

# CIO View



## Life below zero

Dealing with negative interest rates



# Nine positions

## Our key forecasts

China's growth will not decelerate in 2016.



\*GDP growth in China for 2015 and 2016: Deutsche AWM forecast as of 3/12/15

The U.S. Federal Reserve (Fed) is ready, but not yet willing to change course.



\*The Fed removes the word "patience" from its March 18 statement.

Japan's central bank does not achieve its target inflation rate.



\*Inflation in Japan for 2015; Deutsche AWM forecast as of 3/12/15

Russia's economy is shrinking.



\*GDP growth in Russia for 2015 and 2016: Deutsche AWM forecast as of 3/12/15

U.S.-dollar parity with the euro to be reached at the beginning of 2016\*.



\*Deutsche AWM forecast as of 3/12/15

Thanks to the ECB's quantitative easing (QE), periphery bonds remain preferred\*.



\*Deutsche AWM forecast as of 3/12/15

A low-interest-rate environment benefits high yield\*.



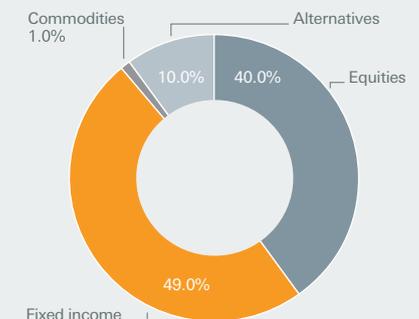
\*Deutsche AWM forecast as of 3/12/15

In a volatile year, the DAX can overshoot our price target.



\*Deutsche AWM forecast as of 3/12/15

Asset allocation of our balanced model portfolio:



Important terms are explained in our glossary.

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Letter to investors

# Europe's markets in QE euphoria

Europe's stock markets are profiting from cheap oil, a cheap euro and zero interest. Better economic prospects and increasing profits are set to be the next driver.

Europeans, who are fond of traveling, will discover over the Easter holiday period, at the latest, the downside to a weak currency. They will now get considerably less for their euros in many countries, meaning the disparities will become visible and tangible to all now. Regional divergences are evident elsewhere too. While Americans can be happy about the recent wave of weakness in oil prices at the gas station, little or none of this is reaching residents of the Eurozone.

And when procuring supplies or conducting cross-border takeovers, U.S.-dollar-based companies have been enjoying relative advantages over euro-based firms lately.

Why am I mentioning this? Surely the weak euro is one of the reasons we like Eurozone stocks? Let us thus have a look at the other three reasons: cheap oil, low interest rates and the – hopefully not just for this reason – resulting profit growth. But however strong the tailwind from oil, euro and interest rates might be for Europe at the moment, it is finite. Or at least it is declining in terms of momentum, after oil prices have already dropped by 50 percentage points, the euro has lost up to a quarter against the U.S. dollar in less than a year and key parts of the yield curve have slipped into negative territory. Based on classic valuation criteria and following the latest market rally in the Eurozone, that is likely to limit further upward potential and drive up volatility.

// Excesses and corrections – a lot can happen this year. //

We should be aware of this risk for the current year, and likewise of the danger that Europe's markets could overshoot our price targets. After all, like it or not, together with the European Central Bank (ECB), all other market participants are part of the big global experiment in

QE, something that raises several questions: Are historical price-earnings (P/E) ratios still a good yardstick? How is the low-interest environment and the cash injection from the ECB and the

Bank of Japan (BOJ) still affecting stock valuations? And how is it affecting the investment behavior of pension funds, life insurers or foundations, all of which traditionally overweight bonds in their portfolios? We believe that we are just seeing the start of huge capital shifts, particularly in Europe, that will herald the temporary end of interest and compound interest. In our opinion, the beneficiaries will remain, at least for the present, high-risk asset classes, particularly stocks. However, because of the fluctuations that can be expected in the course of the year, a good mixture, meaning a multi-asset orientation, is likely to become increasingly important.



Asoka Wöhrmann,  
Chief Investment  
Officer and Member  
of the Deutsche AWM  
Executive Committee

## Focus

# Ice age for savers

Negative interest rates are new economic territory. However, as yet, there is no sign of a major cash exodus to avoid sub-zero yields.

The golden rule used to be: interest rates are positive. Economist Ludwig von Mises based this on the belief that people put a higher value on today's goods than those in the future. The interest rate is a direct result of the time preference for consumption. John Maynard Keynes explained interest rates in terms of the desirability of money – rates are the reward for sacrificing liquidity. Additionally, there was the argument that negative interest rates would prompt savers to squirrel money away under their mattresses.

Today, the deposit rate is effectively negative in the Eurozone, Switzerland, Sweden and Denmark. Some banks are already charging their customers negative interest rates. Still, cash reserves have not grown exponentially. Undoubtedly there are good reasons for this. Holding your cash at home is a risk. Admittedly, there has been an increase in cash in circulation, but certainly no flight to cash. Even negative-yielding Bunds for maturities up to six years are not under selling pressure.<sup>1</sup>

With Bunds it may be that investors tend to accept the negative interest rates out of a combination of minimizing risk and the desire to generate profits. Clearly, Bunds are extremely secure. However, it is also possible that bondholders are anticipating a negative inflation rate – deflation – which will compensate for negative interest. Or perhaps investors expect interest rates to fall even further into negative territory which would push bond prices higher. Besides, regulation frequently compels many institutional investors to buy and hold safe-haven bonds.

## Consequences of QE

It is easy to see what is driving negative interest rates. In the past, central banks were able to push short-term interest rates below zero with negative deposit rates but they had limited influence on longer-maturity bonds. However, that changed when the financial crisis hit in 2007. The new unconventional monetary policy includes buying bonds. Since then, central banks have supported pricing by buying sovereign and corporate bonds, thereby depressing yields.

Since March 2015, the ECB has been buying 60 billion euros of bonds every month as part of its QE program. It plans to invest 10 to 20 billion euros in government-agency bonds, collateralized debt obligations and bonds issued by European institutions. Further, the ECB plans to direct the remaining sum of 40 to 50 billion euros into sovereign bonds. Precisely how many sovereign bonds of one country are purchased is decided by the ECB's capital key – the share of ECB nominal capital held by national central banks (NCBs).

## The ECB's vacuum-cleaner policy

The ECB buys a small proportion of bonds, with the remainder bought by NCBs. To avoid bond-purchase liquidity issues, the ECB has given NCBs the option to choose between sovereign bonds and quasi-government securities. The buyback program is scheduled to run until September 2016. As such, this year the ECB and NCBs are committed to buying sovereign bonds valued at some 450 billion euros. Given that during 2015 Eurozone countries are to issue about 675 billion euros to refinance historical debt and 264 billion euros to finance deficits,<sup>2</sup> around one half of these new bonds should be absorbed by the Eurozone's central-bank sector.

The consequences of this vacuum-cleaner policy are clear: low interest rates. Around 30 % of Eurozone sovereign bonds now carry negative interest rates.<sup>3</sup> Price increases for higher-risk securities show that this has led to evasive activities by investors. Corporate bonds, real estate and equities with attractive yields are all popular. The wide-scale fall in yields prompted by QE also has consequences for the real economy. Such a low-interest-rate environment could encourage companies to be more willing to take on debt to invest. This in turn would improve the Eurozone's growth prospects.

<sup>1</sup> Source: Deutsche Bundesbank, as of 3/16/15

<sup>2</sup> Source: Intesa Sanpaolo SpA, as of February 2015

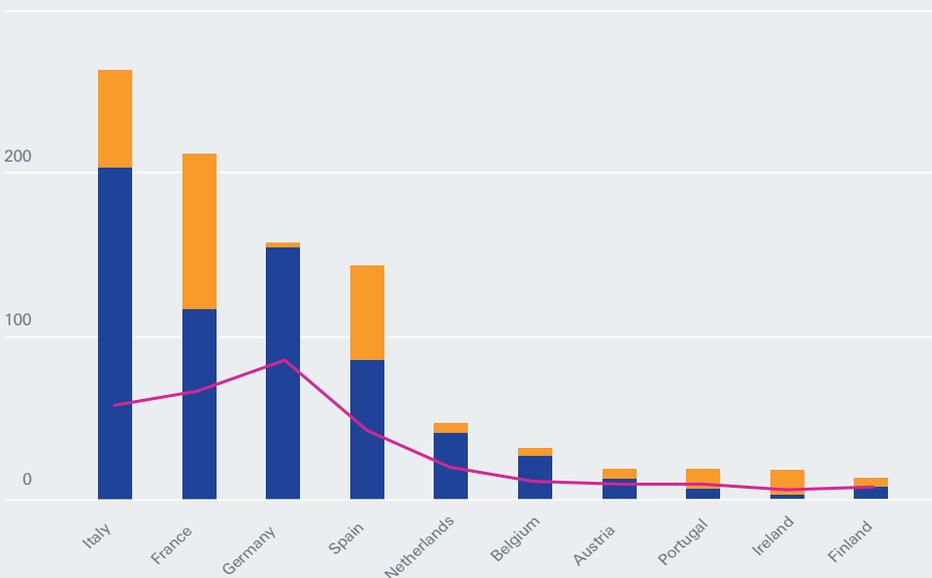
<sup>3</sup> JPMorgan Chase & Co: Market Insights as of 3/16/15

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## Bond issues and bond purchases in the context of QE

300 in billion euros



## Massive ECB bond-buying program\*

The bulk of sovereign bonds with a nominal value of 6.7 trillion euros<sup>4</sup> is in fixed ownership in the Eurozone. As such, QE is anything but simple. In 2015, the estimated volume of newly issued Italian sovereign bonds is 264 billion euros compared with anticipated ECB and Banca d'Italia purchases of around 58 billion euros. In Germany, the ratio of new Bund issues to ECB buying volume as part of the QE program stands at a little over one half this year.

- Bond issues to fund new debt
- Bond issues to refinance existing debt
- Bond purchases in the context of QE

\*Slovenia, Slovakia, Malta, Luxembourg, Estonia, Latvia and Lithuania are not included in the chart due to their low volumes; Greece and Cyprus are excluded from QE as they are under review.  
 Sources: Intesa Sanpaolo SpA, ECB, as of 2/27/2015

## Yield-curve development in German Bunds

yield in percent



\*Yield curves based on month-end figures.  
 Source: Thomson Reuters Datastream, as of March 2015

## Consequences of QE

Evidence for the start of ECB QE has been increasing since mid-2014. These indications, and not least the start of QE in March 2015, have caused the yield curve to flatten. The expectation of the massive bond-buying program worth 1.14 trillion euros, due to run till at least September 2016, has prompted negative yields on Bunds with a maturity of up to six years.



## Eurozone (GDP growth in %)

Lead indicators in the major Eurozone countries indicate moderate, stable growth

**1.3%\*** (2015)

\* Deutsche AWM forecast as of 3/12/15

// Negative yields are impossible to avoid in today's environment, but they will not become the long-term norm. It is therefore a distortion. //



Ewald Nowotny, member of the ECB Governing Council, March 11, 2015; Bloomberg interview.



## 10-year German Bunds

QE prompts investors to invest in bonds with longer maturities and higher yields, which in turn reduces their yields.

**0.35%\*** (March 2016)

\*Deutsche AWM forecast as of 3/12/15

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<sup>4</sup> Source: ECB, as of January 2015

# The big picture

## Our forecasts

// We believe that the ECB's QE program will continue to have a market impact. Despite an overall stimulating effect it will also increase volatility. //

Asoka Wöhrmann, Chief Investment Officer

## Economic data

GDP growth in percent (year-on-year)			
	2015F		2016F
USA	3.2	↘	2.8
Eurozone	1.3	↗	1.6
United Kingdom	2.3	↘	2.2
Japan	1.2	→	1.2
China	6.8	→	6.8
World	3.4	↗	3.7



While consensus believes in a further slowdown of GDP growth in China in 2016 compared to 2015, we believe that progress in public reforms and a bottoming out of the housing market will lead to unchanged growth.

## Inflation in percent (year-on-year)



We slightly increase our inflation forecast for the Eurozone in 2015 as a result of the weak euro.

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## Capital markets

### Equity markets (index value in points)

	Current***		March 2016F	▲(%)**
United States (S&P 500 Index)	2,066	↗	2,150	6
Europe (STOXX Europe 600 Index)	395	↗	400	4
Eurozone (EURO STOXX 50 Index)	3,641	↗	3,800	8
Germany (DAX) <sup>1</sup>	11,799	→	12,100	3
United Kingdom (FTSE 100 Index)	6,761	→	6,800	4
Japan (MSCI Japan Index)	952	↗	980	5
MSCI Emerging Markets Index (in USD)	949	↗	990	7
MSCI AC Asia ex Japan Index (in USD)	573	↗	620	11
MSCI EM Latin America (in USD)	2,413	→	2,400	3

#### Eurozone (EURO STOXX 50 Index)

3,641 ↗ 3,800

(Current\*\*\*) (March 2016F)



Mainly as a result of the strengthening U.S. dollar vs. the euro, more earnings forecasts for 2015 have been revised upwards in Europe than in the United States.

### Capital market yields (sovereign bonds) in percent

	Current*		March 2016F
United States, 2-year	0.61	↗	1.20
United States, 10-year	1.97	→	2.15
United States, 30-year	2.53	→	2.65
Germany, 2-year	-0.23	→	-0.20
Germany, 10-year	0.19	→	0.35
United Kingdom, 10-year	1.53	↗	2.00
Japan, 2-year	0.01	→	0.00
Japan, 10-year	0.34	→	0.35

#### United States, 30-year

2.53% → 2.65%

(Current\*) (March 2016F)



We forecast slightly lower U.S. yields compared to consensus as we anticipate an unusually modest interest-rate cycle.

F refers to forecasts. Our 2015 and 2016 forecasts are as of March 12, 2015.

\* Source: Bloomberg Finance LP, as of March 19, 2015

\*\* Expected total return includes interest, dividends and capital gains where applicable

\*\*\* Source: Bloomberg Finance LP, as of March 12, 2015

<sup>1</sup> Total-return index (includes dividends)

### Commodities in U.S. dollars

	Current*		March 2016F	▲(%)**
Crude oil (WTI)	44	↗	70	59
Gold	1,169	↗	1,250	7
Silver	16	↗	19	19
Copper (LME)	5,853	↗	6,700	14
Aluminium (LME)	1,774	↗	1,800	1

#### Gold

1,152 ↗ 1,250

(Current\*) (March 2016F)



WTI = West Texas Intermediate, LME = London Metals Exchange

The strengthening U.S. dollar hides the fact that gold has performed rather well this year in other currencies.

### Benchmark rates in percent

	Current*		March 2016F
United States (federal funds rate)	0-0.25	↗	0.75-1.00
Eurozone (refi rate)	0.05	→	0.05
United Kingdom (repo rate)	0.50	↗	0.75
Japan (overnight call rate)	0.10	→	0.10

#### United Kingdom (Repo rate)

0.50% ↗ 0.75%

(Current\*) (March 2016F)



As a result of weaker economic data we forecast a rate hike by the Bank of England (BoE) not before end 2015/ beginning of 2016.

### Currencies

	Current*		March 2016F	▲(%)**
EUR vs. USD	1.07	↘	1.00	-6
USD vs. JPY	121	↗	125	3
EUR vs. CHF	1.06	↗	1.10	4
GBP vs. USD	1.48	→	1.47	0
USD vs. CNY	6.20	↗	6.43	4

#### EUR vs. USD

1.07 ↘ 1.00

(Current\*) (March 2016F)



The path to our forecast USD-EUR parity will not be straight forward.

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# Investment traffic lights

## Our tactical and strategic view

### United States (equities)



Institutional investors have been reallocating funds from the United States to the Eurozone since the beginning of the year, reacting to the strengthening U.S. dollar and diverging central-bank policies. We remain neutral.

### Germany (equities)



The DAX has risen by a quarter since the start of the year. Being a highly export-driven index with no direct exposure to the oil sector, it is the major beneficiary of the weak euro, low interest rates and cheap oil. Market setbacks can be used to build positions.

### Consumer discretionary (equities)



Consumer discretionary are enjoying tailwinds in all regions. Europe's consumers are profiting from a better macroeconomic environment, cheaper oil and low inflation, while U.S. consumers' purchasing power benefits from lower unemployment and a stronger U.S. dollar.

### Financials (equities)



Although the United States' March stress test revealed the relative strength of local banks' balance sheets, we prefer the European sector. Their equity ratios have improved, the return on equity is increasing and they may profit from the economic upswing in Europe.

### U.S. Treasuries (10-year)



As a result of higher yields compared to the Eurozone, demand for 10-year U.S. Treasuries should remain high. Because of the rally after the cautious Fed statement of March 18, however, we are downgrading this asset to neutral from a tactical viewpoint.

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Equities*		
Regions		
United States	🔴	↗
Europe	🟡	↗
Eurozone	🟢	↗
Germany	🟢	→
United Kingdom	🔴	→
Japan	🟡	↗
Emerging markets	🟡	↗
Asia ex Japan	🟢	↗
Latin America	🔴	→
Sectors		
Consumer staples	🔴	
Healthcare	🔴	
Telecommunications	🟡	
Utilities	🟡	
Consumer discretionary	🟢	
Energy	🔴	
Financials	🟢	
Industrials	🟡	
Information technology	🟢	
Materials	🟡	
Style		
Small and mid cap	🟡	

\*as of March 12, 2015

### U.S. high yield



This segment has suffered from the renewed oil-price weakness and the anticipation of the Fed statement's new wording, which led to outflows in high-yield funds in mid-March. Since the beginning of the year inflows have dominated, however. The relatively high spread combined with low default rates lets us put this sector on overweight.

### EUR investment grade



In the midterm, euro investment-grade bonds are profiting from improving economic data and the ECB's QE. While heavy issuance of new paper has put pressure on the primary market in March, the situation should improve after Easter.

### U.S. municipal bonds



After six months of munis underperforming U.S. Treasuries, we expect this trend to revise. Munis have a relatively steep yield curve: we prefer the 15- to 20-year range. Mutual funds investing in munis have witnessed strong inflows recently.

1 to 3 months  
up to March 2016

Fixed income**		
Rates		
U.S. Treasuries (2-year)	●	↗
U.S. Treasuries (10-year)	⊙	→
U.S. Treasuries (30-year)	●	→
U.K. Gilts (10-year)	●	↗
Eurozone periphery	●	↘
German Bunds (2-year)	●	→
German Bunds (10-year)	●	→
Japanese government bonds (2-year)	●	→
Japanese government bonds (10-year)	●	→
Corporates		
U.S. investment grade	●	↘
U.S. high yield	⊙	↘
EUR investment grade	⊙	↘
EUR high yield	●	↘
Asia credit	●	→
Emerging-market credit	●	↘
Securitized /specialties		
Covered bonds	●	↘
U.S. municipal bonds	⊙	↘
U.S. mortgage-backed securities	●	→
Currencies		
EUR vs. USD	●	↘
USD vs. JPY	⊙	↗
EUR vs. GBP	●	→
EUR vs. JPY	●	→
GBP vs. USD	●	→
Emerging markets		
Emerging-market sovereign	●	↘
Alternatives**		
Infrastructure	●	↗
Commodities	●	→
Real estate (listed)	●	↗
Real estate (non-listed)	●	↗
Hedge funds	⊙	↗

\*\*as of March 19, 2015

## ⊙ USD vs. JPY



From a tactical point of view we expect a further strengthening of the U.S. dollar against the yen. A rate hike in Japan seems unlikely due to the lack of inflation, while the Fed has not yet stated that it is too concerned about a strong U.S. dollar.

## ⊙ Hedge funds



In a generally benign yet increasingly volatile market environment, we believe that hedge funds can generate excess returns. Our preferred strategies are equity market neutral, equity long/short and discretionary macro. In light of improving macroeconomic data we are less optimistic for the prospects for distressed strategies.

### The tactical view (one to three months)

#### Equity indices:

- positive view
- neutral view
- negative view

#### Fixed income and exchange rates:

- The fixed-income sector or the exchange rate is expected to perform well
- We expect to see a sideways trend
- We anticipate a decline in prices in the fixed-income sector or in the exchange rate

The traffic lights' history is shown in the small graphs.

⊙ A circled traffic light indicates that there is a commentary on the topic.

### The strategic view up to March 2016

#### Equity indices, exchange rates and alternative investments:

The arrows signal whether we expect to see an upward trend (↗), a sideways trend (→) or a downward trend (↘) for the particular equity index, exchange rate or alternative asset class.

#### Fixed income:

For sovereign bonds, ↗ denotes rising yields, → unchanged yields and ↘ falling yields. For corporates, securitized /specialties and emerging-market bonds, the arrows depict the option-adjusted spread over sovereigns for each respective region. ↗ depicts an expected widening of the spread, → a sideways spread trend and ↘ a spread reduction.

The arrows' colors illustrate the return opportunities for long-only investors.

- ↗ positive return potential for long-only investors
- limited return opportunity as well as downside risk
- ↘ high downside risk for long-only investors

Further explanations can be found in the glossary.

Source: Deutsche Asset & Wealth Management Investment GmbH

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# Portfolio

Our asset-class allocation in a balanced portfolio<sup>1</sup>

## Traditional asset classes

Within the core part of our balanced portfolio, we cover traditional liquid assets such as equities, fixed income and commodities. The chart shows how we would currently design a balanced portfolio, including alternative asset classes.<sup>2</sup>

### Equities

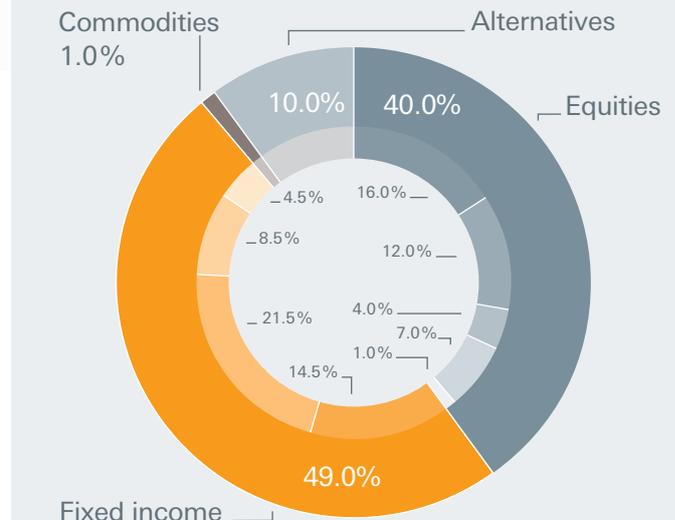
Year to date, Eurozone equities have delivered large gains, benefiting from market anticipation of the ECB's QE. A weaker euro is likely to continue to provide a substantial tailwind. Japanese equities have also done well, helped by a weaker Japanese yen and improving fundamentals. U.S. equities have stagnated by comparison, and mixed U.S. economic data may have added to investors' concerns. We are neutral on U.S. equities, but believe that they are likely to remain supported by inflows, with buy-backs one particular area of interest. We like equities overall, but as investors absorb the fact that the Fed rate hikes will really happen, volatility will increase and some temporary pullbacks are likely.

### Fixed income

We remain in a twin-track world. The ECB's QE has resulted in a situation in which around 30% of Eurozone government debt now has negative yields. But, across the water, both U.S. and U.K. yields are much closer to "normal" levels. We expect Eurozone yields to remain low for some time and this will encourage substantial outflows into U.S. fixed income. One result may be an increase in the volatility of U.S. yields, particularly as we approach the most likely date for a Fed rate hike (September\*). Credit spreads will also rise around this time, but we expect a subsequent tightening as investors start to factor in the likely pace of hiking. We stay constructive on credit on a global basis.

### Commodities

A rapid rebound in oil prices remains unlikely, although a gradual recovery is expected, with prices reaching around \$65 per barrel (\$65/b) by year end.\* The overwhelming issue remains over-supply. Although U.S. rig count is now falling as shale producers become more selective this will take some time to translate into falling output. For gold, the issues are rather different. Outside of the United States, gold may be seen by some as a safe haven. But U.S.-dollar strength will create a substantial headwind, and we believe that this will keep gold range-bound between 1150 and 1250 over 2015.\*



Equities	suggested weight
Developed markets	32.0%
United States	16.0%
Europe	12.0%
Japan	4.0%
Emerging markets	8.0%
Asia ex Japan	7.0%
Latin America	1.0%
Fixed income	
Credit	14.5%
Sovereigns	21.5%
Emerging markets	8.5%
Cash	4.5%
Commodities	
Commodities	1.0%
Alternatives	
Alternatives	10.0%

Source: Regional Investment Committee (RIC), Deutsche Asset & Wealth Management Investment GmbH, Deutsche Bank (Suisse) SA, as of March 17, 2015 Suggested allocation for USD-based investors. This allocation may not be suitable for all investors.

<sup>1</sup> This portfolio may not be suitable for all investors.

<sup>2</sup> Alternative investments are dealt with separately in the next chapter.

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\*Deutsche AWM forecasts as of March 12, 2015



## Long or short, Stéphane Junod?

Six market views from our regional Chief Investment Officer for Wealth Management in Europe, Middle East and Africa (EMEA)

### Is there any room for further equity price gains?

**LONG** Recent price gains have taken valuations to high levels, by historical and other measures. However, the short-term predictive power of valuations on prices may be limited. Consider also fund flows – for example, the likely boost to equities from outflows from low-yielding Eurozone government bonds.

### Time to go back into emerging markets?

**SHORT** Chinese growth is slowing, the Russian economy is contracting and Brazil appears to be facing a “perfect storm” – in terms of slower growth, fiscal deficits, rising inflation and falling exports. So, out of the original BRICs (Brazil, Russia, India and China), only India is doing well, and many of the smaller EMEA and Latin American economies are also struggling. This keeps us cautious about emerging markets.

### Is deflation/low inflation likely to be a long-lasting problem?

**SHORT** Eurozone inflation (year on year) is likely to remain negative for a few more months but will turn positive later in the year. In the United States, attention is currently focused on labor costs, which seem likely to eventually feed through into stronger price rises. Inflation expectations indicators are currently mixed, but we remain confident that the future trend will be upwards.

### Still keen on high yield?

**LONG** Low oil prices continue to cast a shadow over U.S. high yield, but there are a number of reasons to stay positive. These include favorable credit statistics, a significant extension of the debt maturity profile and relatively low interest rates. In Europe, very low interest rates on government bonds are also likely to support investor demand for high yield.

### Will central-bank policy start to converge again?

**SHORT** We believe that the Fed will raise rates later this year, most likely in September. The Bank of England (BOE) may follow suit in early 2016. Meanwhile, the ECB will continue to implement its QE policy, and Japanese monetary policy will remain extremely accommodative. Policy reassessment looks unlikely, unless we experience a sharp pickup in inflation.

### Could slower growth be the new paradigm?

**LONG** Pre-financial-crisis growth was boosted by asset-price bubbles and a number of one-off factors that look unlikely to return. Demographics – in the emerging markets, as well as the developed world – are turning less supportive. The crisis may also have left lingering scars on potential output, which could take a long time to heal.

**LONG** represents a positive answer

**SHORT** represents a negative answer

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# Portfolio

## Our view of non-traditional asset classes

### Alternatives portfolios

Due to their unique characteristics, we are taking a differentiated look at liquid and illiquid alternative investments<sup>1</sup>.

#### Liquid alternatives

##### ■ Equity long/short

We expect increased equity market volatility, and would therefore look to managers operating with a low net exposure, or seeking to outperform the market as relative sector valuations re-adjust to previous levels.

##### ■ Macro/commodity trading advisor (CTA)

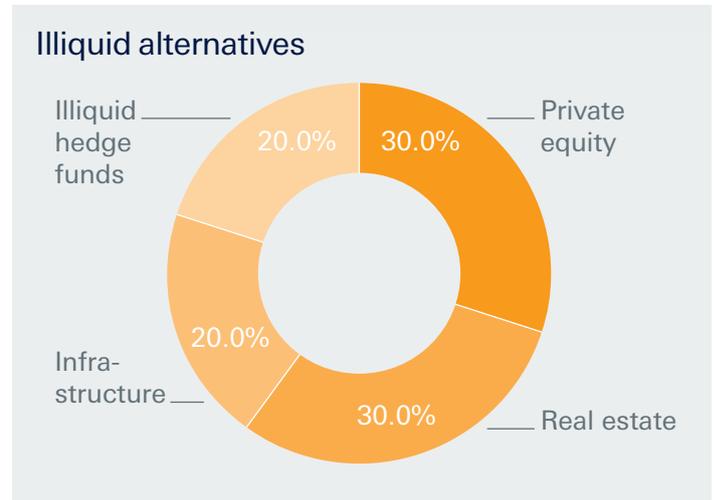
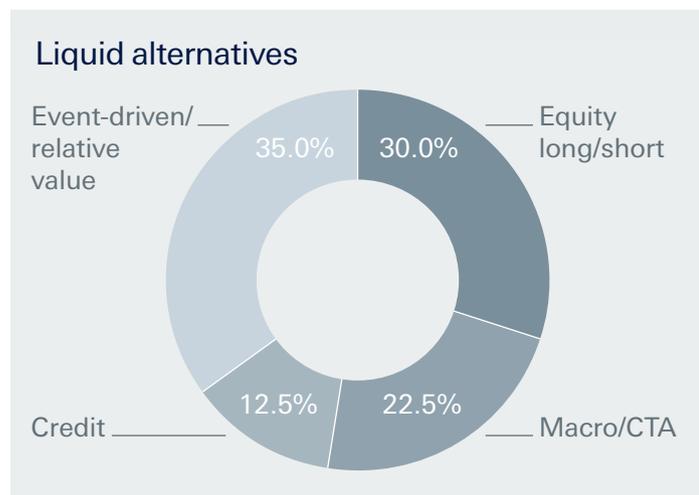
Expectations of greater divergence and decorrelation among asset classes may create a better environment for the sector in 2015. Recent research has focused on developing multi-model funds to identify and take advantage of different market environments.

##### ■ Credit

Given the low absolute yield/carry across non-investment-grade credit, one focus could be on the relative valuations of secured debt (e.g., bank loans) against unsecured debt (e.g., high-yield bonds), both within companies and industries.

##### ■ Event-driven/relative value

Mergers-and-acquisitions activity remains at high levels. In particular, consolidation in the energy industry is likely to create new opportunities. Managers may find interesting entry points for deals previously broken.



#### Illiquid alternatives<sup>2</sup>

##### ■ Private equity

Private equity markets in Europe continue to perform strongly, with a high level of deal activity. The U.S. market also remains active, but valuations have become less attractive. Strong capital inflows over the last year are expected to fuel robust investment activity in Asia.

##### ■ Real estate

We expect to see further improvement in the U.S. market, particularly in the procyclical office and industrial sectors, where there is strong demand and limited new construction. In Europe, the real-estate recovery has spread to Germany and further gains are also likely in Southern Europe.

##### ■ Infrastructure

We would focus portfolios on companies benefiting from improving economic fundamentals and organic opportunities. North American rail companies appear well-placed for growth. Low interest rates support valuations of regulated U.S. utility names. Listed securities may offer opportunities.

##### ■ Illiquid hedge funds

Longer-term strategies within activism, structured credit, insurance-linked assets, secondaries, regulatory capital arbitrage and direct lending could provide opportunities.

Source: Deutsche Asset & Wealth Management Investment GmbH, Deutsche Bank AG Filiale London, as of March 18, 2015  
 This allocation may not be suitable for all investors. In our balanced model portfolio, we currently allocate 10% to alternative investments (see "Portfolio").

<sup>1</sup> These portfolios may not be suitable for all investors.

<sup>2</sup> Not available in discretionary portfolios. Hedge funds and other investments classified as non-mainstream pooled investments are not considered as suitable investments for retail clients in the United Kingdom. Illiquid investments may be difficult to acquire or dispose of. The product's ability to respond to market conditions may be impaired and investors may experience adverse price movements on liquidation.

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## Long or short, Mark G. Roberts?

The Head of Real Estate Strategy and Research considers global property markets

### Are institutional investors becoming more important in real estate?

**LONG** Institutional investors have always had a prominent role in the real-estate industry, through both direct ownership of property and participation in pooled property investment funds. However, independent surveys\* have found that investors are, on average, currently 100 basis points under-allocated to the asset class. If investors are to meet or exceed their target allocation to real estate (9.7%), they will need to contribute approximately another \$200 billion to the asset class this year.

### Will the U.S. market cope with higher interest rates?

**LONG** Although nominal interest rates are set to rise later this year, real interest rates (i.e. adjusted for inflation) are expected to remain below their historical average. Real estate tends to perform well during this macro-economic environment, especially if GDP growth is average to above-average at the same time.

### Can the German real estate recovery accelerate?

**LONG** Due to the polycentric structure of the German economy, there are a range of investment opportunities in second-tier markets. Many medium-sized cities have benefited from rising population growth due to regional migration and a dynamic labor market. Additionally, these markets enjoy a critical mass of investible stock, very healthy supply and demand ratios, sufficient liquidity and attractive yield spread as well as high income security.

### Logistics space – a future bright spot?

**LONG** Multi-channel retailing is creating new demand for logistics space, particularly in key locations close to the major cities which allow retailers to service the last mile of delivery. Technological advancements are also adding to pressures to upgrade older industrial stock. Retailers and logistics service providers need upgraded space to become more efficient and provide more reliable service. As a result, returns here look likely to remain high.

### Will Singapore and Hong Kong markets avoid overheating?

**SHORT** Recently, rent growth has been strong in Singapore and Hong Kong and yields have compressed. Caution should be taken when investing in office space in these markets due to the possibility of future rental corrections and rising capitalization rates. We favor non-discretionary suburban retail as it provides a cushion against fluctuations in discretionary spending.

**LONG** represents a positive answer

**SHORT** represents a negative answer

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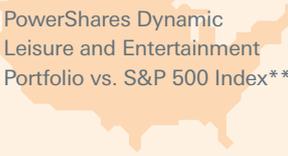
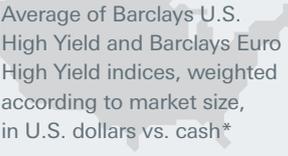
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\*2014 Institutional Real Estate Allocations Monitor by Prequin and Cornell University/Hodes Weill

# High-conviction ideas

Selected investment ideas to complement wealth-management clients' portfolios

German housing	U.S. leisure and entertainment	High-yield debt	Higher GBP/USD volatility
New	New		
Idea initiated April 01, 2015	Idea initiated April 01, 2015	Idea initiated February 24, 2015	Idea initiated February 24, 2015
Reference measure <hr/> Dallas Fed International House Price Index Database for Germany vs. cash*	Reference measure <hr/> PowerShares Dynamic Leisure and Entertainment Portfolio vs. S&P 500 Index**	Reference measure <hr/> Average of Barclays U.S. High Yield and Barclays Euro High Yield indices, weighted according to market size, in U.S. dollars vs. cash*	Reference measure <hr/> CBOE/CME FX British Pound Volatility Index vs. cash*
			
Investment horizon 24 months+	Investment horizon 3 - 12 months	Investment horizon 3 - 12 months	Investment horizon 3+ months
Performance since initiation  n/a	Performance since initiation  n/a	Performance since initiation  	Performance since initiation  
<p>Current monetary conditions are too expansionary for Germany. This situation usually leads to rising asset prices – particularly housing prices. Having stagnated for two decades or more, these are now starting to pick up. German construction activity is rising but at a moderate pace. The volume of mortgage debt is increasing, but only at a slow pace. These two indicators provide some reassurance that the recent rise in German housing prices is not leading to an unsustainable real-estate "bubble."</p>	<p>The U.S. consumer is likely to gain comfort from improving payroll numbers, an expected acceleration in wage growth and low gasoline prices. Recent spending in restaurants has been strong and the number of global airline passengers is at its highest in many years. This apparent preference for leisure and entertainment spending – over that of goods – is reflected in higher consensus earnings expectations for this sector. Leisure is also lagging the S&amp;P 500 Index, providing the opportunity for a catchup in this relative-return idea.</p>	<p>High-yield debt – both U.S. dollars and euros – has rallied since its yield peaked in late December 2014. But, with default rates expected to remain low and oil prices stabilizing before gradually moving higher, high-yield looks set to continue to outperform in 2015. In the United States, new-issue volume has recovered, with recent new issues also well received in the secondary market. In Europe, strong fund inflows and a break in new issues has led to strong demand in the secondary market.</p>	<p>The United Kingdom holds a general election on May 7. The outcome of this is highly uncertain, due in part to the growing power of minor parties, and could result in some potentially disruptive policy changes. Investor concerns about the United Kingdom are likely to grow in the runup to the election, and may remain high in its immediate aftermath, if coalition negotiations are prolonged. Such concerns are likely to be reflected in increased sterling volatility.</p>
<p><b>Past performance is not indicative of future returns.</b>          No assurance can be given that any forecast, investment objectives and/or expected returns will be achieved. Investments come with risk. The value of an investment can fall as well as rise and your capital may be at risk. You might not get back the amount originally invested at any point in time.</p>			

## European Banks

Idea initiated  
 February 24, 2015

### Reference measure

MSCI Europe Banks Index  
 vs. MSCI AC World  
 Financials Index\*\*

Investment horizon  
 3 - 12 months

Performance since initiation



After a difficult few years, the European banking sector is now getting back on its feet. Equity tier 1 ratios have been increased and there is room to raise payout ratios (with a clear focus on dividends). Return on equity is increasing, if slowly, and valuations appear quite attractive. European banks seem likely to offer superior earnings growth to other regions, being well geared to a European macro recovery through improving loan growth and falling loan-loss provisions.

## U.S. consumer discretionary

Idea initiated  
 September 19, 2014

### Reference measure

S&P 500 Consumer  
 Discretionary Index  
 vs. cash\*

Investment horizon  
 3 - 12 months

Performance since initiation



We believe there are several reasons the U.S. consumer discretionary sector is likely to outperform. Crude oil is down more than 50% from its recent peak and a generally accepted rule of thumb is that every \$0.01 fall in gasoline prices adds \$1 billion in consumer spending power per year. Meanwhile, U.S. job creation has been strong and U.S. consumer confidence is now back to pre-crisis levels.

## Association of Southeast Asian Nations (ASEAN) equities

Idea initiated  
 September 19, 2014

### Reference measure

Equal-weighted index comprised of the MSCI Indonesia, Malaysia, Philippines and Thailand indices vs. cash\*

Investment horizon  
 3 - 12+ months

Performance since initiation



This attempts to capture the long-term gains from growing regional trade integration. The ASEAN Economic Community will be in place at the end of 2015, providing a single market for goods, services, capital and labor for a population of 618 million—greater than that of the United States or Europe. ASEAN economies are already benefiting from major regional trade and investment pacts. We would focus on the Indonesian, Malaysian, Philippine and Thai markets.

### High-conviction ideas key

⊕ indicates gain

⊖ indicates loss

\* Total-return idea where performance is measured by the gain/loss in the performance measure in U.S. dollars. Stated performance is from given entry date to March 19, 2015.

\*\* Relative-return idea, based on the relative performance of the two measures in U.S. dollars. Stated performance is from given entry date to March 19, 2015.

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Source: Deutsche Asset & Wealth Management Investment GmbH, Deutsche Bank (Suisse) SA, as of March 19, 2015

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# Glossary

Here we explain the main terms from the CIO View

**ASEAN** is a political and economic organization of 10 countries located in Southeast Asia.

The **ASEAN-5** countries are the five largest economies in Southeast Asia - namely Malaysia, Indonesia, Thailand, Singapore and the Philippines.

The **Bank of Japan (BOJ)** is the central bank for Japan.

The **Barclays U.S. High Yield Index** captures the performance of high-yield debt securities.

The **capitalization rate** is a rate of return on a real-estate investment based on the expected income the property will generate.

The **CBOE/CME FX British Pound Volatility Index** measures the market's expectation of 30-day currency-related volatility for the British pound.

A **collateralized debt obligation (CDO)** is a structured financial product that pools together cash-flow-generating assets (such as mortgages and other loans) and repackages this asset pool into discrete tranches that can be sold to investors.

The **current-account position** is the difference between a nation's savings and its investment.

The **Dallas Fed International House Price Index Database for Germany** is a price index compiled by the Dallas Fed for German real estate.

The **DAX** tracks the performance of the 30 major German companies trading on the Frankfurt Stock Exchange.

**Deflation** describes a sustained decline in an economy's overall price level.

**Discretionary macro strategy** is an investment strategy that aims at exploiting macroeconomic, policy or political changes.

**Distressed strategies** are investment strategies that seeks profit by investing in companies or other investment opportunities that are in financial trouble.

The **European Central Bank (ECB)** is the central bank of the Eurozone.

**Equity long/short** investing strategies seek to profit from gains in long positions and price declines in short positions while trying to minimize market exposure.

**Equity market neutral** investing strategies aim to deliver superior returns by balancing stock picks as to avoid market-risk exposure.

**Equity tier 1 ratios** relate a company's equity to its risk-weighted assets. It's an international standard measure for a bank's financial solvency.

The **Eurozone** is formed of 19 European Union member states that have adopted the euro as their common currency and sole legal tender.

The **federal funds rate** is the interest rate, set by the Fed, at which banks lend money to each other, usually on an overnight basis.

The **Federal Open Market Committee (FOMC)** is a committee that oversees the open market operations of the U.S. Federal Reserve.

The **U.S. Federal Reserve Board (Fed)** is the board of governors of the Federal Reserve; it implements U.S. monetary policy.

**GBP/USD** is an abbreviation for the exchange rate of the British pound vs. the U.S. dollar.

**Gross domestic product (GDP)** is the value of all goods and services produced by a country's economy.

A **hedge fund** is an investment vehicle that pools capital from different investors and uses different investment strategies.

**Illiquid** refers to the inability to easily convert assets or investments to cash.

An **interest-rate swap** is an agreement between two parties where one stream of future interest payments is exchanged for another based on a specified principal amount. Interest rate swaps often exchange a fixed payment for a floating payment that is linked to an interest rate.

**Loan-loss provisions** are expenses set aside as an allowance for bad loans, e.g. customer defaults or renegotiated debt.

The **MSCI AC Asia ex Japan Index** tracks the performance of non-Japanese Asian stocks.

The **MSCI AC World Financials Index** captures large- and mid-cap representation across 45 developed- and emerging-market countries. All securities in the index are classified in the financials sector per the Global Industry Classification Standard (GICS).

The **MSCI Emerging Markets Index** tracks the performance of stocks in select emerging markets.

The **MSCI EM Latin America Index** captures large- and mid-cap representation across five emerging-markets countries in Latin America.

The **MSCI Europe Banks Index** captures large- and mid-cap representation across 13 developed-market countries in Europe. All securities in the index are classified in the banks industry group as per the Global Industry Classification Standard (GICS).

The **MSCI Indonesia, Malaysia, Philippines and Thailand indices** tracks the performance of stocks for the referred countries.

The **MSCI Japan Index** tracks the performance of Japanese stocks.

**Munis** are municipal bonds.

**National Central Banks (NCBs)** are the central banks of the euro area, and the non-euro area central banks that decide to settle their currencies in TARGET2-Securities.

**Net external debt** is the total debt a country owes to foreign creditors.

In economics, a **nominal** value is not adjusted for inflation; a real value is.

**Overweight** means the investment holds a higher weighting in a given sector or security than the benchmark.

The **payout ratio** is the proportion of earnings paid out as dividends to shareholders, typically expressed as a percentage.

The **PBoC (People's Bank of China)** is the central bank of China.

**Periphery** countries (sometimes referred to as just the periphery) are those that are less developed than the core countries of a specific region (in this case the Eurozone).

The **PowerShares Dynamic Leisure and Entertainment Portfolio** is an ETF focused on the U.S. leisure, travel and entertainment sector.

**Price-earnings (P/E) ratio or multiple** compares a company's current share price to its earnings per share.

**Private equity** is a direct or indirect investments in private firms in various stages of development. The companies are not quoted on a public exchange and with a medium to long time horizon.

**Quantitative easing (QE)** refers to broad-based asset-purchase programs conducted by central banks; these assets can be government bonds, but also other assets like asset-backed securities.

**Reaganomics** refers to the economic policies promoted by U.S. president Ronald Reagan during the 1980s, which called for widespread tax cuts, decreased social spending, increased military spending, and the deregulation of domestic markets.

**Regulatory capital arbitrage** is a practice whereby firms capitalize on loopholes in regulatory systems in order to circumvent unfavorable regulation.

**Return on equity (ROE)** is the amount of net income returned as a percentage of shareholders' equity.

**Secondaries** are securities or assets, which are directly purchased from other investors, rather than from the issuers themselves.

**Spread** refers to the excess yield various bond sectors offer over other financial instruments with similar maturities (e.g. government bonds). When spreads widen, yield differences are increasing between bonds in the two sectors being compared.

The **S&P 500 Index** tracks the performance of 500 leading U.S. stocks and is widely considered representative of the U.S. equity market.

The **sterling**, also known as the pound sterling, is the official currency of the United Kingdom.

The **Trade-Weighted U.S. Dollar Index** tracks the performance of the U.S. dollar relative to other world currencies.

The **USD** is the U.S. dollar, the official currency of the United States.

The **yield curve** shows the annualised yields of a security across different contract periods as a curve.

#### Investment traffic lights (pages 8–9): comments regarding our tactical and strategic view

##### Tactical view:

– The focus of our tactical view for fixed income is on trends in bond prices, not yields.

##### Strategic view:

– The focus of our strategic view for corporate bonds is on yields, not trends in bond prices.

– For corporates and securitized/specialties bonds, the arrows depict the respective option-adjusted spread.

– For bonds not denominated in euros, the illustration depicts the spread in comparison with U.S. Treasuries. For bonds denominated in euros, the illustration depicts the spread in comparison with German Bunds.

– For emerging-market sovereign bonds, the illustration depicts the spread in comparison with U.S. Treasuries.

– Both spread and yield trends influence the bond value. Investors who aim to profit only from spread trends must hedge against changing interest rates.

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