

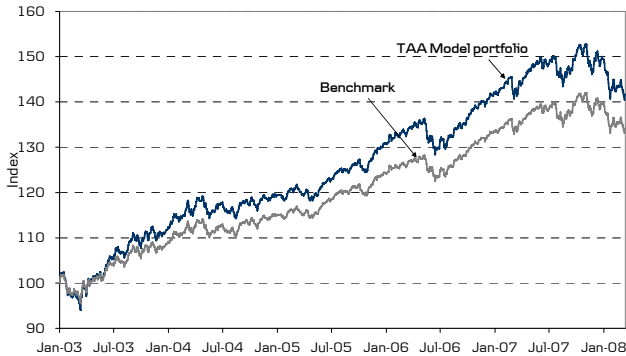
# Tactical Asset Allocation

Danske Capital – 14 March 2008



## Historical Performance

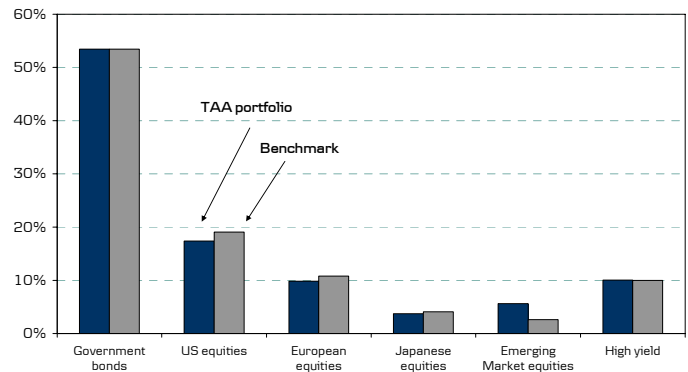
TAA Performance



Information Ratio: 1.4

## Current recommendation

Model portfolio March 2008



Note: Benchmark is rebalanced at the beginning of each year

### Performance results:

Model portfolio 2008 (ytd): -5.2 percentage points

Performance 2008 (ytd): -1.3 percentage points

### Latest strategy changes:

- 12/03/08: Equities downweighted to neutral, government bonds upweighted accordingly. EM upweighted 3% at the expense of the rest of the MSCI AC World index.
- 08/02/08: Equities downweighted from 8% to 5% (allocated according to MSCI AC World). European overweight neutralised.
- 09/11/07: Emerging Market equities downweighted 3%, global equities upweighted accordingly. Overall equity overweight unchanged
- 13/09/07: Emerging Market equities upweighted 3%, bonds downweighted accordingly.
- 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%
- 25/04/07: Global equities downweighted 2% to 8% overweight, bonds upweighted accordingly, European equity 2% overweight retained, overall equity overweight 10%
- 01/01/07: Equities upweighted 2%, bonds downweighted accordingly
- 22/08/06: European equities upweighted 2%, bonds downweighted accordingly
- 07/06/06: Japan, Emerging Markets downweighted to neutral, USA upweighted to neutral
- 01/01/06: Equities overweight increased to 8% at the expense of bonds

At this point in time we can no longer justify running an equity overweight. The liquidity crisis has reached new levels and the probability of a real *credit* crisis seems higher than ever. Add in the relentless rise in commodity prices and combine it with increasing uncertainty about the US outlook, risks of new lows for global equity markets are now very high before things turn for the better. We have thus cut our equity weight to neutral. However, we re-establish a *regional* overweight in EM, thus following our regional models as well as our long-standing optimism regarding the strength of the fundamentals in EM.

More specifically, we have the following advice. If you have followed us all the way down from the top with an equity overweight and cannot sustain a further drop of 5 to 10 percent over the next 3 months, we would recommend reducing your equity allocation. Have you been clever enough to run a neutral or even an underweight in equities throughout the past months, we recommend staying on the sidelines, but use dips in equity markets to add risk in preferred areas.

Why reduce risk now? It has been a very difficult decision! Equity and credit risk premiums have reached extreme levels and market sentiment is very poor - normally not a good time to reduce risk. On the other hand, the past 6 months have taught us that there is a big difference between what *valuations* imply and what markets will *price* - in essence, we still think that both global equities and most of the credit space are discounting something worse than we expect to materialise over the coming 12 to 18 months, but this will not prevent markets from discounting something even more disastrous - our own risk appetite index has not yet reached extreme aversion levels. Thus, as we have been wrong for the past 6 months we cannot afford to be wrong again for the next 3 months! In short - we opt to perform further risk management.

When will we add risk again? We need to see money and credit markets starting to function again and/or a complete collapse in market sentiment (i.e. for our risk appetite index to fall to extreme aversion levels). The former will not happen

until uncertainty about the magnitude of the losses from the US housing mess subsides. In that respect, our long standing assumption of total subprime/Alt A losses of USD 200bn now seems too low. We have been assuming a default rate of 15 percent and a loss rate of 50 percent (for both groups). By historical standards, these assumptions were very pessimistic. However, severe subprime delinquencies are now running at 20 percent, and according to a recent speech by Bernanke, the loss rate on the subprime foreclosures finalised in Q407 is indeed 50 percent. On top of that, we need to add losses from prime *and* non-residential real estate - losses that are no doubt increasing as money and credit markets continue to be in turmoil and lending standards are tightening.

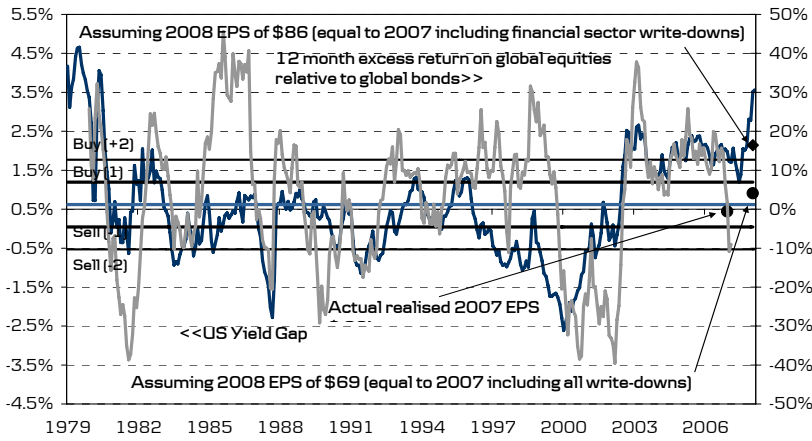
We will refrain from making a new formal assumption, as the extent of the housing mess continues to surprise us by its ugliness. However, we would note the following - by some accounts, the subprime related credit derivatives already imply subprime losses *alone* in excess of USD 400bn (compared to a total amount of outstanding subprime mortgages of 1.3 trn USD). Although these numbers are definitely impacted by the lack of liquidity, we think it goes to show just how *irrational* some markets are right now, and with the advent of *mark-to-market*, further liquidity problems can wreak havoc on financial market participants, hedge funds, investment banks and the like. And this is what worries us the most!

As Fed Governor Don Kohn recently said - this started with the housing market and it will end with the housing market. There are tentative signs of a stabilisation, but it is still too early to call. Therefore, we still retain an overall cautiously optimistic view of the US economy. It looks ever more likely that a formal recession will indeed occur - it might already have - but we continue to think that it will be mild, hence it is already in the price. However, risks of things turning very negative from here have increased, which is why we have decided to go neutral. In that respect, the next few months will be critical - hence, the crucial issue continues to be macro developments in the US.

### 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	buy (+1) Credit Spread
Trigger 1 (+/- 1)	neutral (0) Risk appetite	neutral (0) 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	-2 sell	+3 buy

### Real Yield Gap & excess equity return

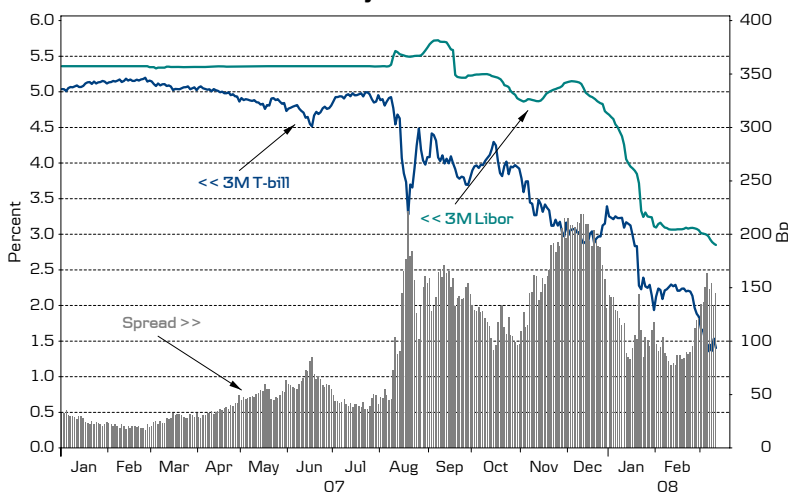


### Does the Yield Gap still work?

As illustrated to the left, our Yield Gap has been very wrong over the past year. What is the explanation for this? It is fairly simple - given the huge write offs in the financial sector, analyst estimates at the beginning of 2007 proved very wrong. That of course has happened many times before, but compared to history, equities never really became expensive this time around.

What about now? As we suggested in earlier editions of this publication, equities are already discounting a mild recession (or further write-offs). However, we want to be more certain about the macro and earnings outlook before adhering to the positive signal.

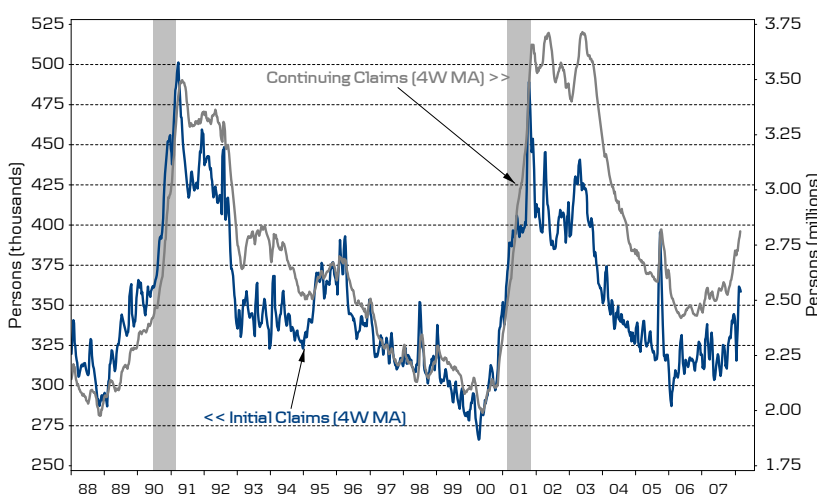
### USA: Money & T-bill market



One way of becoming more certain about the outlook is through stabilisation in money and credit markets. In March, liquidity in money markets once again dried up. Our best guess is that the reasons are the same - continued pressure on bank balance sheets, lack of trust between market participants, deleveraging by financial market participants, but above all, increased likelihood of further write-offs as prices of securities related to the US housing market continue to slide.

Once again, the Fed and other central banks have stepped in - will it work? To be very honest - we have no idea! This is not an LTCM style problem, where risk is concentrated on a few hands. US debt is spread all over the world - hence the only real solution to the problem is stabilisation in the housing market ...

### USA: Jobless Claims



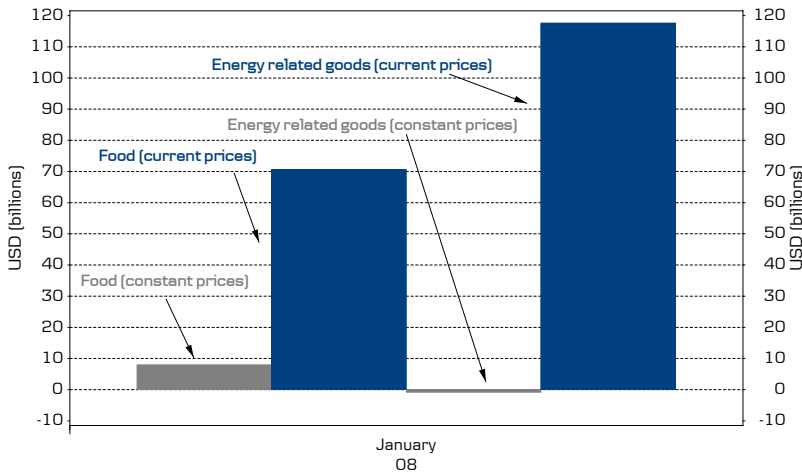
... which, at best, is only just beginning or at worst very far away. On a positive note - affordability has risen, consumer attitudes towards housing purchases have improved, homebuilder confidence has been flat over the past 6 months and so has pending home sales - all of this *during* the credit turmoil!

The labour market, however - our long-standing pillar of support and reason for sticking to our "no recession" expectation, finally shows signs of breaking, thus threatening the tentative stabilisation in housing. Compared to earlier recessions, claims are not yet disastrous, but they have seldom turned like they have now, without being followed by something even more negative. Thus, before adding risk, we want clarity about how bad the labour market will get and thus if we are in for renewed and accelerating stress in the US housing market.

Contacts:

Bo Christensen +45 4513 9644, Frederik Engholm-Hansen +45 4513 9664 & Søren Mose Nielsen +45 4513 9607

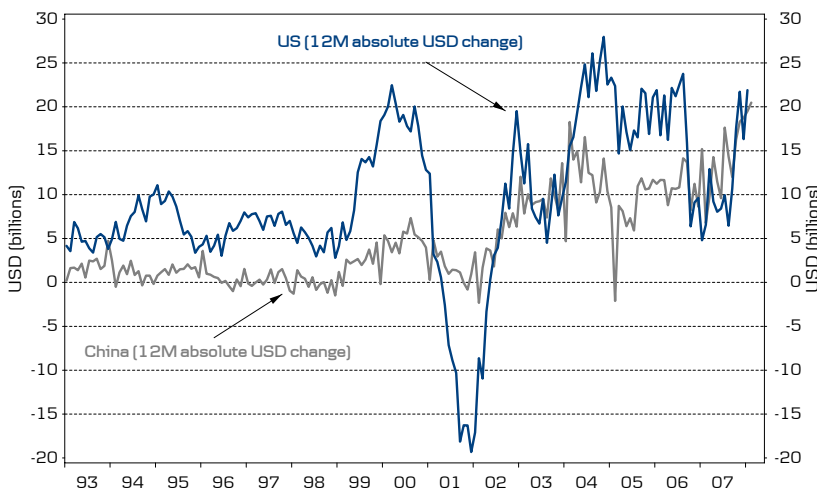
USA: Personal consumption  
12M absolute change



Why has the labour market weakened? First and foremost is the longstanding weakness in housing – on top of that we now have three additional shocks, including 1) in the financial sector (i.e. tighter credit), 2) the blow to confidence in general (for how long can we *talk* about recession without people acting on it), and 3) the blow to incomes from rapidly rising commodity prices. As illustrated to the left, spending on necessities has been broadly stable in real terms, but rising significantly in nominal terms, leaving less income to be spent on discretionary items.

We had expected commodity prices to stop rising or even fall as global growth decelerates – instead many commodities continue to make new highs – this *will* lead to lower growth down the road, if prices are sustained at these levels.

USA vs China: Imports



But why are we so concerned about oil prices going from USD 85 to 110 when they have already moved from 50 to 85? The answer is twofold – first, when oil prices accelerated in 05-06, it was at a time when the US economy was still growing above trend – hence the economy was better able to withstand the shock. Now, the US as well as the Euro area economy is weaker, thus increasing the vulnerability to the commodity shock. Second, the longer term rise in commodities has definitely been driven by strong global growth, and in that respect, as illustrated in the chart on the left, China plays an increasing role for global demand (for everything) *on the margin*.

We have no doubt that the global industrial cycle is strong, but even if the rise in commodities is growth related (the movements over the past weeks looks very speculative), there is just so much the US economy can bear, and right now we are worried that we have passed the threshold!

Disclaimer:

This publication has been prepared by Danske Capital for information purposes only. Any information or opinions herein are based on information obtained from sources believed to be reliable but which have not been independently verified. Danske Capital makes no guarantee, representation or warranty and accepts no responsibility or liability as to the accuracy and completeness of such information or opinions. Neither the information nor any opinion expressed herein constitutes an offer or solicitation of an offer to buy or sell any financial instrument. Such information and opinions are subject to change without notice. Readers should not replace their own judgement with any information or opinions herein and should, whenever necessary contact their investment adviser before making any investment decision.

Any information or opinions contained herein are not intended for distribution to or use by any person in any jurisdiction or country where such distribution or use would be unlawful and, specifically, are not intended for distribution to or use by any "US Person" within the meaning of the United States Securities Act of 1934, nor any personal customer in the United Kingdom.

Danske Capital is a division of Danske Bank A/S. Danske Bank A/S is a European Authorised Institution under the Banking Consolidation Directive 2000. It is regulated by the Danish Financial Supervisory Authority (Finanstilsynet) and in the conduct of designated investment business in the United Kingdom by The Financial Services Authority. Danske Bank A/S, its affiliates, and any of their directors, officers and employees may, to the extent permitted by law, have a position or otherwise be interested in the investments (including derivatives) of issuers mentioned herein. Employees of Danske Capital must comply with Danske Capital's Personal Account Transaction Procedures, including pre-approval by Compliance of personal transactions in equities, corporate bonds and derivatives.

Copyright © Danske Bank A/S. All rights reserved. This publication is protected by copyright and trademark ownership. Any reproduction in whole or in part and redistribution is prohibited.

Further information can be obtained from Danske Capital.