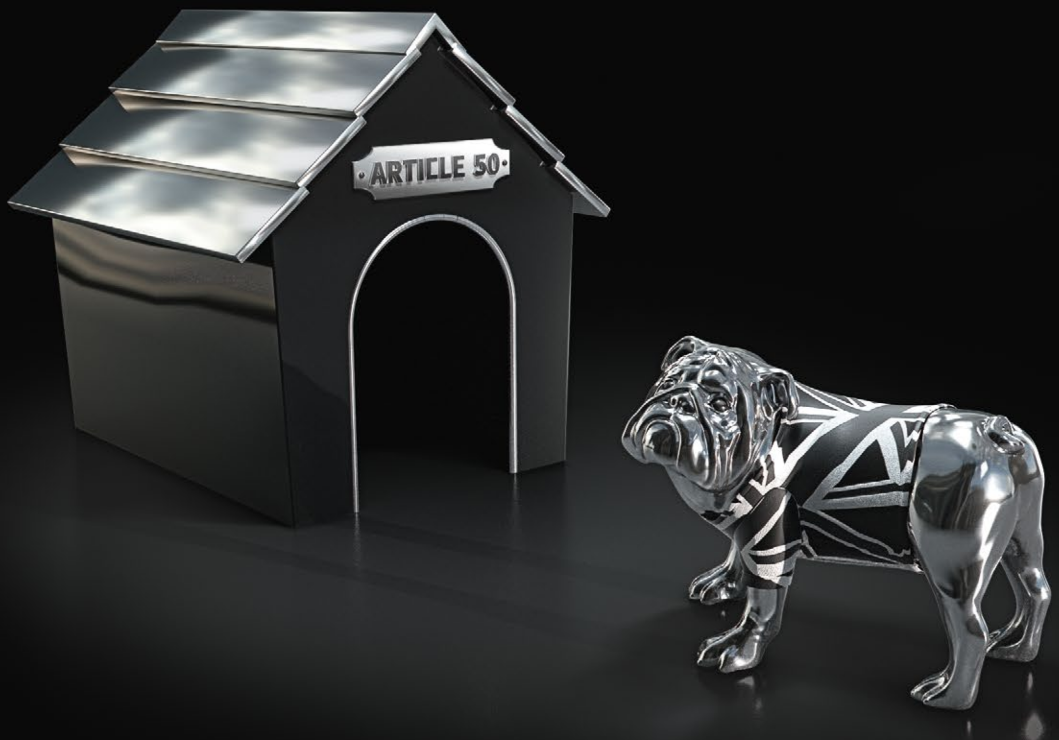
Deutsche
Asset Management

CIO | VIEW

Quarterly August 2016



Brexit woes

The effects on the economy

Marketing Material

Investing in times of one-way rates

Stefan Kreuzkamp,
Chief Investment Officer

Welcome to our first CIO View in the new format. It will be published four times a year following the CIO Day where the global investment platform comes together to determine our strategic views for the next six to 12 months. We will be expanding our views on individual asset classes and our multi-asset strategy. In addition, we will review our strategic and quantitative strategies.

Our most recent CIO Day was overshadowed by the British referendum on European Union (EU) membership. The markets were shocked by the majority's vote to leave the EU. Although this event is quite extraordinary on its own, the market reaction may be indicative of reaction patterns that could manifest more frequently in the future: 1.) A political event is underestimated by the market causing serious dislocations. 2.) Although stock-market indexes recover quickly, price reactions on a sector level are more divergent and persistent. 3.) Fixed-income markets react as usual: Insecurity leads to anticipating even more accommodative monetary policy.

These observations have been incorporated into our outlook. Although we do expect an accelerated economic recovery in 2017, we also assume political risks to increase and potentially have an impact on capital markets. However, central banks should continue to stand by in order to prevent major dislocations.

"We are reaching the point where neither investors nor debtors can afford a sharp turnaround in interest rates."

This short-term stimulus by central banks does, however, have drawbacks. Price distortions across all asset classes are increasing, ever more investors are venturing into ever riskier asset classes. It is a manifestation of these unusual times that all our price targets and investment ideas are directly tied to central-bank policies. We favor EUR periphery bonds despite low yields because the European Central Bank (ECB) is purchasing these securities. We favor EUR investment-grade bonds despite low yields because the ECB is purchasing these securities. We favor U.S. and EUR dividend papers due to the low-interest-rate environment. We favor even Japanese stocks, because the stance of the Bank of Japan's policy is extremely expansive. And we also favor high-yield bonds, despite higher risks, because they are the only ones paying out a coupon worth mentioning.

So we continue to rely on central banks: Whether they are the only ones to blame for low interest rates – U.S. treasury yields have been falling for almost thirty years – or whether concerns about structural changes in industrialized countries are also playing a role. For it does not really change the fact that our asset allocation and market views are firmly based on the assumption that we will not witness a rate-tightening cycle that deserves the name, in the traditional sense. This has led to the truly absurd situation that neither investors nor debtors can afford higher interest rates.

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Focus

Rising TARGET2 balances may be signaling new tensions in the Eurozone. The European Central Bank (ECB) can only help defuse these tensions. Political leaders must act to tackle structural reforms.

Macro

The Brexit vote is likely to slow growth not just in the United Kingdom but throughout Europe. After a weak start to 2016 the U.S. economy is gaining momentum. China continues to slow down.

Commodities

Commodity prices began the year in the doldrums. Energy sources and precious metals have since risen, with oil recovering especially well. Gold should benefit from growing political risks.

Fixed Income

With Brexit looming, monetary policies should get even looser in Europe and elsewhere. The ECB is under growing pressure to do even more. This should create opportunities for investors.

Currencies

Currency markets have quickly digested the Brexit vote. The U.S. dollar looks set to strengthen later in the year. We see the Japanese yen as a possible risk diversifier across all asset classes.

Equities

Equities tend to be fairly resilient in the face of political turmoil. Still, investors are nervous. Thanks to central banks, markets may overshoot in both directions – a situation we intend to take full advantage of.

Real Estate

Macro-risk signals suggest real estate delivers average to above-average returns in most markets. Initial yields relative to bonds are well ahead of historical levels and could contribute to income stability.

Multi Asset

In the current investment environment – where low returns are accompanied by high volatility – we believe the focus should be on effective tactical asset allocation, individual security selection and risk management.

Systematic & Quant

Rarely have so many companies experienced such a prolonged period of stagnation in revenues. So far, equity markets have been surprisingly resilient, with limited regional variations.

Increasing tension in the system

» TARGET2 balances are known as crisis indicators. They have been on the rise again since mid-2014. Are we facing a new euro crisis? «

Economists are generally known for their devotion to equations and identities. These clearly show that in economies without any foreign trade, savings always equal investment. This no longer applies when foreign trade comes into the picture: Then, the difference of saving and investing equals net trade, i.e., exports minus imports. Countries with negative net-trade figures receive capital from countries with positive net trade. Due to fluctuating exchange rates and interest rates there is usually sufficient international capital to reach a balance.

But what happens in a monetary union? Higher interest rates are the only way to attract international capital to finance current-account deficits. Before the establishment of the Eurozone, doubts about the stability of the interbank market to settle capital movements adequately were widespread. For this reason, the payment system TARGET was introduced in 1999 to link national settlement platforms. It was superseded by TARGET2 in November 2007, a common platform for the settlement of bank transfers between central banks via the euro system.

Alternative payment system

Let's take an example to show how it works: An Italian company purchases machinery from a German company on credit. This deal can be settled by the originating Italian bank borrowing money for its client from a German bank. This borrowed money will be transferred to the German exporter. But what if the German bank demands a high interest-rate premium? Thanks to TARGET2, the Italian bank can borrow the money to pay for the machinery via Banca d'Italia from the European Central Bank (ECB) on favorable terms. The Italian central bank in turn receives a loan from the German Bundesbank via the ECB. This kind of settlement creates a TARGET2 liability of the Banca d'Italia and a TARGET2 claim of the Bundesbank in the euro system.

In 2010, distrust among banks caused the interbank market to dry up. TARGET2 stepped in to supply sufficient capital for funding supra-national trade in the Eurozone. Even capital flight triggered by euro-break-up worries did not dry up the peripheral financial sector. TARGET2 flushed money back into the periphery on favorable terms so that money-market rates were prevented from rising further. On the flip side, however, balances in the TARGET2 system exploded.

Distrust returns

The situation calmed down from 2012 onwards. However, TARGET2 liabilities of the Eurozone periphery have increased again since mid-2014 – although these countries meanwhile have been delivering current-account surpluses. This is indicative of capital flowing out of periphery countries via the TARGET2 system. The search for the reasons for this leads inevitably to monetary policies. In spring 2014, the ECB had encouraged speculation about future asset purchases. In January 2015, the ECB then announced quantitative easing (QE). Moreover, in June 2014 and in March 2016, the ECB announced to offer targeted longer-term refinancing operations (TLTROs) at preferential rates. Almost simultaneously, TARGET2 balances started to rise.

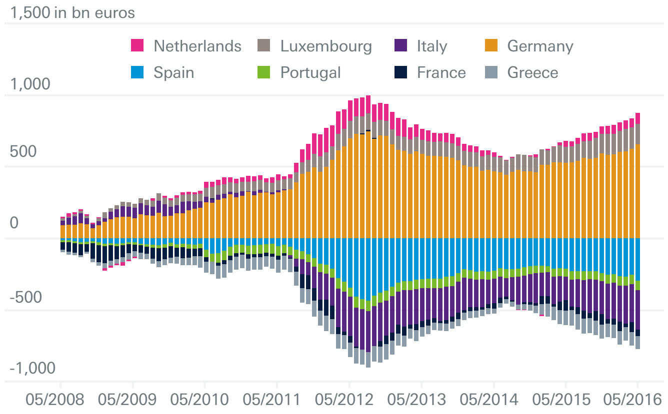
The measures taken by the ECB led to narrower spreads of core and periphery bonds. Capital owners were therefore given a reason to transfer money to countries with sounder economic fundamentals. Additionally, the ECB's asset purchases triggered surplus liquidity in economically weaker countries. This surplus was obviously partly transferred to core countries, and partly used by periphery banks to pay back loans to core banks. All this is diametrically opposed to the ECB's target of boosting lending in periphery countries.

It is true that the ECB succeeded in reducing risk premia between the countries. But investors' doubts about the longer-term sustainability of the Eurozone – which persisted well before the Brexit vote – have not been addressed. Within the Eurozone, the financial system is even more closely interwoven. The economic impact of a break-up would be much higher. Britain's shock vote to leave the European Union should increase the pressure on governments to push structural reforms forward, thus enhancing Eurozone stability. ■

Crisis indicator for the Eurozone

In 2012, the ECB stated that it would not allow a break-up of the Eurozone. Capital was re-channeled into periphery countries. TARGET2 balances have increased again since mid-2014.

TARGET2 balances

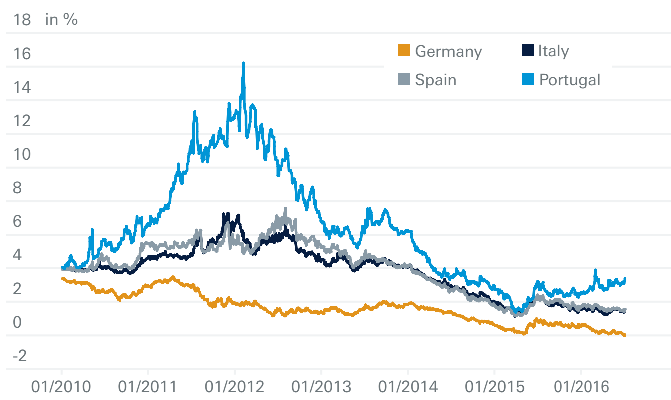


Source: Thomson Reuters Datastream; as of 7/19/16

The impact of quantitative easing

With its asset purchases, the ECB managed to reduce risk premia on peripheral bonds. But investors' skepticism of the Eurozone remained.

10-year government-bond yields



Source: Thomson Reuters Datastream; as of 7/19/16

The burden of Brexit

» The result of the British EU referendum has raised uncertainty in Europe. The pace of growth in the UK and Europe is likely to slow down. «

Phil Poole,
Global Head of Research

Our expectations in a nutshell

- The British Brexit vote is likely to lead to an economic slowdown
- The United States remains on a path of solid growth
- The Chinese economy is losing momentum

In his book "Risk, Uncertainty and Profit", published in 1921, U.S. economist and pioneer of risk research Frank Hyneman Knight distinguishes between risks for which probabilities can be assessed with some confidence and uncertainties which are hard to objectively quantify. The Brexit vote shows that Knight's ideas continue to be relevant.

A number of opinion polls and other indicators appeared to suggest that the probability of Brexit was relatively low. The actual result came as a big surprise. An even bigger surprise, however, was that political leaders in Westminster were caught off guard. It is still unclear when and how exactly the United Kingdom (UK) might leave the European Union (EU). The UK now faces a plethora of uncertainties the probabilities of which are difficult to assign.

The new prime minister Theresa May has not yet triggered Article 50. The new British government declared instead that the nature of the UK/EU relationship after an exit needed to be clarified first. But EU representatives do not want to start negotiations before the UK formally applies to leave the EU. So it is not even clear whether the exit will take place. What remains clear is uncertainty. And this uncertainty is likely to burden economic development and may lead investors and consumers to spend less. This cut can only be measured approximately, not exactly. We expect a deceleration of economic growth in the UK to 0.8% next year. This should lead to declining imports. As the most important trading partner, the Eurozone is likely to be hit hardest. Although there are first signs of recovery, for example in credit demand, Eurozone growth should – compared with our forecasts shortly before the referendum – weaken by 0.3 percentage points to 1.2% in 2017 in the wake of the Brexit vote. Countries with less tight trading links to the UK should be hardly touched. Our U.S. growth forecast of two percent for 2017 remains unchanged as do our mid-June growth estimates for Japan and emerging markets (EM).

Central banks clearly regard the Brexit vote as a burden, requiring them to cushion the economic repercussions of the referendum. The U.S. Federal Reserve (Fed) is likely to raise official rates only moderately. At most, we would expect two rises of 25 basis points each by mid-2017. And discussions whether the European Central Bank (ECB) will start tapering quantitative easing (QE) in spring 2017 have been temporarily muted. Accommodative monetary policies should also contribute to calming capital markets.

In order to cushion major economic setbacks in the UK, the Bank of England (BoE) might once again join the club of central banks pursuing QE policies. In this case, it might additionally cut its official rate by 25 basis points. Over twelve months we expect another rate cut, eventually leading to an official bank rate of 0.1%. The BoE ended its first asset-purchase program in October 2012 after buying assets worth 375bn pound sterling. The Bank of Japan (BOJ) is likely to extend its asset-purchase program and to cut rates further, but the Brexit vote is not to blame. Rather Japan's central bank may be worried about meager economic growth and near-zero inflation rates.

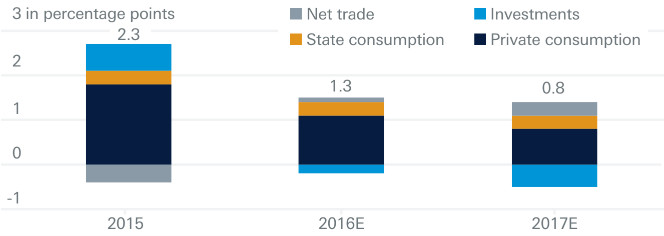
Emerging markets might be beneficiaries of current developments, as EM governments and corporations have used the low-interest-rate environment and significantly extended their debt since 2007. Rising debt has increased the dependency on the monetary policies of advanced economies, particularly the United States. The postponement of U.S. rate hikes has ›

[1] year-on-year gross-domestic-product (GDP) growth

Economic downturn after Brexit vote[1]

Investment should curb growth in the UK by 0.5 percentage points.

Growth and growth factors in the United Kingdom

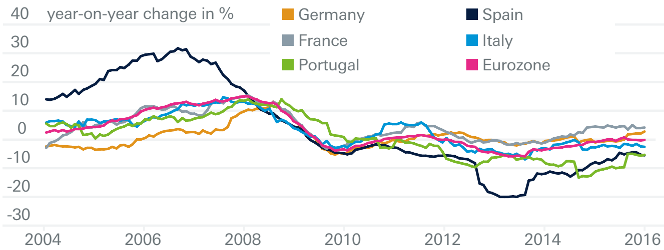


Sources: Bloomberg Finance L.P., Deutsche Asset Management Investment GmbH; as of 07/2016; E = expected

First signs of recovery

Credit demand continues to be low. But the era of receding corporate loans is coming to an end.

Loans to corporations (non-financial)

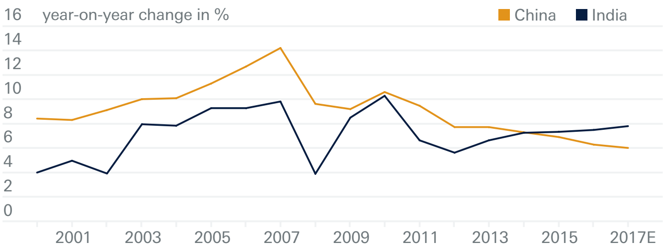


Source: Thomson Reuters Datastream; as of 07/2016

India in the fast lane

China cushions structural change with short-term impetus. India focuses on deregulation.

GDP growth in China and India



Sources: Thomson Reuters Datastream, International Monetary Fund, Deutsche Asset Management Investment GmbH; as of 07/2016; E = expected

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Our forecasts

» The world economy is advancing on a solid growth track. After a weak start to 2016 the U.S. economy is gaining momentum. «

2016 has already seen an abundance of political turmoil. British voters decided in favor of leaving the EU. Forming a government remains difficult in Spain. Moreover, a new U.S. President will be elected November 8th. We expect a stable development of the global economy despite the political uncertainties. Our global growth forecast was however cut by 0.2 percentage points to 3.4%, primarily due to developments in Europe. Apart from politics, the Eurozone is also negatively affected by the insufficient capital base of Italian banks. It is still open whether private creditors will be asked to pay up. Rising TARGET2 balances remain an indication of continuing uncertainties within the Eurozone. ■

GDP growth rate (in %)

	2016F		2017F
United States	1.8	↗	2.0
Eurozone	1.4	↘	1.2
United Kingdom	1.3	↘	0.8
Japan	0.5	↗	0.7
China	6.3	↘	6.0
World	3.3	→	3.4

Fiscal deficit (in % of GDP)

	2016F		2017F
United States	-3.0	↗	-3.2
Eurozone	-1.9	→	-1.9
United Kingdom	-3.3	→	-3.3
Japan	-6.0	↘	-5.2
China	-2.4	↗	-2.5

Consumer price inflation (in %)

	2016F		2017F
United States[1]	1.6	↗	1.8
Eurozone	0.3	↗	1.6
United Kingdom	0.7	↗	2.6
Japan	-0.2	↗	0.2
China	2.0	↘	1.5

Current-account balance (in % of GDP)

	2016F		2017F
United States	-2.7	↘	-2.8
Eurozone	2.9	↘	2.7
United Kingdom	-3.9	↗	-3.5
Japan	2.8	↘	2.5
China	2.5	→	2.5

F refers to our forecasts as of 7/7/16.
[1] core rate, personal consumption expenditure Dec/Dec in % (no average as for the other figures)
Source: Deutsche Asset Management Investment GmbH; as of 7/7/16

› therefore alleviated their situation. Commodity-exporting emerging countries such as Brazil and Russia additionally benefit from rising commodity prices. Both countries should grow by one percent in 2017 after a phase of recession.

In the last few years, China's political leadership has focused on credit-financed investment to stimulate the economy. Several sectors therefore experienced over-capacities and rising non-performing loans. This increases the pressure on the government in Beijing to launch structural reforms. The example of India shows that economic restructuring and market-economy reforms can be worthwhile. For 2017, we expect an acceleration of growth by 0.3 percentage points to 7.8%, and for China a deceleration by 0.3 percentage points to six percent. ■

Benchmark rates in %

	Current*		June 2017F
United States	0.25 – 0.50	↗	0.75 – 1.00
Eurozone	0.0	→	0.0
United Kingdom	0.5	↘	0.1
Japan	0.0	→	0.0

Commodities

The downhill slide of commodity prices, which began in mid-2014, ended in January 2016. The commodity market had been boosted by energy resources and precious metals. Oil prices (West Texas Intermediate, WTI) climbed by roughly 85% since their lows on January 20th (as of 6/29/16). Reasons are the large fall in U.S. oil production and a growing global demand. Price gains were reined in, however, by extended production in Iran. By mid-2017, we expect oil prices to rise only moderately. In the first half of 2016, gold was in heavy demand, the result of growing political uncertainty and receiving a further boost by the Brexit vote. Investors reacted to the expected postponement of Fed rate hikes and the continuation of the ECB's ultra-expansive monetary stance. ■

Our forecasts

Commodities in U.S. dollars	Current*		June 2017F
Crude oil (WTI)	44	↗	55
Gold	1,320	↗	1,390
Silver	20	→	20
Copper (LME)	4,930	↘	4,600
Aluminum (LME)	1,592	↘	1,500

WTI = West Texas Intermediate
LME = London Metal Exchange

F refers to our forecasts as of 7/7/16.
* Source: Bloomberg Finance L.P.; as of 7/26/16
Source: Deutsche Asset Management Investment GmbH; as of 7/26/16

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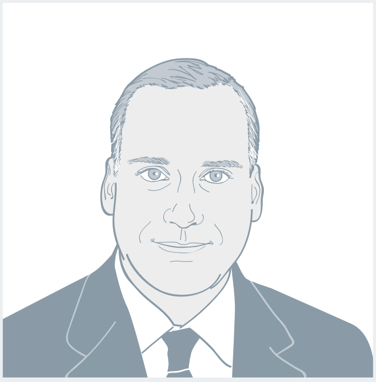
For central banks, Brexit is not just a British issue

» The result of the Brexit referendum caught markets by surprise. Now that the dust has settled, opportunities remain for investors – and challenges for policy makers. «



Joe Benevento...

… and Joern Wasmund
Global Co-Heads of Fixed Income/Cash

Not long ago, the writing was on the wall. Soon, it seemed, the U.S. Federal Reserve (Fed) would hike interest rates again. Eventually, the Bank of England would follow. And, before too long, markets might even begin to fret about European Central Bank (ECB) programs ending or at least shrinking one day.

Then, the Brexit referendum happened. Only time will tell when and on what terms the United Kingdom (UK) might leave the European Union (EU). Two things, however, are already clear. First, monetary policies for developed markets as a whole are likely to get looser, before they get tighter. Already, expectations for more monetary stimulus have pushed government-bond yields lower and frequently deeper into negative territory. Oddities abound. For example, borrowing costs for British corporates have actually shrunk since the vote – despite growing recession risks in the UK. Second, however, Brexit is not – just – a British issue. Fans of the classic TV comedy "Yes Minister" might feel reminded of a famous scene, where top civil servant Sir Humphrey Appleby declares: "Minister, Britain has had the same foreign-policy objective for at least the last 500 years: to create a disunited Europe."

New challenges for the ECB

The Brexit shock places increased pressure on the ECB to do even more. However, traditional tools are limited. While there may be scope for one further rate cut, this could further squeeze Europe's troubled banks. Effectively, this opens the door for further security purchases or even fresh money injections for governments or households, an idea usually referred to as helicopter money. Everything seems possible. But those measures also have their downsides.

Take the recently launched corporate sector purchase programme (CSPP). Under its criteria, which exclude bank issues and issues consistently rated below investment grade, the eligible CSPP universe is probably around €850bn. Out of this, just short of €500bn may be potentially available,

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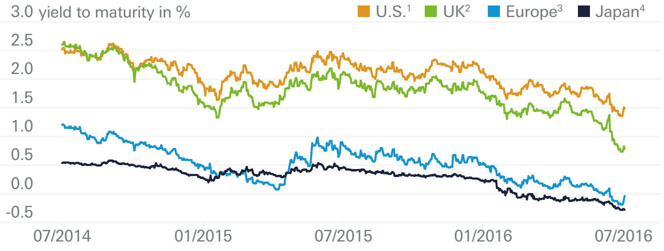
as the ECB is allowed to buy no more than 70% of any single issue and less for state-affiliated companies. The ECB probably aims to buy in the region of €5bn a month. This could take its holdings to about 10% of its CSPP target universe by March 2017 – a helpful addition, as certain other assets, such as German Bunds, continue to grow ever scarcer.

However, getting there is not likely to be easy, nor without risks. The market for euro investment-grade bonds is notoriously thin. Under CSPP, liquidity is likely to dry up further. Core countries such as Germany and France, as well as certain sectors, such as utilities, should be the main beneficiaries. Smaller, hard-pressed companies from the periphery might at best benefit indirectly, from spill-over into non-eligible assets. This too, however, has costs; it distorts economic decisions. Higher M&A activity and difficulties to meet liabilities are some of the visible consequences.

The lesson? As monetary policy continues to keep interest rates at extraordinary lows, it effectively side-lines "normal" market mechanisms. For now, the usual suspects should continue to benefit. This includes periphery bonds and European corporates. More stimulus by the ECB and, perhaps, the Bank of Japan, is likely to make assets in higher-yielding markets, such as the U.S., more appealing. Policy makers would surely be well-advised to fret about market distortions. Investors, meanwhile, might as well continue to enjoy the ride. As Sir Humphrey might say: "Why should we change now, when it's worked so well?" ■

10-year sovereign-bond yields continue to fall

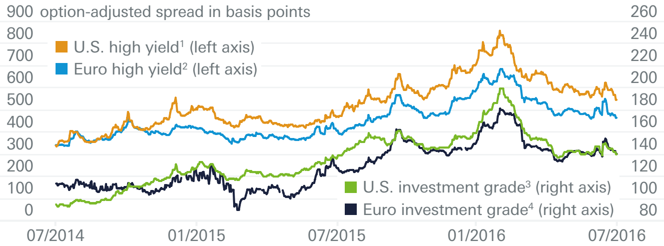
The Brexit referendum has further pushed yields on 10-year sovereign bonds.



[1] Generic 10-year U.S. government-bond yield
[2] Generic 10-year UK government-bond yield
[3] Generic 10-year Euro government-bond yield (Euro benchmark comprised of French and German government bonds)
[4] Generic 10-year Japanese government-bond yield

Spreads on corporate bonds holding steady

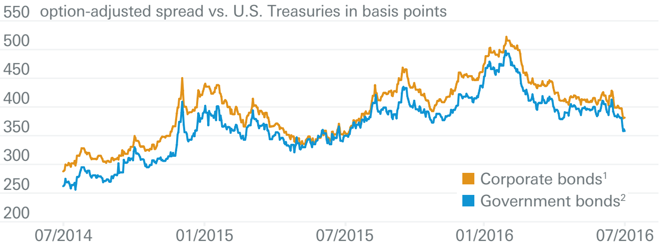
Especially in Europe, corporate borrowers continue to benefit from the ECB's loose monetary policies.



[1] Barclays U.S. Corporate High Yield Index (vs. U.S. Treasuries)
[2] Bank of America Merrill Lynch Euro Non-Financial High Yield Constrained Index (vs. German Bunds)
[3] Barclays U.S. Aggregate Bond Index (vs. U.S. Treasuries)
[4] iBoxx € Corporate Index (vs. German Bunds)

Emerging-market bonds may benefit too

Sovereign and corporate bonds from emerging markets have lately been viewed as relatively stable investments.



[1] J.P. Morgan Corporate Emerging Markets Bond Composite Blended Spread Index
[2] J.P. Morgan Emerging Markets Bond Global Diversified Sovereign Spread Index

Sources: Bloomberg Finance L.P., Deutsche Asset Management Investment GmbH; as of 7/13/16

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Our forecasts

» We expect bond yields to remain lower for longer – in line with looser monetary policies after the Brexit shock. «

	Current*		June 2017F
United States			
U.S. Treasuries (2-year)	0.75%	↗	1.00%
U.S. Treasuries (10-year)	1.56%	↗	1.70%
U.S. Treasuries (30-year)	2.28%	→	2.35%
U.S. municipal bonds	93%	→	93%
U.S. investment-grade corporates	135 bp	↘	125 bp
U.S. high-yield corporates	521 bp	↗	620 bp
Securitized: mortgage-backed securities[1]	98 bp	→	100 bp
Europe			
German Bunds (2-year)	-0.61%	↗	-0.50%
German Bunds (10-year)	-0.03%	↗	0.25%
German Bunds (30-year)	0.46%	↗	0.75%
UK Gilts (10-year)	0.82%	↗	1.00%
Euro investment-grade corporates[2]	122 bp	→	120 bp
Euro high-yield corporates[2]	428 bp	↗	500 bp
Securitized: covered bonds	6 bp	↗	10 bp
Italy (10-year)[2]	128 bp	↘	110 bp
Spain (10-year)[2]	114 bp	→	120 bp
Asia-Pacific			
Japanese government bonds (2-year)	-0.33%	→	-0.30%
Japanese government bonds (10-year)	-0.25%	↗	-0.10%
Asia credit	250 bp	↗	290 bp
Global			
Emerging-market sovereigns	359 bp	↗	400 bp
Emerging-market credit	384 bp	→	385 bp

Comment

When it comes to sovereign bonds, it is easy to sum up both recent market movements and our 12-month forecast changes. Both are generally down since March – and more so if you look at current market rates than if you look at our new forecasts. For Japan, our forecast has not changed, mainly because back in March, we were already expecting the 10-year government-bond yield to fall to -0.1% by March 2017.

In the Eurozone periphery, we continue to expect some further tightening in Italy, but not in Spain. Emerging markets, meanwhile, should benefit from relatively high carry. The same may well be true in the high-yield segment. Particularly in Europe, both high-yield and investment-grade corporate-bond returns may be boosted by continuing ECB support. ■

* Source: Bloomberg Finance L.P.; as of 7/26/16
F refers to our forecasts as of 7/7/16; bp = basis points
[1] Current-coupon spread vs. 7-year U.S. Treasuries
[2] Spread over German Bunds
Source: Deutsche Asset Management Investment GmbH; as of 7/26/16

Pounding along

» Among the world's central banks, only the Fed remains on an – admittedly mild – tightening path. This should provide intrinsic USD support, primarily against EUR and GBP. «

Currency markets have quickly digested the Brexit vote. Risk assets rallied on central-bank liquidity support and expectations that monetary policies are unlikely to tighten any time soon. Against this backdrop, the euro (EUR) receives support relative to the U.S. dollar (USD) from a large current-account surplus. However, U.S. growth is expected to accelerate and remains less exposed to any slowdown in the UK. Markets are likely to again price in a possible Fed rate hike later this year. This may push EUR/USD to 1.05. Some analysts talk about the USD smile: Risk aversion tends to support the USD while risk appetite gives the Fed leeway to hike rates, also supporting the USD. Despite the uninspired EUR/USD trading range for the last 15 months, we, too, like being long USD, also vs. the British pound (GBP). The Japanese yen (JPY) plays a special role, due to its correlation to market risk perceptions. Hence, we see JPY as a possible risk diversifier across all asset classes. The massive offshore funds of Japanese investors are the key catalyst here. Japan might adopt helicopter money in some form, inevitably weakening the JPY. But this should only be temporary; the JPY should strengthen again as soon as market volatility spikes. ■

Dirk Aufderheide,
Chief Currency Strategist

USD stronger, GBP weaker

Brexit and a fragile Eurozone are strengthening currencies perceived as less risky.

	Current*		June 2017F
EUR vs. USD	1.10	↘	1.05
USD vs. JPY	105	↗	108
EUR vs. GBP	0.84	→	0.84
GBP vs. USD	1.31	↘	1.25
USD vs. CNY	6.67	↗	6.90

* Source: Bloomberg Finance L.P.; as of 7/26/16

F refers to our forecasts as of 7/7/16.
Source: Deutsche Asset Management Investment GmbH; as of 7/26/16

ECB balance sheet keeps growing

One reason for the strengthening U.S. dollar is the ECB's quantitative-easing program.

Sources: Bloomberg Finance L.P., Deutsche Asset Management Investment GmbH; as of 07/2016

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Political stock markets

» Sure, there are other options. Still, equities may remain a sound investment in politically challenging times. You just have to look beyond the level of headline indices. «

Henning Gebhardt,
Global Head of Equities

Our expectations in a nutshell

- Stock markets are unusually dominated by political worries
- This is reflected in high cash positions and the relative strength of the S&P 500 Index
- Politics rarely has a lasting negative impact – especially when central banks stand ready to help

Political risk is currently playing a leading role in investment decisions. The Brexit vote is yet another example of equities suffering less lasting damage from political upheaval than other asset classes. Currency and bond-price reactions were much more sustained than those of equity indices, which quickly recovered. But the vote is likely to shape Europe for years to come. It is too early to tell whether the outcome of the referendum will strengthen or weaken the cohesion of the European Union (EU). Although political stock markets tend to be proverbially short-lived, cyclical investment decisions are also ultimately based on sentiment.

Initially, we expect to see cyclical improvements, which should ultimately translate into higher U.S. earnings. In both Europe and Japan, the business environment generally looks better than the political environment.

For many stock-market indices, however, we see little upside potential in the next twelve months. A look at the past is also sobering: none of the major stock markets have managed to reach their 2000 or 2007 highs in U.S.-dollar terms. Of course, there is one exception: the U.S. market. By contrast, the MSCI AC World ex U.S. Index trades around one-quarter below its 2007 high. Admittedly, the United States benefits from its flexibility, high returns on equity and successful technology companies. U.S. shares could also potentially profit from their perceived status as a less risky investment destination. Lingering investor concerns are, after all, reflected in the high cash positions held by institutional investors – at levels not seen since 2001. Still, it pays to take a closer look at another source of strength for the U.S. market.

Who is buying U.S. equities?

Thanks to the European Central Bank (ECB), U.S. companies are buying more of their own shares. This may sound strange at first, but it is closer to the truth than one might think. The ECB's low-interest-rate policy has already put downward pressure on U.S. interest rates. With the ECB's extension of quantitative easing, U.S. companies now have a more direct route toward benefitting from cheap-

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er refinancing across the pond. That is because the ECB can, in principle, purchase euro-denominated bonds from the subsidiaries of U.S. companies registered in the Eurozone. The willingness to take advantage of this type of subsidized financing is demonstrated by the fact that companies whose bonds fit into the ECB's purchasing scheme are having an unusually high volume of issuance. Raising funds is not dictated by need but by availability and price. And what are companies doing with all the money raised? In the United States, they are choosing to buy either their own shares or interests in other companies.

Between 2013 and 2015, S&P 500 Index companies spent 21% more on dividends and share buybacks and 156% more on cash acquisitions. Investment spending on fixed assets grew by only 2%. This may suggest a lack of courage by many companies, who may instead be opting to use shortcuts to boost their growth and earnings per share. Low interest rates make all this possible. That is what has kept interest payments virtually flat for the past four years despite a sharp rise in net debt. Gross debt as a percentage of gross domestic product (GDP) for U.S. non-financial companies has already returned to record levels. A cause for panic?

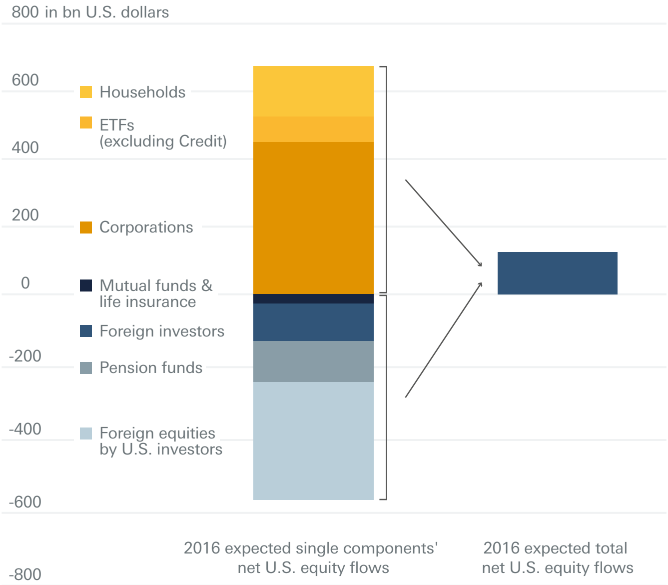
Well, rising interest rates and falling profits could pose an immediate threat to highly indebted companies. However, we see little room for an increase in interest rates and believe profits should rise again in 2016 and 2017. This suggests that U.S. corporate-debt levels may start to pose a risk in the medium term, but not immediately. ■

"The stock market may see fresh momentum from fading political worries and positive earnings surprises in the second half-year."

Henning Gebhardt, Global Head of Equities

Companies tower over U.S. equity markets

The extent to which companies are the dominant buyer of equities is quite remarkable. Is this a sign of confidence – or merely of the lack of other options?



Sources: Goldman Sachs Global Investment Research, FactSet Research Systems Inc.; as of 7/22/16

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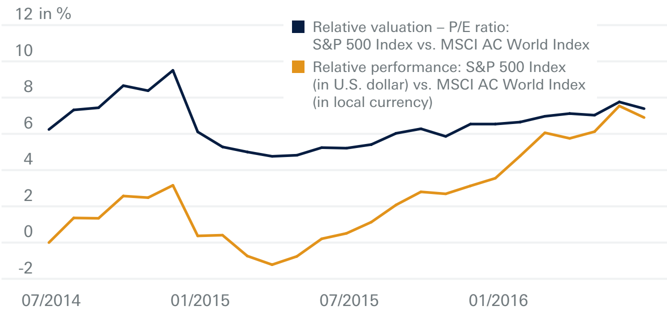
Valuations overview

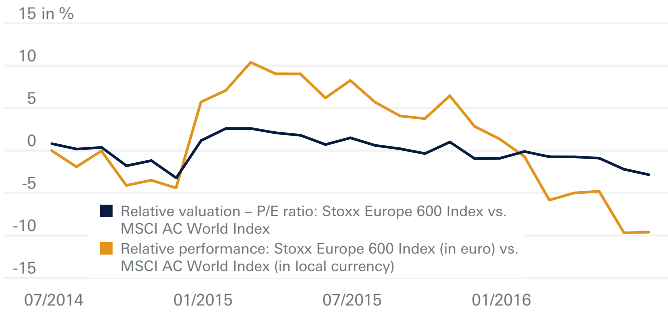
Equities United States

We expect modest earnings-per-share (EPS) growth in 2017. Near-term, EPS acceleration in the second half of 2016, solid macro trends and uncertainty in Europe could cause the S&P 500 Index to overshoot our index target as it is seen as a less risky investment. This might continue to further support defensive dividend payers in particular.



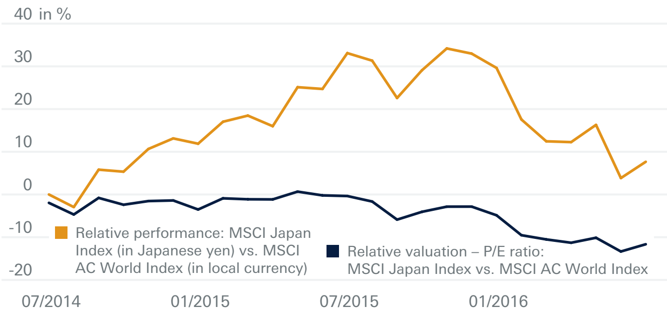
Equities Europe

Near-term Brexit-related concerns and financial-sector challenges are likely to keep a lid on European equities. Europe's valuation discount compared to the U.S. looks set to remain at elevated levels. We have cut our earnings forecasts to reflect less growth and the impact of lower interest rates for financials.



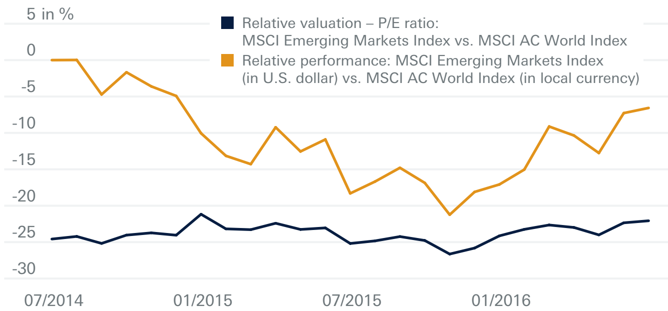
Equities Japan

The strong yen is a stumbling block for Japanese equities, as is the domestic economic backdrop. However, many Japanese firms have strong earnings and solid balance sheets. We remain optimistic on corporate-governance reforms. On top of appealing valuations, this leads us to take a more positive view on export-oriented companies.



Equities Emerging Markets

Emerging markets are benefiting from the U.S. Federal Reserve's hike delay, commodity-price stabilization and little exposure to Brexit-related concerns. While earnings should recover in 2017, we see downside risk to 2016 numbers. Latin American earnings could, however, surprise, helped by commodity prices and a recovery in Brazil.



Sources: FactSet Research Systems Inc., Deutsche Asset Management Investment GmbH; as of 7/21/16

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Forecasts in times of volatile markets

» Our index forecasts suggest little upside potential. This does not mean, however, that equities cannot play a strategic role. «

Oddly enough, our CIO Days almost always take place in times of strong market volatility. This means from the time price targets are set until their publication, there can be considerable changes to upside potential. On this quarter's CIO Day, several markets appeared to continue to have some upside potential. But, the recovery rally that followed quickly made virtually all indices look overvalued.

With respect to our forecasts: We believe giving a precise twelve-month forecast would be futile, with markets likely to bounce between overshooting and undershooting our targets. This would not be a cause for immediate action. Exaggerations are customary in capital markets; momentum is a force that should not be underestimated. The movements we believe are more important are those taking place outside the indices in sectors and at individual-stock levels. Setting price targets prompts us to challenge our assessments.

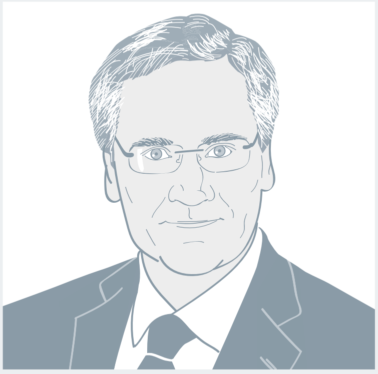
Currently, we see little upside potential. If markets rally further, trimming positions might be worth considering, unless, of course, our earnings estimates – which are below consensus – prove too conservative in the meantime. ■

Equity markets (index value in points)	Current*		June 2017F	Total Return (expected)**			
			Forecast	in %	Expected earnings growth	P/E impact	Dividend yield
United States (S&P 500 Index)	2,169	→	2,100	-1.0	4%	-7%	2.2%
Europe (Stoxx Europe 600 Index)	341	→	330	0.2	4%	-8%	3.5%
Eurozone (Euro Stoxx 50 Index)	2,979	→	2,900	1.3	2%	-4%	3.9%
Germany (Dax)[1]	10,248	→	10,300	0.5	-1%	-2%	3.2%
United Kingdom (FTSE 100 Index)	6,724	↘	6,200	-4.3	7%	-13%	3.4%
Switzerland (Swiss Market Index)	8,227	→	8,150	2.4	4%	-4%	3.4%
Japan (MSCI Japan Index)	785	↗	800	4.2	-1%	3%	2.3%
MSCI Emerging Markets Index (USD)	871	→	830	-2.2	3%	-4%	2.4%
MSCI AC Asia ex Japan Index (USD)	528	→	500	-3.0	1%	-3%	2.4%
MSCI EM Latin America Index (USD)	2,360	↘	2,100	-8.8	18%	-24%	2.2%

* Source: Bloomberg Finance L.P.; as of 7/26/16
** Expected total return includes interest, dividends and capital gains where applicable
F refers to our forecasts as of 7/7/16.
[1] Total-return index (includes dividends)
Source: Deutsche Asset Management Investment GmbH; as of 7/26/16

Real estate continues to deliver interesting relative value

» Initial yields on property relative to bonds are above average. In most markets, supply and demand is balanced with rents increasing. «



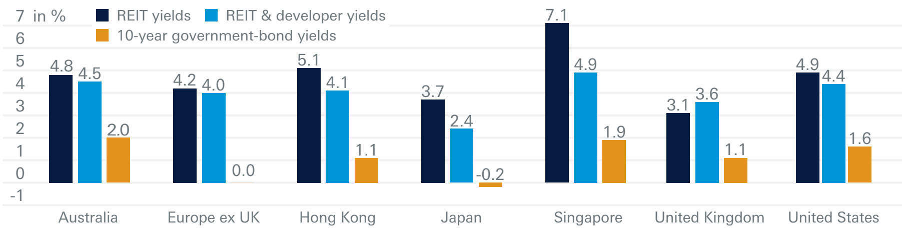
Mark G. Roberts,
Head of Research & Strategy, Alternatives

Real estate performs best when gross-domestic-product (GDP) growth is positive and real interest rates are low. Our post-Brexit GDP growth estimates are modestly lower, yet we do not expect real interest rates to rise. Globally, real estate should deliver average to above-average returns in many markets. The United Kingdom (UK) might slow, but markets like Australia, South Korea, Germany, Spain and the U.S. remain favorable.

Outside of the UK, we don't see material valuation shifts. Initial yields are stable while bond yields have come down, thus spreads are wider. With property supply and demand remaining balanced, we have upgraded our return outlook in certain markets. Supply risk remains well below average, with only a few exceptions such as Singapore, Houston, London and some late-cycle supply in certain Australian markets.

In the listed market, real estate will become the eleventh Global Industry Classification Standard sector at the end of August 2016. We believe this may lead to lower volatility and correlations over time. Also, generalists are estimated to be underweight the Real Estate Investment Trust (REIT) sector by c. $95bn, which could provide support. REIT dividend yields are now at 4.0 percent and well supported by underlying free-cash-flow yields of 5.0 percent. Payout ratios are low by historical standards and could provide an opportunity for high-single-digit dividend growth in the near term. ■

Regional dividend yields: appealing income



Sources: Bloomberg Finance L.P., Deutsche Asset Management Investment GmbH; as of 6/24/16

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Brexit – both a political and financial crisis?

» The unexpected referendum result could generate opportunities for a number of hedge-fund strategies. «

To boldly go where no man has gone before." Once it was the catchphrase of the Starship Enterprise. Now it also appears to be the mission statement of a slender majority of the British electorate. In theory, the journey should take two years. Given the roughly 40,000 pieces of legislation which govern the United Kingdom's relationship with its largest trading partners, it looks more like a five-year odyssey deep into the unknown.

In the meantime, the uncertainty thrown up by the unexpected result and the ensuing negotiation process could generate opportunities for a number of hedge-fund strategies. So, what are the longer-term implications, now that the initial panic has subsided? To help us formulate these updated views, let us remind ourselves of the operating environment.

We reinforce our view that recent events should mean structurally higher volatility across the majority of asset classes. The U.S. dollar presumably benefits until there is more clarity on the future direction of the European Union (EU). Riskier assets across the board could be in for a rocky ride.

So which hedge-fund strategies appear best placed for the new reality that we find ourselves in? Those strategies which are most liquid and most capable of making money in uncertain times. This should clearly include discretionary macro, which has historically performed better in riskier markets, because managers are typically more willing and able to aggressively move exposure around. The breakdown of asset-class correlations should also broaden the opportunity set for discretionary-macro managers. Commodity trading advisor (CTA) based trading strategies are another potential beneficiary. Given our expectation of further volatility in asset markets, we believe they may continue to outperform for the foreseeable future. ■

Tim Gascoigne,
Head of Hedge Fund Advisory

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.

Taking an active approach to low returns and high volatility

» Effective tactical asset allocation, individual security selection and risk management are key. «

Christian Hille,
Head of Multi Asset

Multi-asset investors face an environment where growth remains stubbornly low and there are growing concerns about the long-term implications of very accommodative monetary policy. But, for the foreseeable future, we should live in a situation where core sovereign-bond yields are at record lows, corporate-credit yields are moving down and equities are at record highs. In short, we have an investment cycle where some asset-class price movements are out of sync with economic growth.

Lower effective returns are also accompanied by high levels of volatility. This is most simply illustrated by the classic "efficient-frontier" chart showing the highest rate of return for a given level of risk, or vice versa. As Figure 1 shows, this has moved downwards over time – in other words, to achieve a given return you may have to take on a much higher level of risk than previously. A simple hypothetical example makes the point even more strongly. In 2004 you could achieve a 4% return with a portfolio made up with 85% fixed income and only 15% of equities. Now you would have to allocate ~50% into equities to have a hope of approaching this level of return – and your expected volatility would have doubled.

Portfolio diversification has become very challenging in this cycle. The natural diversifiers, fixed-income sovereigns, are now zero-yield, negative-convexity assets. Inter-asset-class correlation has also increased substantially over the last few years and – as we know – tends to increase to one in larger risk-aversion events, as shown by Figure 2.

The risk-return relationship is changing

As a result, multi-asset investors may need to recalibrate their strategy. Over the last 5-10 years, strategic asset allocation might have accounted for 80% or more of a portfolio's performance. This is no longer the case. Effective tactical asset allocation, individual security selection and risk management may now account for 50% or more of performance.

In this new, active, multi-asset-management world, key concepts include contrarian trading, risk premia or style investing and smart implementation, i.e. selection. The way in which they are implemented and their relative importance changes over time.

Our current approach can be characterized as follows. With the largest contribution to overall portfolio risk coming from equities taking slightly less strategic risk than usual may be warranted, both to allow a portfolio to better cope with and also to provide a sufficient risk budget to buy into larger sell-offs. Across a strategic base portfolio, a "carry-and-income" strategy can offer the ability to add tactically when market dislocations occur.

Diversification across styles can add value

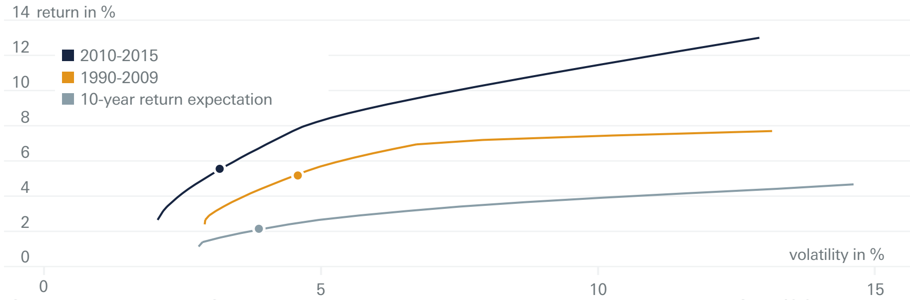
Within the equities exposure, limited expected upside to index targets, together with high expected volatility, suggests focusing on getting the right equity style (i.e. investing criteria). Income-generating dividend stocks and strategies designed to minimize volatility/variance may be important considerations. Figure 3 shows the longer-term risk premia associated with different equity styles.

Fixed-income "carry" assets (i.e. those offering appreciable yield) look set to be more interesting than equities for the next couple of months. U.S. investment grade, euro high yield and emerging-market (EM) hard-currency debt may be preferred considerations.

This is an environment that should require global diversification which includes U.S. exposure – and not to forget currency exposure that is actively managed for risk – and potential return. ■

A new cycle: Lower returns for the same level of risk[1]

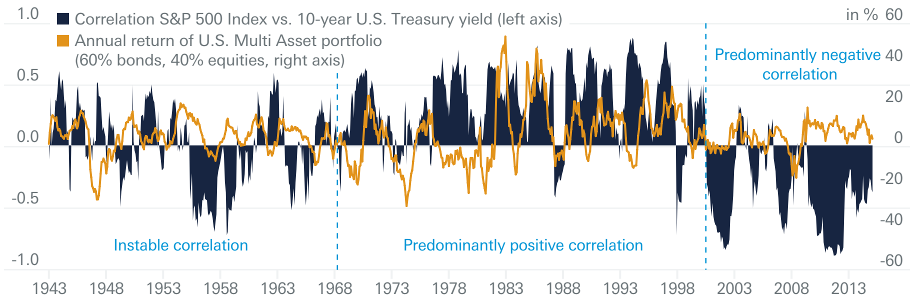
The efficient frontier is likely to be lower going forward. Investors need to adjust their risk budgets or their strategic allocation.



Sources: Morgan Stanley Research, Bloomberg Finance L.P.; as of 11/2015

Diversification will become more challenging

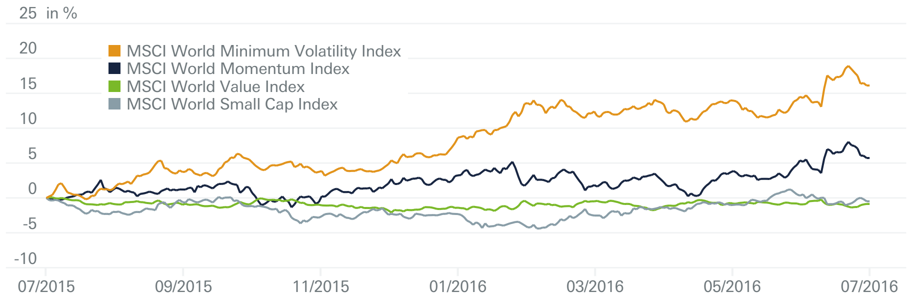
After predominantly negative bond-equity correlations over the past decade, we may be entering a new phase of positive correlation.



Sources: Thomson Reuters Datastream, Global Financial Data, Robert Shiller, Goldman Sachs Global Investment Research; as of 12/2015

Strong performance and dispersion among equity style factors[2]

Minimum-Volatility and Momentum strategies have outperformed Value and Small Caps this year, all of which did better than the MSCI World Index.



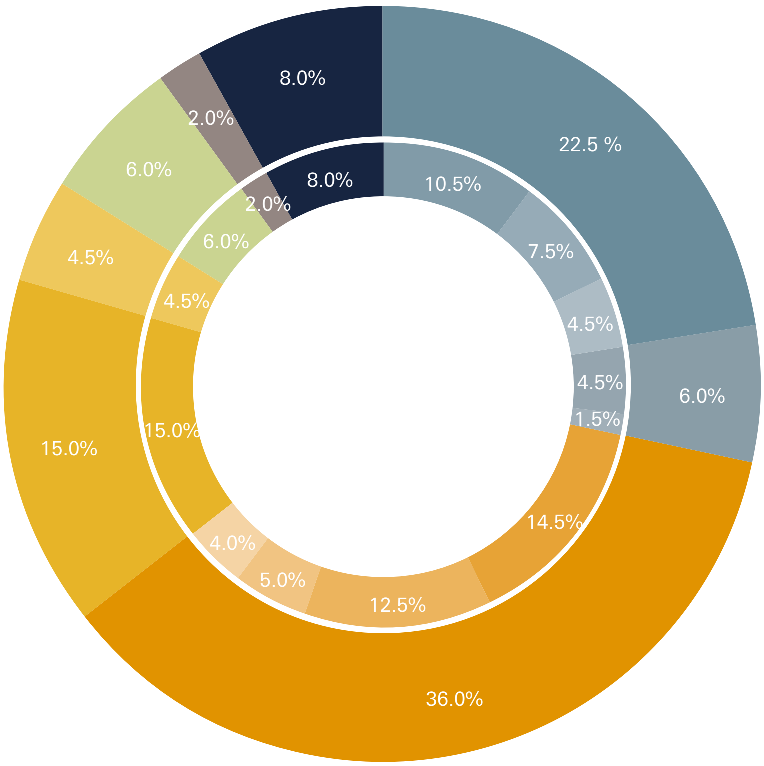
Source: Bloomberg Finance L.P.; as of 7/15/16

[1] Risk-return relationship shown for a portfolio comprised of U.S. equities, 10-year U.S. Treasuries, U.S. investment-grade bonds, U.S. high-yield bonds
[2] Relative performance of equity-style-factor indices vs. the market-cap-weighted MSCI World Index

Credit over equities, for now

» Regional equity preferences reflect political and economic concerns. «

We continue to believe that fixed-income corporate credit may offer better risk-return characteristics than equities on a three-month horizon. That's why we feel comfortable to carry an underweight in equities overall at this point in time. With much of the continuing political and economic uncertainty focused on Europe, we have an underweight in European equities, but continue to see opportunities Japan and acknowledge the continuing momentum in Emerging Markets. Our allocation to U.S. and Asia-ex-Japan equities remains neutral. Our overweight to fixed income overall is mainly via investment grade and high yield. We are neutral on commodities and underweight Alternatives at the moment. We continue to think that the U.S. dollar may strengthen, having an overweight here but an underweight on both the euro and the yen. ■



Developed-market equities	
United States	10.5%
Europe	7.5%
Japan	4.5%
Emerging-market equities	
Asia ex Japan	4.5%
Latin America	1.5%
Fixed Income: Credit	
Euro investment grade	14.5%
U.S. investment grade	12.5%
Euro high yield	5.0%
U.S. high yield	4.0%
Fixed Income: Sovereigns	
United States	15.0%
Fixed Income: Emerging markets (hard currency)	
Emerging markets (hard currency)	4.5%
Convertibles (euro-hedged)	
Convertibles	6.0%
Cash	
Cash	0.0%
Commodities	
Commodities	2.0%
Alternatives	
Alternatives	8.0%

The chart shows how we would currently design a balanced, euro-denominated portfolio for a European investor taking global exposure. This allocation may not be suitable for all investors. Alternatives are not suitable for all clients.
Source: Multi Asset Group, Deutsche Asset Management Investment GmbH; as of 7/13/16

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Looks good – on the surface

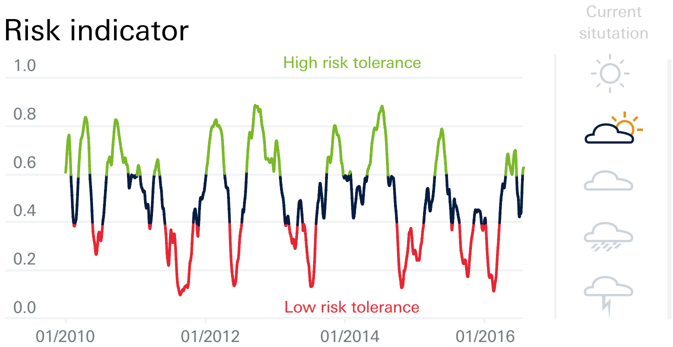
» Development of macro indicators suggests scope for cautious optimism but uncertainties persist. «

Currently, all three of our multi-asset indicators are relatively encouraging. This reflects, to a great extent, the slow but steady improvement in the macroeconomic environment as well as market optimism that central banks will provide further liquidity, if needed. The surprise indicator has been positive since end of May, initially driven by very positive surprises out of the Eurozone. Recent data has also beaten expectations in Asia and the U.S. The generally positive development in the macro indicator since March owes much to improving trade data, global purchasing-manager indices, firm labor-market data and a rise in many commodity prices. This shows a broad-based improvement. Our third measure is the risk indicator, which has recently turned positive after a very volatile period since the beginning of the year. This reflects the changing risk sentiment. Overall, ample liquidity and central-bank support is driving financial markets. Our indicators, too, are partially driven by monetary policy. However, they also provide a very valuable fundamental cross-check to assess markets. In that sense, they should be seen as complementary to other tools for analyzing financial markets. ■

Macro indicator

The macro indicator condenses a wide range of economic data, including consumer confidence, trade figures and employment numbers.

Risk indicator



Our risk indicator depicts the current risk environment in the markets.

Surprise indicator

The surprise indicator tracks economic data relative to consensus expectations.

Source: Deutsche Asset Management Investment GmbH; as of 7/22/16

CROCI: Seeking elusive revenues

» The year 2015 was a year to forget when it came to companies' ability to grow revenues. Globally, 46% recorded negative revenue growth; not a single region managed to diverge significantly from that trend. «

Analysts were optimistic at the beginning of the year. Of our global coverage of 825 companies, 83% were expected to grow their revenues; that number is now only 57%. We cannot recall a situation in history when so many companies had a prolonged period of stagnating revenues.

The issue of top-line growth is very important to macro analysis; nevertheless it tends to be ignored. When a company's revenues are expected to fall, it will generally not invest. In such situations, companies instead seek to minimize expenditures as a way of maximizing the value they can create. The problem with this? For the economy as a whole, growth is postponed, putting further downward pressure on companies' revenues. It is a vicious cycle. Therefore, it is no surprise that the International Monetary Fund (IMF) is downgrading global economic growth just as sovereign yields are hitting record lows. The market is expressing the view that the world economy is facing stagnation.

Equity markets have been surprisingly resilient to these downgrades. Since the beginning of the year, global valuation has risen from an Economic price-to-earnings (Econ. P/E) ratio of 27.3x to 32.6x. One might have expected to witness higher levels of volatility given the turmoil in some emerging markets (EM), such as Turkey, Brazil and China, as well as uncertainty in developed markets (e.g. Brexit, revaluation of yen, turmoil amongst European Financials).

One plausible explanation is that equity-market stability has been provided by the fall in the yield on sovereign debt. This is exemplified by 10-year U.S. Treasuries, whose yield is now lower than the S&P 500 index dividend yield. Our analysis indicates that U.S. corporates have lower financial liabilities and a higher level of profitability. Their dividends are generally not at risk.

In this low growth environment, the apparent conclusion is that investors can afford to simply cash in their dividend coupons and wait for corporate economic earnings (stagnating since 2010) to recover – when that happens, equities may be a better place to be than bonds. This is consistent with our findings in a 2013 report[1]: since 2000, equities have tended to rise when bond yields rise.

Looking for valuation asymmetries between regions is becoming difficult, as there has been a marked convergence. Japan has seen the most down-

The CROCI® Investment Strategy and Valuation Group is responsible for devising the CROCI® strategy and calculating the CROCI® Economic P/E Ratios. The CROCI® Investment Strategy and Valuation Group is not responsible for the management of the funds and does not act in a fiduciary capacity in relation to the funds or the investors in the funds.

grades in revenues, but is also the most interesting region on valuation with the Economic P/E for the median company at 26.9x vs. 30.0x for the U.S., 30.1x for Europe and 32.0x for EMs.

EMs may have had a better performance but we still struggle to find any value in the region from a bottom-up perspective. A positive call must be driven purely by top-down policies. There are signs that companies are at last slowing their capex down, a crucial step on their journey back to value creation. But the recent announcements in China about reviving corporate investment call into question whether there has been the crucial realization that unproductive investments are not good for anyone. Our purely bottom-up view is that any positive performance may be short-lived.

CROCI – an economic valuation method

CROCI is a 20-year old unique proprietary valuation methodology. It is founded on the principle that fundamental investors need to perform a full due diligence on each company they analyze to better understand its valuation and thereby make sound investment decisions. Thus the CROCI process seeks to thoroughly and consistently assess the economic valuation of companies, sectors and markets. This objective framework can then be used to systematically identify fundamentally attractive shares. ■

[1] The appeal of equities and dividends if bond yields rise, 7 May 2013

Proportion of companies with negative revenue growth

There has been a marked increase in the number of companies with negative top-line growth this year.

	2015	2016E	Δ this year[2]
United States	52%	38%	22%
Europe	35%	41%	22%
Japan	44%	66%	46%
Emerging markets	48%	44%	22%
Global	46%	43%	26%

Sources: CROCI, Deutsche Bank AG Filiale London; as of 7/15/16; E = expected

[2] percentage-point change in the number of companies expected to report negative earnings growth in 2016 (from expectations at the beginning of the year)

2016 median Economic P/E based on consensus forecasts

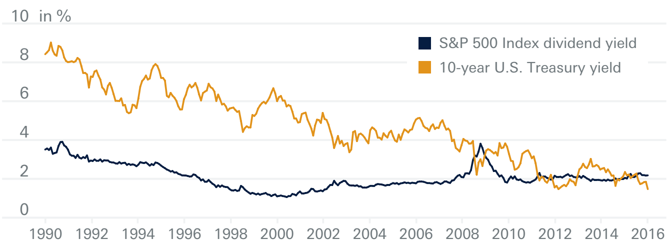
Valuations cheapest in Japan, with convergence in U.S. & Europe; dispersions within regions are very wide.

	Market	Cheaper half	Cheapest decile
United States	30.0x	24.7x	17.1x
Europe	30.1x	24.1x	16.7x
Japan	26.9x	19.5x	14.5x
Emerging markets	32.0x	21.9x	11.4x

Median Economic P/Es of the companies in CROCI's coverage Sources: CROCI, Deutsche Bank AG Filiale London; as of 7/21/16

S&P 500 Index dividend yield now exceeds 10-year U.S. Treasuries

U.S. Treasury yields reflect the deteriorating outlook for growth. They are now close to all-time lows.



Sources: CROCI, Deutsche Bank AG Filiale London, Bloomberg Finance L.P.; as of 7/21/16

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Macro | Solid growth track

GDP growth rate (in %)

	2016F		2017F
United States	1.8	↗	2.0
Eurozone	1.4	↘	1.2
United Kingdom	1.3	↘	0.8
Japan	0.5	↗	0.7
China	6.3	↘	6.0
World	3.3	→	3.4

Fiscal deficit (in % of GDP)

	2016F		2017F
United States	-3.0	↗	-3.2
Eurozone	-1.9	→	-1.9
United Kingdom	-3.3	→	-3.3
Japan	-6.0	↘	-5.2
China	-2.4	↗	-2.5

Consumer price inflation (in %)

	2016F		2017F
United States[1]	1.6	↗	1.8
Eurozone	0.3	↗	1.6
United Kingdom	0.7	↗	2.6
Japan	-0.2	↗	0.2
China	2.0	↘	1.5

Current-account balance (in % of GDP)

	2016F		2017F
United States	-2.7	↘	-2.8
Eurozone	2.9	↘	2.7
United Kingdom	-3.9	↗	-3.5
Japan	2.8	↘	2.5
China	2.5	→	2.5

Benchmark rates (in %)

	Current*		June 2017F
United States	0.25 – 0.50	↗	0.75 – 1.00
Eurozone	0.0	→	0.0
United Kingdom	0.5	↘	0.1
Japan	0.0	→	0.0

Commodities in U.S. dollars

	Current*		June 2017F
Crude oil (WTI)	44	↗	55
Gold	1,320	↗	1,390
Silver	20	→	20
Copper (LME)	4,930	↘	4,600
Aluminum (LME)	1,592	↘	1,500

F refers to our forecasts as of 7/7/16.
Source: Deutsche Asset Management Investment GmbH; as of 7/26/16
[1] core rate, personal consumption expenditure Dec/Dec in % (no average as for the other figures)
WTI = West Texas Intermediate, LME = London Metal Exchange

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Fixed Income | Lower for longer

	Current*		June 2017F
United States			
U.S. Treasuries (2-year)	0.75%	↗	1.00%
U.S. Treasuries (10-year)	1.56%	↗	1.70%
U.S. Treasuries (30-year)	2.28%	→	2.35%
U.S. municipal bonds	93%	→	93%
U.S. investment-grade corporates	135 bp	↘	125 bp
U.S. high-yield corporates	521 bp	↗	620 bp
Securitized: mortgage-backed securities[1]	98 bp	→	100 bp
Europe			
German Bunds (2-year)	-0.61%	↗	-0.50%
German Bunds (10-year)	-0.03%	↗	0.25%
German Bunds (30-year)	0.46%	↗	0.75%
UK Gilts (10-year)	0.82%	↗	1.00%
Euro investment-grade corporates[2]	122 bp	→	120 bp
Euro high-yield corporates[2]	428 bp	↗	500 bp
Securitized: covered bonds	6 bp	↗	10 bp
Italy (10-year)[2]	128 bp	↘	110 bp
Spain (10-year)[2]	114 bp	→	120 bp
Asia-Pacific			
Japanese government bonds (2-year)	-0.33%	→	-0.30%
Japanese government bonds (10-year)	-0.25%	↗	-0.10%
Asia credit	250 bp	↗	290 bp
Global			
Emerging-market sovereigns	359 bp	↗	400 bp
Emerging-market credit	384 bp	→	385 bp

* Source: Bloomberg Finance L.P.; as of 7/26/16
F refers to our forecasts as of 7/7/16; bp = basis points
[1] Current-coupon spread vs. 7-year U.S. Treasuries
[2] Spread over German Bunds
Source: Deutsche Asset Management Investment GmbH; as of 7/26/16

Currencies

	Current*		June 2017F
EUR vs. USD	1.10	↘	1.05
USD vs. JPY	105	↗	108
EUR vs. GBP	0.84	→	0.84
GBP vs. USD	1.31	↘	1.25
USD vs. CNY	6.67	↗	6.90

* Source: Bloomberg Finance L.P.; as of 7/26/16
F refers to our forecasts as of 7/7/16.
Source: Deutsche Asset Management Investment GmbH; as of 7/26/16

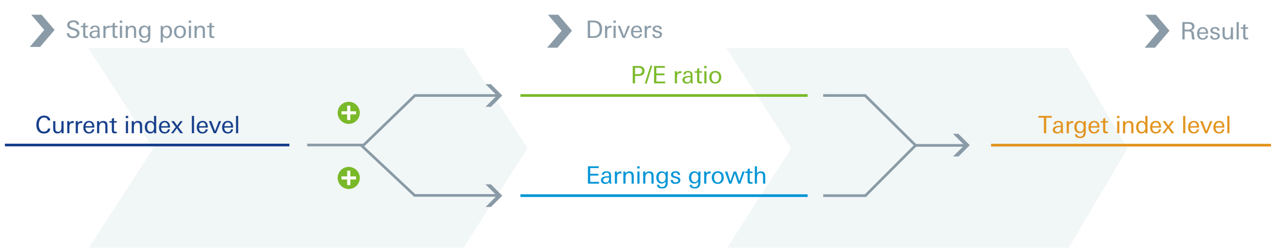
Equities | Little upside potential

Equity markets (index value in points)	Current*		June 2017F Forecast	Total Return (expected)** in %	Expected earnings growth	P/E impact	Dividend yield
United States (S&P 500 Index)	2,169	→	2,100	-1.0	4%	-7%	2.2%
Europe (Stoxx Europe 600 Index)	341	→	330	0.2	4%	-8%	3.5%
Eurozone (Euro Stoxx 50 Index)	2,979	→	2,900	1.3	2%	-4%	3.9%
Germany (Dax)[1]	10,248	→	10,300	0.5	-1%	-2%	3.2%
United Kingdom (FTSE 100 Index)	6,724	↘	6,200	-4.3	7%	-13%	3.4%
Switzerland (Swiss Market Index)	8,227	→	8,150	2.4	4%	-4%	3.4%
Japan (MSCI Japan Index)	785	↗	800	4.2	-1%	3%	2.3%
MSCI Emerging Markets Index (USD)	871	→	830	-2.2	3%	-4%	2.4%
MSCI AC Asia ex Japan Index (USD)	528	→	500	-3.0	1%	-3%	2.4%
MSCI EM Latin America Index (USD)	2,360	↘	2,100	-8.8	18%	-24%	2.2%

* Source: Bloomberg Finance L.P.; as of 7/26/16
** Expected total return includes interest, dividends and capital gains where applicable
F refers to our forecasts as of 7/7/16.
[1] Total-return index (includes dividends)
Source: Deutsche Asset Management Investment GmbH; as of 7/26/16

How we calculate our index targets

We base our index-target calculations on the current index level, on the expected development of the price-earnings (P/E) ratio and on corporate earnings growth forecasts. A rising P/E ratio and rising earnings of the index companies typically result in a higher price target, whereas a declining P/E ratio and declining earnings typically result in a lower price target. The P/E ratio depends, among other things, on the interest-rate environment, the growth outlook and market participants' risk assessments.



Source: Deutsche Asset Management Investment GmbH; as of 07/2016

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The Chief Investment Office …

… is headed by Stefan Kreuzkamp, Global CIO Deutsche Asset Management

… plays a central role in Deutsche Asset Management's investment process

… brings together the expertise of the global investment platform to create a consistent economic and market view

… serves as a point of contact between the portfolio management, the research teams and the distribution teams

… prepares our global investment outlook: the CIO View.

> *"Our broad geographic and thematic reach allows us to offer sector-leading assessment and analysis across all asset classes."*
>
> Stefan Kreuzkamp, Chief Investment Officer

Deutsche Asset Management[1]…

… is one of the world's leading investment management organizations with about EUR 719 billion of assets under management (as of June 30, 2016)

… offers individuals and institutions traditional and alternative investments across all major asset classes

… provides flexible products and solutions to a wide range of investment opportunities across all asset classes – from pooled funds to highly customized portfolios for a wide range of investors.

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Glossary

» Here we explain central terms from the CIO | VIEW. «

(Euro) core – The core is a central or very important part of a region. In the context of the Eurozone, core refers to countries like Germany or France.

(Euro) periphery – Periphery countries are less developed than the core countries of a specific region. In the Eurozone, the euro periphery consists of the economically weaker countries such as Greece, Portugal,Italy, Spain and Ireland.

Article 50 of the Lisbon Treaty – Article 50 of the Lisbon Treaty governs the withdrawal of a member state from the European Union.

Banca d'Italia – The Banca d'Italia is the central bank of Italy.

Bank of England (BoE) – Founded in 1694, the Bank of England (BoE) is the central bank of the United Kingdom.

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

Basis point (bp) – One basis point (bp) equals 1/100 of a percentage point.

BofA Merrill Lynch Euro Non-Financial High Yield Constrained Index – The BofA Merrill Lynch Euro Non-Financial High Yield Constrained Index tracks the performance of euro-denominated below investment-grade corporate debt publicly issued in the eurobond or euro-domestic markets by non-financial issuers, capping issuer exposure at 3%.

Bottom-Up – A bottom-up investor starts with the analysis of specific businesses (financial statements, competitors, markets) and works his way up to industries and sectors, finally arriving at an overall view of the economy.

Brexit – Brexit is a combination of the words "Britain" and "Exit" and describes the possible exit of the United Kingdom from the European Union.

Bunds – Bunds are issued by Germany's federal government, most frequently with a maturity of 10 years, and are the German equivalent of U.S. Treasury bonds.

Capital expenditure (capex) – Capital expenditure (CapEx) are funds used by a company to acquire or upgrade physical assets such as property, industrial buildings or equipment.

Carry (strategy) – Carry is a trading strategy that involves borrowing at a low interest rate and investing in an asset that provides a higher rate of return.

Commodity trading advisor (CTA) – A commodity trading advisor (CTA) is an individual or organization providing advice and services related to trading in futures contracts, commodity options and/or swaps.

Contrarian – Contrarian investing is an investment strategy that is characterized by positioning oneself in the opposite direction of prevailing sentiment.

Corporate governance – Corporate governance refers to the mechanisms, processes and relations by which corporations are controlled and directed.

Corporate-sector purchase programme (CSPP) – The corporate-sector purchase programme (CSPP) is an ECB program to buy corporate bonds of issuers from the Eurozone. It aims to improve the financing conditions of corporations.

Correlation – Correlation is a statistical measure of how two securities move in relation to each other.

Discretionary macro strategy – Discretionary macro strategy is the most flexible global macro trading strategy deploying directional positions at the asset-class level to exploit macroeconomic, policy or political changes.

Earnings per share – Earnings per share is calculated as a companies' net income minus dividends of preferred stock all divided by the total number of shares outstanding.

Economic price-to-earnings (Economic P/E) ratio – The Economic price-to-earnings (Economic P/E) ratio is the CROCI's adjusted P/E ratio, based on economic data rather than the traditional accounting data. It can be thought of as the ratio of a company's Tobin's Q (market value of total assets over the economic replacement value of those assets) to its real cash return on the total economic assets.

Emerging markets (EM) – An emerging market (EM) is a country that has some characteristics of a developed market in terms of market efficiency, liquidity and other factors, but does not meet standards to be a developed market.

EUR/USD – EUR/USD is an abbreviation for the relationship between the euro and the U.S. dollar.

Euro (EUR) – The euro (EUR) is the common currency of the Eurozone states and is the second most important reserve currency in the world after the U.S. dollar.

European Central Bank (ECB) – The European Central Bank (ECB) is the central bank for the Eurozone.

European Union (EU) – The European Union (EU) is a unique economic and political partnership between 28 European countries covering much of the continent, which developed from the European Economic Community (EEC), created in 1958 by six countries.

Eurosystem – The Eurosystem comprises the European Central Bank and the national central banks (NCBs) of those countries that have adopted the euro.

Eurozone – The Eurozone, also called the euro area, is a monetary union of 19 of the 28 European Union member states which have adopted the euro as their common currency.

Free cash flow (FCF) – Free cash flow (FCF) is a measure of financial performance calculated as operating cash flow minus capital expenditures. It shows how much cash a company is able to generate after deducting the money required to maintain or expand its asset base.

Global Industry Classification Standard (GICS) – The Global Industry Classification Standard (GICS) is a four-tiered scheme to hierarchically classify firms by the sector and industry these firms primarily operate in.

Gross domestic product (GDP) – The gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period.

Gross national product (GNP) – The Gross National Product (GNP) includes GDP plus any income earned by residents from overseas investments minus income earned within the domestic economy by overseas residents.

Hedge fund – Hedge funds are alternative, less regulated investment vehicles using pooled funds that may use a number of different strategies in order to earn active return for their investors.

Helicopter money – Helicopter money refers to a large sum of money being directly or indirectly distributed to the public by the central bank in order to stimulate the economy.

High-yield (HY) bonds – High-yield (HY) bonds are issued by issuers with a below-investment-grade rating and often times offer a relatively high yield to compensate for the increased risk.

iBoxx Euro Corporate Index – The iBoxx Euro Corporate Index includes euro-denominated corporate bonds issued by investment-grade-rated entities.

Inflation – Inflation is the rate at which the general level of prices for goods and services is rising and, subsequently, purchasing power is falling.

International Monetary Fund (IMF) – The International Monetary Fund (IMF), created in 1945 and headquartered in Washington, D.C., is an organization of 188 countries, working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world.

Investment Grade (IG) – An investment-grade (IG) rating by a rating agency such as Standard & Poor's indicates that a bond has a relatively low risk of default.

J.P. Morgan Corporate Emerging Markets Bond Composite Blended Spread Index – The J.P. Morgan Corporate Emerging Markets Bond Composite Blended Spread Index depicts the spread of U.S.-dollar-denominated corporate bonds issued by entities in the emerging markets vs. U.S. Treasuries of the same maturity.

J.P. Morgan Emerging Markets Bond Global Diversified Sovereign Spread Index – The J.P. Morgan Emerging Markets Bond Global Diversified Sovereign Spread Index depicts the spread of U.S.-dollar-denominated sovereign bonds from the emerging markets vs. U.S. Treasuries of the same maturity. The "Diversified" index methodology limits the weights of those index countries with larger debt stocks.

Liquidity – Liquidity refers to the degree to which an asset or security can be bought or sold in the market without affecting the asset's price and to the ability to convert an asset to cash quickly.

Median – In statistics and probability theory, a median is the number separating the higher half of a data sample, a population, or a probability distribution, from the lower half.

Mergers and acquisitions (M&A) – Mergers and acquisitions (M&A) are two key methods of corporate consolidation: A merger is a combination of two companies to form a new company, while an acquisition is the purchase of one company by another in which no new company is formed.

Momentum – Momentum in general refers to prices continuing to trend. The momentum and rate of change (ROC) indicators show trend by remaining positive while an uptrend is sustained, or negative while a downtrend is sustained.

Monetary union – A monetary union consists of multiple countries sharing the same currency.

MSCI AC World Index – The MSCI AC World Index captures large- and mid-cap companies across 23 developed- and 23 emerging-market countries.

MSCI AC World ex U.S. Index – The MSCI AC World ex U.S. Index captures large- and mid-cap companies across 22 developed- and 23 emerging-market countries, excluding the United States.

MSCI Emerging Markets Index – The MSCI Emerging Markets Index captures large- and mid-cap representation across 23 emerging-market countries.

MSCI Japan Index – The MSCI Japan Index is designed to measure the performance of the large- and mid-cap segments of the Japanese market.

MSCI World Index – The MSCI World Index captures large and mid-cap representation across 23 developed-market countries.

Multi asset – Multi asset determines investing in more than one asset class, thus creating a group or portfolio of assets with varying weights and types of classes. The diversification of an overall portfolio is thus increased, and risk (volatility) reduced.

Negative convexity – Negative convexity is a characteristic mainly of callable bonds. Most bonds' price reaction to yield changes follow a convex curve, implying that the bond price reacts less to a yield change at higher yields (and more at lower yields) than a linear curve would suggest. The opposite holds true for negative convexity: the bond price reacts less to yield changes at lower yields than a linear function would suggest.

Non-performing loans (NPLs) – Non-performing loans (NPLs) are loans on which scheduled payments have not been made for (usually) at least 90 days.

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

Pound sterling (GBP) – The pound sterling (GBP), or simply the pound, is the official currency of the United Kingdom and its territories.

Price-to-earnings (P/E) ratio – The price-to-earnings (P/E) ratio or multiple measures a company's current share price relative to its per-share earnings.

Quantitative easing (QE) – Quantitative easing (QE) is an unconventional monetary-policy tool, in which a central bank conducts broad-based asset purchases.

Real Estate Investment Trust (REIT) – A Real Estate Investment Trust (REIT) is a company that owns and, in most cases, operates income-producing real estate. REITs sell like a stock on the major exchanges and invest in real estate directly, either through properties or mortgages.

Risk aversion – Risk aversion is a characteristic of investors to prefer the asset with lower risk and thus accept a lower potential yield.

Risk premium – The risk premium is the expected return on an investment minus the return that would be earned on a risk-free investment.

S&P 500 Index – The S&P 500 Index includes 500 leading U.S. companies capturing approximately 80% coverage of available U.S. market capitalization.

Small cap – Small-cap firms have a relatively small market capitalization, generally between $300 million and $2 billion (the cutoffs vary between regions and over time, however).

Spread – The spread is the difference between the quoted rates of return on two different investments, usually of different credit quality.

Stoxx Europe 600 Index – The Stoxx Europe 600 Index is an index representing the performance of 600 listed companies across 18 European countries.

TARGET2 – TARGET2 is the payment system for the execution of cross-border payments between Eurozone countries.

Targeted longer-term refinancing operations (TLTROs) – The ECB's targeted longer-term refinancing operations (TLTROs), announced in June 2014, are designed to enhance the functioning of the monetary-policy transmission mechanism by supporting bank lending to the real economy.

Tightening cycle – A monetary-policy tightening cycle is a period of time during which a central bank raises interest rates with the aim of slowing GDP growth or inflation.

Top-down – A top-down approach moves down from a broad analysis of the economic and investment environment to sector and regional analysis, finally arriving at specific companies to focus on.

U.K.'s EU Referendum – Referendum held on June 23, 2016 in which the citizens of UK voted for an exit of the UK from the EU, with a majority of 52%.

U.S. dollar (USD) – The U.S. dollar (USD) is the official currency of the United States and its overseas territories.

U.S. Federal Reserve Board (Fed) – The U.S. Federal Reserve Board (Fed) is the board of governors of the Federal Reserve System, the U.S. central bank. It implements U.S. monetary policy.

Volatility – Volatility is the degree of variation of a trading-price series over time.

West Texas Intermediate (WTI) – West Texas Intermediate (WTI) is a grade of crude oil used as a benchmark in oil pricing.

Japanese yen (JPY) – The Japanese yen (JPY) is the official currency of Japan.

Yield – Yield is the income return on an investment referring to the interest or dividends received from a security and is usually expressed annually as a percentage based on the investment's cost, its current market value or its face value.

Risk warning

Investments are subject to investment risk, including market fluctuations, regulatory change, possible delays in repayment and loss of income and principal invested. The value of investments can fall as well as rise and you might not get back the amount originally invested at any point in time.

Investments in Foreign Countries – Such investments may be in countries that prove to be politically or economically unstable. Furthermore, in the case of investments in foreign securities or other assets, any fluctuations in currency exchange rates will affect the value of the investments and any restrictions imposed to prevent capital flight may make it difficult or impossible to exchange or repatriate foreign currency.

Foreign Exchange/Currency – Such transactions involve multiple risks, including currency risk and settlement risk. Economic or financial instability, lack of timely or reliable financial information or unfavorable political or legal developments may substantially and permanently alter the conditions, terms, marketability or price of a foreign currency. Profits and losses in transactions in foreign exchange will also be affected by fluctuations in currency where there is a need to convert the product's denomination(s) to another currency. Time zone differences may cause several hours to elapse between a payment being made in one currency and an offsetting payment in another currency. Relevant movements in currencies during the settlement period may seriously erode potential profits or significantly increase any losses.

High Yield Fixed Income Securities – Investing in high yield bonds, which tend to be more volatile than investment grade fixed income securities, is speculative. These bonds are affected by interest rate changes and the creditworthiness of the issuers, and investing in high yield bonds poses additional credit risk, as well as greater risk of default.

Hedge Funds – An investment in hedge funds is speculative and involves a high degree of risk, and is suitable only for "Qualified Purchasers" as defined by the US Investment Company Act of 1940 and "Accredited Investors" as defined in Regulation D of the 1933 Securities Act. No assurance can be given that a hedge fund's investment objective will be achieved, or that investors will receive a return of all or part of their investment.

Commodities – The risk of loss in trading commodities can be substantial. The price of commodities (e.g., raw industrial materials such as gold, copper and aluminium) may be subject to substantial fluctuations over short periods of time and may be affected by unpredicted international monetary and political policies. Additionally, valuations of commodities may be susceptible to such adverse global economic, political or regulatory developments. Prospective investors must independently assess the appropriateness of an investment in commodities in light of their own financial condition and objectives. Not all affiliates or subsidiaries of Deutsche Bank Group offer commodities or commodities-related products and services.

Investment in private equity funds is speculative and involves significant risks including illiquidity, heightened potential for loss and lack of transparency. The environment for private equity investments is increasingly volatile and competitive, and an investor should only invest in the fund if the investor can withstand a total loss. In light of the fact that there are restrictions on withdrawals, transfers and redemptions, and the Funds are not registered under the securities laws of any jurisdictions, an investment in the funds will be illiquid. Investors should be prepared to bear the financial risks of their investments for an indefinite period of time.

Investment in real estate may be or become nonperforming after acquisition for a wide variety of reasons. Nonperforming real estate investment may require substantial workout negotiations and/ or restructuring.

Environmental liabilities may pose a risk such that the owner or operator of real property may become liable for the costs of removal or remediation of certain hazardous substances released on, about, under, or in its property. Additionally, to the extent real estate investments are made in foreign countries, such countries may prove to be politically or economically unstable. Finally, exposure to fluctuations in currency exchange rates may affect the value of a real estate investment.

Structured solutions are not suitable for all investors due to potential illiquidity, optionality, time to redemption, and the payoff profile of the strategy. We or our affiliates or persons associated with us or such affiliates may: maintain a long or short position in securities referred to herein, or in related futures or options, purchase or sell, make a market in, or engage in any other transaction involving such securities, and earn brokerage or other compensation. Calculations of returns on the instruments may be linked to a referenced index or interest rate. In such cases, the investments may not be suitable for persons unfamiliar with such index or interest rates, or unwilling or unable to bear the risks associated with the transaction. Products denominated in a currency, other than the investor's home currency, will be subject to changes in exchange rates, which may have an adverse effect on the value, price or income return of the products. These products may not be readily realizable investments and are not traded on any regulated market.

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