Interior. Brøndums annexe. Ca. 1920. Detail.
Anna Ancher, one of the Skagen painters.
The picture is owned by the Skagens Museum.

Doorway to global interest rates

SKAGEN Tellus

7 February 2011

Portfolio manager Torgeir Høien

SKAGEN funds

What is SKAGEN Tellus?

- SKAGEN Tellus, established at the end of September 2006, is an actively managed global bond fund with a very broad macro mandate that invests in securities and currencies considered to give our unit holders the best risk adjusted return.
- The fund, which has euro as a reference currency, is only invested in sovereign bonds and bonds issued by supranational institutions. The fund holds a diversified portfolio of both developed and emerging market bonds.
- Based on proprietary research and extensive analytical coverage of global markets, we seek to find bonds and currencies that are undervalued in global markets.
- The fund is managed by Torgeir Høien, who has been a portfolio manager with SKAGEN Funds since 2005.

The numbers in a nutshell

- SKAGEN Tellus' net asset value increased 2.3 percent in January as measured in EUR.
- The benchmark index* gained 0.7 percent last month, also measured in EUR.
- At the end of January the fund's net yield was 2.9 percent and the portfolio's average duration was 3.7 years.
- Since inception in September 2006 the fund has had an annualized return of 5.9 percent, while the index has delivered an annual return of 6.7 percent.
- The accumulated return since inception has been 36 percent. Interest income has contributed 76 percent, bond price appreciation 13 percent, and currency gains 11 percent to the accumulated return. Note that this is the average contribution to returns since the fund's inception. From month to month, and from year to year, the contributions show a great deal of volatility, with most of this stemming from foreign exchange fluctuations.
- Volatility as measured by standard deviation has been 7.4 percent for the fund since its inception. The benchmark had a standard deviation of 8.6 percent in the same period.
- The fund's Sharpe ratio has been 0.5, the same as for the benchmark index since the fund's inception. The Information Ratio for the fund has been -0.1

* The benchmark is Barclays' Global Treasury Index. It consists of a representative basket of bonds issued world wide with 3-5 years duration, is unhedged and measured in EUR.

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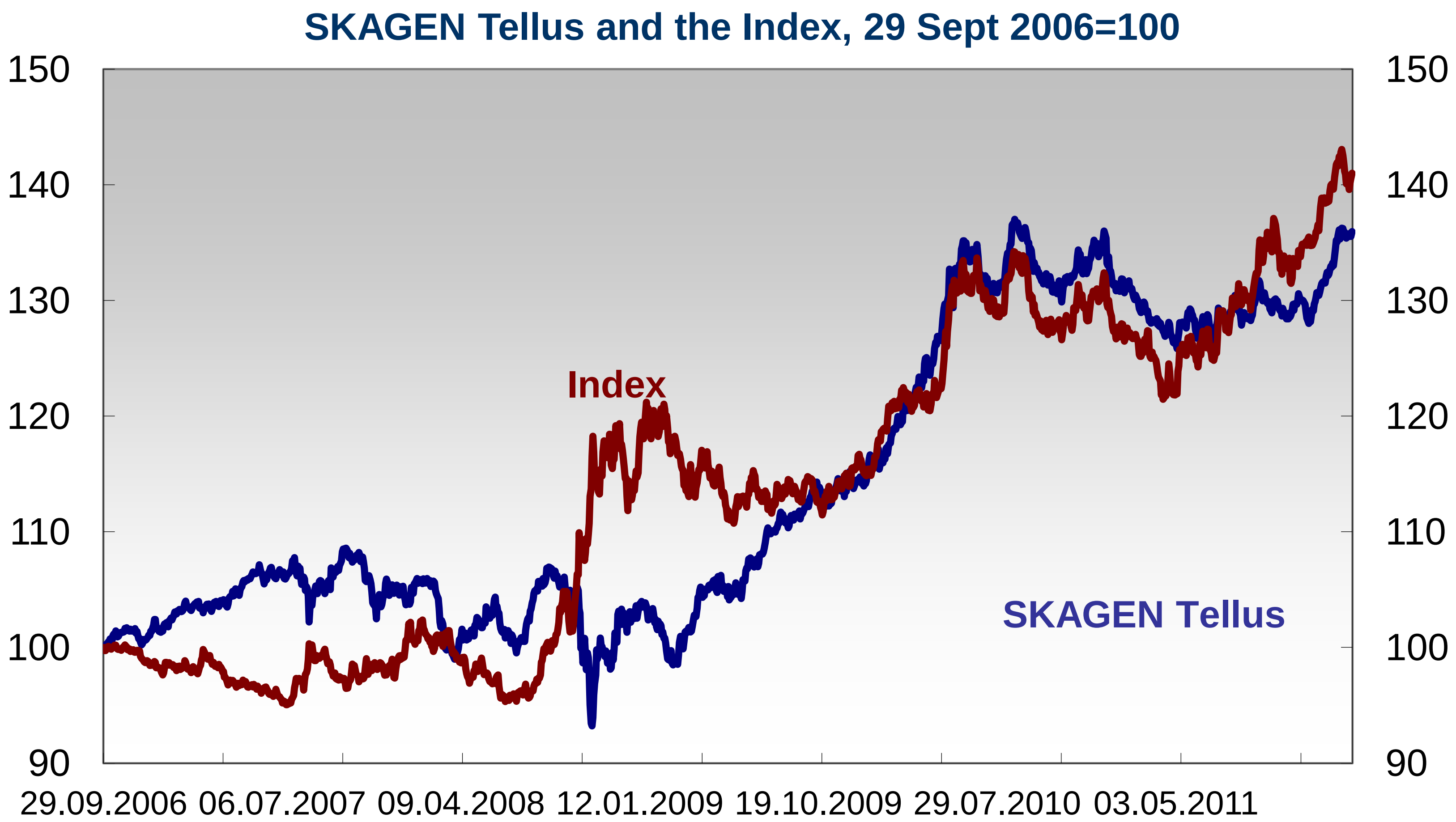
SKAGEN Tellus and its benchmark index since inception



An excellent start

- SKAGEN Tellus had an excellent start to the year, with its net asset value up 2.3 percent in January, 1.6 percentage points ahead of the benchmark index. This came as a relief after the fund's poor performance last year.
- Last month currency gains contributed 60 percent, bond prices 27 percent and interest income 13 percent to the fund's total return.
- We benefited from having fairly broad exposure to emerging market bonds. Most of our emerging market bonds performed well, i.e. their prices rose on falling market yields. Falling bond yields in South Africa, Mexico and Turkey account for most of the contribution from bond price appreciation.
- We also saw contributions to the fund's net asset value through currency gains. That is, securities rose in EUR terms due to a depreciation of the EUR relative to the currencies in which the fund was invested.
- Only the USD, the HK and the CNY (Chinese renminbi) appreciated relative to the EUR from the end of December to the end of January. For the rest of the portfolio there were major gains, i.e. the EUR fell relative to the currencies in which the fund was invested.
- See the chart on the next page for how the various fixed income securities in SKAGEN Tellus performed with respect to foreign exchange movements.

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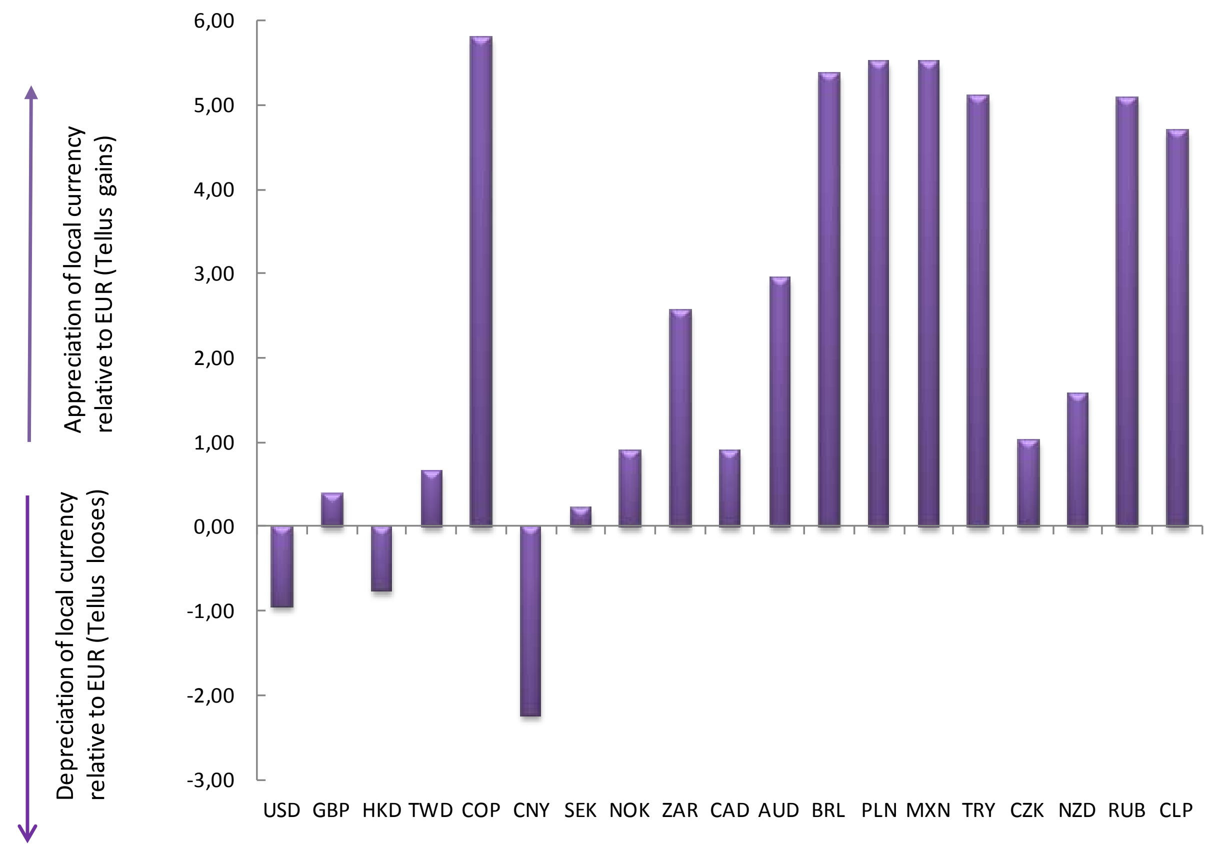
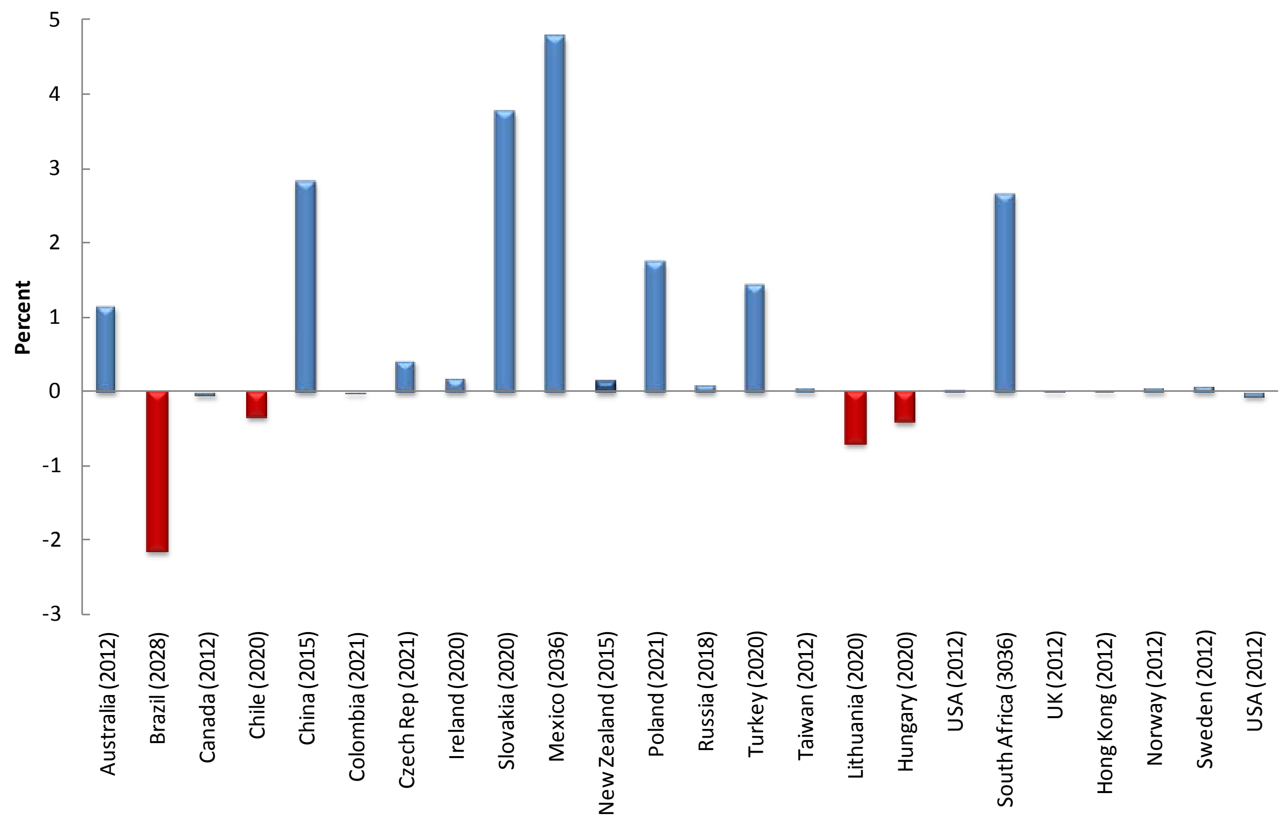
Currency gains and losses relative to EUR in January



Bond price gains and losses



The table shows the percentage change in the price of the bonds that we bought during the month or from the date we purchased the bond last month.

On currency trends

- Foreign exchange rates fluctuate significantly, and these fluctuations cause a lot of volatility in the fund.
- We do not attempt to be ahead of daily movements in exchange rates, which are largely random.
- But we do try to invest in securities denominated in currencies which we think are fundamentally undervalued. (We might invest in bonds even if we do not think the currency is undervalued, but then we hedge the currency risk).
- How do we judge whether a currency is fundamentally undervalued? The basic idea is to measure how far away the currency is from the level implied by purchasing power parity and to assess how such a gap might be closed in the long run.
- Here is the most important application: For good economic reasons the price level in a poor country, when measured in a common currency, should be lower than in a rich country. But if the poor country has much more rapid growth on a per capita basis than the rich country, its price level will over time converge toward the rich country's price level. The gap can be closed in two ways. Either through relatively high inflation or a strengthening of the local currency. Thus if the poor country has adopted an inflation target in line with the rich country, the main adjustment will come though an appreciation of the poor country's currency.
- Identifying undervalued currencies, therefore, is a matter of discerning comparative GDP per capita levels, forming an opinion on relative trends in growth in GDP per capita, and having an opinion on how monetary policy is going to be handled.
- It is not an exact science, but we use all available data and techniques to try to find fundamentally undervalued currencies, and over time we believe that this approach will give our unit holders an extra return. But it goes without saying that such a convergence process is not linear. Currency movements, therefore, contribute significantly to the volatility of the fund.

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Portfolio changes in January

- We sold the position in Finland since we wanted to reduce the fund's exposure to EUR. On January 31 EUR-denominated bonds accounted for 9.4 percent of the portfolio. It is our view that fundamentally the EUR is relatively strong. It is also our judgement that, compared to the other major central banks, the ECB will be more accommodating in its policy stance in the years ahead than the market currently anticipates.
- We reduced our exposure to bills issued by the Swedish and the UK government, as we see a more limited upside potential in those currencies.
- As for purchases, we have broadened the portfolio and included fixed income securities from Chile, the Czech Republic, Ireland, New Zealand, Russia and Hungary. All of these investments are modest – with the exception of the Czech Republic (2.5 percent), each of them are less than 2 percent of the fund – as we have made an effort to diversify the portfolio.
- The investments in Chile, Ireland, Russia, New Zealand and Hungary are in relatively long-term bonds, as we see a potential for bond price appreciation, i.e. lower yields, over the medium term. All of our investments outside of the eurozone are unhedged, as we also see potential in the currency gains. The purchase in the Czech Republic is in a short-term bond with a low yield, and is purely motivated by currency.
- With these adjustments, we now have a total of 24 different sovereigns in the portfolio (including the supranational EBRD CNY-denominated bond).
- Our largest position is in Slovakia, accounting for 6.9 percent of the fund. With solid public finances, good growth prospects and banks that have little exposure to the eurozone periphery, we think the state's long-term bonds are set to fall further relative to the German benchmark. (The spread is currently 2 percentage points).

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Our major bets

- According to our calculations the euro is overvalued relative to the US dollar. Hence we are overweight in dollar and underweight in euro relative to the benchmark index. We think that the Japanese yen – to say nothing of Japanese bond prices – is overvalued, and we are not exposed to JPY-denominated fixed income securities.

- We think long-terms bonds in many of the advanced economies are extremely overvalued. Hence, with the exception of New Zealand, and two countries inside the eurozone, we have very low duration in advanced economies. In New Zealand we see some value in a medium-term bond, and within the eurozone we have a rather large position in a long-term Slovakian bond and a small position in a long-term Irish bond.

- We continue to find most value in long-term emerging market bonds. (See next few pages for full portfolio disclosure). In fact, we think that 2012 and beyond will see a convergence between developed markets' and emerging markets' sovereign bonds. The point is that many emerging markets now finance their public sector using bonds issued in domestic currency. And both their debt levels and deficits are often more "advanced" than in most advanced economies.

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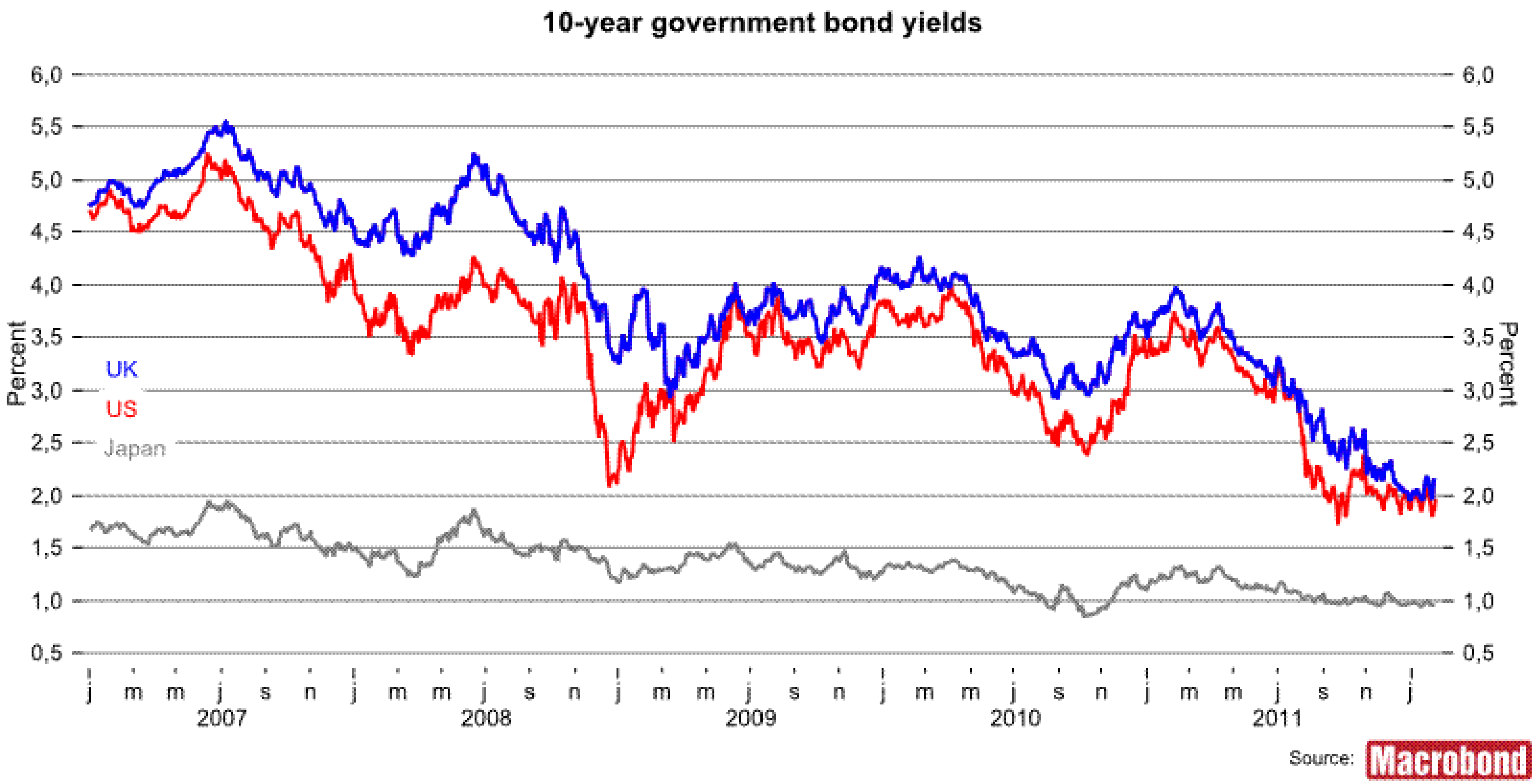
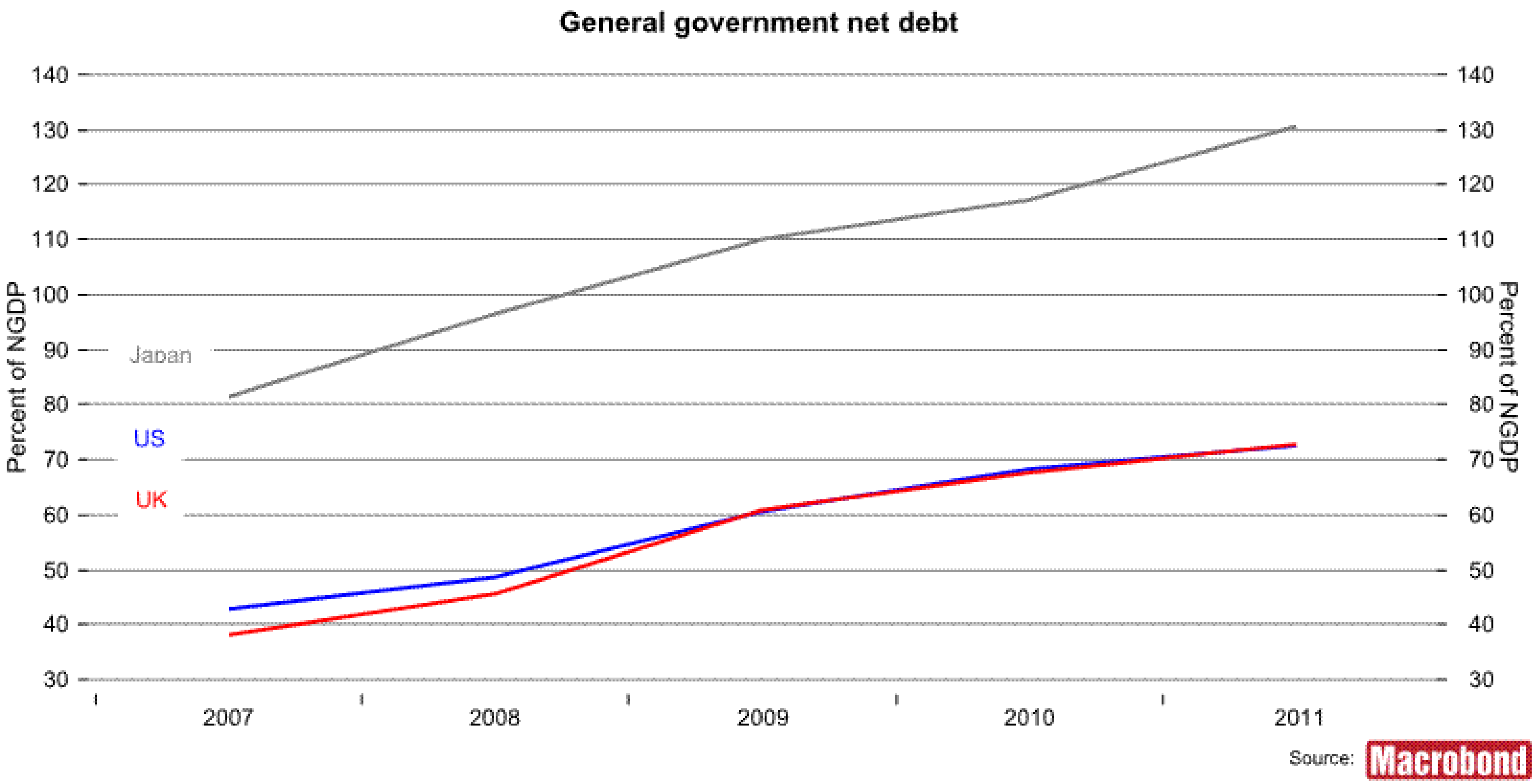
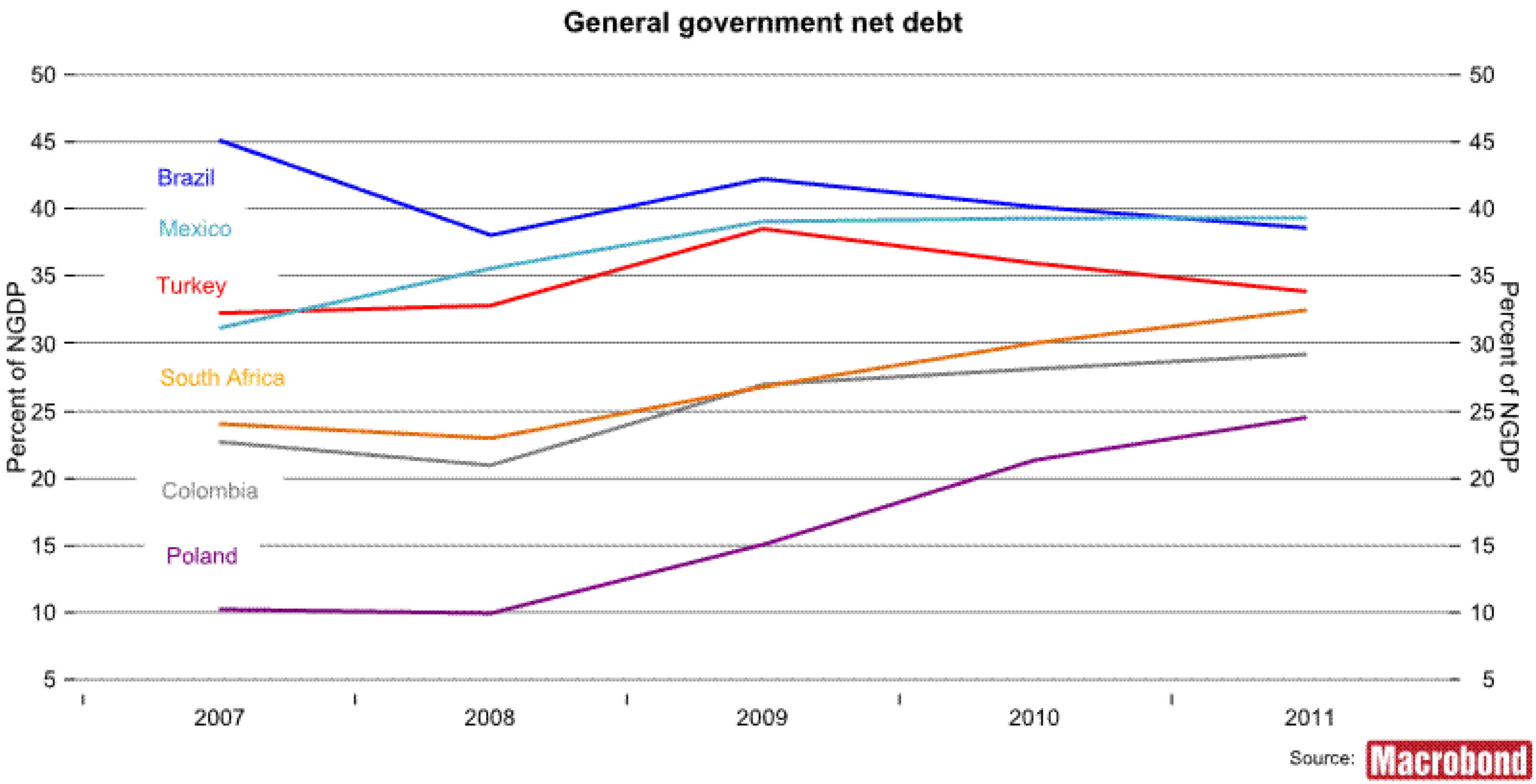
Expensive government bonds



And deteriorating public finances



Many emerging markets' public finances are on a solid footing



Portfolio as of 31 January 2011 – page 1 of 2

Paper	Maturity	Yield	S&P-rating	Share
Slovakian Government	2020	4.9%	A	6.9%
Norwegian Government	2012	1.6%	AAA	5.6%
Taiwanese Government	2012	0.6%	AA-	5.5%
Canadian Government	2012	0.7%	AAA	5.5%
South-African Government	2036	8.8%	A	5.5%
US Government	2012	0.2%	AA+	5.5%
EBRD (CNY)	2015	1.1%	AAA	5.3%
Polish Government	2021	5.3%	A-	5.2%
UK Government	2012	0.4%	AAA	5.2%
Hong Kong Government	2012	0.1%	AAA	4.9%
Australian Government	2012	4.1%	AAA	4.7%
Mexican Government	2036	7.6%	A	4.4%

Portfolio as of 31 January 2011 – page 2 of 2

Paper	Maturity	Yield	S&P-rating	Share
Lithuanian Government (USD)	2020	6.2%	BBB	4.4%
Brazilian Government	2028	9.0%	BBB+	4.2%
Colombian Government	2021	5.2%	BBB+	3.8%
US Government	2013	0.1%	AA+	3.3%
Turkish Government	2020	9.6%	BB+	3.3%
Swedish Government	2012	1.7%	AAA	2.9%
Irish Government	2020	7.0%	BBB+	2.5%
Czech Government	2013	1.4%	AA-	2.4%
New Zealand Government	2015	2.8%	AAA	2.0%
Russian Government	2018	7.3%	BBB+	2.0%
Chilean Government	2020	5.1%	AA	1.9%
Hungarian Government (USD)	2020	7.6%	BB+	1.5%
Net cash (USD)				1.8%

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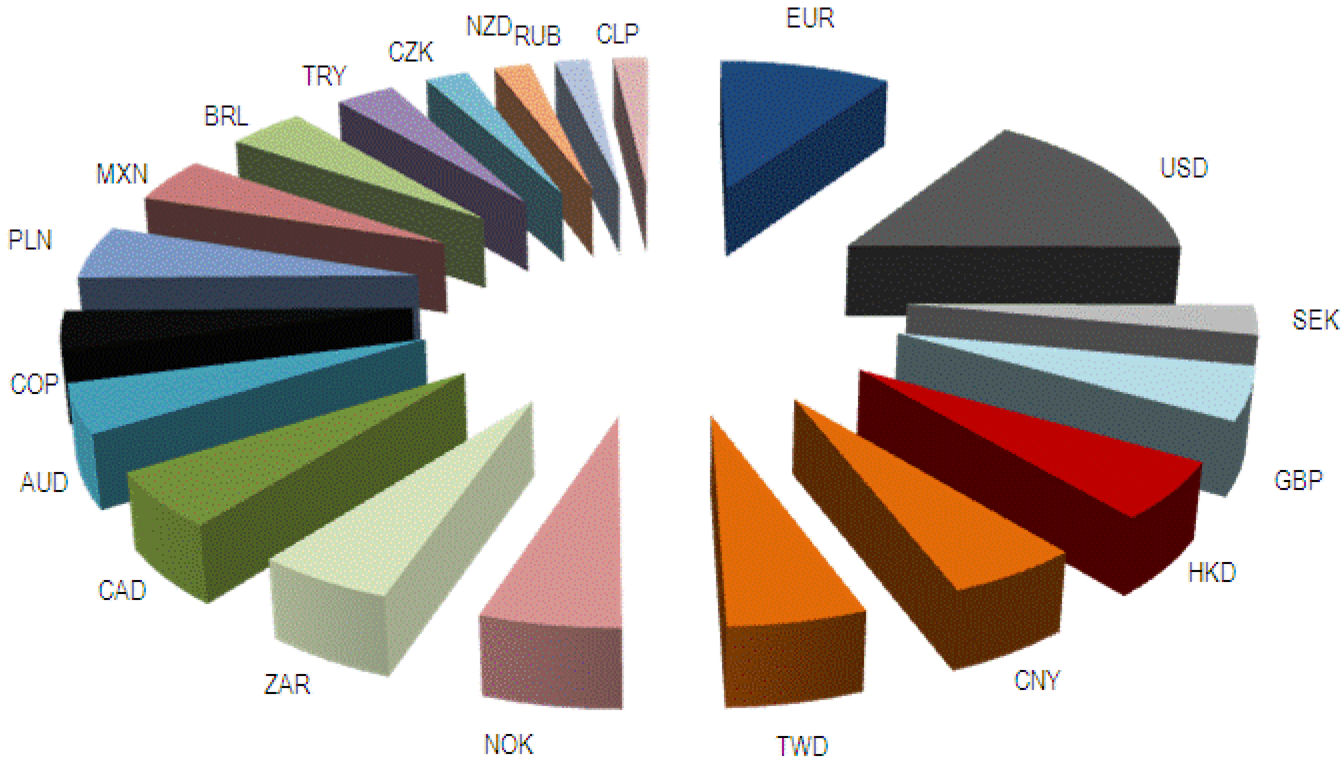
The currency composition of the fund as of 31 January 2012



Working target for the next 36 months

- Although it has increased lately, we still have quite a low yield in SKAGEN Tellus. As of 31 January the yield was 2.9 percent.
- We have a rather modest target for the next 36 months. Though short-term interest will in all likelihood begin to normalise in the major economies in this period, we expect the process to be gradual. As our overall duration is low, due to low duration in our developed market investments, a rise in short-term interest rates will quite quickly translate into higher returns in the fund.
- We do expect capital gains where we have entered the long end of the yield curve. As explained these positions are mostly centred on emerging markets, and we have increased the fund's investments in such bonds lately. Also, over time we should be able to cash in on our currency positions. In sum we therefore target an annual return of 6 percent per year over the next 36 months.
- It should be noted that SKAGEN Tellus, as a global bond fund, does take substantial risk. Hence the fund's NAV will be volatile and there may be periods of negative return. Investors are advised to have an investment horizon of at least one year.

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For more information

- Please refer to:
  - Our latest Market report
  - Follow our macroeconomic analysis Economy at a Glance
  - Information on SKAGEN Tellus on our web pages

The yield refers to the current yield that the fund receives for its interest rate holdings measured as a percentage of the fund's value. The yield is net of the fund's management fee. The fund's future returns will be a function of the current yield that the fund receives, capital gains and losses from the fund's holdings in bonds and certificates, as well as any gains and losses from currency exposure linked to foreign holdings. Also, the yield on inflation protected securities does not incorporate expected inflation. The fund's future returns must be expected to differ from the fund's yield.

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