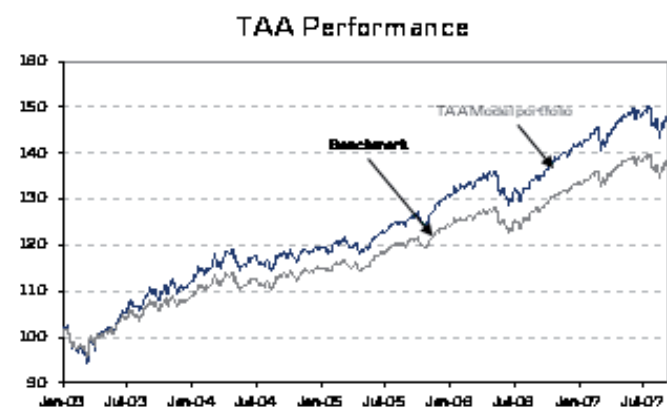


Tactical Asset Allocation

Danske Capital • 11 Sep. 2007



Historical Performance



Information Ratio: 1.4

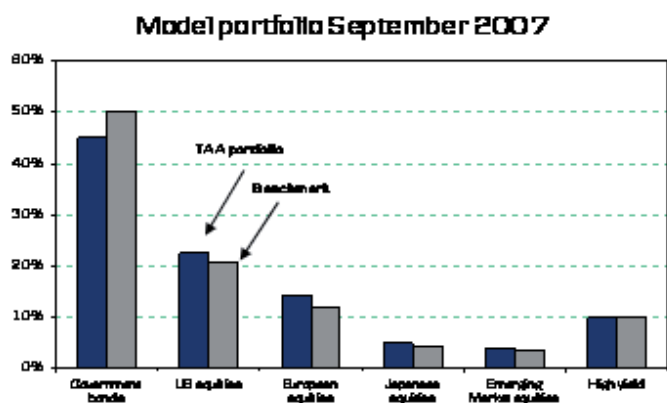
We have prepared ourselves for an increase in our own, as well as in our recommended, equity overweight from 5 to 8 percentage points. The increase will be allocated solely to Emerging Markets and will be funded through an increase in the government bond underweight. However, it has not been executed yet as we are looking for markets to stabilise a bit. The magnitude of the increase reflects the current nervous market conditions; we do not expect equities to fall much further from their current levels, but should we be wrong, we intend to increase our weighting further, i.e. on top of the 8 percent. We will send out a comment on the day that we execute the initial allocation change.

To us, the Fed discussion over the past 12 months has been about whether or not they would need to ease to underpin growth, not if they would need to cut to prevent a recession. We have long been arguing that the Fed would not need to cut - which in the end proved wrong! However, the consequences of the Fed's future actions are much more important than the eventual action itself.

We think the main reason why we were wrong about the Fed is twofold - we underestimated the magnitude and duration of the current dislocations in the money markets and we underestimated the consequences of the shock to the US economy from higher energy prices in H1. To us, however, the effects of the financial turmoil over the past month means that the US will grow below trend for longer than anticipated and such a scenario is by far the most positive scenario for global equities - Fed easing is just an added bonus. As we also disagree significantly with what is priced in interest rate markets, we judge this to be a good time to readjust the level of risk in our portfolios to better reflect the improved outlook.

The most important thing to us, however, is the nature of the current crisis, and here we disagree strongly with what seems to be the prevailing view. This is not a credit crisis (yet, anyway) but a liquidity crisis. The risk of the latter turning into the former, however, is increasing as we write. Central bank action so far has clarified that this is also the way it sees it - both the Fed and the ECB have been injecting massive amounts of liquidity into the money market. The Fed took it a step further on Friday 17 by extending the time period to 30 days (renewable by the borrower) and relaxing the constraints in the discount window (including a rate cut and an expansion of the range of instruments that may be used as collateral). The ECB followed suit by announcing a special 3-month re-financing option last week (while also displaying that it never precommits, choosing to stay on hold). Trichet hence signalled that the ECB is taking the current circumstances seriously. We expect the ECB to act cautiously in the near term, but retain our long held view that 4 or 4.25 percent will not be the end of the ECB tightening cycle.

Current recommendation



Note: Benchmark is rebalanced at the beginning of each year

Performance results:

Portfolio return 2007 (ytd): 3.2 percentage points
 Performance 2007 (ytd): 0.5 percentage points

All in all, central bank action so far has been aimed at trying to counter the problem of perceived counterparty risk as opposed to real counterparty risk. And although we do not think that the Fed is anywhere nearly as worried as markets about a recession, we simply think that FOMC members do not dare disappoint markets at this point in time. The magnitude of Fed easing truly depends on the chosen approach by Bernanke & Co, i.e. the (Greenspan) "risk management" approach vs the (Volcker) "do the right thing" approach – and by that we mean the following; the "risk management" approach would likely see the Fed easing aggressively in both time and scope while the "do the right thing" approach would likely mean only very few cuts, if any at all. We adhere to the latter as, in our opinion, 1) the FOMC is extremely worried about a significant reacceleration in growth from these levels of capacity constraints and 2) it truly wants to make a point of not bailing out economic agents that have acted irresponsibly (banks and hedge funds) and recklessly (subprime borrowers) and 3) does not want to be seen as alleviating effects from illegal activities (sub-prime, again). Most importantly, we think the FOMC can afford less tightening than what is priced in the markets due to the underlying fundamentals. We thus expect the Fed to surprise markets by its relative hawkishness.

The investment case for Emerging Markets remains self evident. On a global scale, EM equities are not expensive (though

they are not as cheap as they used to be either). Furthermore, we firmly believe that the EM complex should be trading at a premium to developed markets to reflect the superior growth outlook and the improved macro fundamentals, especially when it comes to Asia. In addition, we do expect US monetary policy to work and thus expect to see the normal relationship between US interest rates and equity performance to materialise over the next 12 months (as signalled by our indicators).

The pessimistic view of the world is mainly built on 1) excessive levels of leverage (the US consumer and the global financial system) and 2) the exuberance in the equity space as signalled by the fact that global (and EM) equities have performed extremely well despite the fact that we are in the middle of a serious crisis.

To counter this we will point to a few key factors. The US household sector is leveraged, no doubt about that, but the subsector that is overleveraged is not the subsector that will drive the economy. The corporate sector is, if anything underleveraged. Finally, the increased leverage in the financial system goes hand in hand with an increase in the dispersion of risk. And finally, when wondering why equities so far have behaved relatively well we note, once again, that global equities are not the asset class that is mispriced. For more in-depth analysis, please see our latest quarterly investment strategy.

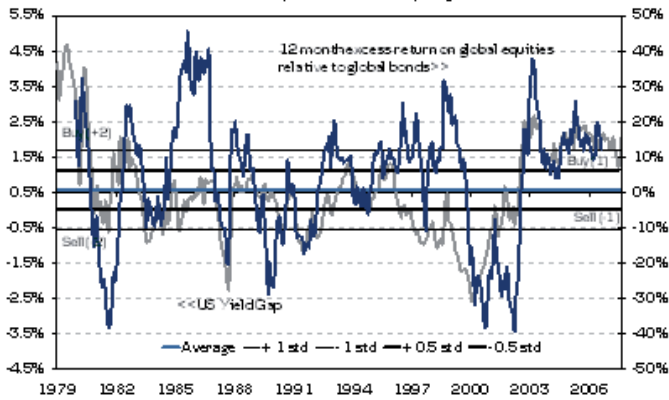
Latest strategy changes:

08/06/07:	Equities downweighted 5%, bonds upweighted accordingly. Global equities downweighted from 8% to 4%, European equities downweighted from 2 to 1%. Overall equity overweight 5%	22/08/06:	European equities upweighted 2%, bonds downweighted accordingly
25/04/07:	Global equities downweighted 2% to 8% overweight, bonds upweighted accordingly, European equity overweight of 2% retained, overall equity overweight 10%	07/06/06:	Japan, Emerging Markets downweighted to neutral, USA upweighted to neutral
01/01/07:	Equities upweighted 2%, bonds downweighted accordingly	01/01/06:	Equities overweight increased to 8% at the expense of bonds

Quantitative indicators for Tactical Asset Allocation

Asset classes	Equities/Bonds	High Yield/Equities	High Yield/Bonds
Valuation (+/- 2)	buy(+2) Yield gap	sell(-2) High Yield gap	sell (0) Credit Spread
Trigger 1 (+/- 1)	neutral (0) Risk appetite	sell (-1) Slope of the yield curve	sell (-1) Slope of the yield curve
Trigger 2 (+/- 1)	neutral (0) Production	neutral(0) Capacity Utilisation	buy (+1) Real Interest Rate
Trigger 3 (+/- 1)	neutral (0) Volatility	neutral [-1] Volatility	buy (+1) Investments
Total Score (+/- 5)	+2 neutral	-3 sell	+1 neutral

Real Yield Gap & excess equity return

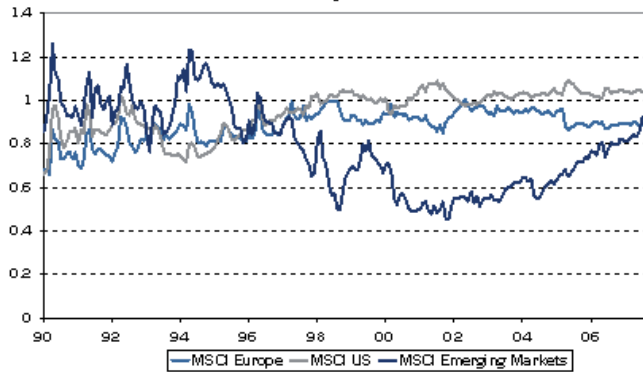


Has the Yield Gap lost it?

Though we do think that overweighting equities is now a true macro call, we judge the information inherent in our TAA model to be significant.

The main pillar is of course the Yield Gap which is once again signalling a strong buy for global equities. The major movement in the Yield Gap is due to the fall in US yields. As such, one has to believe in the expansion-ary effects of lower rates in the US from these levels, as well as corporate earnings. We do and would note the major difference between the current level of the Yield Gap and the episodes in 1987 and 1998 in comparable times of crisis.

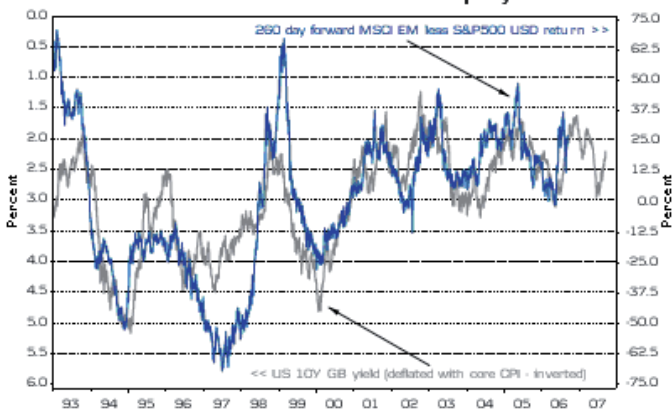
IBES 12M forward P/E - Relative to world



EM equities have massively outperformed developed market equities in this expansion, as well as over the most recent 12 months. However, we think that the EM story has some way to go, due to still attractive valuations (whether on a P/E, P/B, P/CE or dividend yield basis). Furthermore, compared to the late 90s internal as well as external balances are much more solid (LatAm and Asia displaying massive CA surpluses).

In addition, the global growth story is now hugely consensus. We do think this constitutes the early signs of exuberance, but given our judgement of global growth and EM fundamentals, we think excessive exuberance is some way off.

US interest rates & EM vs USA equity return

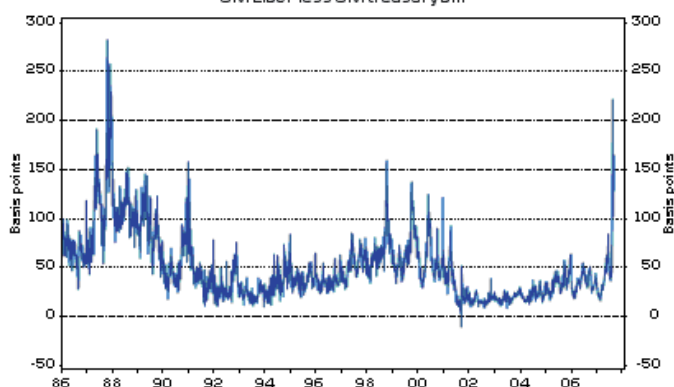


If we are right about the global macro outlook and the fundamentals in EM, allocating to EM is all about timing. Although we clearly missed the opportunity in the spring, we now think we have another good opportunity.

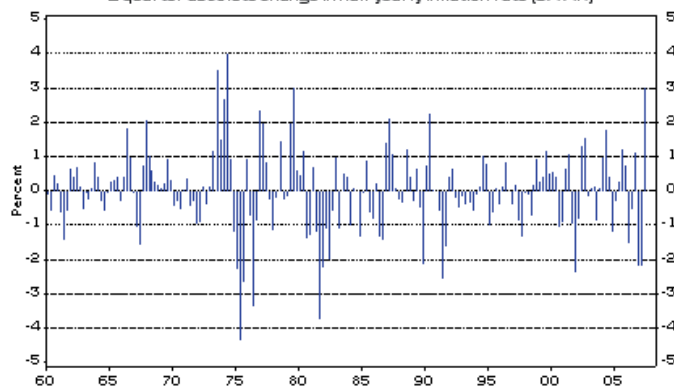
Short term, we think Fed easing will provide some momentum for global equities, though part of that move has most likely already been priced in.

Second, and slightly longer term, our regional equity allocation setup is signalling a high probability for EM outperformance over the coming 12 months. The chart on the left shows the relationship between the real US 10 year yield and EM 12M outperformance. Though the short-term outlook is thus a bit uncertain (which is also the main reason why we only plan to increase by 3 percent) we are confident that in 12 months' time, our allocation change will have paid off significantly. strength of the Euro, as illustrated in the chart on the left. The

USA: Treasury bills vs money market
 3M Libor less 3M treasury bill



USA: Headline inflation shock
 2 quarter absolute change in half-yearly inflation rate [SAAR]



main development since the last edition of this publication has been the dislocations in global money markets as illustrated for the US in the chart on the left.

We think it mainly reflects three issues. Banks are reluctant to deal with each other as no one knows who is infected with the subprime virus, no one knows just how far the virus has spread and no one really knows just how extensive the epidemic will prove to be. In addition, banks are right now taking various items onto their balance sheets including subprime related assets from SIVs and loans for M&A and LBO transactions, as well as honouring credit lines they thought would stay inactive. This is what central banks are trying to combat and we expect them to succeed, though it will take time (and disclosure).

The second reason why we think we have overestimated the strength of the US economy is because we have underestimated the shock to aggregate demand (and thus to companies' willingness to add labour) stemming from higher oil and gasoline prices in the first half of this year.

Although nominal consumption has held up, real consumption has suffered from the largest inflation shock since the first oil crisis in the 70s (as illustrated by the acceleration in headline inflation).

Going forward, we think households will continue to underpin aggregate demand and would note that if the US does truly enter a recession we will most likely be faced with an offsetting boost to real demand from lower commodities prices as in Q4, thus supporting aggregate demand.

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First date of publication

Please see the front page of this research report.

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