

A year of two halves

2015 was characterised by large currency movements and a decline in energy and commodity prices. This had both positive and negative effects, depending on the region companies were active in. For some of our funds, the outperformance in the latter part of the year was not enough to make up for a disappointing first half.

Events in 2015

Global stock markets continued upwards for most investors in 2015, in line with the consensus at the beginning of the year. However, there were substantial currency movements in 2015 which meant forecast returns did not materialise for USD-based investors. 2015 was more positive for European investors. The decline in energy and commodity prices is obviously not good for regions active in that space.

Nevertheless, for the vast majority of the global population, lower input prices are a net benefit; lower petrol, material and food prices leave consumers and corporates with more to spend elsewhere.

To illustrate just how much currency influenced returns, global stocks including dividends rose 15.3% in NOK in 2015, 8.7% in EUR and fell 2.4% in USD. The growth rate was roughly ten percentage points lower than in 2014 and in line

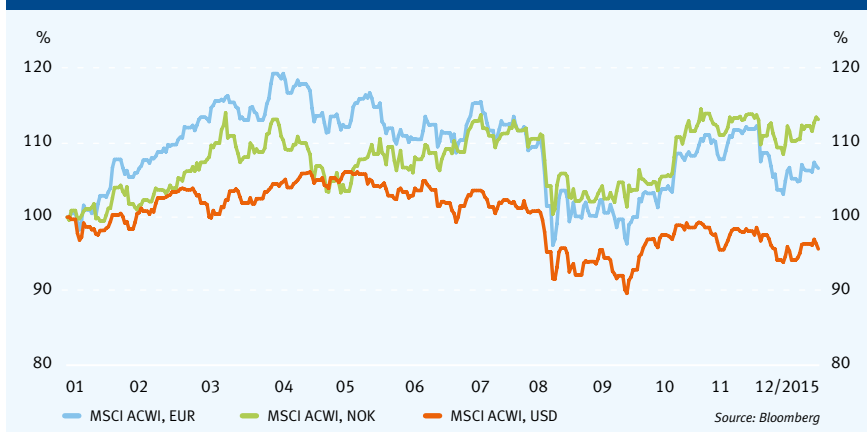
with the underlying earnings growth of 8%. Asian and European earnings met or slightly exceeded estimates, while American earnings, including Latin American earnings, disappointed.

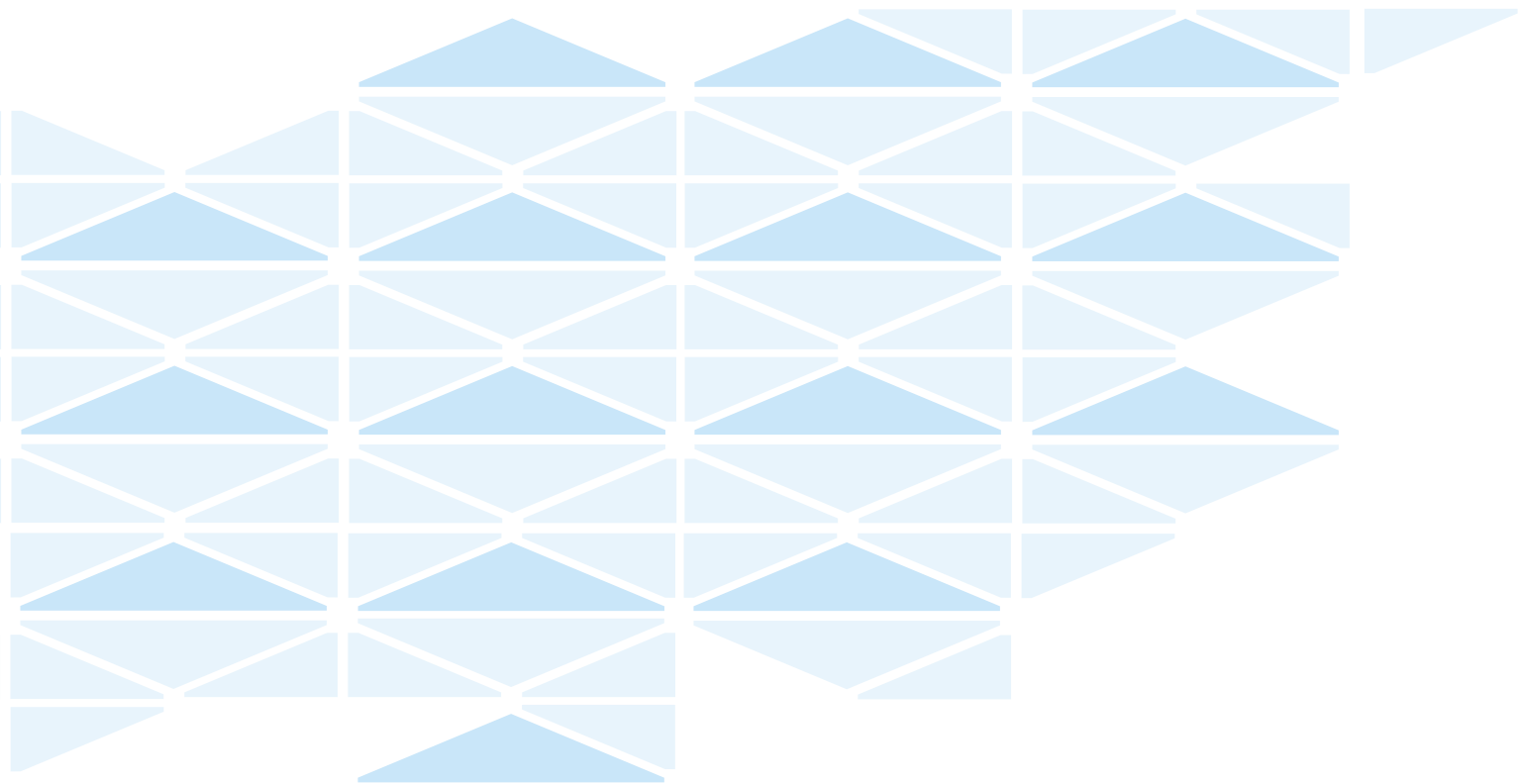
Emerging markets fell 15% in USD and 0.5% in NOK reflecting weak commodity and energy prices – a key driver for many emerging markets.

There were fewer surprises in 2015 than in 2014, but we saw a repetition of certain themes including geopolitical unrest and climate oddities. The Ukraine crisis and Ebola in West Africa faded from media focus, to be replaced by the Syrian refugee crisis and Chinese expansion in the South China Sea.

One of the major events of the year was the Paris Climate Conference, COP21, and the ensuing agreement to reduce global CO2 emissions. The successful fusion energy test was another highlight, indicating that fusion energy may be a commercial way forward. But it will take until 2050 to get the process into production mode, so until then we need to rely on other sources of energy.

MSCI ACWI EUR VS NOK VS USD 2015





SKAGEN funds' performance

Although our key funds outperformed their respective benchmark indexes in the second half of 2015, the funds did not achieve the outperformance that we have seen from them in past years. 2015 is the second consecutive year that the majority of our funds delivered returns below that of their respective benchmarks. For a more detailed review of each fund please refer to the individual fund reports.

The performance of all our funds has been impacted by currency movements, the strong performance of USD assets, and the disappointing performance of emerging markets. When it comes to the equity funds, value-based investing underperformed growth-based investing by 7.5% percentage points.

We stand firm by our investment philosophy

One may well ask whether SKAGEN's value based investment philosophy or investment execution is at fault for our poor relative return over the calendar year. The answer is neither. We continue to pick individual companies with a good business model when the market price tells us that other investors do not correctly factor in the potential returns and risks. Nonetheless, the funds' benchmark indexes include many large growth companies, which benefit in a world with QE (Quantitative Easing or very low interest rates provided by the central banks) as the net present value of future earnings is very highly valued. SKAGEN is

not opposed to investing in growth companies, as long as the valuation is attractive. We do not, however, find value and hence a solid risk buffer, in many of the most popular companies at present.

Turning over all the stones

During 2015 the portfolio management team dedicated time to re-examining our analytical process, decision making and the risk factors in the funds and individual investments. The conclusion is that our investment philosophy, working methods and the exposure in our portfolios are solid. We continuously test all our equity investments for a 50% upside potential over a 2-3 year horizon and against a 20% downside risk. Obviously, some of our investment cases have not turned out as planned. All the learning points from investments, both good and bad, are taken to form a retrospective investment case library – a key source for ensuring good working practice and outperformance going forward.

Standing out from the crowd

If our portfolios looked just like everyone else's, we would not excel. Being different – or contrarian – is vital to achieving exceptional returns. This is a signature profile for SKAGEN; we are and will continue to be different.

One might then ask – when will we next deliver world class performance? The very low level of interest rates has created superior returns for true growth companies – and in many cases this has translated into very high – and more risky – valua-

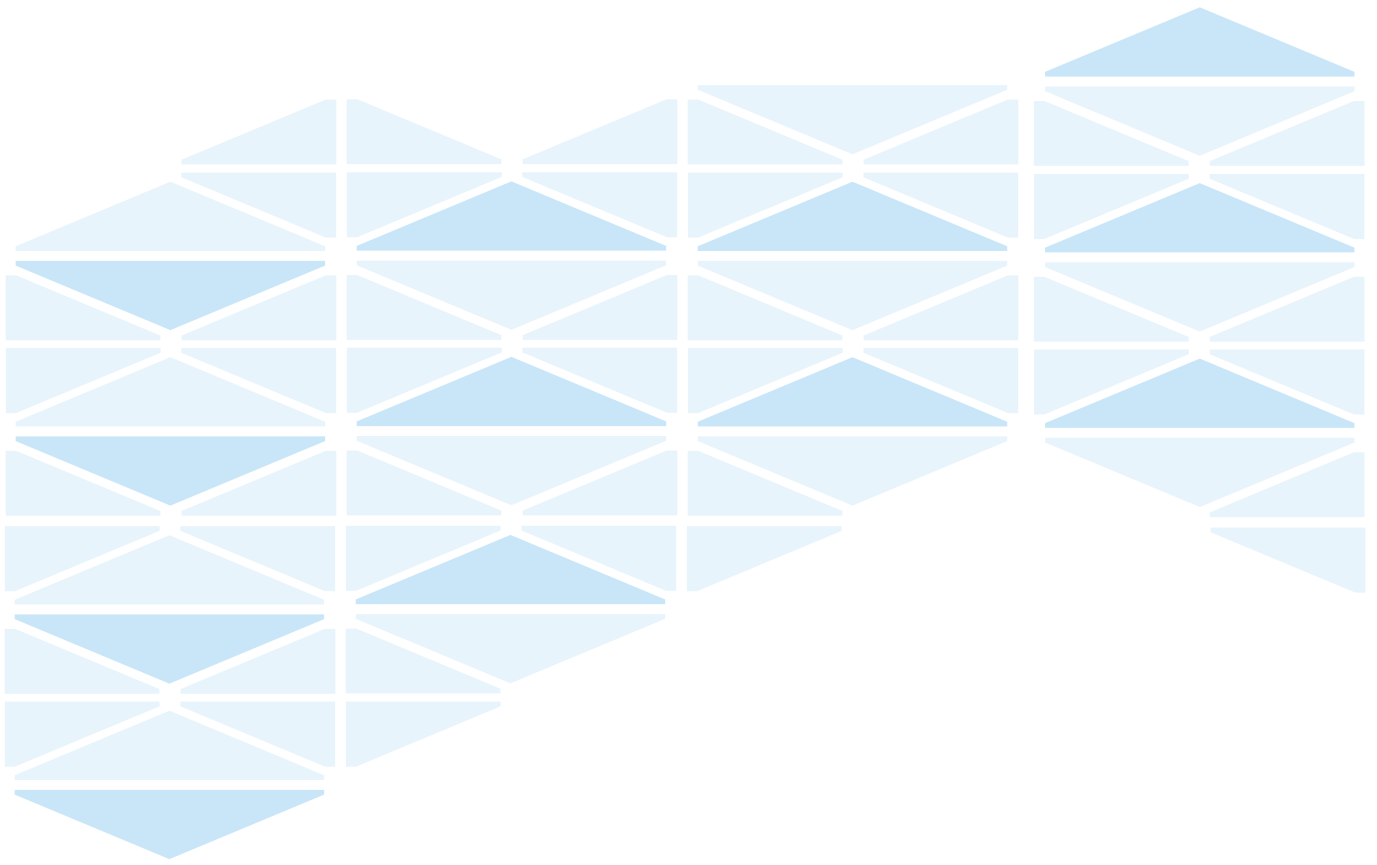
tions. Based on our value based philosophy, we have assessed the investments in our bond and equity funds and concluded that most of them are in good shape to be able to deliver. We have trimmed exposure in a number of investments and by the end of 2015 the funds are more concentrated and with updated return profiles, triggers to release value, and risk factors to be monitored.

There is a saying that “a smooth sea never made a skilful sailor”. The past five to six years in the financial markets have seen a steady upwards movement, so all investors have made decent returns. The question now is how investors will behave once we get into choppy waters, as we inevitably will.

A livelier year ahead

2015 in the Chinese zodiac was the year of the sheep – a calm animal which walks in flocks. As we reached the end of 2015 it became clear that some sheep flocks ended more or less where they had started.

Early on in 2016 the year of the monkey will begin. The monkey is a lively, intelligent and creative animal. In the past, the year of the monkey has often turned out to be a good investment return year even if the period was perceived as somewhat difficult as the monkey likes to tease. In 2016 we will likely see reduced correlation between financial assets classes and this provides a good backdrop for active and value based investors like SKAGEN.



2016 OUTLOOK

There are an overwhelming number of media and investment outlook reports for 2016 and they provide a solid sense of where consensus lies. While consensus is rarely correct, it is a valuable source of what the average investor has factored into asset prices.

According to the International Monetary Fund (IMF), global GDP growth in 2016 is about 3.4% and with China and India delivering most of the absolute growth. The US is expected to grow 2-3% and Europe and Japan should see positive but unimpressive growth of 1-2%. Brazil is the only major economy to be in recession as Russia is back on firmer ground.

The consensus view of interest rates is that they will move up a tad driven by tighter monetary conditions in the US. Europe and Japan will continue with low rates.

Company earnings are expected to increase 8-10% in local currencies with dividends of 2-3% in addition. Valuations for 2016 are at 15-16 times earnings and with continued low interest rates, this looks likely to remain. However, higher US rates will likely create some turmoil.

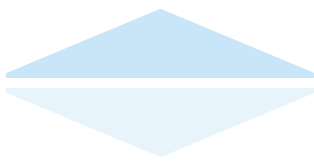
Earnings growth and valuation consist of many moving parts and the outcome is never certain, so history tells us investors should be prepared for 15-20% fluctuations over the year.

It is one thing to have a consensus base case roadmap for 2016, but what makes investing interesting is all the moving parts that can alter the way forward. For investors who carry out prudent preparations, solid analysis, scenario testing and use pattern recognition from past experience, the potential changes can work to their advantage. While some investors mistakenly view increased volatility as a risk, we see it as an opportunity as financial assets get pushed down to attractive valuation levels.



Photo: Bloomberg

While 2016 promises its fair share of uphill struggles, there are some opportunities on the horizon. We will continue to pick individual companies with good business models and where we see clear triggers for revaluation. Pictured here, Marian Croak, the vice president of access strategy and emerging markets at Google Inc speaks at an event in New Delhi, India. Google was one of the top three contributors to SKAGEN Global in 2015.



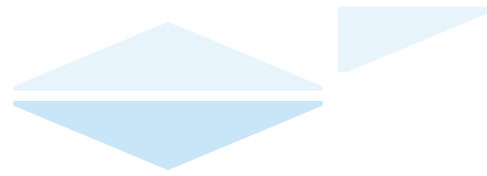
OPPORTUNITIES

1. China's new 5 year plan focuses on further urbanisation, encourages the expansion of the private and service economy and motivates increased innovation.
2. Low energy prices trigger higher consumption and push world GDP to above 4% - a trigger for better utilisation of capacity in cyclical businesses and hence improved profitability.
3. The change in demographics is slowly creating a lack of skilled labour in some developed markets, which will create upward pressure on wages.
4. Commodity prices fell in 2015, however this could turn out to be an opportunity in 2016 as financial strains in the industry improve the supply and demand balance



DEVELOPMENTS WITH MULTIPLE EFFECTS ON MANY BUSINESSES

1. Car and traffic safety improve as cars get cameras and sensors that enable them to avoid collision. This would impact insurance, healthcare and automotive companies' high-margin revenues from spare parts.
2. Further steps to cure cancer and other previously dangerous and difficult to cure illnesses. This would impact pension, work force participation and hospital needs.
3. Consumption in DM is replacement driven and new consumption is often intangible and difficult to grasp in a globally scalable business model. Consumption in EM is tangible so easier to grasp in listed companies, but also fragmented in many aspects.



RISKS

1. Poor trading and liquidity conditions in some segments of the capital markets could set off a domino effect of investment losses.
2. US investors did not get any returns in 2015, so if there is a move towards lower risk appetite, then corporate bonds, equities, ETFs, etc. could suddenly enter a downward spiral. Higher short-term rates in the US could accelerate this move.
3. Low oil and commodity prices create a funding problem in countries dependent on these assets as well as financial institutions with too much exposure to these sectors.
4. The geopolitical turmoil in the Middle East, the South China Sea and elsewhere will likely create several periods of volatility in 2016. The situation needs to be monitored closely for potential opportunities that may arise.
5. Low interest rates lead to the misallocation of capital and poor return on investments which in turn lead to decline of unsustainable asset values.



– Ole Sjøberg
Investment director