Date: 17 December 2019

SUPPLEMENTARY MANAGER COMMENTS - OUTLOOK 2020

Nordic High Yield – 5 reasons to invest in 2020

The year is drawing to an end and it is time to take stock of developments in the Nordic high yield market and look at opportunities and threats for 2020. 2019 has been a year of relatively stable credit spreads in the Nordic high yield market. As a result we see that the returns in many of the Nordic high yield funds are quite close to the stated yields of the funds at the start of 2019. Stable credit spreads is generally a good thing for long term performance but in a year in which high yield spreads both in Europe and the US have tightened considerably we have seen that Nordic high yield funds in general have underperformed their European and US counterparts. So, given these developments what are the main reasons to invest in this marketplace in 2020.

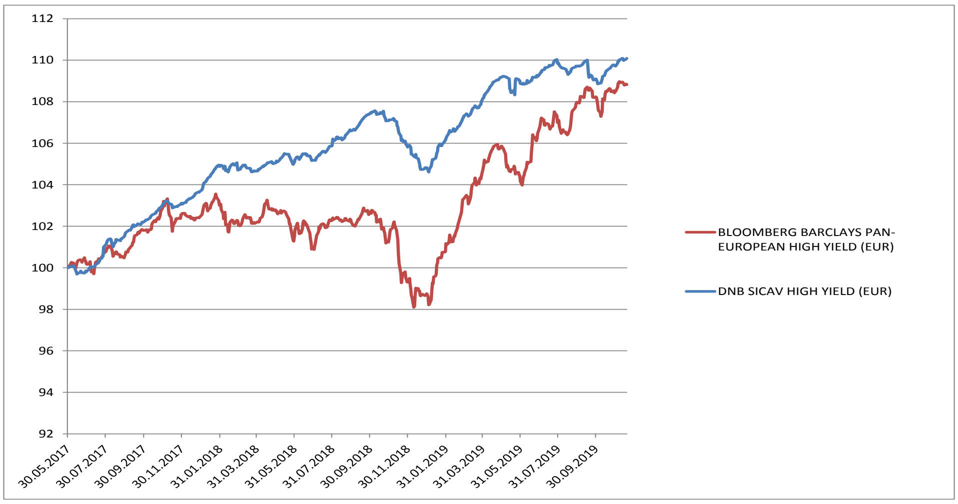
1 - Attractive credit spreads relative to European and US high yield markets

Unfortunately we do not know what 2020 will bring. What with trade skirmishes, the US election, potential Brexit and UK trade negotiations with the EU there are plenty of uncertainty going into the new year. Thus, it is difficult to be certain when it comes to the absolute return in equity and credit markets in 2020. Our main scenario is that economic growth will stabilize and continued low interest rates will maintain the demand for credit risk and spread products leading to decent returns in credit. But admittedly, there are risks to this scenario. We are quite convinced, however, that the developments in 2019 have made credit spreads in the Nordic high yield market attractive relative to spreads in the US and European high yield markets.

2 - Relatively low volatility in the Nordic high yield market

Over the past few years the volatility in the Nordic high yield market has been lower than in the European and US high yield markets. Admittedly this could partly be due to the lack of liquid index instruments for the overall market and credit default swaps for most names, leading to potential lags in market pricing. But there are also some structural aspects of the market leading to stability. Among these are the lack of ETFs and the fact that institutional investors make up the bulk of the overall investor base.

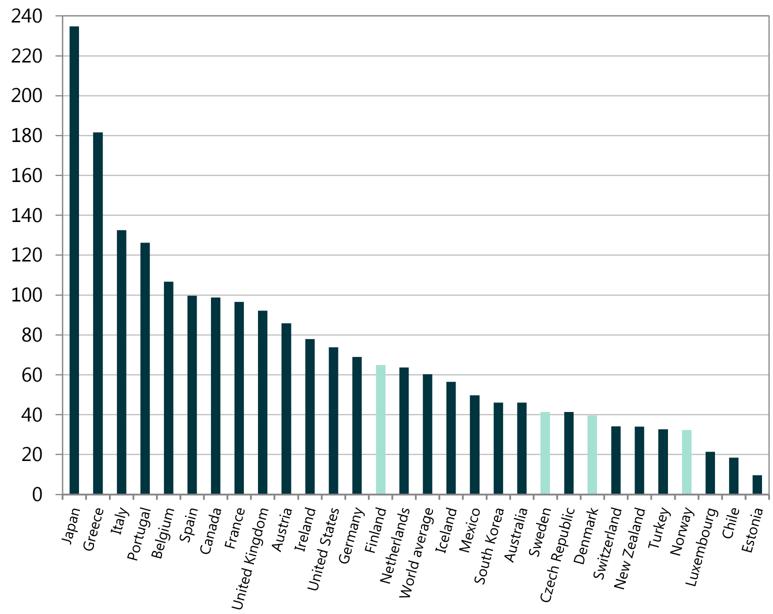
Return of the Bloomberg Barclays European high yield index and DNB SICAV High Yield in EUR



Source: Bloomberg, DNB Asset Management

3 - The Nordic economies are well placed to counter the effects of a potential global downturn
As mentioned above, the global economy (as usual) faces a number of potentially grave risks in 2020. Whether any of these risks (or other risks we do not yet know about) will materialize is inherently uncertain. Hopefully, they will not. But if they do, the Nordic economies should be well placed to weather the effects. High education levels, well-developed infrastructure, low income inequality, strong institutions and a comprehensive public welfare system are important factors in this respect. And perhaps even more salient, the Nordic countries have low public debt to GDP ratios and strong public finances in combination with a proven willingness to employ fiscal policy to counter downturns.

Public Debt to GDP ratio

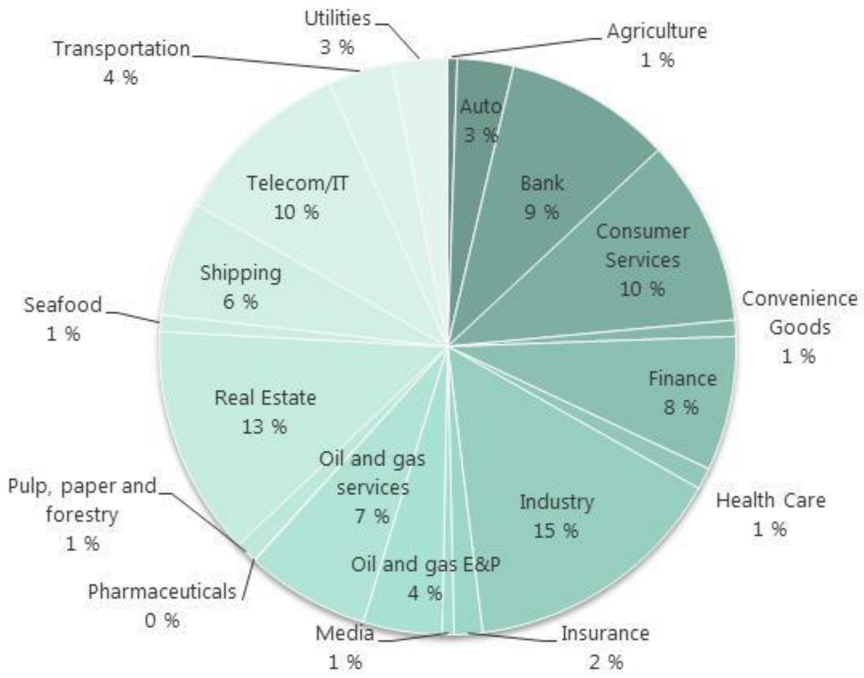


Source: The World Factbook (CIA), Bloomberg

4 - The Nordic high yield market has become quite well diversified

The Nordic high yield market naturally reflects the business structure in the Nordic region. As the market has developed and grown over the past 10 years it has become quite diversified both when it comes to the sector composition and in the number of individual issuers. This development will continue into 2020 and in the years ahead.

Sector composition of the Nordic high yield market (September 2019)



Source: Stamdata, DNB Asset Management (further analysis)

5 - Attractive risk/return characteristics in Nordic High Yield

We tend to believe that at present credit spreads levels the expected return relative to risk is quite attractive in the Nordic high yield market. High yield credit spreads are clearly negatively correlated to equity market returns. i.e. returns in the two markets are strongly positively correlated. However, as the volatility in the high yield market is considerably lower than in the equity market this would imply that the 'beta' of the high yield vs. the equity market is well below 1 (<0.5). Given an overall credit spread level of around 500 basis points above swaps in the Nordic high yield market at present an investor would need a quite positive view of equity market returns to beat expected risk adjusted returns from Nordic high yield. This is clearly no guarantee for 2020 but in combination with relatively stable credit spreads in the Nordic high yield market in 2019 it creates what we believe to be a constructive backdrop for the coming year.