



OUTLOOK 2016: Strong economy, but potentially unsettled markets

Macroeconomy and allocation: 2016 could potentially be a great year for the global economy. Nevertheless, US monetary policy and declining oil and other commodity prices could cause problems for risk assets, such as global equities and corporate bonds.

US economy
cements its
status ● ● ●

China still
faces major
challenges ● ● ●

Europe
supported on
several fronts ● ● ●

Interest rate
hikes, commodities
and oil could
unsettle markets ● ● ●

MARKET EXPECTATIONS

Strong economy, but potentially unsettled markets in 2016

Here, on the cusp of a new year, the global economy again looks set to deliver a solid performance, with the US cementing its status as the world's largest and most important economy. This essentially bodes well for risk assets such as equities. However, we can already see significant challenges ahead that could unsettle the financial markets.

► BRIEF LOOK BACK AT 2015:

A dramatic year with three major events

2015 has been a good year for the global economy. The US recovery entered its seventh year without any real sign of losing steam. Despite its crisis, Europe has consistently delivered growth on the high side of 2% for more than six months now and, while slowing, China continues to grow at a relatively strong 5-6%, according to our calculations.

Nevertheless, 2015 has been a dramatic year in the financial markets, with a number of events leaving their mark. The three biggest events were of course the political debate on the future of Greece, China's shifting exchange rate policy in August and September, and the collapse in oil prices. While the first two events proved fairly insignificant in the sense that they have not inflicted any major damage on either global growth or investment returns, the sharp fall in the price of oil has created challenges for the financial markets and therefore tops our list of potential problems in 2016.

► EXPECTATIONS 2016: MACROECONOMY

USA: Growth locomotive

The US central bank, the Fed, has just raised interest rates for the first time in almost 10 years, which in our view heralds a new phase in the current recovery - namely one with a US economy that is seriously regaining its vigour. It was undoubtedly also an event which the Fed had been looking forward to after being in crisis mode for so long.

We remain optimistic regarding the prospects for the US economy, and again estimate growth at 2.5-3.0% in 2016, supported in particular by a further pick-up in the housing market. The more upbeat economy will be reflected in employment growth of around 150,000 to 200,000 new jobs per month, which should be more than sufficient to reduce unemployment further. Our forecast for the US economy is slightly more optimistic than what the Fed



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Allocation scorecard

Current expectations on various asset classes on a scale from -3 (negative) to +3 (positive)¹.

| | Outlook | | | | | | | Conviction ² |
|-----------------------------------|---------|----|----|---|----|----|----|-------------------------|
| | -3 | -2 | -1 | 0 | +1 | +2 | +3 | |
| Equity, developed markets | | | | | | | | (4) |
| Equity, global emerging markets | | | | | | | | (2) |
| Global inflation-linked bonds | | | | | | | | (2) |
| EU short bonds | | | | | | | | (4) |
| EU long bonds | | | | | | | | (2) |
| EU investment grade bonds | | | | | | | | (2) |
| EU high-yield bonds | | | | | | | | (3) |
| US high-yield bonds | | | | | | | | (2) |
| EU senior bank loans | | | | | | | | (3) |
| US senior bank loans | | | | | | | | (3) |
| Emerging market debt (HC) | | | | | | | | (2) |
| Emerging market debt (LC) | | | | | | | | (2) |
| Market risk (3 mth.) ³ | | | | | | | | Neutral |
| Risk appetite | | | | | | | | Neutral |

Notes: ¹No specific time horizon attached to the expectations, which are based on the latest tactical allocation meeting in Danske Capital on 07.12.2015. Danske Capital acts as advisor for Danske Invest. ²Expresses degree of certainty for the stated expectation. ³Expresses current estimate of return potential in the traditionally most risky assets.

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“We would therefore urge investors to follow developments closely, as this will present opportunities to create return by active asset management.”

markets. even though we previously stated that concerns about China in late summer were probably overblown and were pleased when they eased in the autumn, we are by no means out and out optimists about 2016, as China and a number of other emerging market countries face major challenges.

China, in particular, is nursing a hangover after a housing and construction boom that was partly debt-financed. While the authorities still seem to have the situation under control, in our view, and there is little risk of a bank crisis like that in Spain, the hangover will nevertheless have a long-lasting effect in the form of declining activity. Add a Chinese leadership that appears serious about

and the finance markets in general are indicating at the moment, which means we also expect the Fed will continue to raise interest rates in 2016.

EMERGING MARKETS: China faces major challenges

The US will thus make a positive contribution to the global economy, which is struggling with relatively weak growth, particularly in the emerging

cutting pollution to this and the signs point to another weak year in terms of Chinese demand for certain commodities.

This is all happening at a time when many of the major emerging markets are struggling to find their footing. Some countries are overly dependent on commodities, while others, like China, have seen very substantial lending growth. Finally, the political response of several countries has been decidedly chaotic and insufficient. Hence, the combination of a weak China and tighter US monetary policy may once again prove a dangerous cocktail for emerging markets in 2016.

EUROPE: Support on several fronts

Strong US growth and falling commodity prices are a particularly beneficial combination for the eurozone. Even though we see the European banking system as the main driver of further solid growth in the eurozone of close to 2%, Europe will also be helped by any falls in commodity prices and additional hikes in US interest rates, which will tend to weaken the euro. Furthermore, the eurozone is one of the few major economies that still has copious spare capacity, which means monetary policy will again be exceptionally accommodative in 2016.

While the refugee crisis is certainly dominating the headlines, from a purely economic perspective it should cement one significant change – fiscal policy will be eased for the first time in several

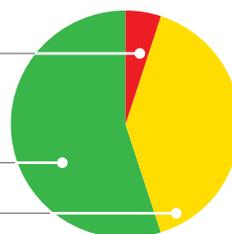
Global macroeconomic outlook

Most likely macroeconomic development over a 6-month horizon.*

Economic phase

Probability

| | |
|---|-----|
| RECESSION (negative and falling growth) | 5% |
| RECOVERY (negative growth, but turnaround under way) | 0% |
| EXPANSION (positive and accelerating growth) | 55% |
| SLOWDOWN (growth is positive, but slowing) | 40% |



NOTE: * Based on the Danske Invest Macro Barometer by Danske Invest's chief analyst Bo Bejstrup Christensen and his team of analysts.

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years to cope with the flow of refugees. So while geopolitics will again play a role in 2016, we do not see it preventing 2016 from becoming the best growth year for the region in many years.

JAPAN: A helping hand from global growth

Finally, Japan, which on the one hand will benefit from solid growth in the global economy and in its main trading partner, the US, but which on the other is struggling – just like many emerging market economies – to find an appropriate economic policy and to implement necessary reforms.

Overall, our view is that the global economy will once again perform quite respectably, with the US looking ready to firmly cement its status as the largest and most important economy in the world.

► EXPECTATIONS FOR 2016: FINANCIAL MARKETS**US rate hikes and commodities could unsettle the markets**

The scenario we have outlined above for the global economy is essentially synonymous with a general optimism on risk assets, including global equities. When global growth is positive, companies often have an opportunity to increase their earnings. And given that global equity prices are still not too high, we should be looking forward to 2016 as a year that can deliver positive equity returns. However, we first need to revisit the strength of the US economy, commodity prices and the emerging markets.

The financial markets are currently pricing in two to three rate hikes in the US in 2016. In our opinion there will be at least three and that might create short-term uncertainty and concern about how

high rates may actually go, which could have a negative impact on equities. On top of this comes a still more than ample supply of oil relative to demand, and an OPEC that, for now, appears to have been sidelined by the flexible US shale oil and gas sector.

Furthermore, technological advances, such as improved solar and wind energy and more efficient use of fossil fuels, could potentially reduce the demand for oil by more than we can currently envision.

Risk of bankruptcies in the oil sector...

Oil prices falling dramatically again would undoubtedly be positive for the most important parts of the global economy, but major oil and commodity companies would take a very hard earnings knock. We saw this in 2015, when especially the sharp fall in oil prices resulted in energy sector earnings plummeting so low that overall US equity market earnings have not increased at all. Moreover,

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Macro Barometer

Danske Invest's Macro Barometer describes the current strength of the global economy and the economies of the US, Europe and China. Danske Invest regularly uses the Macro Barometer as a guide for asset allocation – in other words, how investments should be divided between equities, bonds and corporate bonds.

The Macro Barometer differentiates between whether the economy is in recession or expansion (growth) and between whether growth is accelerating or slowing. This then gives four possible phases in all for a particular economy at a particular time:

GREEN: Expansion – positive and accelerating growth. Equities and corporate bonds typically perform best, while rising yields hit the return on bonds.

YELLOW: Slowdown – growth is positive, but slowing. It is not clear which asset will perform best in this phase. Themes and trends play a greater role than normal for market developments.

Current Macro Barometer

RED: Recession – negative and falling growth. Government and mortgage bonds typically outperform equities.

BLUE: Recovery – negative growth, but a turnaround is under way. Equities and corporate bonds typically perform best, but as yields are still falling, bonds also do well.

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lower oil prices may mean we risk a number of energy companies, particularly in the US, simply going broke, which could lead to temporary stress in the corporate bond market.

...and pronounced fluctuations in the financial markets

Add the very substantial falls in several emerging market currencies in 2015 to this, and unexpected skeletons could start falling out of cupboards. Hence, in our view, 2016 could be characterised by a series of pronounced fluctuations in the financial markets despite the global economy growing at a reasonable rate. We

would therefore urge investors to follow developments closely, as this will present opportunities to create return by active asset management.

This is also why we are starting out in 2016 with a limited positive exposure to risk assets, and why we to a greater extent than normal expect to generate return via the active selection of regions and sectors instead of simply overweighting, for example, global equities.

DISCLAIMER

Danske Invest has produced this material for information purposes only; it does not constitute investment advice. We recommend you discuss any transactions based on this material with your investment advisor.