



# Fund Portrait

Third quarter 2018

## Nordea 1 – Danish Mortgage Bond Fund

ISIN: LU0076315968 (BP-DKK) / LU0229519045 (BI-DKK)

### Highlights

- The Danish mortgage market is a very liquid, predominantly AAA-rated market which has not experienced any default in more than 200 years<sup>1</sup> – even during the financial crisis in 2008 thanks to the Danish balance principle
- Danish mortgage bonds offer a solid performance, coupled with a potentially higher yield compared to European government bonds
- The fund gives investors access to a unique investment opportunity which provides good diversification characteristics



### Asset Management at Nordea

As an active investment manager, Nordea Asset Management manages asset classes across the full investment spectrum and aims to serve its clients in every market condition. Nordea's success is based on a sustainable and unique multi-boutique approach that combines the expertise of specialized internal boutiques with exclusive external competences allowing us to deliver alpha in a stable way for the benefit of our clients. Furthermore, we have put a lot of emphasis on launching outcome – as opposed to benchmark – oriented investment solutions whose basis, "stability investment philosophy", is designed to meet clients' risk appetite and needs.

The Nordea 1 – Danish Mortgage Bond Fund was launched 1997 and is managed by Nordea's Danish Fixed Income & Euro Covered Bond Team, comprising eight investment professionals specialized in Danish mortgage bonds and its unique features. They are part of Nordea Asset Management, the leading fixed income manager in the Nordic region.

### An attractive and multifaceted investment

Investment returns from high-quality bonds have fallen to historical lows. The Euro zone debt crisis has forced investors to look for investment alternatives – even in the supposedly safe Euro government bonds. As a result, investment decisions must take into account newly defined risk dimensions going forward.

Investors looking for additional returns, but unwilling to take substantially higher risks, will find a hitherto not very well known investment solution in the Nordic region: Danish mortgage bonds. In 2010, when analysing the origins of the US sub prime crisis George Soros, chairman of one of the most famous US hedge fund companies Soros Fund Management LLC, stated: *"There is a proven mortgage financing system already up and running. The Danish model has been in use, continuously, since the aftermath of the Great Fire of Copenhagen in 1795"*<sup>2</sup>.

### What makes Danish mortgage bonds so special?

They are comparatively safe mortgage-backed securities with unique characteristics. The secret behind this asset class is in the so-called "balance principle" introduced in 1850. Furthermore, Danish mortgage bonds provide at least a 99 percent match between the borrowers' interest and capital payments as well as the interest and capital payments to mortgage bond holders.

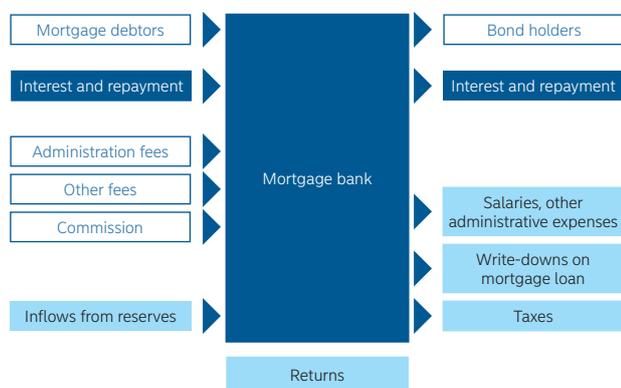
Mortgage banks offer loans with fixed and flexible terms as well as with and without prepayment option.

The loans are pooled and passed on to the investors as mortgage bonds that perfectly match the size, cash flows and maturities of the underlying loans.

1) Nordea Investment Management. Date: 30.09.2018. 2) Source: George Soros, official website www.georgesoros.com. Date: 25.03.2010.

This is the main difference between the sub-prime mortgages launched in the US where issuers pooled not just loans from borrowers with different credit qualities but also bonds with different features.

## The Danish mortgage bond system



Source: The traditional Danish mortgage model, Realkreditratet, as of December 2009.

## Liquid bond market, even in times of great uncertainties

The financial crisis has shown once again that liquidity is key for investments. Indeed, during the crisis Danish mortgage banks were still able to sell their mortgage securities despite the difficult times. With the oldest and largest mortgage bond market in Europe (approximately EUR 391 billion as at December 2016)<sup>3</sup>, Denmark boasts a very stable, efficient and liquid credit system even during economic downturns.

### Differences to US sub-prime mortgages

- Borrowers' interest and capital payments must match those to mortgage bond holders by at least 99 percent (Danish balance principle)
- Reselling loans to third parties is forbidden
- Strict regulatory loan-to-value limit of 80 percent for owner-occupied properties
- No loans to sub-prime borrowers
- The collateral for mortgage bonds is the loan holder rather than the property

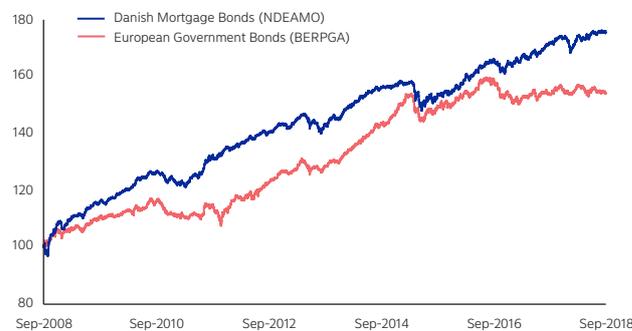
Compared to the US mortgage market, the Danish system is extremely safe because it has strict regulatory loan-to-value limits (e.g. 80 percent for owner-occupied properties) and loans are not granted to subprime borrowers. In addition, this market is extremely transparent due to the fact that loans can't be sold to third parties. As a result, the market has seen no bond defaults for over 200 years.

## An investment alternative with historically higher yield levels

Liquidity and security are an important characteristic of an attractive investment, solid returns are another. Compared to European government bonds, Danish mortgage bonds are a solid investment alternative. Historically, the yield of Danish mortgage bonds exceeded that of comparable European government bonds.

As the borrower is entitled to prepay outstanding debt at par each quarter, the bond investor bears the reinvestment risk resulting from the prepayment. To compensate the bondholder for this risk, he receives a premium, the so-called convexity premium.

## Comparison: Danish mortgage bonds vs. European government bonds



Data for Danish mortgage bonds have been calculated in Euros. Source: Nordea Investment Funds S.A. and Bloomberg; period under review: 10 years. Date: 30.09.2018.

## Stable investment under all interest scenarios

The relative price stability of Danish mortgage bonds is another positive aspect for investors. Normally, borrowers will prepay existing loans when interest rates decrease and take out new loans at lower rate levels when a certain threshold is crossed.



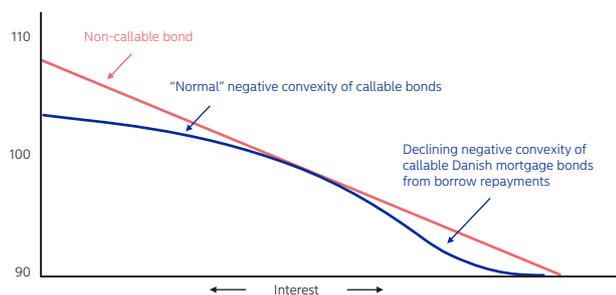
Portfolio Manager,  
Henrik Stille

**The prices of Danish mortgage bonds suffered after the Lehman bankruptcy, but – unlike German government bonds – the market remained liquid at all times.**

<sup>3</sup>) Source: ECBC European Covered Bond Factbook 2016. Date: 31.12.2016.

The price of Danish mortgage bonds could come under pressure when interest rates increase. Borrowers have the chance to purchase their mortgage bonds below par in the stock exchange and return them to the relevant bank. By doing so, they can reduce their debts by the discrepancy to the par value. This mechanism ensures that the price of Danish mortgage bonds most likely remain stable under all interest-rate scenarios. For this reason, they generally trade in a price range between 85 and 105 whereas other bonds are much more volatile (interest-rate sensitivity).

### The impact of the call option on the bond price



Source: Nordea Investment Management AB.

### Diversification potential and superior risk/return profile

As many client portfolios have a traditional bias towards bonds, investors bear a high default and interest rate risk. Danish mortgage bonds offer both diversification potential and a superior risk/return profile. The diversification potential is reflected in lower correlations to other bond segments.

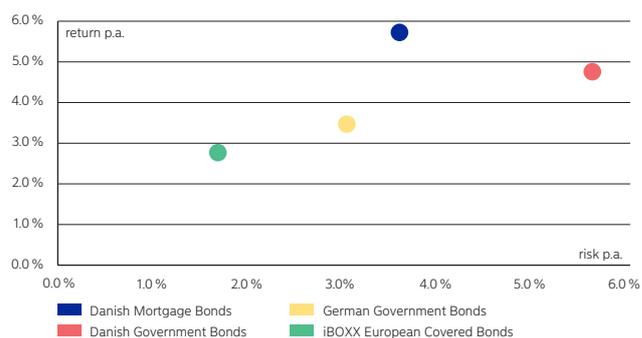
In addition, Danish mortgage bonds can offer investors a superior long-term risk/return profile from the combination of a higher current return (via the convexity premium) and a lower interest-rate sensitivity of bonds in the medium maturity range.

#### Diversification potential

Correlation (5 year period)	Danish mortgages (NDEAMO)	European mortgages (EPOO)	European government bonds (BERPGA)	German government bonds (BEGRGA)
Danish mortgages	1.00	0.76	0.63	0.72
European mortgages		1.00	0.80	0.92
Europ. government bonds			1.00	0.77
German government bonds				1.00

Source: Nordea Investment Funds S.A. and Bloomberg. Date: 30.09.2018.

### Superior risk return profile



Return data for Danish government and mortgage bonds have been calculated in Euros. Source: Nordea Investment Funds S.A. and Bloomberg; period under review: 10 years. Date: 30.09.2018.

### Nordea’s strategic investment alternative: Nordea 1 – Danish Mortgage Bond Fund

Nordea has been a reliable partner for fixed income investments over more than two decades, the Danish Fixed Income & Euro Covered Bond Team is managing around EUR 39 bn<sup>4</sup>. With the team led by Martin Hagelskjær Nielsen, Nordea has an expert and highly experienced management team for “Danish bonds” on board.

The winning formula of the Nordea 1 – Danish Mortgage Bond Fund is its investment philosophy. It is based on in-house research expertise for selecting individual Danish mortgage bonds with adequate premiums and emphasizes active risk management that focuses predominantly on tracking error and on identifying all sources of risk. At the same time, the managers seek to optimally use the risk budget in order to generate the most advantageous results for investors.

The Nordea 1 – Danish Mortgage Bond Fund boasts a long and successful track record<sup>5</sup>, which is remarkable given the rather difficult historical background.

**This mechanism ensures that rising interest rates will put less pressure on Danish mortgage bonds than on other fixed income instruments.**



Head of Danish Fixed Income  
Martin Hagelskjær Nielsen

4) Source: Nordea Investment Management AB. Date: 30.09.2018. 5) Past performance is not a reliable indicator of future results and investors may not recover the full amount invested.

Cumulative returns in % (30.09.2018)	Fund <sup>6</sup>
YTD	0.35
1 month	-0.13
3 months	-0.07
6 months	0.31
1 year	0.76
3 years	8.59
5 years	12.99
10 years	48.25
Since launch (21.02.1997)	135.92

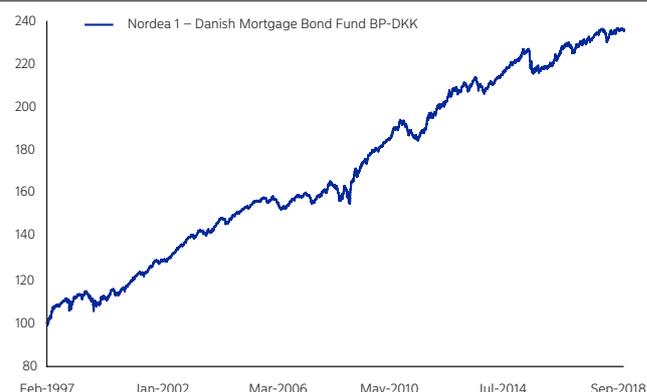
Calendar year returns in %	Fund <sup>6</sup>
2017	2.94
2016	4.78
2015	-2.31

Rating breakdown in % (30.09.2018)	
AAA	91.59
AA	3.56
A	1.28
NR	0.16
Net Liquid Assets	3.41

### Nordea 1 – Danish Mortgage Bond Fund

Fund manager	Danish Fixed Income Team
Fund domicile	Luxembourg
ISIN codes*	LU0076315968 (BP-DKK)/LU0229519045 (BI-DKK) <sup>7</sup> LU0255620204 (AP-DKK)/LU0476538607 (AI-DKK) <sup>8</sup>
Annual management fees	0.60% (BP-DKK / AP-DKK) 0.30% (BI-DKK / AI-DKK) <sup>9</sup>
Base currency	DKK
Fund size in millions	5,875.32
No. of holdings	89
Launch dates	21.02.1997 (BP-DKK) / 02.11.2005 (BI-DKK) <sup>9</sup> 30.06.2006 (AP-DKK) / 14.01.2010 (AI-DKK) <sup>9</sup>

### Performance (21.02.1997 – 30.09.2018)



### Asset allocation in % (30.09.2018)

Mortgage Bonds	87.78
Corporate Bonds	5.86
Government Bonds	2.94
Net Liquid Assets	3.41

### Fund characteristics (30.09.2018)

Fund characteristics (30.09.2018)	Fund <sup>6</sup>
Effective Duration	4.61
Average Weighted Rating	AAA
Average Weighted Coupon	1.98%
Running Yield	1.91%
Yield to Maturity	1.47%

### Risks

Please be aware that there are risks associated with investing in this sub-fund. For further details, please refer to the Key Investor Information Document, which is available as described in the disclaimer at the end of this document.

\*Other share classes may be available in your jurisdiction. 6) ISIN Code LU0076315968 (BP-DKK). Starting from 21.02.1997. 7) Accumulating share classes. 8) Distributing share classes. 9) AI and BI share classes: only for distribution towards institutional clients. Minimum investment amount: EUR 75,000 (or the equivalent).

Source (unless otherwise stated): Nordea Investment Funds S.A. Period under consideration (unless otherwise stated): 21.02.1997 – 30.09.2018. Performance calculated NAV to NAV (net of fees and Luxembourg taxes) in the currency of the respective share class, gross income and dividends reinvested, excluding initial and exit charges as per 30.09.2018. Initial and exit charges could affect the value of the performance. **The performance represented is historical; past performance is not a reliable indicator of future results and investors may not recover the full amount invested. The value of shares can greatly fluctuate as a result of the sub-fund's investment policy and cannot be ensured.** If the currency of the respective share class differs from the currency of the country where the investor resides the represented performance might vary due to currency fluctuations. 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