Nordea
ASSET MANAGEMENT

Fund Update – Special Edition

January 2019

2018 – A rocky year for markets and multi asset solutions

Nordea 1 – Stable Return Fund

ISIN: LU0227384020, BP-EUR

- 2018 was a **difficult year** for major asset classes with **few places to hide**
- SRF performance can be split in two different periods with a **strong recovery in the 2nd half of 2018**
- SRF is **well positioned** for a late cycle market environment

2018 was a tough year for major asset classes (e.g. equities and fixed income) and was characterised by market shifts and style dispersion, stemming from trade war and interest rates uncertainties that gained momentum in H2. The year was driven by both macroeconomic developments and political risks. Historical high macroeconomic data in the US led to a more hawkish Federal Reserve's stance and continuous back-to-back interest rate hikes. Within the political arena, the US led tough negotiations with its trade partners, including NAFTA members and China. This triggered a lot of concerns for investors regarding the nascent trade war's potential consequences on global growth. Overall, this was a situation not seen since 2008 with only few asset classes having a positive performance.

More concretely we saw within the equity space that up until September 2018, the strong cyclical rally continued (mainly in Tech companies with stretched valuations). This situation changed later in H2 2018, where we saw a shift in investor behaviour and a sector rotation in favour of more defensive companies. Already in June/July 2018, but even more so in October/November, the clear preference for growth stocks vanished, and investors got increasingly concerned about late cycle fears including fading growth momentum as well as peak earnings on top of the continuous rate hikes of the FED.

All in all, this led to increased volatility levels in the market with most asset classes ending the year with losses:

	2018
German Govt 7–10 years	2.7%
US Treasuries 7–10 years	0.5%
Euro Investment Grade	−1.1%
US High Yield	−2.4%
US Investment Grade	−2.5%
Euro High Yield	−3.7%
EMD HC	−4.2%
EAA Fund EUR Cautious All. Global	−5.1%
Nordea 1 – Stable Return Fund BP-EUR	**−5.78%**
MSCI USA	−5.9%
EAA Fund EUR Moderate All. Global	−7.1%
EAA Fund EUR Aggressive All. Global	−9.8%
MSCI World EUR Hdg	−9.9%
Commodities	−10.2%
MSCI Europe	−10.9%
MSCI Emerging Markets	−14.8%
MSCI Japan	−15.1%

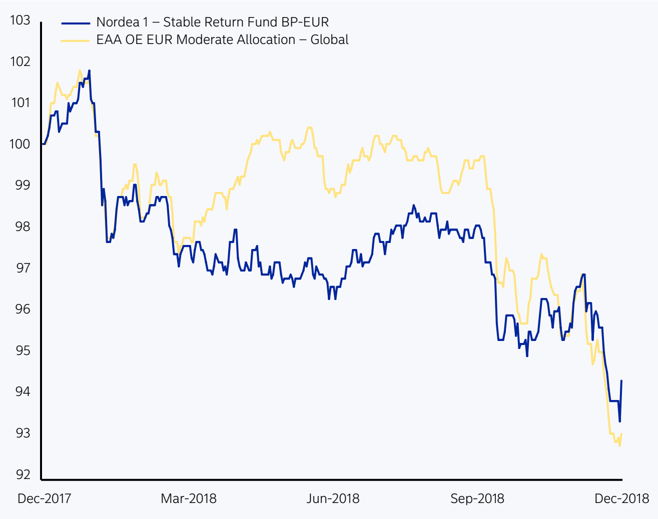
Source: © 2019 Morningstar, Inc. All Rights Reserved as at: 04.01.2019. Period under consideration. 31.12.2017 – 28.12.2018. Performance in base currencies. **The performance represented is historical; past performance is not a reliable indicator of future results and investors may not recover the full amount invested. The value of shares can greatly fluctuate as a result of the sub-fund's investment policy and cannot be ensured.**

How did the Nordea 1 – Stable Return Fund perform in this environment?

In this context, the fund recorded overall negative returns of −5.78%[1] (BP-EUR). However, in order to better understand what happened we can split the year in two different periods. We mostly underperformed over the first half of the year, as our low risk anomaly and the duration exposure were hurt. However, the fund offered a much more resilient profile during H2, mostly due to the comeback of our defensive return drivers like our low risk anomaly and duration. This also highlights the clear diversification benefits of owning the SRF in a portfolio. While the fund was lagging in an overall positive market environment in H1, it managed to offer good downside protection in H2 amidst a more fundamental and prolonged sell-off, where most financial assets were down. This can also be shown when comparing the SRF performance against the performance of its peers during 2018:

1) Period under consideration: 31.12.2017 to 28.12.2018. **The performance represented is historical; past performance is not a reliable indicator of future results and investors may not recover the full amount invested.**

Performance vs Morningstar peers



Source: © 2019 Morningstar, Inc. All Rights Reserved as at: 04.01.2019. Period under consideration 31.12.2017 – 28.12.2018. Performance shown is for Nordea 1 – Stable Return Fund (BP-EUR). **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.**

How did our return drivers behave?

Please find below the table with the corresponding return contributions for each single return driver for the first and second half of 2018 (gross of fees):

Contribution by return drivers	H1	H2	YTD²
Cross Assets Anti-Beta	0.05%	0.06%	0.11%
Developed Market Stocks Beta	0.03%	−2.99%	−2.95%
Developed Market Stocks Low Risk Anomaly	−1.01%	1.17%	0.16%
Emerging Market Stocks Beta	−0.23%	−0.31%	−0.53%
Emerging Market Stocks Low Risk Anomaly	−0.35%	0.48%	0.13%
FX Valuation and Quality	0.03%	0.61%	0.65%
Duration	−1.06%	0.44%	−0.62%
Momentum	−0.33%	−0.38%	−0.71%
TAA	**0.18%**	**−0.50%**	**−0.33%**
Total	−2.70%	−1.41%	−4.11%

Data sources: Multi Assets Team, Nordea Investment Management AB. The presented performance figures are cumulative, gross of fees and in currency EUR. Note: For illustrative purposes only. 2) Period under consideration 31.12.2017 – 28.12.2018.

Equity Beta: Equity Beta (from both DM and EM) was by far the main detractor as equity markets experienced a rather turbulent year. On the back of heightened investor risk aversion due to potential impact of the trade war on global growth, back-to-back FED interest rate hikes as well as increased market volatility, the market experienced sell-offs like in February and October and finally ended the year with the Dow Jones recording the worst month since 2008.

Low Risk Anomaly: During H1 2018, the dispersion in style widened with growth strongly outperforming low risk and value stocks. This situation changed later during the year where we saw a sector rotation in favour of more defensive companies and it finally became one of the main positive contributors in 2018 for the fund.

Duration: During the first nine months of 2018, US yields increased quite sharply, as illustrated by US 10 Years Treasury Note, which rose from 2.41% to 3.06% over the period. Consequently, our duration exposure, mostly tilted to the US, detracted from performance. While the timing for raising the duration in the fund was unfortunate and we moved in a bit too early, the motivation for doing this was clearly justified as the situation reverted during the fourth quarter when fundamental concerns gained momentum. In this context of an increased focus on fundamentals, duration managed to offer better decorrelation features when global equities tumbled during a sharp sell-off in October and December.

Currencies: Our currency strategy consistently added value throughout the year as well as providing downside protection when equity markets sold off. This is also highlighting the need to have other defensive return drivers to compensate for the lower decorrelation power of duration in a portfolio.

Momentum: The Momentum strategy suffered from oscillating volatility and unclear risk signals in the market. The strategy had difficulties to offset equity losses during the flash market crash in February, which was more technical, and sentiment driven. The strategy also detracted over the summer, where risks were rising but overall equity markets continued to deliver positive performance mainly due to defensive equities.

Cross Assets Anti-Beta: Our Cross Assets Anti-Beta strategy added value. The strategy is highly correlated to duration as it combines high quality government bonds and G10 currencies, and thus may struggle in a strong rising yield environment (like in September). Nevertheless, the strategy offered some protection overall.

Main changes and actions taken

It is important to remember that we are neither in the business of chasing the latest trends nor are we willing to take unnecessary risks to trade near-term profits. As such, we didn't radically change the portfolio throughout the year, even after the relative underperformance in H1 and stayed true to our philosophy and process. This has actually paid off in H2, where the more defensive nature of the fund was again revealed. All in all, there have not been significant changes, except some risk reallocation due to changes in terms of risk/return profile for some return drivers and fine tuning of certain strategies. Examples include:

> **Equity beta and Low Risk Anomaly:** Due to a deterioration of the expected risk-return profile for EM equities in comparison to DM equities, the strategic allocations were adjusted in favour of an increased exposure to developed market equities. The increase of the DM equity beta was counterbalanced by an equivalent increase of the Cross-Assets Anti Beta strategy as well as an increase of the Developed Markets Low Risk Anomaly.

Currencies: In September, there was a change in our currencies risk premia, as the FX Valuation and Quality replaced the FX Valuation strategy. This new return driver bundles two sub-strategies, including the old FX Valuation (which remains exactly the same) and the new FX Quality. The latter aims to improve diversification and downside risk management by implementing pair trades characterized by long positions in a defensive and quality currency (e.g. USD) vs. EUR.

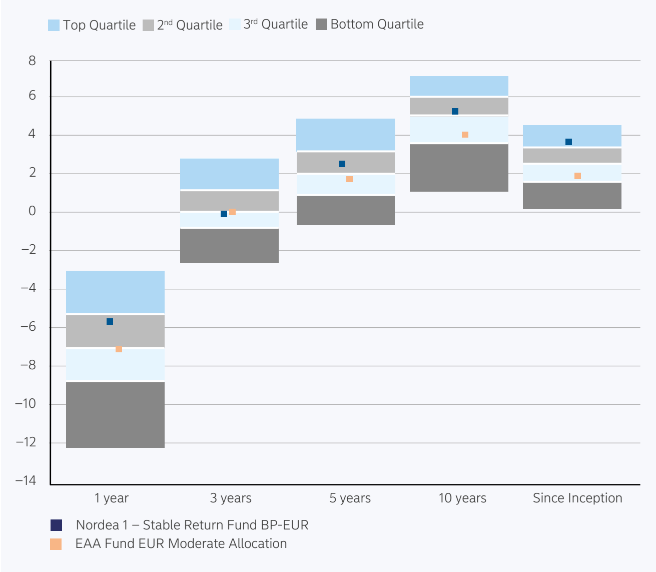
Momentum: The risk allocation to the strategy was reduced throughout the year with risk re-allocated to other defensive return drivers offering higher diversifying and return potential (like currencies and the low risk anomaly).

Going forward: outlook and positioning for 2019

Overall, we have a modestly positive outlook for 2019 and the outlook will get much more positive when the FED stops their rate hikes. Of course, we continue to monitor the markets and will make any changes accordingly. We have also been increasing our positions in US Treasuries over the year to benefit from a more recessive market environment. Therefore, in our US Treasury allocation we see quite good embedded insurance against possible market woes and heightened volatility levels going forward. In sum, our strategy is aimed at putting together an all-weather portfolio that works in different phase of the economic cycle and which maintains a strong focus on keeping an overall risk-balanced approach. We believe the fund is well positioned for a late cycle environment where growth peaked and recessionary concerns are rising. Despite the 2018 performance being lower than expected, our efforts continue focusing on delivering gains that develop steadily to protect our investors' capital.

On a final note, despite a weaker performance over the last 3 years, the SRF still remains a strong solution being ranked either top or second quartile compared to its peers over different time periods:

Performance Relative to Peer Group



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