

# Government Bond Weekly

## Week 46: November 9 – November 13

This week's government bond issuance was dominated by Spain, Greece, and France with combined bond issues of EUR20bn. The joker of the week was the new Greek EUR7bn 5.3% Mar-26 which was issued through a syndicated deal. This deal was a huge success with amount tendered of EUR11bn. We are impressed that Greece – given the negative headlines streaming from rating downgrades and rising deficits – is capable of issuing a EUR7bn 16Y bond at mid-swap +142. However, many investors apparently switched out of the old 15Y and into the new 16Y for a pick-up of roughly 20bp. The Spanish and the French issues were “business as usual”; all auctions went well, and the amount issued was by and large in line with expectations. Moreover, Austria issued EUR0.5bn in the 4.15% Mar-37 and Slovakia issued EUR86m in the 3.50% Mar-13. Both auctions went well, but given the low amount issued, they were of little significance to the market.

In Scandinavia, Denmark issued DKK5bn in the 4% Nov-12. This auction went also well with bid-to-cover of 3.7. Measured by bid-to-cover, this auction was more successful than the average 2009 auction (2.9) and the last two issued (3.2 and 2.9). In our view, the reason is likely to be the increased foreign investor interest in the short end of Denmark.

### Recommendations:

- **Open trading strategies:**

Buy NST 472 or 473 against swaps or Bunds

Buy DGB 419 against Bund Jul'19 or DKK swaps

Buy DGB 6'09 or DGB 4'10 against 3M Bubiil or OBL 147

Buy DBR 4.25% Jul 2014 and IRISH 4% Jan 2014 (ratio 2:1) against SPGB 4.75% Jul 2014.

Table 1. Auction results week 45

Date	Issuer	Type	Coupon	Maturity	Sold	Bid-to-cover	Level
2 Nov	Slovakia	SLOV	3.50%	Mar-13	0.086bn	6.6	2.97%
3 Nov	Denmark	DGB	4%	Nov-12	DKK 5bn	3.7	2.30%
3 Nov	Spain	SPGB	FRN	Oct-12	2.29bn	2.2	0.58%
3 Nov	Austria	RAGB	4.15%	Mar-37	0.5bn	2.8	4.33%
3 Nov	Greece	GGB	5.3%	Mar-26	7bn	-	MS+142
5 Nov	Spain	SPGB	3.30%	Oct-14	3.1bn	1.87	2.75%
5 Nov	France	OAT	3.25%	Apr-16	2.15bn	1.69	2.97%
5 Nov	France	OAT	3.75%	Apr-17	0.9bn	2.83	3.18%
5 Nov	France	OAT	3.75%	Oct-19	2.49bn	2.08	3.62%
5 Nov	France	OAT	4.50%	Apr-41	2.18bn	1.56	4.30%

Source: Danske Markets

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### Update of our scorecard model

On Tuesday the European Commission released their autumn economic forecast, see section above. As we use some forecast from the European Commission in our scorecard model for sovereign yields (see *Introducing a scorecard model for sovereign spreads*) the models need to be re-calibrated. The economic forecast from the European Commission included a general upward revision of government deficits for most countries and Greece in particular (see also our comments on Greece from last week's edition of Government Bonds Weekly). Further, the autumn forecast included 2011 forecast which are now included in the scorecard model.

The two tables below show the results from the scorecard model when calibrated to the old spring forecast and the new autumn forecast respectively. We clearly see that the outright model score for Greece has changed significantly and based on our model Greece now has the worst model score. On a relative basis the cheapest sovereign bonds are still IRISH according to the model and PGBs still look significantly overpriced as well. Among the AAA-countries the model still picks NETHERs as the cheapest.

**Table 2. Model score and rankings – European Commission autumn forecast (new forecast)**

	Germany	Nether-lands	France	Finland	Austria	Belgium	Spain	Italy	Portugal	Slovakia	Ireland	Greece
Model score	-0.94	-0.66	-0.41	-0.37	-0.27	-0.16	-0.03	-0.02	0.37	0.57	0.80	1.12
Rank	1	2	3	4	5	6	7	8	9	10	11	12
10y yield (%)	3.32	3.58	3.60	3.59	3.64	3.70	3.85	4.12	3.81	4.34	4.76	4.70
Rich(-)/cheap (bp)	7	13	-2	-6	-9	-11	-4	22	-37	3	28	0

Source: Danske Markets

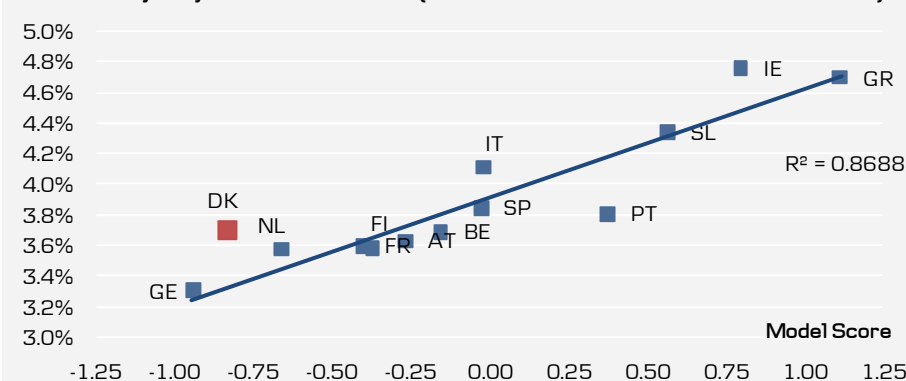
**Table 3. Model score and rankings – European Commission spring forecast (old forecast)**

	Germany	Netherl-ands	Finland	France	Austria	Belgium	Italy	Spain	Portugal	Slovakia	Greece	Ireland
Model score	-0.82	-0.63	-0.48	-0.37	-0.21	-0.04	0.04	0.07	0.31	0.62	0.67	0.85
Rank	1	2	3	4	5	6	7	8	9	10	11	12
10y yield (%)	3.32	3.58	3.59	3.60	3.64	3.70	4.12	3.85	3.81	4.34	4.70	4.76
Rich(-)/cheap (bp)	7	17	6	-2	-12	-20	16	-13	-36	-9	23	14

Source: Danske Markets

The chart below shows results from our scorecard model.

**Chart 1. 10-year yield vs. model score (calibrated to the new forecast from the EC)**



Source: Danske Markets

## Update on economic forecasts

As noted above the European Commission has released its autumn 2009 edition of the European Economic Forecast, and to be perfectly frank, the prospects for some peripherals are not good at all. It is especially Greece, Ireland, and Spain that stand out with double digit budget balance deficits (in % of GDP). Furthermore, Portugal has a double digit negative current account balance, and Greece and Italy have government debt well above GDP. All in all, these numbers point to a significant economic challenge in the years to come for the Eurozone. Moreover, a large budget deficit usually translates into large government bond issuance, which of course, ceteris paribus, is bad in terms of performance on existing bonds. As the chart below shows, most European countries are not expected to fulfil the Euro convergence criteria (a.k.a. the Maastricht criteria) in 2009-2011, as budget balance deficits exceed 3% of GDP, and as government debt exceed 60% of GDP. The star performers in terms of economic forecast are the Scandinavian countries, cf. the table below.

Chart 2. European Economic Forecast

	Budget bal, % of GDP				CA bal.		Gov debt, % of GDP		
	2008	2009F	2010F	2011F	2009F	2010F	2009F	2010F	2011F
Austria	-0,4	-4,3	-5,5	-5,3	1,5	1,4	69,1	73,9	77
Belgium	-1,2	-5,9	-5,8	-5,8	0,6	0,9	97,2	101,2	104
Finland	4,5	-2,8	-4,5	-4,3	1,1	1,2	41,3	47,4	52,7
France	-3,4	-7,0	-7,0	-6,5	-2,3	-2,2	76,1	82,5	87,6
Germany	-0,1	-3,4	-5,0	-4,6	4,0	3,9	73,1	76,7	79,7
Greece	-7,7	-12,5	-12,2	-12,8	-8,8	-7,9	112,6	124,9	135,4
Ireland	-6,3	-12,5	-14,7	-14,7	-3,1	-1,8	65,8	82,9	96,2
Italy	-2,7	-5,3	-5,3	-5,1	-2,4	-2,4	114,6	116,7	117,8
Netherlands	0,7	-4,7	-6,1	-5,6	3,1	3,1	59,8	65,6	69,7
Portugal	-2,7	-8,0	-8,0	-8,7	-10,2	-10,2	77,4	84,6	91,1
Spain	-4,1	-11,2	-10,1	-9,3	-5,4	-4,6	54,3	66,3	74
Denmark	3,4	-2,0	-4,8	-3,4	1,9	2,2	40,4	35,3	35,2
Norway	8,0	7,9	10,4	11,8	9,5	13,4	54,3	50,6	45,2
Sweden	2,5	-5,0	-3,3	-2,7	7,8	7,7	42,1	43,6	44,1
UK	-5	-12,1	-12,9	-11,1	-2,4	-1,6	68,6	80,3	88,2

Source: Danske Markets, European Commission

## Issuance calendar for the coming week

Next week we will be focusing on the new 10y Bund, where we expect a coupon of 3.50%. We think that the auction should go well even though we are getting closer to year-end and the periphery has begun to tighten yet again. However, the statements from ECB indicate that the exit strategy will be very gradual and this should also be supportive for the long end of the bond market.

Supply next year from Germany is expected to increase - we look for gross issuance of some EUR 220bn in Schatz, Bobl and Bunds with the risk on the upside given the soft fiscal policy. However, the German Debt management could also use both the index-linked market as well as issuing in USD in order to avoid too much pressure on German Schatz, Bobl and Bunds. Hence despite the soft fiscal policy, Germany remains one of our favourites for 2010 given the solid surplus on the current accounts and their much lower deficit and better fundamentals.

Next week there will also be issuance from Italy, Netherlands, Slovakia and Portugal. Italy is expected to sell EUR 6-8bn, while we see small taps from Netherlands and Portugal. We look for a gross issuance of EUR 16bn next week.

Sweden and Norway are also coming to the market next week. Sweden will tap in the new 10Y benchmark SGB #1047 (5% Dec-2020). This is the first time since February 2008 that the Debt Office will tap in this bond. Since it is the new 10Y benchmark, we would expect the auction to go well even though spreads to Bunds have tightened, but SEK is trading on the weak side against the Euro compared to our forecast. However, if we look at the previous 10Y auctions in the SGB 1052 we have seen some lacklustre demand given the low bid-to-covers. The average bid-to-cover has been 1.8 compared to e.g. the bid-to-cover in the 2Y and 5Y benchmarks where the average has been 3.4.

Norway is issuing in the 5Y benchmark (NST 471, 5% May-15). This is the second time this year that Norges Bank is selling the NST 471. The last time was in September, when they sold NOK 4bn. The bid-to-cover was 2.4, which is in lower range, when we look at the auctions in 2009.

However, we expect solid demand at the auction as this is the last bond auction in 2009. Next year we expect to see the number of government bond auctions decrease substantially, as there has been very limited demand from both banks and corporates to use the facilities provided by Norges Bank, whereby banks could raise capital and corporates could sell bonds to Norges Bank. These facilities were to be funded by government bond issuance. Furthermore given the recent weakening of the NOK, we expect to see solid demand for the 5Y bond.

Finally, it is also a big week in the US Treasury market with the Treasury issuing USD 40bn in the 3Y segment, USD 25bn in the 10Y segment and USD 16bn in the 30Y segment. So all in all a total USD 81bn coming to the market.

**Table 4. Issuance calendar for the coming week**

Date	Issuer	Type	Coupon	Maturity	Amount	Type	Status
10/11/2009	Netherlands	DSL	2.5%	Jan-12	1.5-2.5bn	Tap	Confirmed
11/11/2009	Portugal	PGP	3.6%	Oct-14	0.75bn	Tap	Confirmed
11/11/2009	Germany	Bund		Jan-20	6bn	New	Confirmed
11/11/2009	Norway	NGB	5%	May-15	NOK 3bn	Tap	Confirmed
11/11/2009	Sweden	SGB	5%	Dec-20	SEK 3bn	Tap	Confirmed
13/11/2009	Slovakia	SLOV	FRN	Jan-15	600mn	Tap	Confirmed
13/11/2009	Italy	BTP			6-8bn	Tap	Estimated

Source: Danske Markets. Note. Auction amounts for Scandinavian bonds are denominated in local currency.

## Net cash flow for the coming weeks

There is a negative net cash flow next week of EUR 16bn as there are hardly any coupons and redemptions next week. In the following weeks (week 47 and 48) we continue to see negative net cash flows in Euroland, although issuance is gradually fading as we are getting closer to year-end.

**Table 5. Net cash flow for the coming week (values in million, local currency)**

Net cash flow	Week 46	Week 47	Week 48
Germany	-6,000	0	-5,000
France	0	-9,000	0
Italy	-7,000	0	-2,000
Spain	0	-2,500	0
Portugal	-750	0	0
Greece	14	0	341
Belgium	0	0	0
Netherlands	-2,000	0	-2,000
Austria	0	0	0
Finland	0	0	0
Ireland	176	-1,000	0
Slovakia	-600	0	0
Total (EUR)	-16,161	-12,500	-8,659
Denmark	1,710	49,099	
Sweden	-3,000		
Norway	-3,000		

Source: Danske Markets.

## Duration extension in Danish government bond indices

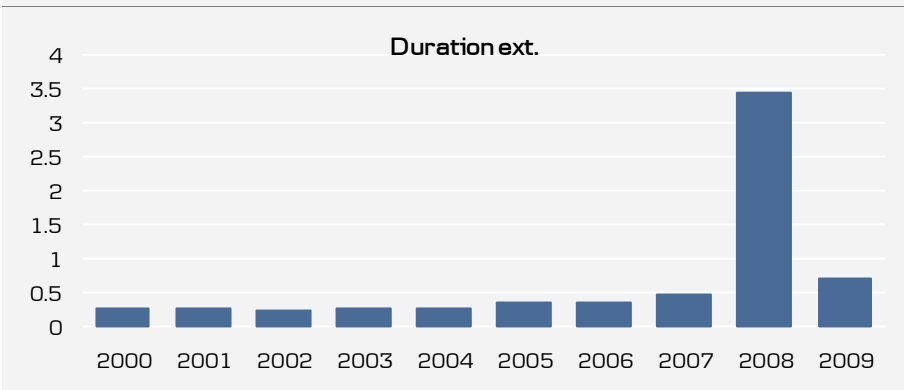
One of the most common bond indices used in Denmark and abroad – the EFFAS index – will see a duration extension in both the broad index but also in the EFFAS 1-3Y index as DGB 4'10 will leave the broad index and the 1-3Y index. In the 1-3Y index it will be substituted by the DGB 4'12, which should be supportive for DGB 4'12.

We will see an increase in the duration of the broad index as well as the 1-3Y index. The duration on the broad index will be increased by 0.7 in December. It is smaller than the increase in December 2008, when the DGB4.5% 2039 entered the index. Here the duration increased with 3.5Y as a result of the significant issuance in DGB 4.5% 2039

However, the current duration extension is larger than normal as shown in the chart below. In the chart we have listed the duration extension in the broad EFFAS 1Y+ index on Danish government bonds. The duration extension usually happens in December as almost every Danish government bond matures on November 15. The odd one out was back in September 2007, when DGB 4% Aug. '08 left the index. Here the duration increased with 0.45. The average duration extension in December going back to 2000 and until 2007 is 0.3. Hence, the current extension is more than double the normal extension

Why? This is due to the fact that the overall duration on Danish government bonds has increased as a result of the significant issuance of DGB 4.5% 2039.

Chart 3. Significant duration extension in Denmark



Source: Danske Markets

Hence, we expect to see an increase in the demand for DGB 4'19 in order to match the increase in duration as this is the on-the-run 10Y benchmark. Alternatively - if the investors do not want to increase their exposure in DGB's, then they can sell DGB 4'17 and buy DGB 4'19.

## Follow up on current trading strategies

### Open trades – we recommend:

- Buy NST 473 against swaps at -50bp (target: -75bp) or DBR 3.5% Jul'19 at 90bp (target: 60bp). Currently at -58bp and 74bp.
- Buy DGB 4'19 against Germany or DKK swaps at 39bp or -15bp. P/L at 28bp/ 46bp and -25bp/-8bp. Currently: 35bp against DBR Jul'19 and -21bp against DKK swaps.
- Buy NST 472 against swaps at 50bp, p/l target: 75bp/35bp. Currently: 60bp. Alternatively, Buy NST 472 against Bunds at a spread of 100bp, p/l target: 70bp/115bp. Current yield spread: 88bp.
- Buy DGB 6'09 against Bubill 18 Nov'09. Opened at a spread of 88bp (act/360). Target: hold to maturity.
- Buy DGB 4'10 against OBL 147 (2.5% Oct'10). Opened at a spread of 55bp. Current spread: 57p.
- Buy 66mn (nom.) DBR 4.25% Jul 2014 and 36.4mn (nom.) IRISH 4% Jan 2014 against 100mn (nom.) SPGB 4.75% Jul 2014. Opened at a yield spread: 13bp. Current spread: 3bp.

### Closed trades: Trades in Blue were closed with a profit, while trades in Red were closed with a loss.

- Tactical overweight of 10y high-beta peripherals (BTPs, IRISHs and GGBs; overweight distributed evenly for the three countries) against Bunds. Trade initiated at +77bp (BTP 4.25% Sep'19), IRISH 5.9% Oct'19 at +154bp and GGB 6% Jul'19 at +136bp. All yield spread against DBR 3.5% Jul'19. Target 10bp tightening, loss: 10bp widening. Closed at BTP +69.5bp (7.5bp profit), IRISH +145bp (9bp profit) and **GGB +137bp (1bp loss)**. Overall performance: 5bp profit.
- Buy DGB 4'12 against OBL 151 or DKK swaps at 58bp (target: 40bp, loss: 75bp) or -40bp (target: -55bp, loss: -30bp). Closed at **59bp (1bp loss)** and -45bp (5bp gain).
- Buy DGB 4.5% 2039 against Bund July'39 at 10bp - P/L 4bp/13bp or against swaps at 4bp P/L -5bp/8bp. Closed at 6bp against DBR Jul'39 and -4.5bp against DKK swaps
- Buy BTP 4.25 Feb'15 against PGB 3.6% Oct'14 at a yield spread of 14bp. p/l target: 0bp/25bp. Current yield spread 6bp.

- Buy NETHER 3.75% Jul 2014 against SPGB 4.75% Jul 2014 at a yield spread of -4.7bp. Current spread: -12bp (-7bp).
- Buy RAGB 3.4% Oct 2014 against SPGB 4.75% Jul 2014 at 13bp or RAGB 3.5% Jul 2015 against SPGB 4.4% Jan 2015 at 20bp. Currently at 10bp (9bp) and 7bp (13bp), respectively.
- **Closed with a loss: Buy RFGB 4.25% Sep 2012 against SPGB 3.9% Oct 2012 at -14bp. Currently at -11bp (-10bp).**
- Buy DGB 4% 2012 against OBL 151 at 60bp. Currently at 37bp. Profit taken at 23bp.
- Buy BTP 4.25% 09/19 against DBR 3.5% 07/19 at 115bp. Closed at 88bp. Profit taken on half of the position at 106bp with the rest of the position closed at 88bp. Total (weighted) profit: 18bp.
- Buy IRISH 4.4% Jun 2019 against DGB 4% Nov 2019 at 174bp. Profit taking at 160bp. Total profit: 14bp.
- Given the significant rally in the front end of the Euroland government curves ahead of the 1Y LTRO and afterwards, we close our outright long position in PGB 5% 2012, which was opened at an ASW spread of 48bp. Closed at 4bp.
- We have closed our long position in RFGB 2017 against DGB 4'17 which was opened at -17bp. Closed at -1bp with a profit of 16bp.
- We have closed our long position in PGB 4.35% Oct 2017 vs. BTPS 5.25% Aug 2017, which was opened at 22-24bp. Closed at 1bp with a profit of 21bp.
- **We have closed the relative curve trade between the SEK government curve and the DKK government curve. Buy SGB 1052 against SGB 1045 at 183bp relative to DGB 6'11 versus 4'19 at 140bp. The spreads were closed at 228bp and 181bp with a loss of 5bp.**
- We have closed our Long peripherals against Germany. Opened: March 26, closed: May 11. Performance in five-year benchmarks: 31bp in BTPs, 100bp in GGBs, 50bp in PGBs and 72bp in IRISH.
- We have closed our long position in 10Y Spain versus 10Y Italy, where we:
  - Bought SPGB Jul 2018 against BTP Aug 2018 at -12bp. Closed at -31bp.
  - Bought SPGB Jul 2019 against BTP Mar 2019 at -17bp. Closed at -27bp.
- We have closed our short government bonds against swaps, where we:
  - Sold DGB 4'17 or DGB 4'19 at -15bp and -11bp respectively. Closed at -9bp and -1bp.
- **We have closed our long position of Danish government bonds against swaps:**
  - **Buy DGB 4% 2019 against DKK swaps at -11bp. Closed at -10bp.**

## Government bond supply 2009

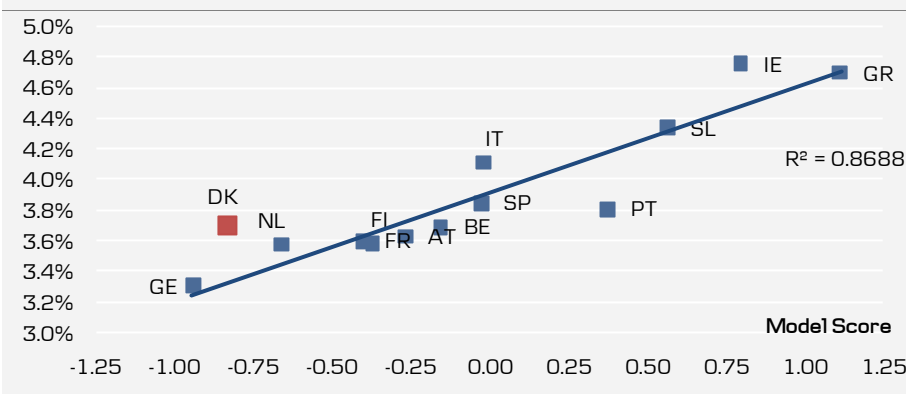
Table 6. Government bond supply 2009 (values in million, local currency)

Expected issuance (m)	Expected gross bond issuance 2009		Gross issuance 2009 YtD	Bonds matured 2009 YtD	Net issuance 2009 YtD	Expected net issuance 2009	% issued YTD of expected gross issuance	
	Official estimate	Danske Markets					Official estimate	Danske Markets
Germany	153,000	153,000	131,000	128,573	2,427	18,000	86%	86%
France	165,000	165,000	144,700	95,169	49,531	60,000	88%	88%
Italy		230,000	232,578	53,433	179,145	100,000	0%	101%
Spain	87,000	115,000	116,332	30,774	85,557	85,000	134%	101%
Portugal	12,000	15,000	14,532	6,310	8,222	10,000	121%	97%
Greece	40,739	61,000	61,288	25,872	35,416	34,000	150%	100%
Belgium	34,500	34,500	32,218	19,466	12,752	13,000	93%	93%
Netherlands	48,000	48,000	44,671	36,944	7,726	13,000	93%	93%
Austria	19,000	24,000	23,710	9,075	14,635	15,000	125%	99%
Finland	10,000	10,000	10,000	5,830	4,170	6,000	100%	100%
Ireland	25,000	33,000	32,761	5,245	27,516	30,000	131%	99%
Total - EUR	824,239	888,500	843,788	416,692	427,096	384,000	102%	95%
Denmark	94,000	94,000	90,274		90,274		96%	96%
Sweden	110,000	110,000	97,335	65,880	31,455		88%	88%
Norway		31,000	31,000	47,423	-16,423		0%	100%

## Scorecard model

The chart below shows results from our scorecard model. For more info see [Government Bonds – Introducing a simple scorecard model for sovereign spreads](#).

Chart 4. 10-year yield vs. model score



Source: Danske Markets

Table 7. Model score and rankings

	Germany	Nether-lands	France	Finland	Austria	Belgium	Spain	Italy	Portugal	Slovakia	Ireland	Greece
Model score	-0.94	-0.66	-0.41	-0.37	-0.27	-0.16	-0.03	-0.02	0.37	0.57	0.80	1.12
Rank	1	2	3	4	5	6	7	8	9	10	11	12
10y yield (%)	3.32	3.58	3.60	3.59	3.64	3.70	3.85	4.12	3.81	4.34	4.76	4.70
Rich(-)/cheap (bp)	7	13	-2	-6	-9	-11	-4	22	-37	3	28	0

Source: Danske Markets



## Latest benchmark asset swap spread movements

Table 8. Benchmark ASW-spread change - 2y segment

Spread change - 2Y segment	Today	- 1 week	- 1 Month	- 3 Month	YtD
Germany	-34	-6	-3	-4	55
France	-34	-5	-4	-4	10
Italy	-15	-5	-5	-10	-47
Spain	-25	-5	-8	-7	-32
Portugal	-18	3	-9	-4	-40
Greece	15	-8	-11	2	-128
Belgium	-26	-7	-5	-6	-23
Netherlands	-32	-7	-5	-4	12
Austria	-29	-8	-18	-8	-20
Finland	-34	-5	-4	-4	-8
Ireland	5	4	-16	-25	-33
Denmark	-55	-3	-2	4	20
Sweden	-46	-5	-7	-15	17
Norway	-63	7	-7	7	-12

Source: Danske Markets

Table 9. Benchmark ASW-spread change - 5y segment

Spread change - 5Y segment	Today	- 1 week	- 1 Month	- 3 Month	YtD
Germany	-33	-8	-6	-4	49
France	-25	-8	-12	-6	19
Italy	3	-9	-19	-14	-
Spain	-16	-9	-20	-11	-25
Portugal	-7	0	-26	-6	-37
Greece	164	-6	-23	8	46
Belgium	-16	-9	-16	-16	-29
Netherlands	-21	-9	-11	-8	1
Austria	-17	-10	-19	-20	-9
Finland	-32	-9	-14	-11	-22
Ireland	45	-2	-30	-28	-
Denmark	-37	0	1	25	27
Sweden	-24	-8	-3	-4	69
Norway	-58	-1	-3	5	9

Source: Danske Markets

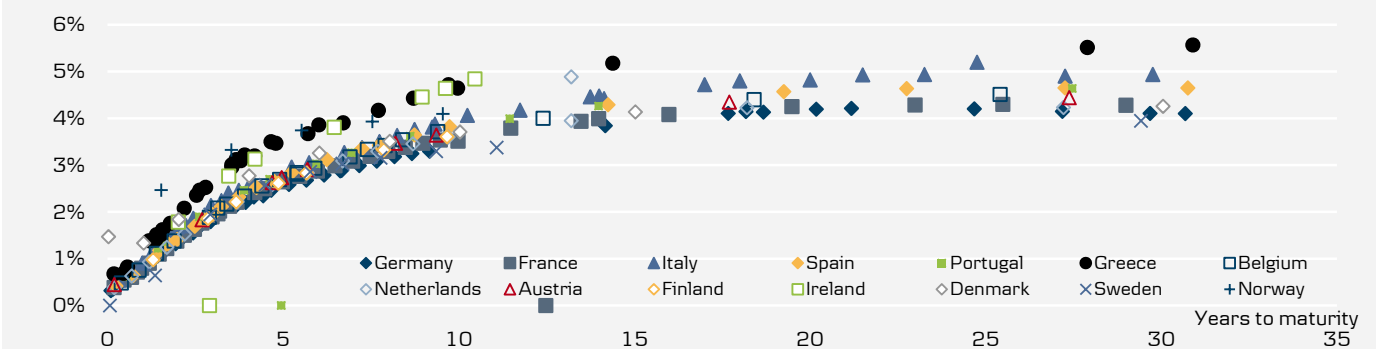
Table 10. Benchmark ASW-spread change - 10y segment

Spread change - 10Y segment	Today	- 1 week	- 1 Month	- 3 Month	YtD
Germany	-24	-4	-1	1	54
France	-2	-5	-10	-1	28
Italy	33	-9	-19	-16	-40
Spain	16	-6	-15	-6	3
Portugal	16	-2	-24	-16	-9
Greece	113	-5	6	21	-37
Belgium	10	-6	-15	-10	-2
Netherlands	-3	-6	-10	-6	12
Austria	10	-7	-18	-14	-2
Finland	3	-5	-11	-5	9
Ireland	101	-2	-22	-17	38
Denmark	-24	0	-10	3	32
Sweden	-27	-4	-2	-3	52
Norway	-56	-3	-6	1	23

Source: Danske Markets

## Government bond yield curve

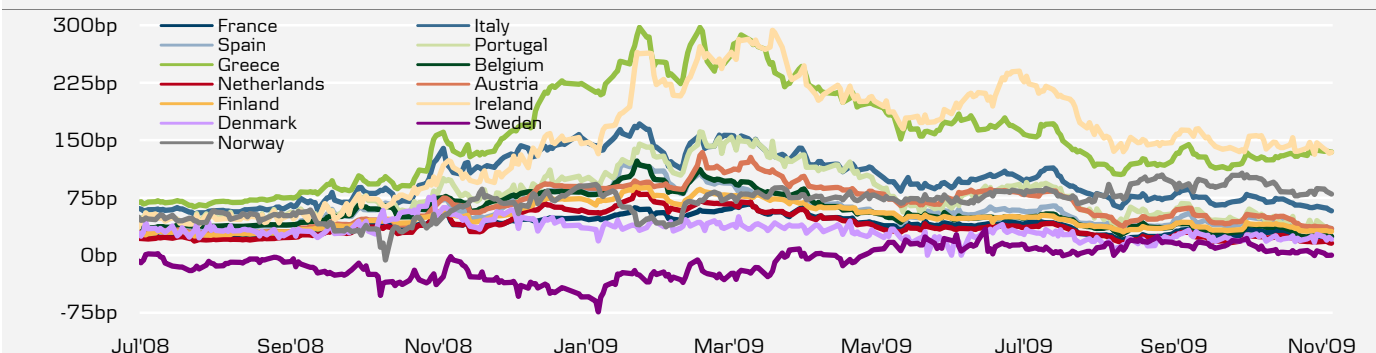
Chart 5. Government bond yield curve (effective yield, mid-market)



Source: Danske Markets

## 10y yield spread vs. Germany

Chart 6. 10y yield spread vs. Germany



Source: Danske Markets

## Disclosure

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