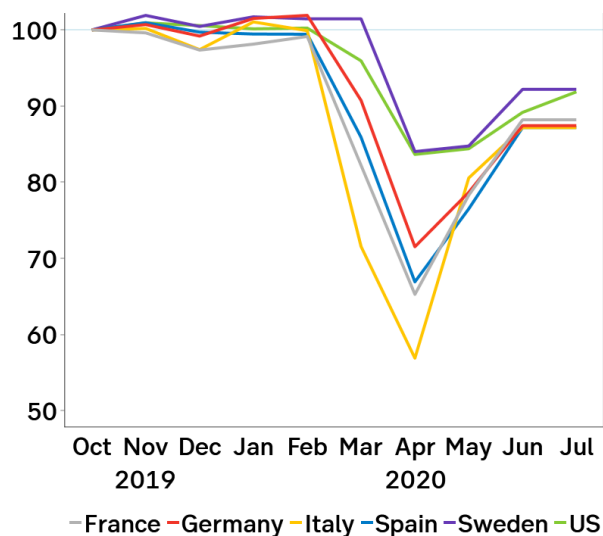
The global economy is recovering



Source: Macrobond, SEB

After an abrupt halt this past spring, the economy is recovering at a relatively rapid pace, illustrated here by our forecasts for OECD countries. Of course there is still great uncertainty. We see a 60 per cent probability for our main scenario, and 20 per cent probabilities for each of our two alternative scenarios.

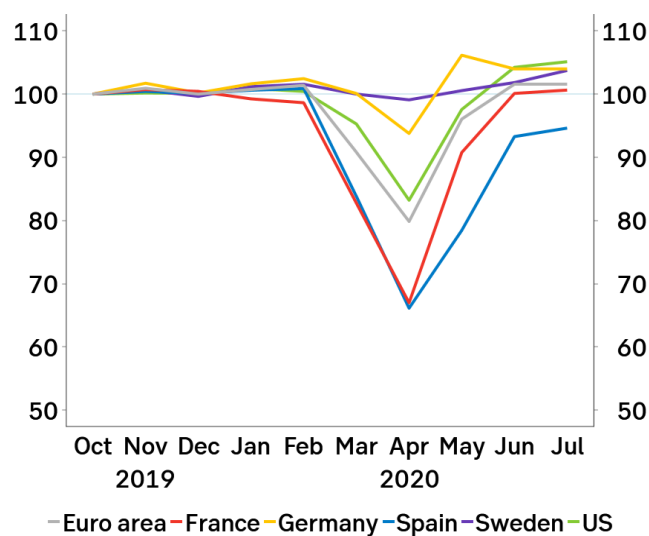
Manufacturing has not quite recovered yet...



Source: Macrobond, SEB

Advanced economies are gradually reopening. Purchasing managers' indices and other sentiment indicators suggest that this recovery trend will continue.

...while households are bouncing back faster



Source: Macrobond, SEB

Household consumption is contributing strongly to the recovery, but worth noting is that services are not included in the above chart and that the service sector recovery has been slower.

Although there is a clear recovery scenario, it does not mean that everything will return to normal. Unemployment is likely to remain high for some time to come. Partly due to continued major problems with the pandemic in emerging market (EM) economies, we have downgraded our growth forecasts for these countries.

On the other hand, the growth picture now looks much brighter for the Nordic countries, including Sweden. At the global level, we expect growth to be well above trend during

the next few quarters and years. But after the disastrous first half of 2020, this recovery will not be strong enough to generate positive growth for 2020 as a whole. Our forecast is that the global economy will shrink by 4.3% this year, by far the worst downturn we have seen in modern times. It will take several years before the economy reverts to its previous growth trend, but the next few quarters and years will still be a period of recovery.

GDP forecasts, year-on-year percentage growth

Market	2019	2020	2021	2022	Comments
United States	2.2	-5.5	4.0	3.5	Recovery in the shadow of elections and virus outbreaks.
Japan	0.7	-5.8	2.4	0.7	New structural problems are being added to old ones.
Germany	0.6	-6.1	5.0	2.8	A strong economy is leading to faster recovery.
China	6.1	2.0	8.0	5.6	First in, first out of crisis, but relations with the US are a question mark.
United Kingdom	1.5	-11.6	8.0	1.0	COVID-19 and Brexit are weighing down a fragile economy.
Euro area	1.3	-8.8	6.6	3.4	A new recovery fund is a bright spot in a difficult landscape.
Sweden	1.2	-3.8	4.2	3.1	Better than anticipated, with potential new stimulus on the way.
Baltic countries	3.6	-2.9	3.7	3.4	Surprisingly resilient, thanks to effective public sector action.
OECD	1.6	-6.6	4.8	2.8	Better than feared, once crisis responses have an impact.
Emerging markets	3.9	-2.5	5.6	4.8	Historic GDP declines, worsened by weak exports and virus effects.
World, PPP*	2.9	-4.3	5.3	4.0	Gigantic stimulus measures are driving a sluggish recovery.

Source: OECD, IMF, SEB. *Purchasing power parities.

Valuations

Economic activity has fallen steeply, and so have corporate earnings, but a global equity index is at near-peak levels. Near-term valuations of earnings have thus skyrocketed. This limits the potential for equities and means there is more room for stock market indices to fall if events take an undesired turn. The price/earnings ratio based on a 12-month forecast is 21 according to the global index, which is well above normal. Although this is an elevated figure, it can be explained by the likelihood that earnings will recover sharply over the next two years and the fact that interest rates and bond yields are extremely low. However, high valuations at an aggregate level are mainly due to sharply higher valuations for certain sectors such as technology and media. The world's largest listed company in terms of market capitalisation, Apple, is now valued at a P/E ratio of 31 for 2021, which is more than a doubling of its earnings multiple compared to a few years ago. Since information technology (IT) giants account for an ever-larger percentage of the global index, they have a large impact on aggregate figures. However, traditional companies in sectors that are not growing structurally have not seen their valuations grow significantly, creating an uncomfortably wide discrepancy. We see global share valuations as an inhibiting factor for future stock market performance.

The expansionary monetary policies of central banks are one big reason behind the positive performance of risk assets. The credit market has benefited from key interest rate cuts and quantitative easing. Credit spreads have decreased by more than half from their peaks in late March and are approaching pre-crisis levels. The price potential for corporate bonds has thus also decreased.

Risk appetite and positioning

Risk appetite was close to zero at the end of March 2020, but has gradually increased since then and is now at a relatively high level, while not as high as in February this year when it was extreme. Asset managers have generally become more optimistic about both the stock market and the future real economy. As a result, institutional asset managers are overweight in the stock market and have reduced the percentage of cash equivalents in their portfolios. IT is still the most popular sector to own, but flows have recently begun to move increasingly towards traditional companies that still have relatively low valuations. If risk appetite and positioning shift further in a positive direction, this will be an inhibiting factor for market performance. But at present we are not picking up any clear signals, since fund managers as a group are still showing a healthy scepticism.

Fixed income investments

Strong short-term corporate bond performance

The knowledge that central banks will not raise interest rates is subduing tendencies towards higher long-term yields in light of historically large budget deficits. Many factors point to yields remaining low for a long while. With the risk of negative returns on government bonds, investors must look to riskier investments in the fixed income segment to generate returns.

We are positive towards corporate bonds, particularly those with a sustainable focus, although there is less potential than before. Investments in emerging markets benefit from a weaker dollar, and yields in many of them are higher than in advanced economies.

Government bonds (excl emerging markets)

Despite increased risk appetite and climbing share prices, government bond yields remain low. This is because major central banks will not raise interest rates for a long time and have said there is essentially no limit to the amount of fixed income securities they can buy.

Despite mixed inflation signals, central banks have stated clearly that they will allow inflation to exceed their targets. Monetary policy, both globally and in Sweden, is instead entirely focused on supporting economies with “promises” of low interest rates and liquidity support. With clear signals,

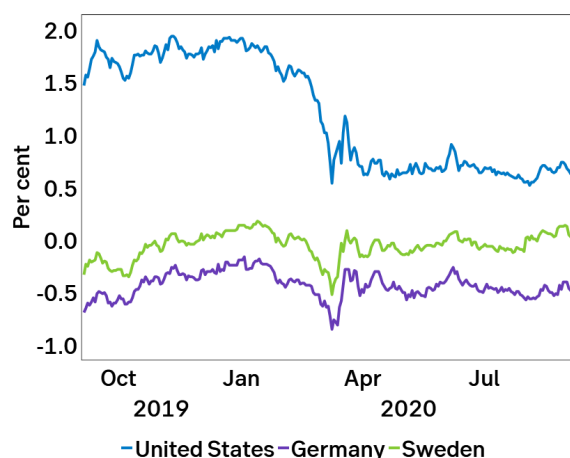
Forecasts for 10-year government bond yields

Market	Sep 7 2020	Dec 2020	Dec 2021	Dec 2022
United States	0.72	0.80	1.00	1.20
Germany	-0.45	-0.40	-0.20	0.00
Sweden	-0.03	0.00	0.20	0.50

Source: SEB, market data September 2020

especially from the US Federal Reserve (Fed), that they will not introduce negative interest rates, we see a limited downside in short-term rates. This suggests that short-term government bond yields will remain low for a while.

Tug-of-war between increased supply and bond purchases



Source: Macrobond

Long-term bond yields have fallen, given uncertainty about the increased spread of COVID-19 and central banks' clear message that interest rates will remain low. A combination of better economic growth and an increased bond supply will lead to somewhat higher yields in 2021, but due to central bank bond purchases, yields will remain historically low.

Looking ahead, the tug-of-war between bond supply and demand will determine long-term yields. Central banks will need to fund their enormous stimulus measures by issuing more bonds but at the same time be prepared to buy more if interest rates rise in a way that jeopardises economic growth. The US Treasury Department estimates that the federal government will need to borrow at least 5.4 trillion dollars this year, compared to USD 1.2 trillion in 2019. After purchasing USD 75 billion in government securities a day at its peak, the Fed has now slowed purchases to about USD 80 billion a month. As a result, the supply of US Treasury securities will swell greatly in the next few months, indicating some upward pressure on yields. Our conclusion is that the Fed will allow long-term yields to rise gradually as long as this is accompanied by better economic prospects. We believe US 10-year yields will climb to 0.9 per cent at the end of this year and 1.2 per cent at the end of 2021.

Returns on Swedish government securities have largely been driven by the fall in long-term yields, which boosts bond prices. Since underlying bond interest rates are at record lows, total bond return is largely linked to the interest rate trend, which

can be difficult to predict in these times. Investors who want better return potential from the fixed income market must therefore seek out higher-risk fixed income investments.

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

Since last spring, corporate bonds have seen a strong recovery. Yields on high-risk corporate bonds (high yield, HY) have fallen to 4-5 percentage points above government bond yields, from 10-11 percentage points at their peak in March. When stock markets collapsed due to coronavirus worries, investors demanded better payment for risk-taking. Corporate bond yields thus rose (and bond prices fell).

The trend of credit events during the period reinforced this positive picture. The market is now counting on a default rate of about 5 per cent, which is a more positive picture than expected earlier in the year. In late March, it was noted that about 10 per cent of companies would cause some form of credit loss for bond holders.

Central banks and governments continue their aggressive measures to stimulate the economy. These measures, implemented in order to help companies ride out the crisis, probably reduce the risk of credit losses and also imply lower corporate funding costs. We believe the yield spread between government and corporate bonds may thus continue to narrow and that high yield investments – even taking into account the default risk – may provide good long-term returns.

We are thus still positive towards owning corporate bonds, especially those with a sustainable focus. However, given their already strong performance during the summer, their potential is more limited than before. Return levels are still good given the low-yield environment, but they are not as attractive as last spring and there are risks. Neither central bank nor government stimulus will be able to save companies that already have high debt levels. There is still great uncertainty, and there could be new negative news about the spread of COVID-19 and the economic consequences of this.

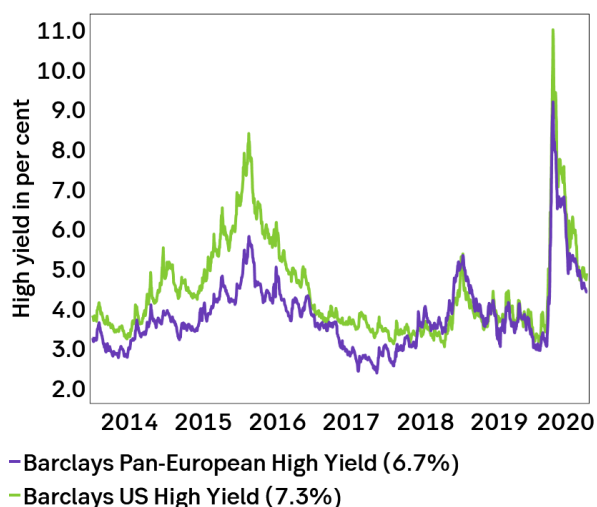
Since their decline in March, corporate bonds with a lower risk (investment grade, IG) have made a strong recovery, which means the potential there is also somewhat limited. IG bonds have benefited from central bank purchases and from declining government bond yields, primarily in the US. This type of bond is more sensitive to interest rate changes than high yield bonds. We believe these companies will benefit from increased central bank stimulus. They are often large and stable and should be able to cope with the effects of the economic downturn relatively well.

Emerging market debt (EMD)

On the whole, emerging market bonds have performed well during the summer, although there are clear differences between regions and countries. The importance of choosing the right securities is also clear. EM bond performance has been driven by narrowing yield spreads, with prices thus rising, and by positive currency effects, in part due to the weaker USD. As for currencies, several in Eastern Europe stand out given their positive performance, having recently been helped along by the strong euro. Rising yields in Turkey combined with the country's depreciating currency made this one of the weaker markets during the period, along with Russia.

The global economic recovery expected in late 2020 and in 2021, helped in part by various economic stimulus measures, should be positive for EMD. Although the yield spread between corporate and government bonds has narrowed, there is room in a number of EM economies for further narrowing. Interest rates in most emerging markets are also much higher than in advanced economies, which should attract additional investor capital. However, one question is the trend for EM currencies, since the global economy is still weak and global trade, which is so vital to EM countries, has still not reached full speed and is also vulnerable to political manoeuvres.

Higher bond prices due to shrinking yield spreads



Source: Bloomberg/ Macrobond

The yield spread that is supposed to compensate for the higher risk of corporate bonds vs government bonds widened in March, following growing concerns that companies would not be able to repay their loans. Although we believe the positive trend will continue, there is less potential than before.

Global equities

Surprisingly strong reports and steady recovery

Corporate earnings far exceeded low expectations for the second quarter. The downward earnings revision trend is over, and earnings forecasts have started to be revised upward. If these forecasts hold and if yields and interest rates remain low, the upturn can continue – although valuations are starting to become challenging.

Seldom have corporate earnings produced such great upside surprises as they did in the second quarter of 2020. Of course, analysts had revised their forecasts substantially lower ahead of the report period, so the threshold was low. Sales figures were more or less consistent with expectations, but the surprise was how companies had managed their costs. They were quick to cut expenditures and reorganise production. The growing share of profitable companies with modern business models in the IT and media sector was relatively unaffected by the pandemic, pushing overall corporate earnings higher. Government grants such as wage subsidy schemes were also utilised to a great extent, something that was difficult to predict. However, we expect continued negative earnings growth for the next two quarters before the demand situation normalises.

Many investors have their eyes on America's broad S&P 500 index, which was followed especially closely during the report period. Earnings of companies in the index fell by nearly 34 per cent during Q2. The biggest declines were in the energy sector, due to falling oil prices and a collapse in demand. Earnings of cyclical consumer goods companies and industrials fell about 80 per cent, and because of large loss provisions at banks, earnings of financials more than halved. The non-cyclical health care sector was a positive stand-out, with higher earnings compared to last year, as was the technology sector, whose earnings were virtually unchanged. One reason for strong US stock market performance despite the sharp earnings decrease is that major digitisation companies, with their gigantic market capitalisations, posted sharply higher earnings during the period. Companies that make up the acronym FAAMG (Facebook, Apple, Amazon, Microsoft and Google) together increased their earnings during the period and accounted for about 15 per cent of earnings among S&P 500 companies. Fast-growing Amazon had an especially good Q2, with quarterly earnings 97 per cent higher, since the company benefited from the lockdowns and increased online shopping. Despite upward-revised estimates, US earnings are expected to decrease by 20 per cent for the full year.

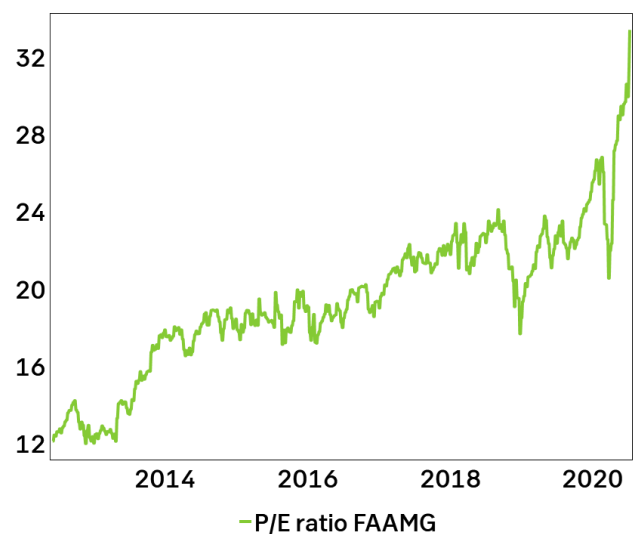
In Europe, earnings also offered upside surprises, with subsequent upward-revised estimates, though not to the same extent as in the US. This is natural since Europe has a larger share of traditional companies. In Europe, earnings are expected to fall by more than 30 per cent for the full year. It

is noteworthy that earnings of cyclical companies have been revised upward more than those of defensive companies.

Stimulus measures provide support

Since the market bottomed out in late March, the S&P 500 has gained 54 per cent and is just above its year-end 2019 levels. Meanwhile the technology-heavy Nasdaq index has risen by an impressive 67 per cent, which represents a significant upturn since year-end in US dollar terms. However, for Swedish investors, returns were hurt by the stronger krona. Many people have warned that a major correction must now follow. This should never be ruled out, but we see several reasonable factors that explain the upturn. Unprecedented fiscal stimulus programmes are bolstering growth forecasts. Just as importantly, investors have reason to believe that new earnings disappointments will be countered by new support measures. Central banks are also making powerful contributions, now by buying corporate bonds as well. These efforts

Upward revision of FAAMG earnings forecasts has happened quickly



Source: Bloomberg

The chart shows 12-month forward P/E ratios for FAAMG (Facebook, Apple, Amazon, Microsoft and Google).

to mitigate business risks are pushing down corporate funding costs and helping the stock market. Because of low interest rates, which are being kept down by central banks, the discount rate used in cash flow analyses is favourable to growth companies. They will have higher earnings in the future than traditional companies, which partly explains the increasing dominance of growth companies in the stock market. When these stimulus measures fade and interest rates and yields rise, this comparative advantage in valuations will be reduced and the trend may reverse, but we are not there yet.

Higher valuations are acceptable

It is not surprising that share prices and valuations have risen in this environment. The difficult questions are how long this environment will continue and how high a valuation is acceptable. As noted earlier, we expect this environment, with relatively good growth and low yields and interest rates, to continue for the foreseeable future. What about high valuations? One important explanatory factor is the above-mentioned "digitisation winners". The five US listed companies in the FAAMG group now account for around 22 per cent of S&P 500 market capitalisation, a proportion only surpassed by the high during the IT (dotcom) bubble. It is easy to draw parallels with the stock market crash around the turn of the millennium, but with a crucial difference: earnings generation. FAAMG valuations are indeed high and have risen sharply in recent years, but at the same time these five companies have proved themselves through rapid earnings growth and high profit margins, which merit higher valuations. Add to that the structural growth in demand. As for operations, there are very few question marks but, given the growing dominance of these companies, political leaders have begun to strongly

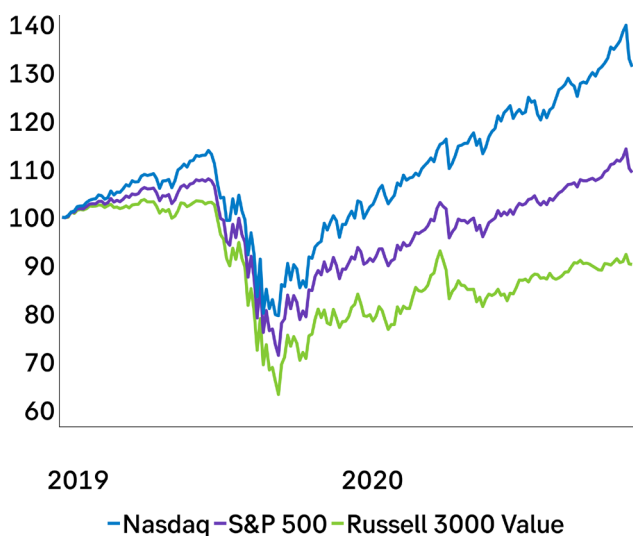
question their monopoly-like situation, as well as their often aggressive tax planning. Some of the FAAMG companies may also be hurt by the trade war between the US and China.

Apple, whose products have grown in popularity in China and which has doubled its market capitalisation to USD 2 trillion in two years, is one such example. Should interest rates begin to rise, the high earnings multiples of the FAAMG companies would also be questioned. There has been a rapid upward revision in forecasts of these companies' future earnings, and their valuations are starting to become stretched. More subdued share price performance is thus anticipated, as are somewhat larger corrections when FAAMG valuations are questioned. But as long as earnings forecasts hold, interest rates and yields are low and traditional sectors are having a tough time, the digitisation winners will probably continue to attract investors.

Investors are more optimistic, but not yet euphoric

Institutional investors have become more optimistic about economic and earnings growth. Equities have also been upweighted, relative to other asset classes. However, there is still some scepticism about the sustainability and strength of the recovery. Price movements in risk asset markets nonetheless clearly show that risk-taking is high. This can be interpreted as meaning that sceptical investors do not see any other alternative to taking a risk, since risk-free investment alternatives provide no return at all. Technology and health care are still the most overweighted sectors, but investors have recently begun to seek out companies, sectors and regions with lower valuations. Investors have increased the weight of their holdings in Europe and emerging market (EM) countries, as well as in commodity companies and banks. Small caps have been bought at the expense of large caps. These are natural movements, since the valuations of technology companies have run wild. It is also common to sell defensive sectors, such as health care, when economic indicators point upwards.

Digitisation winners are pulling up stock market indices



Source: Bloomberg

The chart shows the performance of the broad S&P 500 index, the technology-heavy Nasdaq index and the broad Russell 3000 index.

We are sticking to our strategic positions

We continue to have a positive view of growth companies thanks to their superior market positions and generally highly advanced digitised business models. However, we are closely monitoring these valuations since they have climbed alarmingly fast.

We also have a positive view of Asian emerging markets, dominated by China, South Korea and Taiwan, since the general economic trend in these countries is improving at a better pace than, for example, in Europe.

In the small cap segment globally, we see many companies in traditional industries that have been hit far too hard by the downturn. Should the economic recovery continue as we forecast, there is great potential here. As long as yields and interest rates remain low and the economy gradually recovers, this is enough for the stock market to attract further capital, but we expect some bumps in the road.

Nordic equities

More money resulting in lower return requirements

The stock market has had a dramatic year. After a strong start, it plunged at record speed by more than 30 per cent. Since then it has shown a very strong performance, with remarkably small and few corrections given the great uncertainty prevailing about the coronavirus pandemic, economic growth and politics. Record-large stimulus measures have quickly calmed financial markets and contributed to a clear rebound in real economic growth.

Despite persistent uncertainty about the situation regarding the spread of COVID-19, we can already note with some confidence that the exceptionally strong pessimism prevailing in March was greatly exaggerated and did not sufficiently take into account the massive monetary and fiscal stimulus measures launched at that time.

The gigantic liquidity injections and asset purchases carried out by central banks were probably crucial to the sharp recovery seen in the stock market for nearly the past six months.

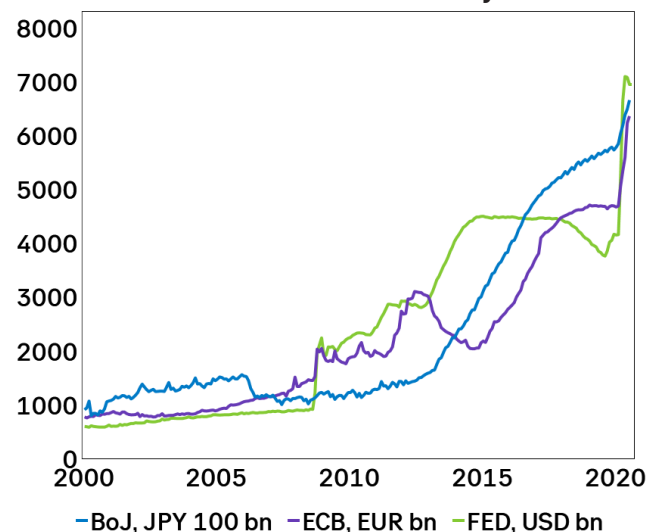
It is risky to dismiss the upturn as irrational. The upturn was a consequence of the (monetary) policies that were pursued, and second quarter corporate earnings reports showed surprisingly strong resilience during the downturn – and in many cases an encouragingly rapid rebound in sales from pandemic-related lows. Meanwhile the stock market recovery has been very unevenly distributed. Return requirements have been further lowered for many of the companies considered most resilient to a lengthy recession, with COVID-19 being the main cause, while large parts of the stock market are still noting sharp downturns so far this year. The difference between valuations of popular and unpopular equities has widened significantly in 2020. Selectivity will remain vital in the year ahead, and we see potential for a major sector rotation. The US presidential election in November will be crucial for environmental technology companies and other “green equities” that have seen brighter prospects and sharply higher share prices recently, supported by US opinion polls and green stimulus packages in Europe and East Asia. Upward-revised price/earnings (P/E) ratios in the stock market as a whole will probably persist as long as the main reason for the upturn – monetary stimulus measures and in particular quantitative easing/asset purchases – still persists.

Stock market rally on more solid ground than many believe

Monetary policy is key to understanding the strong, swift recovery seen in global stock markets since their March lows. Naturally, it may seem strange and “wrong” that the upturn in the main Stockholm equity index is just above zero so far this year and that essentially the entire coronavirus collapse has been erased, now that earnings of Swedish listed companies are expected to shrink by more than 20 per cent this year instead of increasing by 11 per cent, which was the forecast as recently as January.

However, we cannot ignore the fact that in 2020 the balance sheets of major central banks have expanded at a faster pace than ever before. The US Federal Reserve (Fed) has created about three times more new dollars than during the 2008 financial crisis. The European Central Bank (ECB) has also expanded much more aggressively than ever before, including during the euro crisis about a decade ago. Meanwhile the Bank of Japan (BoJ) has reported a clear acceleration in its balance sheet expansion pace.

Monetary stimulus has provided extensive support to financial markets and the economy



Source: Bloomberg

The chart shows the total balance sheet assets of the US Federal Reserve, the European Central Bank and the Bank of Japan. The quantitative easing measures implemented across the world to calm financial markets and stimulate the economy during the coronavirus crisis have been exceptionally aggressive. Enormous asset purchases have provided liquidity in different countries, which is also flowing into the stock market and pushing up share prices.

Meanwhile 2021 earnings forecasts have been revised upward again after surprisingly strong second quarter reports this year and today are “only” about 10 per cent lower than in January 2020. A record-large share of companies reported surprisingly strong operating earnings, compared to previously sharp downgrades in Q2 earnings forecasts. A combination of factors probably accounts for this positive divergence in earnings; analysts had underestimated the scale of government wage subsidies that companies received as well as the magnitude of other cost savings, but also the improvement in demand from the low in April until late June.

Analyses show that, for most companies, the bulk of these upside earnings surprises – in some cases exceeding the total amount – was equivalent to the wage subsidies paid to them during the quarter. However, this should not be interpreted as meaning subsidy schemes fully explain the upside surprises, since it was well known that such wage subsidies were available and they must have been included to some degree in analyst forecasts, though probably not to a sufficient extent.

Cost savings in other areas were also record-large; for instance, business travel budgets have never shrunk to the extent they did during Q2 2020. In many cases, marketing was probably also de-prioritised exceptionally fast. The effects of the wage subsidies are transitory; nor are low budget levels for business travel and marketing sustainable in the long term. However, many companies have made it clear they have not “wasted” the crisis. Like after Lehman Brothers’ collapse and the 2008-09 financial crisis, in many cases their cost base was lowered permanently. As a result, many companies can revert to or exceed 2019 earnings with a smaller rebound in volume than they lost during the COVID-19 crisis.

At the same time, it is noteworthy that large parts of the real economy are now growing again after a historically deep downturn in March and April 2020. This is true, for example, of retail sales in both the EU and US. Naturally, the continued spread and in many places accelerating rate of COVID-19 infections mean there is a risk that the economic recovery will fizzle, although there is now considerable resistance to new blanket lockdowns.

If and when central banks gradually begin to shrink their balance sheets again, it will probably be best to avoid many of the equities whose valuations have recently climbed the most, but it is probably far too soon to worry about that today. The risk of stagflation (simultaneous inflation and high unemployment) is limited by digitisation, and any recovery in the real economy that is strong enough for central banks to dare withdraw stimulus measures would meanwhile be really good news for large portions of the stock market – often precisely those companies that have not yet benefited from this year’s rally or even from the multiples expansion that has taken place over the past decade.

All in all, we believe it is quite risky to dismiss the stock market rally this summer as a bubble with no fundamental underlying support. The economic trend has been far less bad than many people probably feared during the stock market collapse in February and March, and the monetary stimulus measures introduced during the COVID-19 crisis may very well justify even higher P/E ratios and even lower return requirements than before. These effects could persist for a long time.

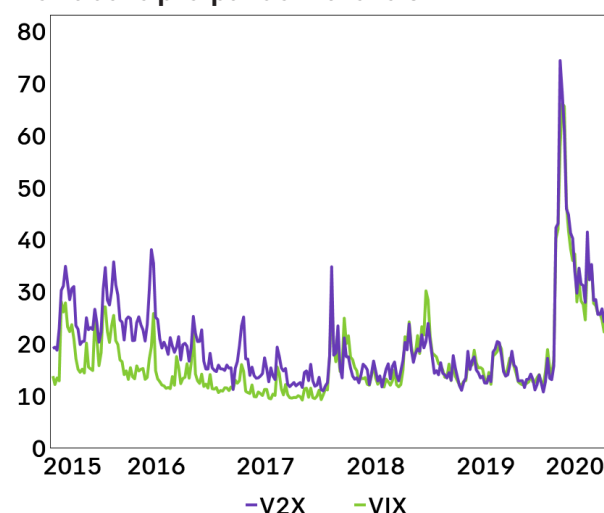
Worries have eased dramatically but are still elevated

The panic has long subsided; investor worries as measured by volatility indices have eased substantially and steadily since March. Growing optimism (reduction in worries) has also been key to the stock market recovery and is of course directly connected to the belief that economic stimulus measures have saved us from a financial market crisis on top of the downturn in the real economy earlier this year. Only for a very brief period did the functioning of the credit market seem as shaky as during the financial crisis following the 2008 Lehman Brothers collapse. This time around, massive and rapid central bank intervention put a stop to any such negative domino effect before it had time to pick up speed.

However, there is still great uncertainty about the economic growth trend, the spread of the coronavirus and political developments around the world, in particular the conflict between the US and China but also between these two superpowers and the rest of the world. There are growing concerns about the former Soviet Union, while the Brexit saga also continues. New virus-related lockdowns, for instance in Australia, and growing concerns about the virus in parts of the US and Europe have also caused the economic recovery to lose momentum recently in the affected regions. The prevailing uncertainty is also reflected in volatility indices (the VIX in the US, the V2X in the EU), which are still much higher than was normal during the five years before the coronavirus crisis, although the resources provided by central banks to cushion crisis effects have never been greater than today.

Continued elevated worries are justified, but this meanwhile implies there is still significant potential for improvement. In order to be “normalised” again, the VIX needs to fall by half from its current level. It is difficult to see how this scenario could be realised without a significant stock market upturn at the same time. The continued abnormally high level of worries in financial markets is both a reflection of persistent risks and an indication of continued upturn potential if there is an improvement in economic growth/the virus/politics.

Financial market worries have subsided but remain well above pre-pandemic levels



Source: Bloomberg
The chart shows volatility indices for the US (VIX) and European (V2X) stock markets. Financial market worries have eased dramatically from their peak levels in March, but are still much higher than was normal in the years before the coronavirus crisis.

Uneven stock market recovery – expensive equities are more expensive, cheap ones are cheaper

Strong stock market performance, as measured by indices, conceals dramatic differences between winners and losers at the company and sectoral level. The clearest difference is between equities with high versus low valuation multiples. High valuation multiples are normally associated with better growth prospects, higher profitability and greater stability whereas the reverse is true of lower valuation multiples. The latter are instead often associated with higher dividend yields and less need for future earnings growth in order to generate an acceptable return over the long term.

In 2020, low valuations have been a trap for investors. Valuations of equities with high multiples have been pushed even higher, while equities with lower multiples have often not benefited at all from the recent stock market rally. Taking a look at the 29 biggest equities in the Nordic region – the VINX30 Index excluding the Swedish company Investor – the difference between those with high P/E ratios and those with lower P/E ratios is striking. The 14 equities with the highest P/E ratios have shown strong performance, with an upturn of about 20 per cent, while the equities with low P/E ratios as a group have lost about 6 per cent this year. Only four of the 15 equities with low P/E ratios have shown a positive performance this year, whereas all but two of the 14 with high P/E ratios have turned in a positive performance. We have excluded Investor from the comparison since its P/E ratio is not a relevant financial ratio for the company's shares. We are using 2021 consensus forecasts as a basis of comparison since many times it can be misleading to use 2020 earnings affected by the coronavirus crisis.

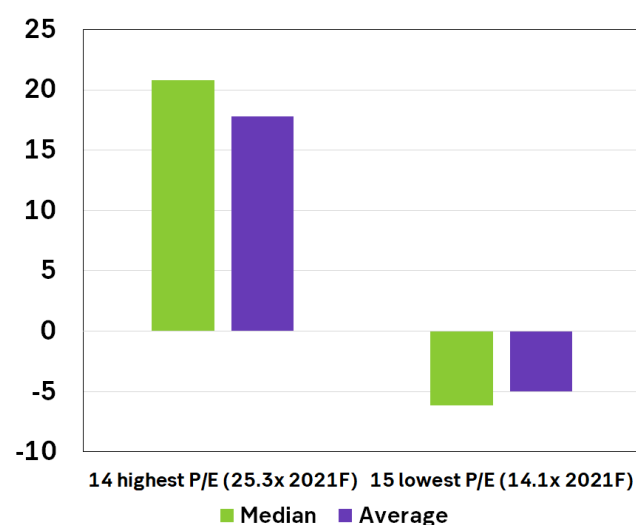
This pattern is repeated on all of the Nordic stock exchanges as well as between them. Copenhagen stands out as by far the strongest Nordic exchange this year, with a 17 per cent upturn for the OMXC20 Index, while the corresponding indices in Stockholm and Helsinki are near zero and Oslo is down 10 per cent. A clear connection is seen between the proportion of equities with high valuations on each stock exchange and 2020 share price performance in Copenhagen, Stockholm and Helsinki. Only 7 per cent of equities in Stockholm have a P/E ratio (consensus 2021F) above 25, whereas 60 per cent of equities in Copenhagen do. Oslo deviates somewhat from the pattern since several oil-related companies are also found in the group with P/E ratios above 25, but in this case it is because earnings forecasts have collapsed even faster than share prices.

The difference in valuations and share price performance can be described in part as a difference between sectors. Many of this year's winning equities are included in one of three categories: health care, IT or companies with green solutions and environmental technology. But the pattern of high versus low P/E ratios is also repeated in sectors where there are significant differences between – for example – industrials with high and low multiples, financial companies with high and low multiples, and health care companies with high and low multiples.

IT and green equities top the list

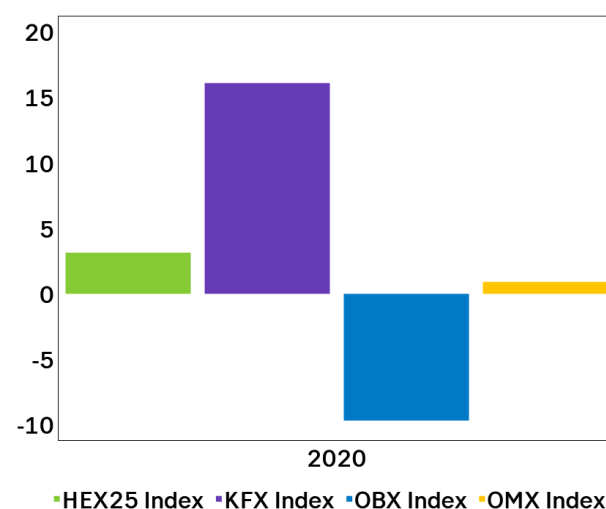
Two sectors where we have seen strong share price performance during the year, both among Nordics and internationally, and for companies with lower P/E ratios as well as those with high multiples are the information technology (IT) and environmental technology sectors – or “green equities,”

Equities with high P/E ratios have done well, while those with low P/E ratios have been punished



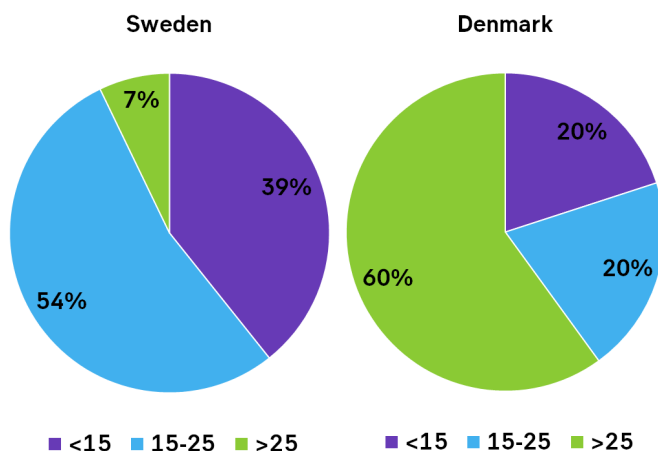
The chart shows the share price performance this year for equities in the VINX30 Index (excluding Investor, since the P/E ratio is not a relevant financial ratio for its shares) divided into two roughly equal groups: one with higher and one with lower P/E ratios. We are using consensus 2021 forecasts. Earnings levels this year are exceptional due to the coronavirus crisis, which is why 2021 provides a more accurate picture. The contrast between these two groups of leading companies is extreme.

Uneven Nordic performance – Copenhagen on top



The chart shows stock market performance so far this year for the largest companies on the Oslo, Stockholm, Helsinki and Copenhagen exchanges. The Danish stock exchange has outperformed the rest of the Nordics – driven by its large health care sector, but also wind power. It is also noteworthy how investors' preference for equities with high valuation multiples this year has benefited the Copenhagen exchange.

The proportion of high P/E equities is dramatically larger in Denmark than Sweden



Source: SEB, Bloomberg

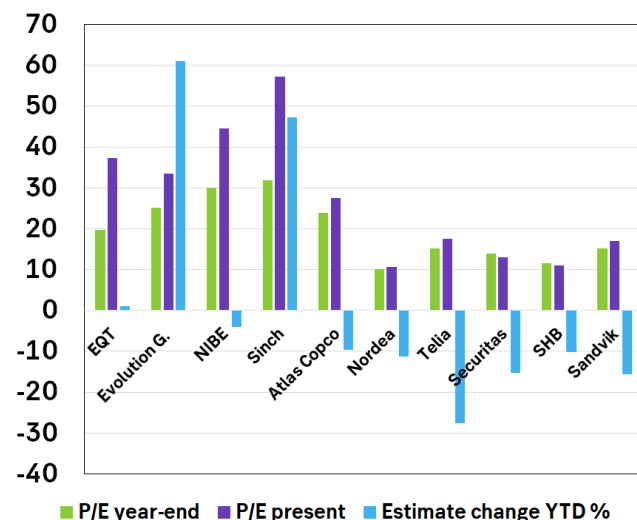
The chart shows the proportion of companies in the OMXS30 Index (Stockholm) and OMXC20 Index (Copenhagen) of the largest listed companies on these exchanges with P/E ratios (consensus 2021F) above 25, between 15 and 25 and below 15. Only 7 per cent of companies in Sweden have P/E ratios above 25 (2021F) whereas 60 per cent of companies in Denmark are valued at more than 25 times their annual earnings. A high valuation is not by definition positive – quite the opposite – but this year investors have put a premium on equities with high valuations that have better expected growth prospects, profitability and/or stability.

shares of companies that provide solutions to improve sustainability. The two most notable exceptions to the pattern of equities with high P/E ratios driving the index upswing this year in the Nordic region are Ericsson and Nokia, which are two of the biggest engines of their respective indices but have relatively modest valuation multiples for 2021 (consensus P/E ratios of 17 and 14, respectively).

Meanwhile, it is noteworthy that two IT companies few people had heard of just a few years ago – Sinch and Evolution Gaming – are among the ten equities that have pushed the Stockholm exchange's total index up the most this year. Evolution Gaming's market capitalisation is already greater than that of well-established companies like Alfa Laval, Industrivärden and ICA Gruppen, while Sinch has moved past Securitas, Trelleborg and Elekta.

The digitisation of society was already a strong, significant long-term trend even before the coronavirus crisis. It has now accelerated in many important respects as a result of social distancing, which has boosted interest in everything from e-commerce to video conferencing to a completely new level. In many cases, this involves trends that were already anticipated but that have been speeded up by a few years due to the coronavirus crisis. It is completely natural that this has a strong impact on the stock market. Note how the FANG+ index of ten of the most successful US and Chinese IT companies listed in the US has outperformed the stock market in general over the past few years, but also how this trend accelerated dramatically during the first half of 2020.

High P/E ratios have risen in 2020; low P/E ratios are more stable

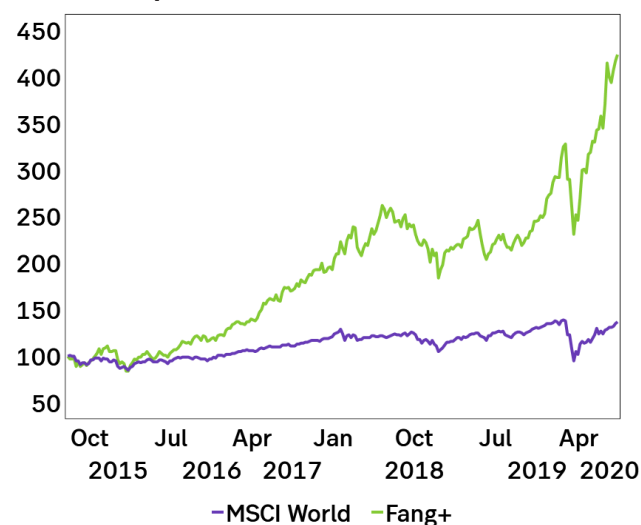


Source: SEB, Bloomberg

The chart shows P/E ratios for the 2021 consensus forecast at year-end 2019 and on August 19, 2020 for five of the equities that have contributed most to lifting the Stockholm exchange this year, as well as for five of the equities that have contributed most to holding back index performance. In general, companies with high valuation multiples at the start of the year have had the most positive share price performance in 2020, whereas companies with relatively low P/E ratios have often had far worse share price performance. In some cases above, multiple expansion has been accompanied by sharp upward-revised earnings forecasts, whereas there were significant downward-revised earnings forecasts for all five of the losing equities above.

We believe that in many cases, current valuations will require very strong performance from companies for a long time, and that any setbacks or problems could have a major impact on share prices when they are now so high. Selectivity is critical.

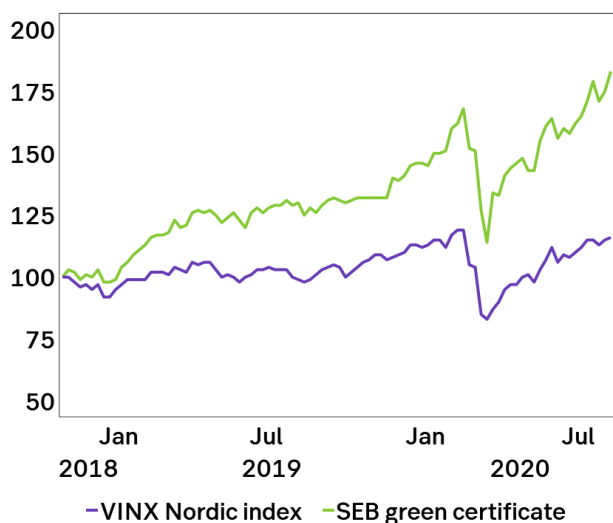
Major IT equities have outclassed the world index, with a sharp acceleration in 2020



Source: SEB, Bloomberg

The chart shows the performance of the NYSE FANG+ Index of ten large IT companies listed in the US, compared to the MSCI World Index. FANG+ equities have outperformed the world index in recent years, and this trend has accelerated sharply since the stock market bottomed out in March.

Green environmental technology firms have outperformed Nordic stock markets



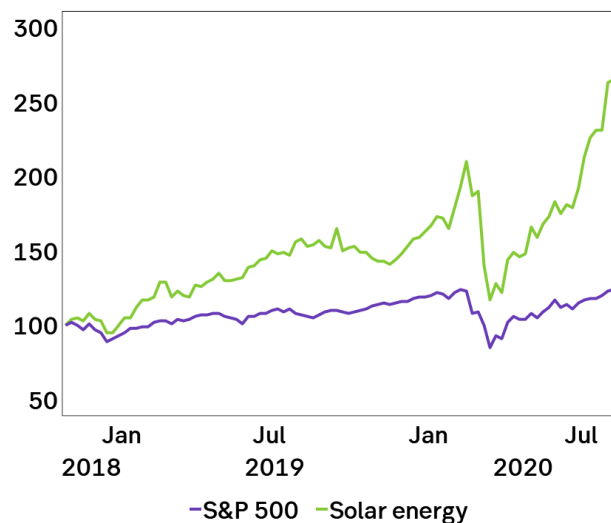
Source: SEB, Bloomberg

The chart shows the price performance of SEB's Grönare Tillväxt Norden ('Greener Growth Nordics') certificate, which includes nine large Nordic companies that provide solutions for improved sustainability, compared to the VINX Nordic Index. Companies with a focus on solutions to improve sustainability have generally outperformed the stock market in recent years, and their relative strength has further increased due to the coronavirus crisis. The good recent performance of green companies is probably the result of a combination of increased interest in sustainable investments and the green stimulus plans now being launched in many countries around the world to kick-start the economy and at the same time speed up the transition in society.

In our Nordic equities article in February's *Investment Outlook*, we wrote: "The next time new economic stimulus measures are needed, it is reasonable for them to take the form of fiscal stimulus for sustainability-improving investments in infrastructure, climate change adaptation and incentive programmes for households and companies to improve their energy efficiency and/or reduce emissions." At that time we were still blissfully unaware of the dramatic turn that the global economy would take as a result of the spread of COVID-19, which at the time was still regarded as limited to the Chinese province of Hubei. Although we had no idea how quickly our predictions would come true, it is gratifying that this now seems to be the case.

Throughout the world, with the exception of the US, the stimulus packages launched over the past six months have been significantly "green" in nature. If something positive has come out of the coronavirus crisis, it is that the transition to a greener society appears to be speeding up. This has been clearly reflected in the stock market, both in the Nordic region and internationally. Renewable energy, energy efficiency improvements, hydrogen gas technology, biomaterials, bioenergy and recycling are all among the stock market winners this year. Note below the strong performance of solar energy equities compared to the US stock market index and the performance of SEB's Grönare Tillväxt Norden ('Greener Growth Nordics') certificate, which includes nine large Nordic companies that provide solutions to improve sustainability, compared to the Nordic equity index.

Solar energy equities have outperformed the US stock market



Source: Bloomberg

The chart shows the performance of the index of solar energy equities compared to the S&P 500, a benchmark index of large US listed companies. Companies with a focus on solutions to improve sustainability have generally outperformed the stock market in recent years, and their relative strength has further increased due to the coronavirus crisis. The good recent performance of green companies is probably the result of a combination of increased interest in sustainable investments and the green stimulus plans now being launched in many countries around the world to kick-start the economy and at the same time speed up the transition in society.

Sustainability is NOT a fad, but high valuations call for selectivity

The transition of our societies in response to climate change has only just begun, but there is good potential for this to be the most revolutionary economic trend of the 2020s. There is probably still a great deal to gain from this trend on the stock market over the next decade. Meanwhile valuations for many technology companies are already very high; markets have priced in a highly favourable performance for a long time to come. The stock market situation is strikingly similar to that of the late 1990s, and we should be able to learn a number of lessons from that period, although we must be cautious about drawing too many parallels. An exact repetition is unlikely, but it should be possible to recognise some features shared by both periods.

Twenty years ago, optimism about the potential for mobile telephones, the internet and especially the mobile internet knew no bounds. This author wrote at the time about the potential for everything from e-commerce to superfast broadband and how convenient it would be, for instance, if we could pay for a parking space using a mobile phone. Today virtually everything that was then just a vision has become part of our everyday life, but the effects of this on the stock market have not at all been what investors then factored into share prices. The future of two Swedish IT consultancies – Framtidsfabriken and Icon Medialab – turned out to be much shorter and bleaker than stock market investors speculated

at the turn of the millennium. Telecom operators have not at all captured much of the added value they have contributed to society, as was generally expected when Telia – a former state-owned telecom monopoly – launched its stock market listing. Telecom infrastructure providers such as Ericsson and Nokia were considered by many to be the most obvious winners from anticipated advances in IT, but the outcome was quite the opposite. Ericsson and Nokia stand out as two of the absolutely worst investments among Nordic corporations over the past 20 years. The fact is that, among the really big stock market winners internationally – the companies in the FANG+ Index – only three had so far gained stock market listings at all: Amazon, Apple and Nvidia. Although their shares have undergone a sometimes turbulent journey, this trio has turned in outstanding performances since January 2000, with share prices rising between 46 and 156 times.

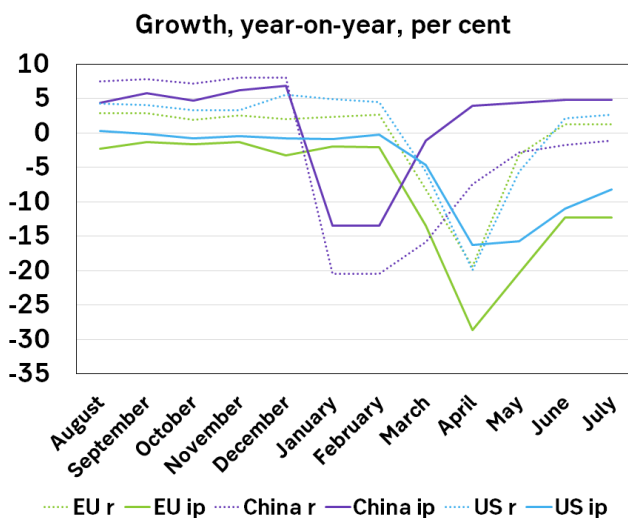
Many of the biggest winners in this decade's societal transition towards more environmentally sustainable development have probably not yet gained stock market listings, and some of the equities that now appear to be obvious winners from this trend will most likely not at all live up to expectations. However, this trend has only just begun and is not a fad. Interest in green equities will probably fluctuate in the years ahead. Given current valuations, selectivity is very important, but we are still convinced that many of the winning equities in the decade ahead will be environmental technology companies.

US election will probably affect green equities most

One important near-term issue for environmental technology companies is the US presidential election in November. A promised reversal of Donald Trump's tax cuts and restoration of all the environmental requirements for businesses that were rolled back over the past four years will probably not be appreciated by financial markets if Joe Biden and Kamala Harris win the election, but it should be a bonanza for green equities. We believe that this time around, the environmental technology sector has by far the biggest stake in the presidential election and that its share price movements should be greater than those of sectors traditionally affected by election outcomes, such as health care and defence. The oil industry is probably also holding its breath as the election approaches, but is hoping for Trump's re-election.

A Democratic victory can be expected to lead to a post-crisis US rebuilding plan that will be deep green in nature, including gigantic investments in renewable energy, energy efficiency improvements and an expanded role for hydrogen gas technology. Although a victory for Trump would "only" mean a continuation of the trend we have already seen over the past four years, we believe it is dangerous to underestimate the risks to environmental technology companies from such an approach over the next four years. The progress the US has nonetheless made on the environmental front under the current administration is very much due to the initiative of individual states, but the Trump administration is working hard to undermine them at the federal level. One example that has drawn considerable attention is the US Environmental Protection Agency's lowering of future fuel economy standards for passenger cars, as well as the Trump administration's insistence that California may no longer set more stringent standards than federal authorities. One threat to the thriving

Clear but uneven global economic recovery



The chart shows annualised growth for industrial production (ip) and retail sales (r) in the EU, US and China. After a swift, strong collapse earlier this year, there has been a significant recovery in all segments and regions. Retail sales grew again in June and July in the EU and the US, while industrial production lagged behind. In China this situation is reversed, and statistics are a little hard to interpret since January and February are lumped together, but here too the collapse was severe. For example, auto production in China fell by half during the first quarter.

solar energy sector and the rapid roll-out of rooftop solar panels is the administration's new requirements that all solar energy production must be overseen by a federal authority. It is feared this authority would then intervene in price-setting in order to put a stop to the trend we see today towards distributed generation of electricity. The stock market has also already partly discounted a Democratic victory; the trend in US opinion polls (at the state/electoral college level since national averages are irrelevant) is probably one important reason for this summer's positive performance of environmental technology equities in general and renewable energy equities in particular.

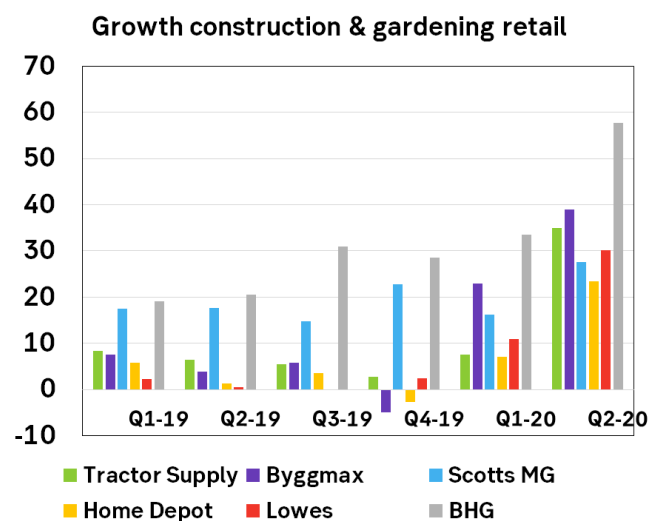
Much of the world economy is already growing again

The recovery has been faster in the stock market than in the real economy – a statement that has been frequently repeated by market analysts, economists, fund managers and financial journalists over the past six months. That statement is totally correct, and perhaps the stock market trend has been a little too fast and driven just as much by central bank stimulus measures as by economic recovery. After all, financial markets always try to factor in future developments in advance. But important parts of the real economy are now also growing again. Retail sales are growing in Europe and the US, while industrial production has more than recovered in China, which is also reflected in sharply higher prices for important industrial commodities such as copper and iron ore.

Winners from the "staycation" trend

Although retail sales are again growing, our habits have changed significantly. More time spent at home and social

Exceptionally strong growth in the construction, home furnishing and gardening sectors



The chart shows sales growth per calendar quarter (or the closest quarter for companies with a non-calendar fiscal year) for six US and Swedish companies that specialise in building materials, home furnishings and gardening products. Growth has accelerated sharply during the coronavirus crisis, with households giving higher priority to their homes and gardens.

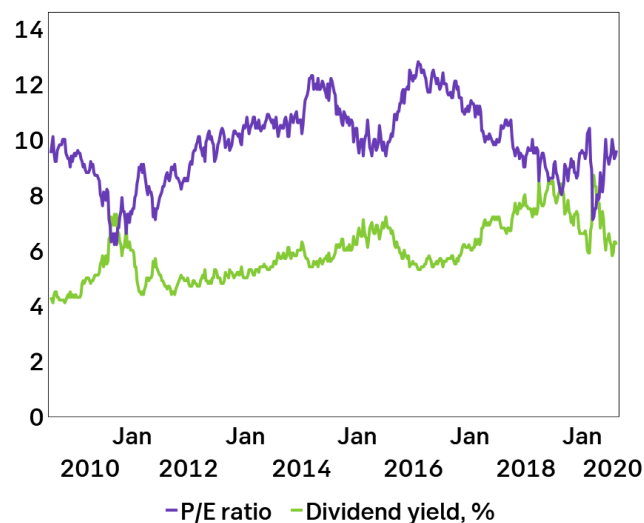
distancing have stimulated interest in home improvements, re-decorating, gardening, camping, pleasure boats, home gyms, cycling and more. In contrast to the hoarding of toilet rolls and canned goods that characterised the first few weeks of the coronavirus crisis, but which has eased since then, we believe the staycation trend may very well continue for a long time. Just as we predict that e-commerce will remain at a permanently higher level, with continued growth, interest in everything from caravans to gardening may very well stay at higher levels than before the coronavirus crisis for many years to come. A clear breakthrough for home renovations and gardening was apparent even during Q2 2020. Note the sharp increases for some companies in Sweden and the US, in the chart above. However, the summer holiday period in the northern hemisphere had not yet started in June, and almost all companies reported poor sales in April this year. More staycation winners should be apparent in third quarter corporate earnings reports.

Low valuations have been a trap in 2020 but will be an advantage again long-term

In the years right after the Lehman Brothers collapse, 2009-11, investment strategists frequently emphasised what a poor asset class equities were. Historical returns did not at all compensate for high stock market volatility, especially not for the most recent ten-year period. Today this argument almost sounds like a joke, but at the same time it illustrates the importance of not simply focusing on historical performance but rather taking valuations into account when discussing the stock market. In an analysis of the period 2000-10 and the surrounding years, valuations at the start and end of the period gave rise to seriously misleading conclusions.

The reason for emphasising this today is that valuations are important for future returns. It is not always a given – as in

Valuations of major Nordic banks have not kept up with the stock market in the past decade



The chart shows expected dividend returns and P/E ratios (consensus) on a rolling 12-month basis one year forward – in other words, forecast earnings/dividend for 13-24 months from each starting point, for six major Nordic banks. By looking an additional year forward, we avoid extreme and temporary effects of the coronavirus crisis. While stock market valuations have generally risen due to lower return requirements, the forward P/E ratio for banks has fluctuated within the same range for more than 10 years. The expected dividend yield of about 6 per cent is also within the normal range for the past decade and is about twice the stock market average.

2020 – that the higher valuations are, the better the outcome. All else being equal, lower valuations are preferable. Of course high valuations reflect expectations of better growth prospects, higher profitability and/or greater stability, but the higher a valuation is, the more sensitive an equity should be to unexpected setbacks. Today many excellent, well-run and profitable companies are valued to perfection; there are high expectations and nothing can go wrong. Not all of them will manage to deliver what is expected of them. Meanwhile expectations are very low for many other companies. In some cases, they need not deliver any growth at all going forward. Perhaps the most obvious example is banks. In itself, an expected dividend yield of about 6 per cent annually is sufficient to generate a competitive total return; neither earnings expansion nor multiple expansion is needed.

Summary and conclusion

Record-large quantitative easing has energised financial markets; elevated P/E ratios in the stock market may persist for a long time. Second quarter earnings reports provided very large upside surprises. The resilience of companies in this crisis is better than had been feared. Large parts of the economy are already growing again; the economic downturn was extreme, but the worst is over. Still, the recovery in the stock market is very unevenly distributed; expensive equities have become more expensive and low valuations have been a trap for investors in 2020. However, valuations affect the potential for future returns, and a major sector rotation may occur in the year ahead. Green companies will be the winners of the 2020s, but after the stock market upturn, selectivity in choosing equities is called for. The US presidential election will be very important in the near term. There is still great uncertainty about the coronavirus, economic growth and politics; this entails both risks and opportunities for equity investors.



Theme: Hydrogen

Key to a green future

Hydrogen technology companies have been red-hot in the stock market over the past year. A number of countries have recently declared national hydrogen strategies, and many large companies will be accelerating their hydrogen-related investments after the coronavirus crisis. “Green” (or “clean”) hydrogen – produced from renewable energy sources – offers solutions to many of the remaining purely technical barriers to the transition of our societies to renewable energy. Half of the necessary emission cuts in the European Union by 2050 could potentially be solved by increasing the use of hydrogen.

Filling gaps in the ongoing transition

Hydrogen gas can serve as an energy storage medium between high and low seasons, as a green fuel in heavy vehicles – where battery technology is not yet a viable alternative – and as a replacement for fossil fuels in energy-intensive process industries that have long been considered dependent on coal or natural gas, due to high process temperatures and/or chemical properties. But hydrogen is far from always green. Green hydrogen is also still very expensive to produce, and handling all hydrogen is associated with significant safety risks. However, there are hopes that the cost of green hydrogen will fall dramatically as production becomes more large-scale: possibly by 60 per cent even before 2030.

We see great potential for hydrogen to fill a number of gaps in the ongoing energy transition, but at the same time we consider it very risky for investors to be swept away by the prevailing stock market euphoria surrounding small start-up companies that work with fuel cells and/or hydrogen gas technology.

One alternative for long-term investors may be industrial gas companies, which do not have the same incredible potential but might still be big winners if the role of hydrogen increases, and which have significantly more down-to-earth valuations – limiting their maximum possible losses compared to small high-flying development companies.

Everyone is joining in

Recently governments, companies and not least the European Union have been competing to launch the most ambitious investments in hydrogen and related technology. Especially notable is the EU's brand-new Hydrogen Strategy, with its ambition to increase the region's green hydrogen production capacity to 40 gigawatts (GW) by 2030 while importing an equal amount from neighbouring regions, especially North Africa. Germany is expected to provide 5 GW of this capacity, but its national strategy foresees that the country will consume far more hydrogen than it can suitably produce within its borders. Germany is already seeking partnerships and import deals with neighbouring countries well situated for offshore wind power.

The Rocky Mountain Institute, a non-profit research and consulting organisation with a focus on the transition of our societies towards greater sustainability, sees hydrogen as critical to achieving climate goals. The International Renewable Energy Agency estimates that 6 per cent of global energy consumption by 2050 will consist of hydrogen, while Bloomberg New Energy Finance (BNEF) believes that as much as 24 per cent is fully possible.

Many companies have also recently announced new investments in hydrogen. US-based Air Products announced in July that it is joining with ACWA Power in Riyadh and NEOM – a planned futuristic city in Tabuk province – to invest USD 7 billion in a giant hydrogen project in Saudi Arabia, where

solar and wind power will be converted into ammonia for export.

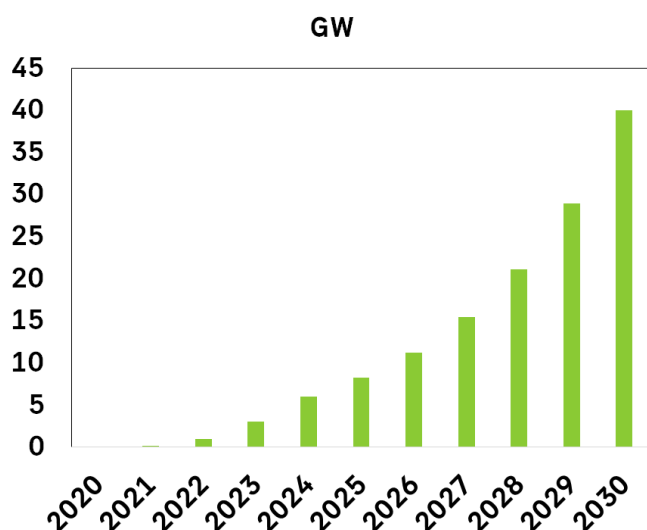
A consortium of large Danish firms including Ørsted, DSV Panalpina and AP Møller-Mærsk announced in May that they will jointly build up 1.3 GW of electrolysis capacity by 2030. This hydrogen production will be based entirely on electricity from wind power, and the hydrogen will be used as fuel for trucks, ships and aircraft. The expansion will take place gradually, with the first 10 MW of electrolysis capacity in place by 2023.

At least seven steel companies around the world are working on projects in which hydrogen will replace coal in the production of steel. These include Swedish-based companies such as steelmaker SSAB, which is working with the iron ore mining group LKAB and the power utility Vattenfall. But significantly larger European steel producers such as ThyssenKrupp and ArcelorMittal have similar projects. Siemens and the electric utility Engie are building a pilot plant in France, where hydrogen will be used to temporarily store energy from surplus electricity and then fuel a hydrogen turbine for electricity production when shortages arise.

Several oil companies, including Norway's Equinor (formerly Statoil), also want to be involved. This applies not only to "blue" hydrogen, for which they can sell their natural gas without causing carbon dioxide emissions, but also "green" hydrogen, a field in which the oil major BP is evaluating a large project in Australia. The number of members of the interest organisation known as the International Hydrogen Council has climbed from 13 three years ago to 81 today.

All in all, these well-publicised developments related to the potential of hydrogen have fuelled the risk appetite of investors and speculators in hydrogen and fuel cell-focused project companies. A group of eight European (including Nordic) and North American shares with exposure to hydrogen technology – focusing on fuel cells, electrolysis and vehicles – has soared by 150-560 percent in just one year.

EU plans to invest heavily in hydrogen



Source: The EU Hydrogen Strategy, July 2020

The chart shows planned EU electrolysis capacity in gigawatts (GW). The EU's targets are for the 2024 and 2030 levels. The trend between these dates is our estimate, assuming a steady percentage growth rate during the period. To make the scale of these ambitions easier to understand, the Rocky Mountain Institute explains that 1 GW of electrolysis capacity is what is needed for 100,000 hydrogen-powered buses, 27 large container vessels or one steelworks with an average-sized blast furnace.

Green, blue or brown hydrogen?

Green hydrogen – the current focus of politicians, companies and investors who see hydrogen as a key element of the transition to more environmentally friendly technology – accounts for less than 4 per cent of hydrogen production in Europe. Green hydrogen refers to hydrogen extracted from water with the help of electricity from renewable energy sources, mainly solar and wind power. Ninety-six per cent of all hydrogen for industrial use is still produced by separating hydrogen from natural gas or by using gasification of coal.

An intermediate strategy is extraction of hydrogen from natural gas or coal combined with carbon capture and storage (CCS), which is often called blue hydrogen. In practice, it is very difficult to completely eliminate carbon dioxide emissions in this way, but they can be reduced by about 90 per cent at a reasonable cost. Regardless of the production method, hydrogen itself is colourless. This theme article fo-

cuses on the potential of green hydrogen, while also noting that blue hydrogen might play a significant role as a transitional solution, since existing hydrogen production facilities can be supplemented with CCS at significantly lower costs than construction of new green production capacity.

Vehicle fuels

With the help of fuel cells, hydrogen can be converted into electricity, providing an alternative to batteries with both advantages and disadvantages. In passenger cars, the battery alternative has already gained a strong lead over fuel cell vehicles. With very few exceptions, the future strategies of major auto manufacturers have focused almost entirely on battery-powered cars.

In heavy long-distance haulage, however, batteries are not yet a commercially viable alternative and time is running short to come up with emission-free solutions. Fuel cells are already a major success in forklifts. According to industry giant Toyota Industries, 60 per cent of all new forklifts are now hydrogen-powered. Going forward, hydrogen has exciting potential as a fuel for trucks, locomotives, buses, aircraft and ships, either pure or in the form of a hydrogen-based synthetic fuel. One advantage of synthetic hydrogen-based fuels over bio-based alternatives is that they do not require biomass, which may require competing for land with agriculture, forestry and wilderness.

Japanese automaker Toyota Motors has long advocated the fuel cell alternative, but South Korean companies have also come a long way in this field. South Korea is aiming at 310 hydrogen filling stations as early as 2022 and a nationwide network of 1,200 stations by 2040. These ambitions have also helped lay the groundwork for related exports. In July 2020, Hyundai shipped its first 10 fuel cell-powered electric trucks to Switzerland in a high-profile venture to build a truck fleet there in partnership with Swiss-based H2 Energy. In Switzerland, emission-free commercial vehicles do not have to pay road tax. According to Hyundai and H2 Energy, this provides a sufficient financial incentive to level the playing field between fuel cell-powered and conventional diesel trucks. Hyundai expects to deliver 1,600 trucks of this type by 2025.

In the United States, investments in fuel cells – as well as environmentally friendly technology in general – are being driven by California. The state currently has 41 hydrogen filling stations, making good service possible at least in metropolitan regions. By 2040, there will be 1,000 stations located throughout the state. However, many other US states are well on their way to following this example. The governors of 15 states recently signed an agreement that all heavy vehicles should be emission-free by 2050 and that their share of fleets will be 30 per cent by 2030. Although "emission-free" may include other solutions, it probably implies extensive use of hydrogen or hydrogen-based synthetic fuels. Together, these 15 states make up 35 percent of the US truck market.

Fuel cells are just one of many applications in which hydro-

gen can be very important. The need for an emission-free molecule is even greater in several other applications besides the transport sector.

Energy storage

The current global energy transition will require a higher percentage of electricity coming from "variable" sources such as solar and wind power. These sources produce a surplus of electricity when weather conditions are favourable; zero or negative electricity prices are already common in many geographic areas. This requires storage of electricity, and here too hydrogen can play an important role. Today, natural gas in some countries – notably in Germany – is being mixed with hydrogen to reduce emission intensity. Meanwhile the existing natural gas infrastructure can be used for transport and combustion of hydrogen gas.

By producing hydrogen from water by means of electrolysis when electricity is cheap or free, energy use can be postponed until it is needed, either in existing natural gas infrastructure for electricity generation or space heating, as vehicle fuel or as a process industry input. One advantage of hydrogen as an energy storage alternative – compared to batteries and thermal storage solutions – is that it can handle supply and demand imbalances over a longer time period: between seasons, not just between days. Another advantage of hydrogen compared to pumped hydropower is that the latter is dependent on specific natural conditions. In many countries where natural gas is currently being used for heating, hydrogen can also be used in the existing space-heating infrastructure (as a synthetic gas mixed with natural gas or pure in upgraded infrastructure) without taking a detour via electricity, resulting in lower seasonal variation in electricity demand.

If green hydrogen is to become a major industry in the long run, consistent with the ambitions that the EU and most of its member countries are now communicating, actual hydrogen production can also serve as a stabiliser for power systems. It is far cheaper to have surplus capacity in electrolysis plants than in electric power generation plants. A capacity relationship can thus be created in which hydrogen production intensifies when there is an oversupply of electricity and shuts down when there is a shortage. This would reduce electricity loss due to involuntary production restrictions from wind and solar power plants during periods of favourable weather, while electricity-intensive electrolysis plants could be put on hold in periods of electricity shortages or high electricity prices.

A solution for the process industry

Hydrogen is one of many alternatives for energy storage. In portions of the transport sector it can expect fierce competition from batteries, especially for lighter vehicles. But there are a number of industrial applications where today hydrogen is the only existing alternative to fossil fuels. This includes both applications requiring very high temperatures and those that are dependent on chemical reactions with hydrocarbon molecules in fossil fuels. Important sectors

that contribute significant carbon dioxide emissions today, and where electrification is not an option but hydrogen has the potential to function much better, include steel, artificial fertilisers and various chemical plants.

Safety risks

On June 10, 2019 a hydrogen filling station outside Oslo exploded and burned. No one was injured, but the shares of Norwegian-based Nel – the company that supplied the filling station – plummeted 30 per cent in two days. Hydrogen is highly flammable, explosive and volatile, requiring strict handling standards to avoid accidents. But it has been an important and heavily used industrial gas for at least 50 years, and there is widespread expertise among industrial gas companies and certain process industries in its safe handling, storage and transport. Modern hydrogen fuel tanks experience a minimum of leakage and have safety valves to prevent explosions. However, expertise in the safe handling of hydrogen is likely to be extremely valuable in a society where the importance and use of the gas will dramatically increase in scope – as many people today are expecting, planning for and speculating on.

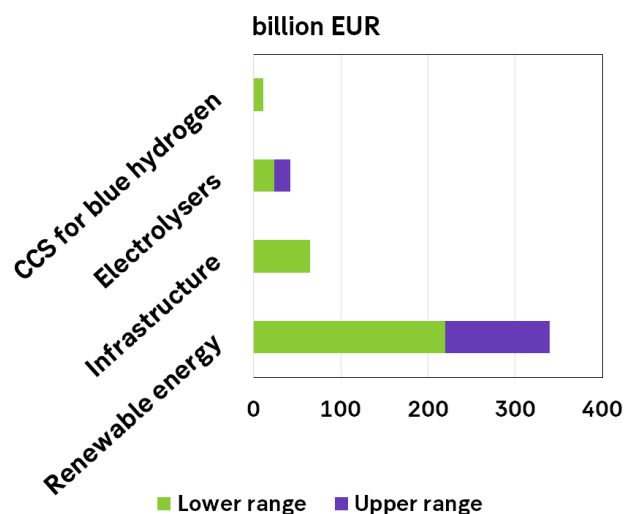
High costs that may fall rapidly

Hydrogen is very useful, but the increased use of traditionally produced hydrogen from natural gas or coal entails no (or little) environmental benefit, and green hydrogen is still very expensive. Hydrogen will probably remain expensive compared to the fossil fuels that authorities now hope it will replace, as long as users are not forced to pay a high price for carbon dioxide emissions caused by current fuels. However, there are many indications that production costs may fall rapidly and significantly in the future – based on large-scale use, more experience and continued development work. BNEF estimates that the EU's ambitious hydrogen plans will reduce the cost of green hydrogen production by 60 per cent to USD 1.50 per kilo by 2030. This is on a par with or cheaper than blue hydrogen, given current historically low natural gas prices in the United States. Even with free natural gas, BNEF estimates the cost of blue hydrogen at about USD 1 per kilo, about half for the extraction of hydrogen and half for the capture and storage of carbon dioxide. Morgan Stanley also estimates that the cost of hydrogen may fall much faster than most observers have expected so far. The same investment bank estimates that electrolyzers in close proximity to power plants, plus an extension of the US production tax credit (PTC) enjoyed by wind and solar energy in recent years, can make green hydrogen commercially competitive in as little as 2-3 years. The world's largest industrial gas producer, Linde, estimates that a cost reduction of 50-60 per cent from today's price of about USD 4 per kilo for green hydrogen is quite possible over the next decade.

Green hydrogen requires a lot of renewable electricity

Provided that political leaders around the world continue to favour hydrogen and provide the necessary support in the form of regulations, carbon taxation and other incentives,

Renewables cost more than electrolysis



Source: EU Hydrogen Strategy, July 2020

The chart shows expected investments by category in order to achieve the EU's 2030 hydrogen production target. The largest investment need is for renewable energy sources, but the amount required for related infrastructure is also larger than for actual production (electrolysis) plants.

BNEF sees potential for nearly 700 million tonnes of hydrogen to contribute the equivalent of 24 per cent of global energy consumption by 2050 in a 1.5 degree global temperature increase scenario. This will probably mean a market worth USD 700 billion a year at today's prices, but it will also require USD 11 trillion in investments, mainly in renewable energy but also electrolysis plants and hydrogen distribution and storage infrastructure. To produce close to 700 million tonnes of hydrogen, more electricity will be needed than today's total global production – just to produce hydrogen. Since this electricity must be green, it means that the world needs 10 times more renewable energy than today's global capacity, just to produce hydrogen. In such a scenario, it is also reasonable to continue electrifying society in general, and BNEF estimates that the total capacity requirement for renewable energy in 2050 will be more than 20 times today's global capacity. Such a massive expansion will require enormous physical resources in the form of land for erecting solar panels and wind turbines, but also water from which hydrogen can be extracted. A world like this is still a long way off, but it is not surprising that many investors are fascinated by the potential.

Hydrogen stocks – great potential, but beware of hype

The potential of hydrogen and fuel cells has been known for a very long time. The technology exists, but in practice the right commercial conditions for green hydrogen have not existed – until now. Climate crisis awareness, experience from extensive testing of various applications in recent years,

Risk of collapsing market prices?



Source: SEB, Bloomberg

The chart shows the performance of an index that is based on the shares of eight companies in Europe and North America that mainly focus on hydrogen-related technology, including electrolyzers and fuel cells. The growth outlook is probably very good for several of these firms, but after the extreme price increases of the past year, expectations are already high.

the lack of other climate-smart alternatives in certain key industries and a deep recession due to the coronavirus crisis have combined into a perfect cocktail for the breakthrough of large-scale green hydrogen production.

There has been great enthusiasm about fuel cells and hydrogen technology a number of times historically, but the fact that we are now getting strong regulatory support both in the EU and elsewhere suggests that this time it is for real. We are thus not surprised by the euphoria surrounding hydrogen technology and fuel cell companies in the Nordic region and around the world.

However, there is an obvious risk that reality will not keep up with the pace that financial markets today seem to be discounting for companies with a focus on electrolyzers and/or fuel cells. The hydrogen market may well be poised for very rapid growth in the coming years, but other stocks besides the most obvious winners may benefit the most from today's levels.

There are alternatives to buying the hottest and most hopeful companies. The potential of these other companies may not be as dizzying, but they already have proven business models and predictable earnings at reasonable valuations.

Increased use of hydrogen will require far bigger investments in renewable energy and in infrastructure for storage and distribution than in the actual hydrogen production facilities (electrolyzers). Based on European Commission estimates, more than eight times more investments in renewable energy than in electrolyzers will be needed to achieve the Commission's hydrogen targets. Twice as much investment will be needed in related transport, distribution and storage infrastructure.

If we look instead at the USD 7 billion project that Air Products is pursuing with its local partners in Saudi Arabia as a concrete example, the tilt towards distribution infrastructure is even greater. In addition to the USD 5 billion investment in power generation and production assets, as much as USD 2 billion worth of related infrastructure for handling and export of hydrogen and its derivatives will be needed.

Conclusion

Hydrogen has environmental advantages and the technical potential to become a vital piece of the puzzle in the transformation to a carbon dioxide emission-free economy. Many factors are coinciding to create a very promising environment for green hydrogen. After decades of hopes and speculation, it is now poised for an imminent, large-scale commercial breakthrough. The growth potential is dizzying, but the challenges are significant. Meanwhile we see great risks in being caught up in the euphoria now surrounding many hope-inspiring niche companies focusing on hydrogen-related activities. There are alternatives that are less speculative but that may also benefit from current trends.

Theme: Ageing populations

Megatrend with investment potential

According to Statistics Sweden, the population of the country (now close to 10.4 million) will exceed 11 million in 2028. The largest increase, in percentage terms, is expected among those aged 80 and older – a full 50 per cent. The United Nations confirms this trend and expects the number of people aged 80 and older to triple between 2019 and 2050, from 143 to 426 million globally.

The ageing of the world's population will create investment opportunities. As we age, our economic behaviour changes while our need for care increases. That affects a number of sectors, such as pharmaceuticals, health care, elderly care and consumer products. Meanwhile there is growing pressure on pension systems, public transport and infrastructure.

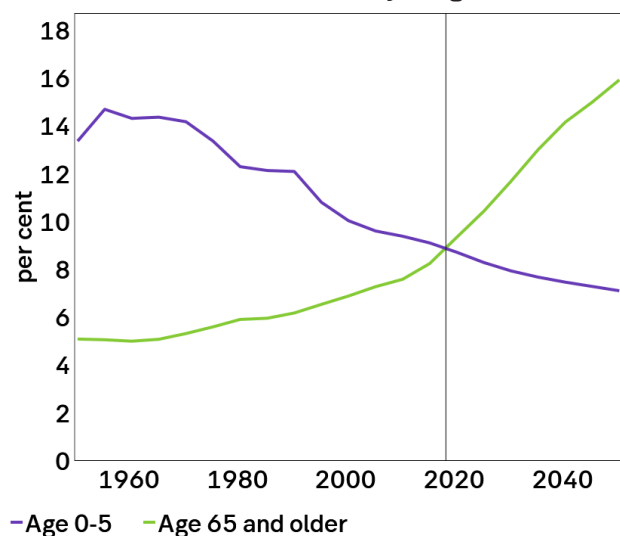
Why are more and more people living longer?

Researchers are divided as to whether we are actually living longer, in terms of maximum age. Some believe that the risk of a 100-year-old dying today is the same as 40 years ago and that the maximum age someone has reached does not seem to be climbing either. Other researchers expect a 120-year-old Swede by as early as 2050.

However, what is clear is that the demographic structure is changing and that average age is increasing rapidly both in Sweden and globally. This is essentially due to two factors – falling birth rates and high, increasing average life expectancy – which are shifting the line dividing the older and younger halves of the population, with the older population growing at a faster pace. Today the increase in average life expectancy is due almost exclusively to reduced mortality among people 65 and older: a result of more effective health care and medical advances, improved living conditions and better lifestyles due to public health measures.



Older adults now outnumber young children



Source: The UN's "World population prospects", April 2020

In late 2017, the number of people 65 and older surpassed the number of children under five, and the older group's share of the total population is growing rapidly.

Diseases of affluence on the rise, even in low-income countries

Unfortunately, our modern lifestyle is in many ways detrimental to people's health. We exercise less, while we stress and eat more – and then mainly processed food. People are indeed living longer, but "diseases of affluence" are also steadily increasing. According to the Public Health Agency of Sweden, 90,000 people in the country fall ill each year with diseases linked to food and physical inactivity. Today half of all adults in Sweden are overweight or obese – a doubling since the 1980s. This trend is accelerating even faster among older schoolchildren; the percentage who are obese has doubled since the 1990s. The World Health Organisation (WHO) sees the same trend globally and believes overweight or obesity can no longer be categorised as a developed world problem. Nowadays it is also found to a growing extent in low- and middle-income countries.

The trend in mental well-being is also gloomy. A 2018 report from the Swedish National Board of Health and Welfare indicates that anti-depressant prescriptions are on the rise, including to a growing share of children – mainly girls. How will this affect them, and society in general, when they enter the workforce in a few years?

Yet there is growing awareness among consumers of the long-term effects of our modern lifestyle. Foods marketed as natural, organic or healthy are increasingly available. Studies also show that more than 75 per cent of people around the world are willing to pay a higher price for healthier food; the same is also true of exercise. Nowadays physical activity may be prescribed as a complement to, or in some cases instead of, medication. The market for food supplements and sport nutrition is also growing; in 2019 Swedes spent more than 5.5 billion kronor on such products, and in neighbouring Norway and Finland the average consumption of food supplements is more than twice that in Sweden. This health trend – in terms of food, exercise and general lifestyle – is probably here to stay.

Megatrends that have attracted increased attention

In previous issues, we have written about megatrends such as sustainability and digitisation. Megatrends are always relevant; that is what makes them megatrends. But one could argue that all three – sustainability, digitisation and ageing – have been especially relevant this past spring and summer. For example, the gigantic fiscal stimulus packages launched by governments provide opportunities for sustainable investments, while social distancing has accelerated the use of digital solutions. Meanwhile the spread of COVID-19 has not only highlighted differences in the demographic structures of the countries that have been affected, but also in the functioning of health care infrastructure around the world.

It is good news that people are living longer, but given falling birth rates in advanced economies, it also means that fewer people will have to support more pensioners as the working-age share of the population decreases. In the February issue of *Investment Outlook*, we discussed automation using robots as a potential solution to the resource shortage. Robots, as well as other digital solutions, would probably improve the quality of care and shorten queues, thus further fuelling the demographic trend. Sustainability-related investments may also bolster the trend, for example, through the construction of hospitals and elderly care facilities as well as through initiatives to improve air quality and increase access to clean water.

Growing potential in health care

Although China has been heavily criticised for its handling of COVID-19 at an early stage, the pandemic would probably have developed into something much worse without the country's digital solutions. Long before other countries, China as well as South Korea tracked the spread of the virus in part through facial recognition technology and thermal cameras. Meanwhile, officials communicated with selected members of the population via apps, depending on their proximity to infected people and any points of contact in their movement patterns.

However, health technology – or health tech – has even greater potential. WHO defines it as the application of organised knowledge and skills in the form of devices, medicines, vaccines, procedures and systems developed to solve a health problem or improve quality of life. Using artificial intelligence (AI), doctors can make faster diagnoses and customise patient treatment plans, freeing up staff and reducing the risk of misdiagnosis. AI also enables the processing of large quantities of data, which should speed up the development of medicines. To give a few examples: Using 3D printing, medical devices can be produced cost-effectively on a small scale. With the help of robots and drones, people who show symptoms of a disease can be identified and examined without the risk of infection spread.

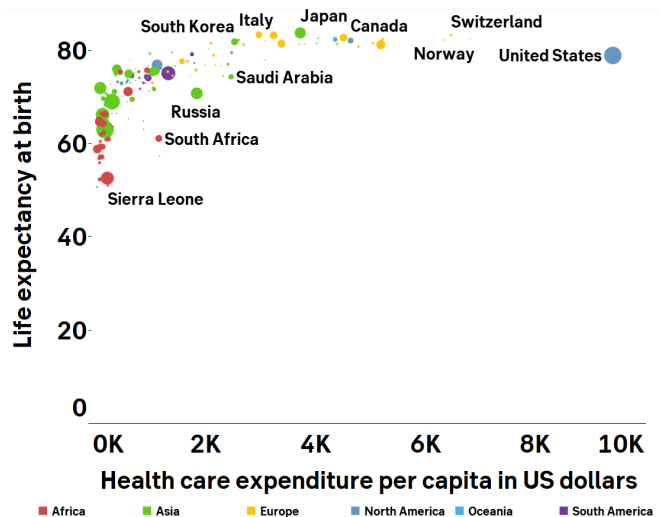
Different generations show different saving and consumption patterns

The longer we live, the more money we spend on health care. On average, an 80-year-old spends four times more than a 40-year-old.

Population changes will affect the chances of sustaining good economic growth, not only by limiting the labour supply, but also because older people exhibit different saving and consumption patterns than younger generations. But it is hard to determine which patterns are attributable to a given age category and which are instead due to the environment and circumstances under which a specific age group grew up. When people take out a mortgage and start a family, their savings ratio is generally lower, whereas it increases as they get older, earn higher incomes and approach retirement age. This is also true of consumption; young people need to get a place to live, a car and the like, whereas middle-aged people have usually already made these purchases. From that perspective, it is reasonable to believe that demand for services – relative to goods – will increase as the population ages.

Having said that, the age group between 55 and 75 is not just growing; it is often described as the group with the biggest purchasing power by far. Examples of areas that should benefit from an ageing population are various kinds of online shopping – especially for food and pharmaceuticals – and online medical consultations. This is especially true now after the COVID-19 outbreak, with online shopping having become a more natural part of many people's everyday lives. Another market in which older people should theoretically be a segment with strong purchasing power is self-driving cars, since their owners would still have all the freedom a car brings without actually having to drive it. This should probably attract older people, who for various reasons do not dare to (or should not) drive a car – for example, due to impaired vision or slow reaction time.

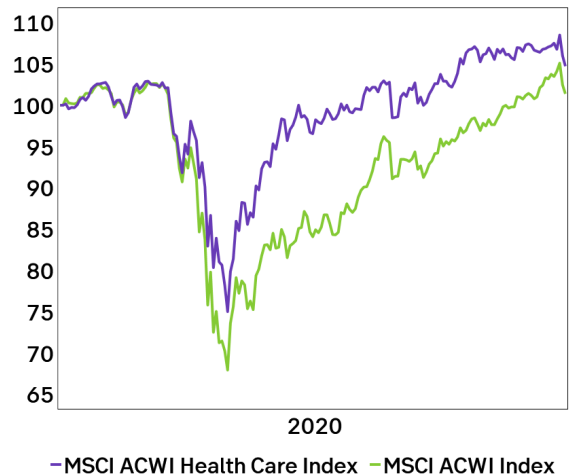
Strong correlation between life expectancy and health care spending, up to a certain limit



Source: The World Bank

As shown in the above chart, there is a strong connection between average life expectancy and a country's health care costs, at least up to a certain level. We expect that the current focus on health care will also continue once the pandemic subsides and that governments will prioritise health tech investments going forward. Such innovations have historically shown a low correlation with global stock markets, while the broad health care sector has performed relatively well during the crisis. Moreover, forecasts indicate that countries like the US and Switzerland will spend half their GDP on health care within the next 50 years.

Shorter fall and steeper rise



Source: Macrobond

The health care sector has outperformed the global stock market, both before the COVID-19 outbreak and since. Both are shown here in SEK.

It is reasonable to assume that, once people retire, a large part of their spending will be on leisure-related activities such as travel, food and drink, whereas job-related expenses such as office attire and transport will decrease. Meanwhile it may be a challenge for them to fund their pension, creating opportunities for insurance and wealth management companies.

Summary

Given the ageing global population, there are a number of areas with investment potential. As we get older, our economic behaviour changes, while our need for care increases. That affects such sectors as pharmaceuticals, health care, elderly care and consumer products. At the same time, there is increased pressure on pension systems, public transport and infrastructure. We expect the current focus on health care to continue once the COVID-19 crisis has eased, and we believe governments will prioritise health tech investments going forward.

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