

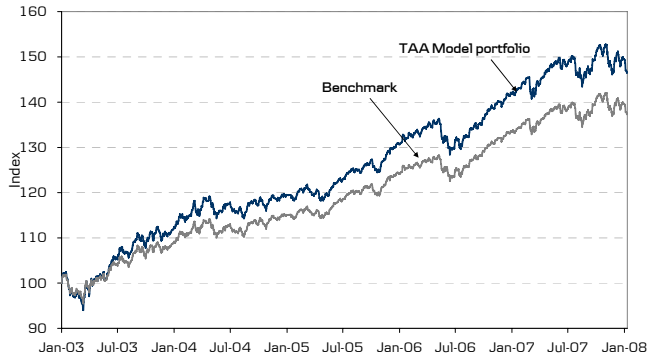
Tactical Asset Allocation

Danske Capital – 11 January 2008



Historical Performance

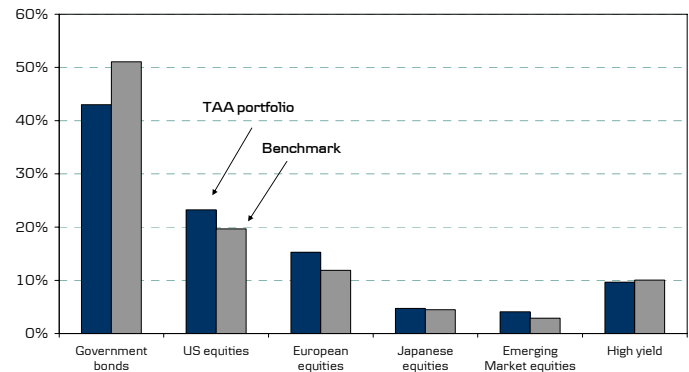
TAA Performance



Information Ratio: 1.4

Current recommendation

Model portfolio January 2008



Note: Benchmark is rebalanced at the beginning of each year

Performance results:

Model portfolio 2007: 5.2 percentage points

Performance 2007: 0.7 percentage points

Latest strategy changes:

- | | |
|---|---|
| 09/11/07: Emerging Market equities down-weighted 3%, global equities up-weighted accordingly. Overall equity overweight unchanged | 22/08/06: European equities upweighted 2%, bonds downweighted accordingly |
| 13/09/07: Emerging Market equities upweighted 3%, bonds downweighted accordingly. | 07/06/06: Japan, Emerging Markets down-weighted to neutral, USA upweighted to neutral |
| 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% | 01/01/06: Equities overweight increased to 8% at the expense of bonds |
| 25/04/07: Global equities downweighted 2% to 8% overweight, bonds upweighted accordingly, European equity 2% overweight retained, overall equity overweight 10% | 06/12/05: Cash downweighted to neutral 0%, bonds upweighted accordingly
Europe downweighted to neutral, US upweighted accordingly to -5% |
| 01/01/07: Equities upweighted 2%, bonds down-weighted accordingly | 20/10/05: Japan overweighted to +3%, USA downweighted to -7% |

It's crunch time - for pessimists and optimists alike! We are standing on the edge of what will either be a severe US recession or the longest US expansion in post WWII history. We are still in the positive camp and expect a scenario of the latter kind to play out over the coming quarters - we thus continue to recommend overweighting equities.

2008 promises to be a year of conclusions - especially for the US! Housing prices are falling, US consumer confidence is at recessionary levels, the flow of credit is threatened, energy prices are at historical highs and overall sentiment in financial markets, media and political circles is very negative. If the US economy really is powered by easy credit and speculative housing, if the fabled US consumer really is overextended and if corporate earnings really are unsustainable - then this is the year that will bring conclusions! It is likely to happen in H1 and will happen independently of whatever the Fed ends up doing in the very short term, although more easing is clearly in the pipeline.

If, on the other hand, the US economy is in fact as flexible and dynamic as we have basically been arguing for the past couple of years, then all of the above points of criticism (some of which we would label myths) will be proven wrong in 2008. The factors that we have pinned (and still do) our case on include solid corporate fundamentals, lack of overinvestment and overemployment, a resilient (but weaker than 05/06) labour market, unprecedented corporate leverage over employees, descent (and much better than in the 80s and early 90s) productivity growth, globalisation and in its wake, strong competitive pressures and finally a lack of restrictive monetary policy (now moving towards accommodative).

Speaking strictly of the economic side of the above argument, we feel vindicated as 2007 has come to a close. Having bottomed at 1.5 percent yoy in Q1 of 2007, US GDP reaccelerated to 2.8 percent in Q3. Though Q4 data has yet to be released, it is unlikely to come in below 1.5 percent (qoq AR), thanks in large part to continued solid growth in private consumption. Thus, in a year of falling housing prices, (rapidly) rising energy prices, financial crisis and rock bottom consumer confidence (in H2), US private consumption has done what it has done for so long - grown solidly!

Although the housing story (in terms of consumption) has yet to play out fully and will be with us for the next couple of years, markets finally seem to understand

that private consumption is not (and never has been) driven by increases in housing prices. Key, instead, is persistent growth in employment and wages which has now become consensus and that is why the labour market report spooked markets. Crucially, the weak employment report came on top of something much more important, the weak ISM, which (as long-standing readers will know) is our favourite statistic. With the New Orders component dropping to 45.7, something negative clearly happened in December. The question is if this is the first step towards the 35-40 range.

What do we do? We look at a range of high frequency (but very volatile) statistics including claims (which signal new slack in the labour market, but *not* recessionary slack), ISM Non-Manufacturing (where key sub-indices such as New Orders and Employment rebounded), the NFIB survey (where labour market indicators held up), the labour market report (which was weak but not catastrophic), FOMC minutes (for hints and anecdotes including references about tighter but still readily available credit), etc. And we combine these observations with our fundamental analysis and decide to stick to our allocation and not to call a US recession.

However, to make things very clear - we are not ignorant! Risks have risen and a US recession is more likely now than ever before in this expansion. The key point is that we think we are currently being paid a very attractive risk premium to stay in equities, and judging our 8 percentage point overweight to be a moderate overweight position, we are willing to bear the risk. Had we had a 10 to 15 percentage point overweight, we would have reduced some of our exposure now to reflect the increased risks to our expectations.

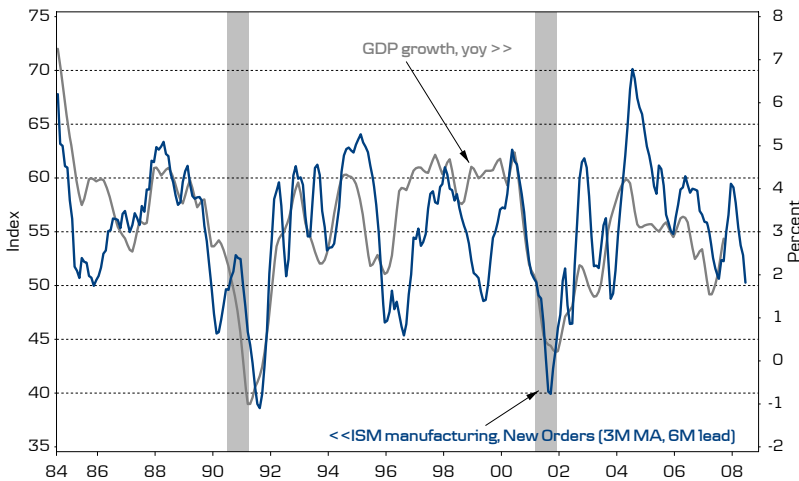
Having said all of this, we think it is crucial to have a period of (well) below trend US growth, which is still our call for the two coming quarters. Inflation *has* to come down and growth *has* to be weak, so as not to end up in a scenario three months' time from now with an economy that was not affected by the turmoil, continued acceleration in inflation and markets thus seriously questioning the Federal Reserves' capabilities.

In that respect, if anyone had any doubts, the Federal Reserve is also feeling the pain. The minutes from the December FOMC meeting clearly show a set of policy-makers who are more uncertain than ever. We expect them to err on the side of caution and thus continue easing monetary policy, even though we must admit that we have no clue as to how far they will go.

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	neutral (0) Credit Spread
Trigger 1 (+/- 1)	neutral (0) Risk appetite	sell (-1) Slope of the yield curve	neutral (0) 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 (0) Volatility	buy (+1) Investments
Total Score (+/- 5)	+2 buy	-3 sell	+2 buy

USA: Business confidence and GDP growth

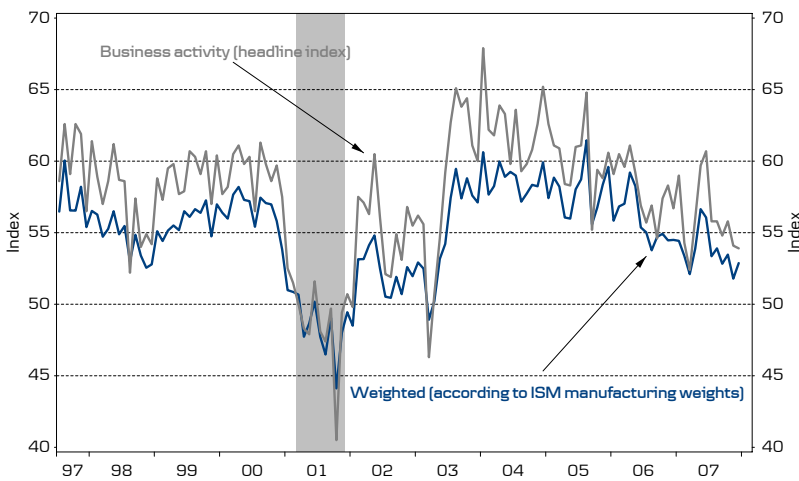


Where is the ISM headed?

We normally refrain from in-depth comments about the various risks to our main expectations, since we want to be as clear and precise as possible. However, given the current circumstances, we thought it prudent to highlight the risks as we see them.

First up, of course, is the drop in December's manufacturing ISM. The pivotal New Orders sub-index fell to 45.7. However, at these levels, it is consistent with sub trend US growth - which is exactly what we want in order to curb inflationary pressures and (longer term) secure the credibility of the Fed. Obviously, markets worry that this is the first step towards even lower levels. What happened in December?

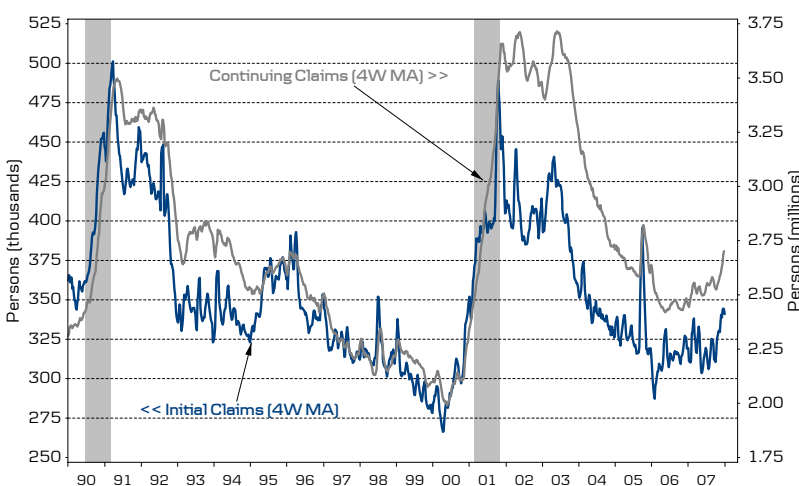
USA: ISM non manufacturing



Our best judgement is that it was an odd man out. We were expecting the ISM manufacturing index to remain subdued in early 08 due to a classic cyclical slowdown and recent oil price rises - but had not anticipated the kind of drop displayed above. The ISM Non Manufacturing index released a few days later was slightly stronger than expected, including improvements in New Orders and Employment.

The ISM manufacturing index has a longer and better track record than the Non Manufacturing index. Thus, if the ISM Manufacturing signal that all the negative news have finally hit corporate confidence, then ISM Non Manufacturing is likely to follow suit in the coming months. Such a confidence shock would pose a threat to investment spending and employment growth.

USA: Jobless Claims



On that note, something clearly happened to the labour market in late November and December. Although we would advise not to put too much emphasis on the NFP number in December (as it is extremely volatile month to month and prone to revisions), markets clearly got spooked by the 0.3 percentage point rise in the unemployment rate.

But to us, the information in the employment report was not too surprising as it had already been signalled by the claims data. Initial jobless has risen indicating that more people are losing their jobs, and so has continuing claims indicating that people who do get fired have a harder time finding a new job. We will be monitoring these data very carefully over the coming weeks, and continued weakness here will certainly move us closer to an allocation change.

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From the minutes of the December 11th FOMC meeting

“Some members noted the risk of an unfavourable feedback loop in which credit market conditions restrained economic growth further, leading to additional tightening of credit; such an adverse development could require a substantial further easing of policy. Members also recognized that financial market conditions might improve more rapidly than members expected, in which case a reversal of some of the rate cuts might become appropriate.”

“... Moreover, credit losses and asset write-downs at regional and community banks had generally been modest; these institutions typically were not facing balance sheet pressures and reportedly had not tightened lending standards appreciably, except for those on real estate loans. And, although spreads on corporate bonds had widened over the intermeeting period, especially for speculative-grade issues, the cost of credit to most nonfinancial firms remained relatively low; nonfinancial firms outside of the real estate and construction sectors generally reported that credit conditions, while somewhat tighter, were not restricting planned investment spending; and consumer credit remained readily available for most households.”

Even the FOMC is uncertain!

To us however, the anecdotes about credit availability are crucial. If the broader US economy had indeed experienced a true credit crunch last autumn, then such a shock would be starting to materialise in the official data around now – such as the ISM. However, these anecdotes (along with official data on consumer lending and bank balance sheets) strengthen our conviction that although financial conditions have clearly tightened in H2 (which, if conducted properly, is an excellent thing for the long term health of the US economy), we are not in the middle of a credit crunch.

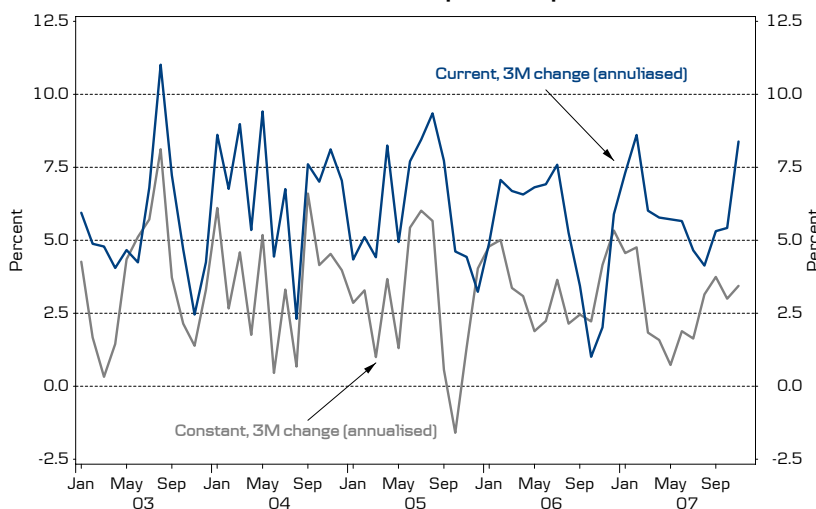
Instead, damage so far has been confined to major investment banks, which have been in the middle of the securitisation boom and now must face the consequences of their reckless behaviour. However, there are still risks to the financial sector and thus to the economy – the only way of monitoring this in real time for outsiders like ourselves is by monitoring money markets and see if the improvements in the wake of the CB intervention continues.

If all of the above mentioned risks materialise, that would most likely be the end for personal consumption growth.

However, so far, in the face of rising energy prices, falling housing prices and recession-like consumer confidence, private consumption growth has remained solid. If anything, it has reaccelerated during the autumn, driven by what was back then *still* a solid labour market.

Going forward, we expect a slowdown in growth (indeed we need a slowdown in consumption as it has been way too strong lately) but not a collapse. But risks are on the rise! Thus our advice is twofold. 1) Watch what consumers do, not what they say and 2) the labour market holds the key (as it has always done).

USA: Personal consumption expenditures



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