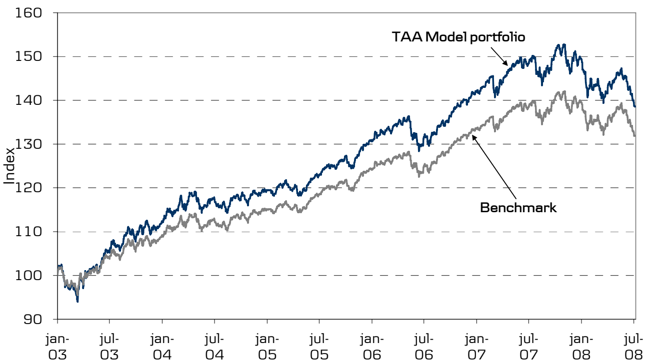
Tactical Asset Allocation

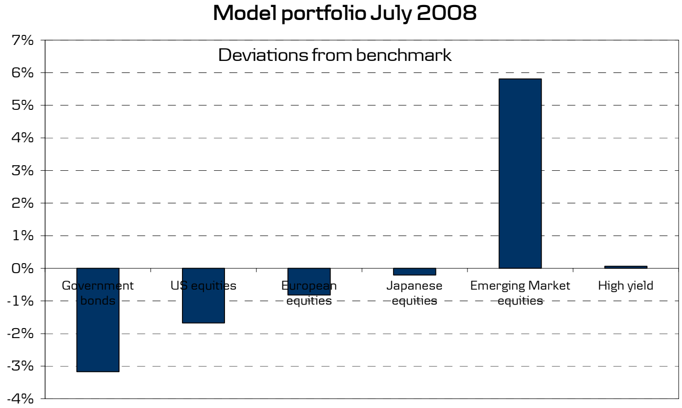
Danske Capital – 8 July 2008

Historical Performance



Information Ratio: 0.8

Current recommendation



Note: Benchmark is rebalanced at the beginning of each year

Performance results:

Model portfolio 2008 (ytd):	-7.2 percentage points
Performance 2008 (ytd):	-1.7 percentage points

Latest strategy changes:

09/06/08:	EM Equities upweighted 3%, government bonds downweighted accordingly.
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 downweigthed 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

Danske Capital

Where do you expect commodity prices – especially oil and food prices – to go from here? In our opinion, oil and food hold the key to both the short-term outlook for financial markets and the short to medium-term outlook for the global economy. If you expect oil and food to continue their rapid increase, stay away from risk assets. If you expect oil and food prices to stabilise or fall, consider increasing risk now.

We are of the latter view and thus continue to recommend both a slight equity overweight and an EM bias. However, as we judge our short term commodity forecast capabilities to be very limited, we remain fairly cautious in our allocation. We judge the latest selloff in risk assets to be absolutely overdone and are biased towards increasing risk further, but since short-term performance will ultimately be decided by factors outside of our understanding, we retain our current allocation for now.

One has to admire the speed with which financial markets can change their focus. In the first few months of this year, extreme growth concerns drove the massive selloff in risky assets. As growth expectations stabilised (and systemic financial system risk was reduced), risk assets rebounded. Three months later, financial markets have switched to extreme inflation concerns, which have ultimately sent risk assets back to levels last seen during the height of the financial panic. A very telling example of this has of course been the turnaround in expectations for the monetary policy outlook, especially ECB policy. We never expected the ECB to cut in response to the financial crisis, but, equally, nor did we expect them to hike. With Thursday's move to 4.25 per cent, the ECB policy rate now stands only 50 bp below the most recent peak before the dotcom bubble burst. And if you ask us, this is where it will stay for a long time to come.

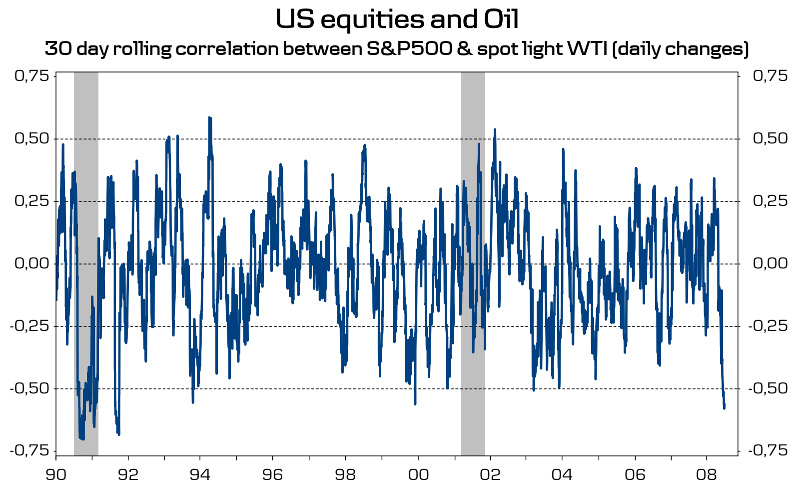
What markets underestimated was first of all the ECB's commitment to price stability and secondly the relative resilience of key euro area economies. During the press conference Thursday, asked whether the hike was intended as a signal or intended to slow the economy, Trichet was as clear as a central banker can be – it was intended as a signal. A signal in order to communicate to all economic agents that the ECB will do whatever it can to secure medium-term price stability.

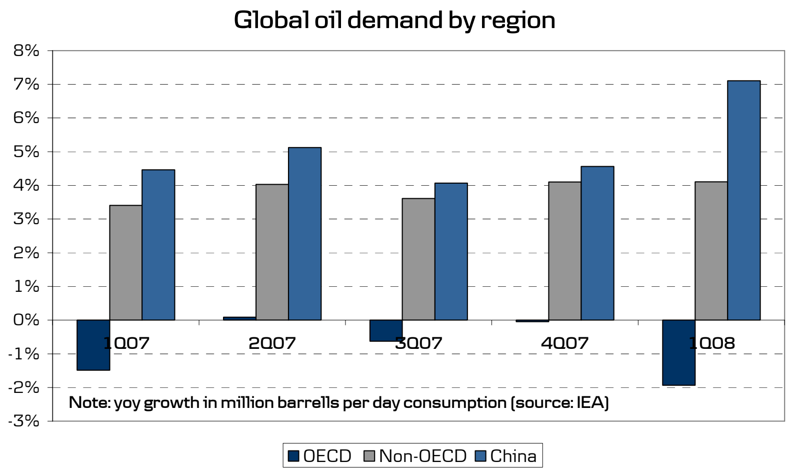
We think this *signal* along with the rest of the extremely interesting press conference bear two important messages – the ECB is fully aware that the risks to euro area growth are high and skewed fully to the downside. Therefore, if commodity prices stabilise, the ECB is done for now (and well into 2009). However, should commodity prices continue their strong upward trend (or if the global economic cycle turns decisively for the better), the ECB will act. Judging by Trichet's words and comparisons with the 70s the ECB stands ready to force through a material slowdown in growth so that the prices it can actually affect (compared to global commodity prices which Trichet fully acknowledges is beyond reach of the ECB) will adjust downward, i.e. the ECB can and will enforce a relative price adjustment in order to secure well-anchored inflation expectations.

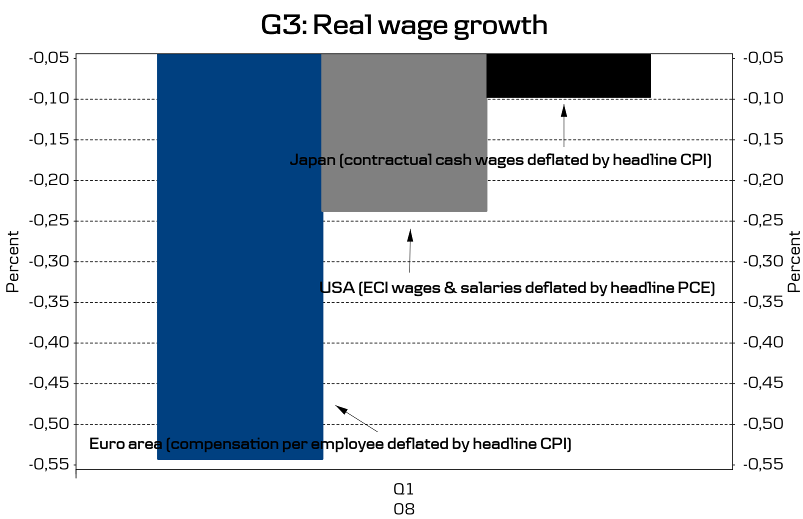
Why focus on the ECB? Because we think recent ECB hawkishness has been one of a few key drivers of financial markets lately and because the ECB rate hike illustrates the threat to as well as the opportunity for global risk assets in general and global equities in particular. Apart from the commodity discussion above, we think the ECB press conference and the latest set of US data are pivotal. The ECB has now clearly signalled that they are not about to kill growth. Secondly, the US data are fully consistent with continued slow, but positive growth. This means two things – the US economy might be in recession (technically we do not know yet), but so far the economy has weathered the storms much better than feared. And judging from our favourite indicator, the US manufacturing ISM, it will continue to do so. That should provide a floor for corporate profits, as well as securing lower inflation. Lower inflation (and inflation volatility) means stabilising interest rates. And this combination means that global equities are extremely undervalued at current valuations. As such, we think it highly likely that the past week marks a turning point for risky assets in 2008. BUT (in our opinion) – commodity prices are key.

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	buy (+1) Slope of the yield curve
Trigger 2 (+/- 1)	sell (-1) Production	buy(+1) Capacity Utilisation	buy (+1) Real Interest Rate
Trigger 3 (+/- 1)	neutral (0) Volatility	neutral (0) Volatility	buy (+1) Investments
Total Score (+/- 5)	**+1 buy**	**-1 sell**	**+4 buy**







Oil: Where from and where to?

Judging from recent market action it seems to us that oil holds the key to financial market sentiment right now. The chart to the left illustrates the rolling 30-day correlation coefficient between daily movements in the S&P500 and the spot WTI.

Barring a few short and sharp episodes, rising oil prices have generally been accompanied by rising equities during the past five years. Lately however, the correlation coefficient has turned very negative (very fast). We think this illustrates the fast move from growth fears to inflation fears. Furthermore, we basically agree with markets – these oil price movements are NOT positive.

So the question becomes, where does oil go from here? We think demand growth outpacing supply growth has been the main driver of the structural rise in oil prices over the past five years. According to the just published BP 2008 statistical review, global oil demand grew by 1.1 per cent in 2007, whereas supply fell 0.2 per cent. Where is incremental demand coming from? According to the BP publication, China and the Middle East accounted for the bulk of growth in global demand. More recently, as shown in the chart to the left, growth in Chinese oil demand seems to have accelerated strongly during the first part of this year (China accounted for 7.8 per cent of global demand in 2004 vs. 9.1 per cent in Q1 of this year according to IEA data).

The acceleration in Chinese oil demand growth is consistent with macro data (along with global freight rates), suggesting that real Chinese growth reaccelerated at the turn of the year (we suspect various temporary factors have been at play, including the snowstorms, the Sichuan earthquake, Olympic preparations as well as the short-term boost in domestic refinery activity related to the hike in domestic gasoline prices). As we expect Chinese economic growth to slow from here through the end of 2008 and as end demand reacts to higher prices (already happening in advanced economies) and China raises domestic gasoline prices further, we think the most likely outcome is for oil prices to flatten or fall. Indeed, we think this is crucial to an improvement in financial market sentiment and...

Danske Capital

Contacts:

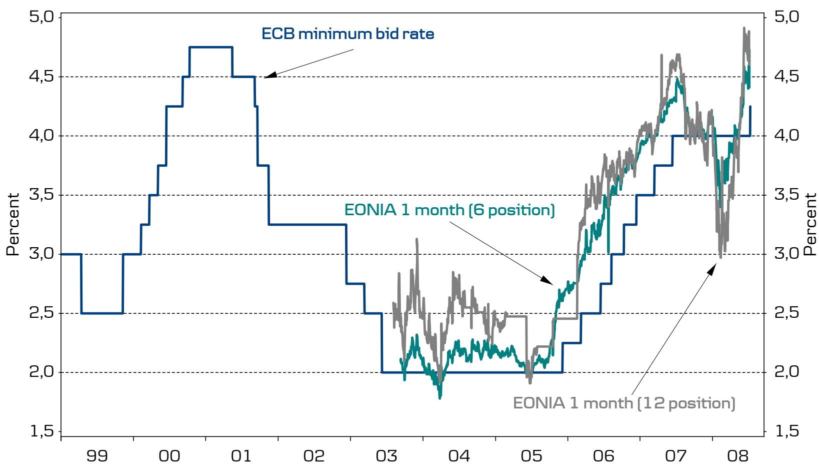
Bo Christensen +45 4513 9644, Frederik Engholm-Hansen +45 4513 9664 & Søren Mose Nielsen +45 4513 9607

Comments from the July ISM non-manufacturing survey:

- "Oil prices are affecting most every supplier we have" (Transportation and Warehousing)
- "Energy costs are beyond the pain point. They are disruptive to every part of our business" (Agriculture, Forestry, Fishing & Hunting)
- Challenging due to continuing cost pressure from suppliers. Planning on decreased production activity as summer wears on and budgets tighten" (Other Services)
- "High cost of commodities, fuel prices, are impacting margins and economic conditions are negatively impacting traffic counts and average check amounts." (Accommodation & Food Services)
- "Energy cost is starting to have an effect on cost of products from all sectors." (Wholesale Trade)

Note: we generally do not judge the ISM input price indices as leading indicators, but with the manufacturing ISM price index reaching a 30-year high in July, we think it illustrates the oil shock point very clearly.

Euro area: ECB rate and market pricing



... the medium-term outlook for G3 economic growth. In our opinion, the global economy has weathered the structural rise in oil because it has 1) been a fairly stable and growth induced rise and 2) oil importing nations have been spending a substantial amount of the oil gains. However, when the oil price rises as rapidly as has been the case for the past six months, we think it is too much too fast. The global economy cannot adjust fast enough. This is also the stance of the major central banks, as illustrated by both the recent FOMC statement and Trichet's comments .

In short, we think the chart on the previous page says it all – oil is eroding purchasing power (note those data are Q1 – with the latest oil moves, real wage growth is even more negative) and the quotes to the left ram the message home – this shock is very hard on corporates as well.

In conclusion, we need oil to stabilise for our forecast and allocation to hold. Oil and food is negative for growth, inflation (expectations) and monetary policy. The current situation reminds us of May/June 2006 which was when we last had an inflation scare. It proved temporary – we think it will do so again.

Finally, a last comment on the ECB. The chart on the left shows the ECB policy rate and market expectations. When financial panic was at its most extreme in March, markets expected the ECB to cut by 100 basis points before Q1 2009 – in the course of just two months markets swung to price in a hike of approx. 75 basis points.

This is testimony to just how much the recent ECB action and intentions have surprised the markets. But from our perspective, it also provides hope – if markets can be this wrong about the ECB, they can also be wrong about their current pricing of equity risk. We think they are very wrong, i.e. implied earnings expectations are too low. Hence, last week, in our opinion, marks a turning point for risky assets in 2008.

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 1933, 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.