Deutsche Asset
& Wealth Management

Europe, Middle East & Africa Edition
July 2015

CIO View

Economic growth

Slow sailing ahead?

Marketing Material

Nine positions

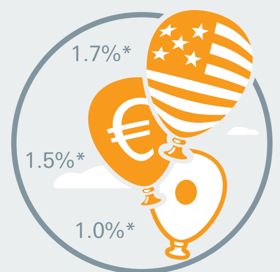
Our key forecasts

Global economy remains on a solid growth path.

*Global gross domestic product (GDP) growth 2015; Deutsche AWM forecast as of 6/16/15

Developed economies' growth could flatten out over the medium term.

Inflation is slowly rising in the developed economies.



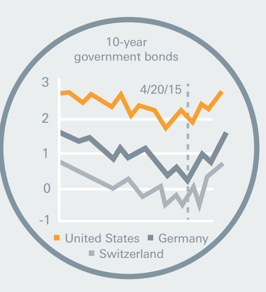
*Inflation rate 2016 (United States, Eurozone and Japan); Deutsche AWM forecast as of 6/16/15

Low commodity prices lead to growth differentials between emerging markets.

GDP growth 2015 (top: China, India; bottom: Brazil, Russia); Deutsche AWM forecast as of 6/16/15

Greece and expectations of rising U.S. interest rates drive volatility.

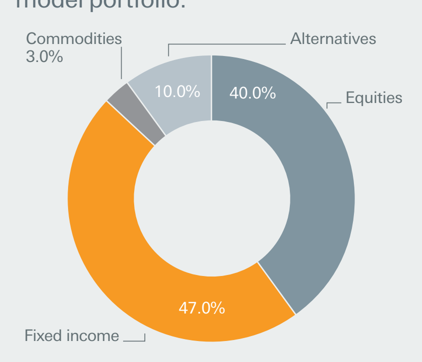
The interest-rate trend is reversing; threat of economic setbacks persists.



German real estate is still attractive.

"Mix it up:" active multi-asset management remains trump card.

Asset allocation of our balanced model portfolio:



Important terms are explained in our glossary.
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Source: Deutsche Asset & Wealth Management Investment GmbH, as of 6/19/15

Letter to investors

12 months in 12 months' time

Where capital markets stand in 12 months will depend on expectations then and not today's expectations. But we can be reasonably certain that central bank support will fade.

“Nobody over the last fifty years, not the International Monetary Fund (IMF), not the U.S. Treasury, has predicted any of the recessions a year in advance, never.”[1] Don’t worry! I do not quote Lawrence Summers to indicate that I believe a recession is coming. Our recent strategy meeting has not changed our expectations for accelerated global growth in 2016. Nevertheless, this statement came to my mind during this meeting where we usually issue our 12-month forecast – a particularly challenging task this time because we expect the key market driver, official rates, to be disrupted. Within these twelve months we are likely to experience the first interest-rate hike by the Federal Reserve (Fed). After these twelve months, we might experience a policy reversal by the European Central Bank (ECB). The point is: Where equities and rates stand in June 2016, does not depend on the economy and central-bank action until June 2016 but on the markets' expectations for the quarters to come. Although everyone knows that investors always anticipate, it does not cease to surprise people. Just take quantitative easing (QE): Almost in an act of defiance, euro periphery spreads widened, exactly when the ECB started its asset purchases in March. Bunds at least waited for a two week grace period before tumbling. European equities weakened from April onwards.

> “We are still on the dance floor. But we move more slowly, like a turtle.”

What counts are expectations not facts. So where will we stand one year from now? Which current expectations will become facts, and what could we expect then? The Fed should have cautiously hiked interest rates by then, while the ECB might start to think about continuing, suspending or tapering QE in September. Tailwinds from the central banks could thus turn into gentle headwinds. The U.S. dollar should have peaked, and all eyes will be set on the U.S. economy and signs of a slower pace or shift in direction. This could support the euro unless it still suffers from the effects of a half-baked solution to the Greek crisis. If the European labor market continues to improve alongside that of the United States, fears of inflation might emerge again, and also be fueled by a Chinese economic rebound. There is also the possibility that everything could point to lower potential and economic growth in the industrial states by then.

Compared to our current 12-month view, the outlook in twelve months' time will be gloomier, at least from the standpoint of support by central bank policies, and as for economic growth, it will be neutral at best. As a result, our yield forecasts are rather modest. In face of continuing risks such as Grexit, Brexit, rising interest rates, ISIS and the Ukraine conflict, nobody could be blamed for increasing cash positions – and to stop dancing before the last tone fades away. But as for the time being we still like moderate yields and economic growth rates, we will keep dancing. But at a slower pace, like a turtle.

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

[1] Lawrence Summers at the World Economic Forum in Davos, 1/22/15

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Focus

Slow sailing ahead?

Trend growth appears to be slowing in the industrialized world. Is this development temporary or permanent?

In 1938, Alvin Hansen, a professor of economics at Harvard, argued that the American economy's growth would slow further or even turn negative due to slower population growth and the uneven distribution of income.[1] The consequences would be long-term unemployment, declining investment and negative interest rates. This thesis disappeared with World War II and the solid growth rates that followed.

Now – six years after the severe financial crisis – Hansen's thesis of secular stagnation crops up again. It was revived by economist Lawrence H. Summers. Population is stagnating or shrinking in many industrialized countries, while a redistribution of income to wealthier households has taken place. Households with higher income generally have lower consumption rates. Both factors account for an overall decline in demand.

Due to the slack demand, returns on investment are very poor. This prevents companies from investing. The supply of capital thus exceeds the low demand for capital, leading to falling rates. In order to strike a new balance, real interest rates must decline to match lower returns on investment. Since inflation rates are very low or even negative and nominal rates cannot fall far below zero, there is hardly any scope for a further decline of interest rates. This means that real interest rates are still too high, further aggravating the problem of tepid investment levels. The outcome: due to low investment, the capital stock is growing slowly, and potential economic growth is weakening in the longer term.

Former Fed chairman Ben Bernanke is a critic of the thesis of secular stagnation.[2] He argues that the number of profitable investments will rise in line with declining real rates. Under his chairmanship, the Fed managed to push real rates on government bonds below zero for quite a while, turning almost any investment profitable. Bernanke starts from the assumption that capital can always be spent in a profitable way. And if the domestic economy does not offer any rewarding investment, capital will be transferred abroad.

Debt as a handicap for growth

Whereas interest rates hold centre stage for Summers and Bernanke, Kenneth Rogoff focuses on debt.[3] He blames elevated debt levels for triggering the financial crisis. The first response would be to reduce them, with the consequence of lowering demand. A new credit cycle cannot be started before companies and private households have cleaned up their balance sheets. Debt levels clearly show that household debt is approaching its long-term growth trend again. This would indicate that the cleaning up of balance sheets is gradually coming to an end.

All these explanations of weak growth focus on the demand side. The supply side has not featured prominently in the debate so far. However, this side – where production resides – is key in the long run. Technological progress and demographics will determine the future level of growth.

Supply-side growth pessimists are faced by optimists for growth who point out that periodic waves of innovation have always come about and should continue to do so. Technological progress has been a permanent driver of growth. Digitalization, the development of new materials, biogenetics and others allow us to expect further waves in the future. Demographics will, however, be a handicap. History shows that population growth has always entailed a growing gross domestic product (GDP).[4] If national population numbers stagnate or dwindle, technological progress gets even more important. Progress can even overcompensate for population decline if it develops far enough. In the face of low birth rates and an ageing population, industrial countries need immigration and innovation to achieve long-term growth.

[1] Source: Hansen, A.H.: Economic Progress and Declining Population Growth. American Economic Review 29 (I), 1939
[2] Source: Bernanke, B.: Why are interest rates so low (Part 2). Ben Bernanke's Blog in Brookings. 3/31/15
[3] Source: Rogoff, K.: Debt supercycle, not secular stagnation. VOX CEPR's Policy Portal, 4/22/15
[4] Source: Berry, C.: The relationship between economic growth and population growth. Sheffield Political Economy Research Institute, September 2014

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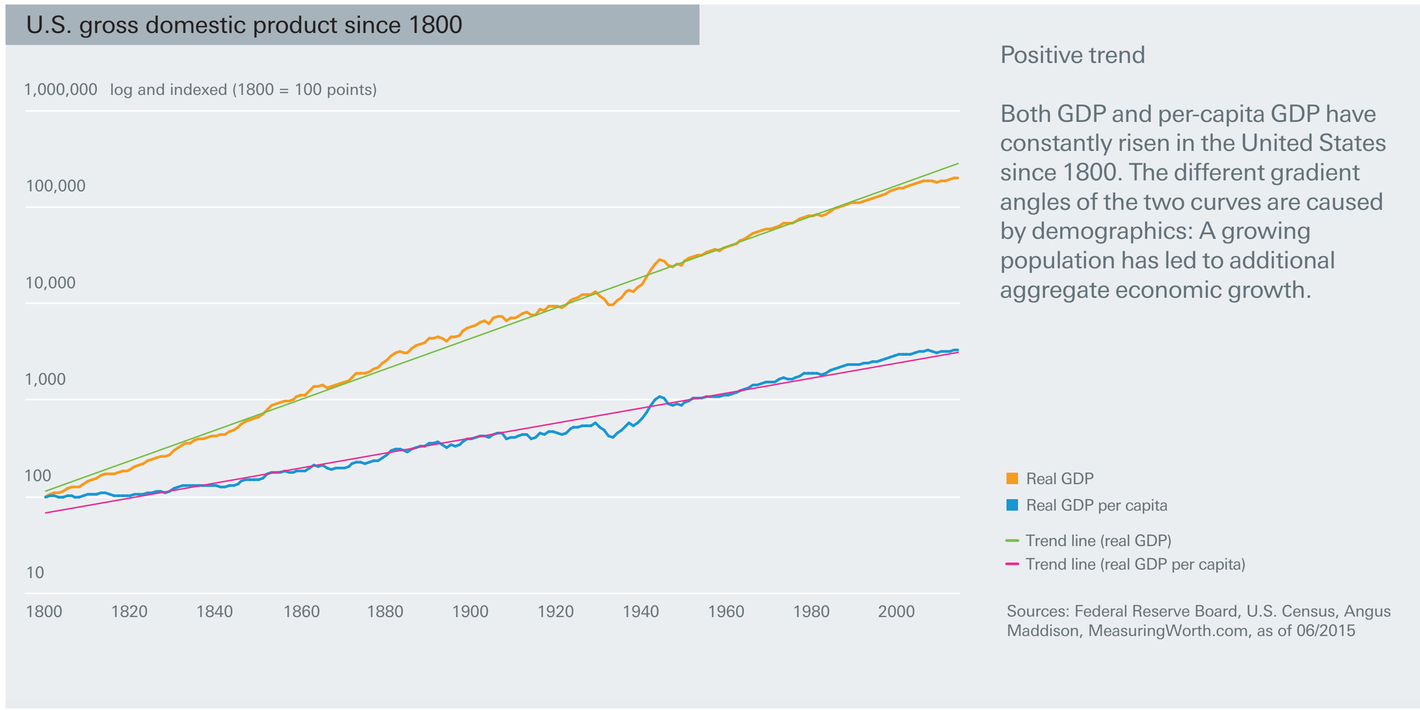
U.S. gross domestic product since 1800



Sources: Federal Reserve Board, U.S. Census, Angus Maddison, MeasuringWorth.com, as of 06/2015

Positive trend

Both GDP and per-capita GDP have constantly risen in the United States since 1800. The different gradient angles of the two curves are caused by demographics: A growing population has led to additional aggregate economic growth.

Changes of population and GDP per capita in the United States

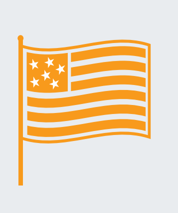
160 in %
140
120
100
80
60
40
20
0
-20
-40
1800 1820 1840 1860 1880 1900 1920 1940 1960 1980 2000

- Changes of real GDP per capita (annualized 10-year average)
- Changes of population (annualized 10-year average)

Sources: Federal Reserve Board, U.S. Census, Angus Maddison, MeasuringWorth.com, as of 06/2015

Major trends

Technological progress triggered a long-term boost of GDP per capita in the United States. Cyclical fluctuations or a war as in the years of 1942 to 1945 only shortly interfere with the long-term effects of technological progress. Since the growth trend of GDP per capita and the population have declined over more than four decades in the United States, there are growing fears that the economic momentum is running out of steam.



United States (GDP growth in %)

The U.S. economy is set to pick up next year. We forecast an acceleration of growth by 0.7 percentage points in 2016.

3.1 %* (2016 F)

*Deutsche AWM forecast as of 6/16/15

"We live in a 21st century economy that rewards knowledge and innovation like never before."

Barack Obama, U.S. president, remarks at Lake Area Technical Institute on 5/8/15

World (GDP growth in %)

The global economy is gaining momentum. The main thrust comes from Asia.

3.8 %* (2016 F)

*Deutsche AWM forecast as of 6/16/15

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The big picture

Our strategic forecasts

"Deflation risk is low in the Eurozone. Inflation should accelerate alongside economic growth in the Eurozone next year."

Asoka Wöhrmann, Chief Investment Officer

Economic data

GDP growth in percent (year-on-year)

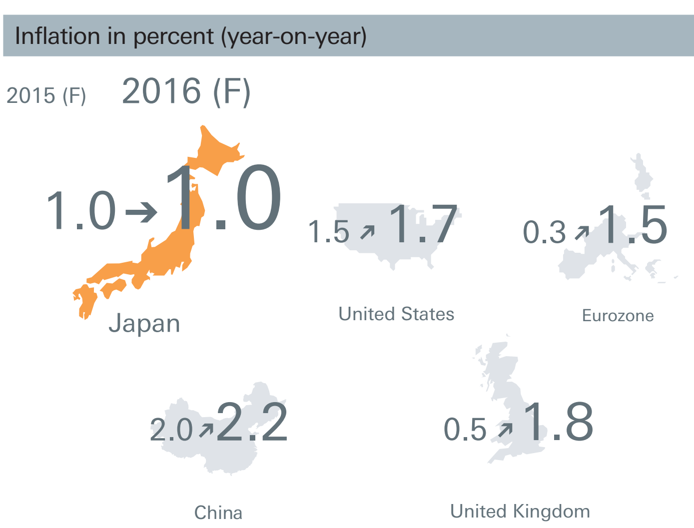
	2015 (F)		2016 (F)
United States	2.4	↗	3.1
Eurozone	1.4	↗	1.6
United Kingdom	2.3	↘	2.2
Japan	1.2	→	1.2
China	6.8	→	6.8
World	3.5	↗	3.8

United States (GDP growth in %)

2.4% ↗ 3.1 %
(2015F) (2016F)

Due to weaker growth in the first quarter of 2015, we revised down our U.S. growth forecast for 2015. After this temporary soft patch, the U.S. economy should gain traction again.

Inflation in percent (year-on-year)



Japan's government hopes for more private consumption. Its acceleration has been lukewarm at best. Inflation should thus remain below the Bank of Japan's target rate of 2%.

F refers to forecasts. Our 2015 and 2016 forecasts are as of 6/16/15.

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Capital markets

Equity markets (index value in points)

	Current*		June 2016 (F)	▲(%)**
United States (S&P 500 Index)	2,100	↗	2,160	5
Europe (STOXX Europe 600 Index)	384	↗	410	10
Eurozone (EURO STOXX 50 Index)	3,429	↗	3,850	16
Germany (DAX)[1]	10,978	↗	12,400	13
United Kingdom (FTSE 100 Index)	6,681	↗	6,800	5
Japan (MSCI Japan Index)	1,002	↗	1.050	7
MSCI Emerging Markets Index (in U.S.	969	↗	990	5
MSCI AC Asia ex Japan Index (in U.S.	589	↗	630	10
MSCI EM Latin America (in U.S. dollars)	2,533	↘	2,300	-6

Eurozone (EURO STOXX 50 Index)

3.429 ↗ 3.850

(Current*) (June 2016F)

Economic recovery should continue, and the euro weaken again. Both these factors should help Eurozone companies to improve their earnings.

Capital market yields (sovereign bonds) in percent

	Current***		June 2016 (F)
United States, 2-year	0.68	↗	1.35
United States, 10-year	2.37	↗	2.50
United States, 30-year	3.15	→	3.10
Germany, 2-year	-0.20	↗	0.00
Germany, 10-year	0.84	↗	1.10
United Kingdom, 10-year	2.13	→	2.25
Japan, 2-year	0.00	→	0.00
Japan, 10-year	0.46	→	0.45

Germany, 10-year

0.84% ↗ 1.10%

(Current***) (June 2016F)

Bund yields are currently depressed by ECB asset purchases. As first signs of QE ending could emerge in mid-2016, we expect gradually rising yields.

F refers to forecasts. Our 2015 and 2016 forecasts are as of 6/16/15.
* Source: Bloomberg Finance L.P., as of 6/17/15
** Expected total return includes interest, dividends and capital gains where applicable
*** Source: Bloomberg Finance L.P., as of 6/24/15
[1] Total-return index (includes dividends)

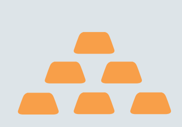
Commodities in U.S. dollars

	Current*		June 2016 (F)	▲(%)**
Crude oil (WTI)	60	↗	70	17
Gold	1,186	↗	1,250	5
Silver	16	↗	19	18
Copper (LME)	5,745	↗	6,700	17
Aluminium (LME)	1,705	↗	1,800	6

Silver

16 ↗ 19

(Current*) (June 2016F)



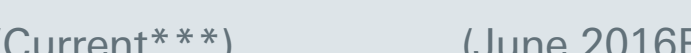
Silver is both, a precious and an industrial metal. Silver prices should be boosted by central-bank balance-sheet growth and a gradual economic recovery.

Benchmark rates in percent

	Current***		June 2016 (F)
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 States (federal funds rate)

0 - 0.25% ↗ 0.75 - 1.00%



(Current***) (June 2016F)

The U.S. labor market continues to improve, and private consumption is doing well. September therefore continues to be the most likely month for a first Fed rate hike.

Currencies

	Current***		June 2016 (F)	▲(%)**
EUR vs. USD	1.12	↘	1.00	–11
USD vs. JPY	123.85	↗	130	5
EUR vs. CHF	1.05	→	1.02	-3
GBP vs. USD	1.57	↘	1.49	-5
USD vs. CNY	6.21	→	6.21	0

EUR vs. USD

1.12 ↘ 1.00

(Current***) (June 2016F)

$/€

We expect official rates to rise in the United States by mid-2016 whereas they should stay low in the Eurozone for a while. This argues in favor of a lower EUR/USD rate.

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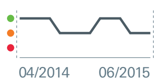
Investment traffic lights

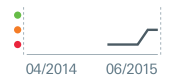
Our tactical and strategic view

Eurozone (equities)



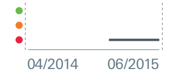
We stay neutral on Eurozone equities. The last quarterly earnings season proved strong enough to avoid negative earnings revisions, unlike in the United States. In the short term, however, a strengthening euro, fewer inbound fund flows and Greece weigh on equities. We are waiting for the right time to increase our positions.

United Kingdom (equities)



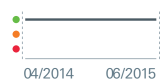
British equities also remain neutral. The Conservative party's election win as well as stabilizing commodity prices are already reflected in stock-market prices, which have trended sideways almost since year start anyways.

Latin America (equities)



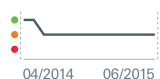
Latin America is currently the only region we are underweighting from a tactical perspective. Earnings forecasts have been cut by more than a third in the past four months. Especially in Brazil, an economic improvement seems to be far away.

Consumer discretionary (equities)



We remain overweight cyclical consumer stocks, mainly based on confident consumers in the United States and Europe. We are, however, cautious on luxury brands – including auto makers – that have already or are likely to be affected by Beijing's fight on corruption.

Small and mid cap (equities)



While we remain neutral on small and mid caps from a global perspective, we are positive on this segment in Europe. Despite an attractive economic environment for the asset class, valuation compared to large caps is not excessive and offers further opportunities.

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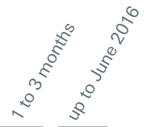
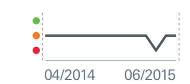


Equities*	1 to 3 months	up to June 2016
Regions		
United States	● (orange)	↗
Europe	● (orange)	↗
Eurozone	◉ (orange)	↗
Germany	● (orange)	↗
United Kingdom	◉ (orange)	↗
Japan	● (orange)	↗
Emerging markets	● (orange)	↗
Asia ex Japan	● (green)	↗
Latin America	◉ (red)	↘
Sectors		
Consumer staples	● (red)	
Healthcare	● (red)	
Telecommunications	● (orange)	
Utilities	● (red)	
Consumer discretionary	◉ (green)	
Energy	● (orange)	
Financials	● (green)	
Industrials	● (orange)	
Information technology	● (green)	
Materials	● (orange)	
Style		
Small and mid cap	◉ (orange)	

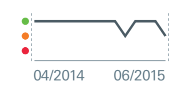
*Source: Deutsche Asset & Wealth Management Investment GmbH, as of 6/17/15

U.S. Treasuries (2-year)



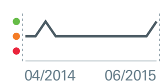
We stick to our neutral weighting on 2-year U.S. Treasuries trying to avoid risk exposure ahead of the first Fed rate hike. While we still see September as the single most likely month for this to happen, the Fed's tone in its June meeting has been slightly tilted to the, cautious side. Volatility in both directions could lead to short-term trading opportunities in this asset class.

Eurozone periphery

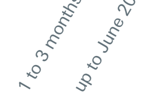


We reduce periphery sovereign bonds to neutral in order to stay away from any negative surprises while Greece still dominates the headlines and also the spread development. With any agreement proving very elusive, this threatens skepticism in the medium term.

Emerging-market credit



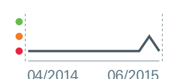
We increase emerging-market credit tactically to overweight. While prices can err on both sides of our target range, we generally believe in a spread tightening. This is not likely to play out evenly over the entire asset class, making a thorough selection of countries, sectors and companies mandatory. The Fed's recent dovish tone underpins this assessment.



Fixed income**	1 to 3 months	up to June 2016
Rates		
U.S. Treasuries (2-year)	● orange (circled)	↗ red
U.S. Treasuries (10-year)	● orange	↗ red
U.S. Treasuries (30-year)	● green	→ orange
U.K. Gilts (10-year)	● orange	→ orange
Eurozone periphery	● orange (circled)	↘ green
German Bunds (2-year)	● orange	↗ red
German Bunds (10-year)	● orange	↗ red
Japanese government bonds (2-year)	● orange	→ orange
Japanese government bonds (10-year)	● orange	→ orange
Corporates		
U.S. investment grade	● green	↘ green
U.S. high yield	● orange	↘ green
EUR investment grade[1]	● orange	↘ green
EUR high yield[1]	● orange	↘ green
Asia credit	● green	↗ red
Emerging-market credit	● green (circled)	↘ green
Securitized / specialties		
Covered bonds[1]	● orange	↘ green
U.S. municipal bonds	● green	↘ green
U.S. mortgage-backed securities	● orange	→ orange
Currencies		
EUR vs. USD	● red (circled)	↘ red
USD vs. JPY	● orange	↗ green
EUR vs. GBP	● orange	↘ red
EUR vs. JPY	● red	↘ red
GBP vs. USD	● orange	↘ red
Emerging markets		
Emerging-market sovereigns	● orange	↘ green
Alternatives*		
Infrastructure	● orange	↗ green
Commodities	● red	↗ green
Real estate (listed)	● orange	↗ green
Real estate (non-listed)	● green (circled)	↗ green
Hedge funds	● green	↗ green
Private Equity[2]	● green	→ orange

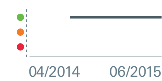
**Source: Deutsche Asset & Wealth Management Investment GmbH, as of 6/24/15

EUR vs. USD



We stick to our strategic view of further U.S. dollar strengthening, based on the interest-rate divergence and the low yield environment in the Eurozone in absolute terms. Tactically we do not see a lot that speaks for the euro, either, with noise surrounding the Greek development and repositioning of large investors adding to volatility.

Real estate (non-listed)



The low yield environment on the back of slowly improving macroeconomic data and international trade makes us stick to our overweight position in unlisted real estate. In the United States as well as in Europe and Japan we particularly see opportunities in office and commercial real estate.

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 June 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 expected move of the option-adjusted spread over U.S. Treasuries, if not stated differently. ↗ 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.

[1] Spread over German Bunds
[2] These traffic-light indicators are only meaningful for existing private-equity portfolios
Source: Deutsche Asset & Wealth Management Investment GmbH

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Portfolio

Our asset-class allocation in a balanced portfolio[1]

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.[2]

Equities

Over the medium and long term, we remain with our constructive view on equities. European markets have suffered a setback recently, triggered by the uncertainties surrounding Greece. The beginning of a Fed tightening cycle may also lead to some volatility. Nevertheless, at some point in the future setbacks may become potential buying opportunities. Emerging-market (EM) equities could well prove vulnerable to Fed rate rises and associated exchange-rate changes as EM corporations have significantly raised their leverage since 2007 and much of their debt is USD-denominated.

Fixed income

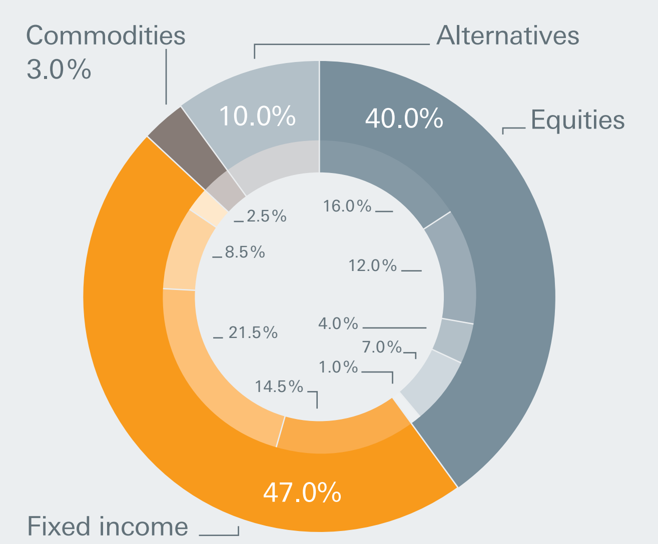
Anticipation of Fed rate hikes remains the dominant theme. We still expect these to start in September, but the upward path is likely to be a gentle one and it is possible that core government bond yields will overshoot before falling back again. In Europe, we believe that the ECB will continue its QE policy, but market uncertainty over its future policy direction could result in bouts of volatility, as could concerns about liquidity. We see continued potential in high-yield and emerging-market hard-currency debt, but see only limited room for further spread tightening in investment grade.

Commodities

Oil prices have risen slightly in recent months but remain more than 40 percent below year-earlier levels. Although U.S. shale production looks likely to fall back, supply from other sources remains ample and we still await evidence of a sustained increase in global demand. For this reason, we believe that any further rise in prices in coming months should be limited. In the absence of any sharp downturn in global growth, we think that gold prices will be range-bound, facing headwinds from a strengthening U.S. dollar.

[1] This portfolio may not be suitable for all investors.

Europe, Middle East & Africa



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	2.5%
Commodities	
Commodities	3.0%
Alternatives	
Alternatives	10.0%

Source: Regional Investment Committee (RIC), Deutsche Asset & Wealth Management Investment GmbH, Deutsche Bank (Suisse) SA, as of 6/19/15. Suggested allocation for USD-based investors. This allocation may not be suitable for all investors.
[2] Alternative investments are dealt with separately in the next chapter.

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Long or short, Stéphane Junod?

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

Will the Fed play a careful game on rate hikes?

LONG We still think the most likely date for the Fed to start raising rates is September. The economic environment is also likely to discourage an aggressive sequence of rate hikes. There is still some slack in the U.S. economy and inflation remains below target. Moreover, it is possible that the neutral real interest rate – the rate which allows the U.S. economy to grow at its trend rate – is lower than before the crisis. The Fed will be feeling its way, trying to gauge how resilient the U.S. economy really is.

Japan: more policy easing to come this year?

SHORT Japanese GDP growth was 3.9% annualized in the first quarter. Investment was a key driver but the news is positive on private consumption too. Business surveys also indicate that the domestic recovery is continuing and although second-quarter GDP growth may be less rapid, a further rise in quantitative and qualitative easing (QQE) is not expected in 2015. Look however for further structural reforms – if only in small steps – as the Trans-Pacific Partnership (TPP) has an increasing impact.

U.S. equities: time for caution?

LONG We are long-term positive on U.S. equities, but three factors keep us cautious in the short term. First, the Wilshire 5000 Total Market Index market capitalization (i.e. that of all stocks traded in the United States) is at its highest since 2000; previous highs have preceded falls in the equity markets. Second, share buyback levels remain high, but have recently slowed as has the third factor, mergers and acquisitions (M&A) activity: history suggests that both these developments can also foreshadow a market correction.

Eurozone equities: possible gain after pain?

LONG The promise of ECB QE – combined with signs of a European growth revival – resulted in major gains in European equities earlier this year. More recently, Eurozone equities have fallen back against a background of an upward move in European bond yields and some mixed economic data. But European corporate-earnings data was solid in the first quarter and looks likely to improve further in the second. We would view further market falls as possibly creating attractive entry points.

Do Chinese equities still appeal?

LONG Over the last few months, Chinese equities have made substantial gains – despite disappointing Chinese economic data. The market has assumed that poor macroeconomic data will lead to a yet more accommodative policy stance by the Chinese authorities. As importantly there have been structural changes within the Chinese market, notably the opening up of the Shanghai-Hong Kong "through train". Both these factors could continue to drive gains in the future – although you will need to be selective.

Is market volatility a temporary phenomenon?

SHORT Recent bouts of volatility were to be expected in the run up to the first Fed rate hike. They may also reflect changing inflation expectations – particularly in the Eurozone – and, to a lesser extent, fears that structural changes in some markets could decrease liquidity. With the situation unlikely to normalize quickly, it would be wise to expect further bouts of volatility in coming months.

LONG represents a positive answer
SHORT represents a negative answer

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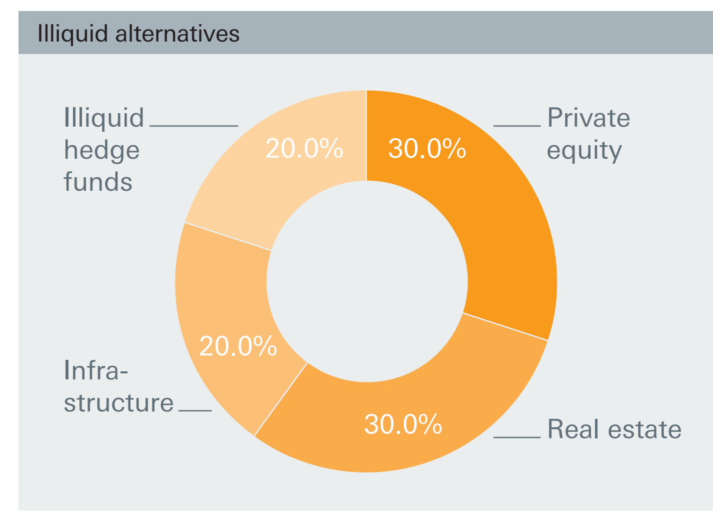
Portfolio

Our view of non-traditional asset classes

Alternatives portfolios

Due to their distinct characteristics, we take a differentiated look at selected liquid and illiquid alternative investments.[1]

Illiquid alternatives

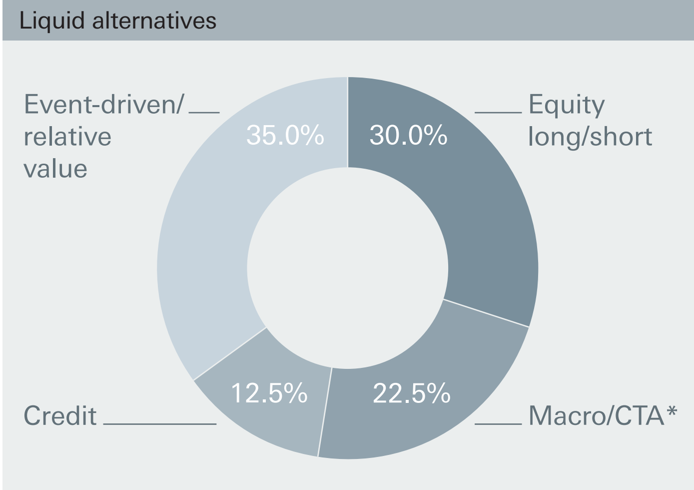


Liquid alternatives

Equity long/short and equity market neutral

In the equity long/short space, European-focused managers have continued to outperform their U.S. counterparts. They have been helped by the impact of ECB QE and positive European corporate earnings revisions, both of which helped create a tailwind for the European equity market overall. Even within the equity-market-neutral space, European-focused managers have fared better than U.S. or global-focused managers as stock returns within the various possible investment styles have shown healthy dynamics and dispersion. Short strategies by both traditional long/short equity managers and equity-market-neutral strategies should start producing more market outperformance as interest rates start to normalize. This has in the past resulted in more differentiated individual stock and equity sector returns, something that is likely to be broadly positive for such strategies.

Liquid alternatives



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Illiquid alternatives[2]

Real estate

Over the next year, U.S. real estate net operating income (NOI) growth is predicted to remain at healthy levels. Pro-cyclical sectors such as office and industrial real estate stand to benefit the most. We have also observed a significant decline in vacancy rates. Prime offices and shopping centers should fare particularly well in southern Europe. Trade flows into and within Europe are also set to rise, boosting demand for logistics space. In Asia, Japan continues to be a bright spot especially for logistics assets, but a few markets (such as Seoul central business district) have an excess supply of office space.

Private equity

Global investment activity, driven by buyout funds, totaled $41.3 billion in the first quarter of 2015, well below the $78.7 billion recorded in the previous quarter. Investment activity in both North America and Europe fell in the first quarter, from $31.8 billion to $19.9 billion and from $33.5 billion to $15.8 billion, respectively.[3] Half of European limited partnerships (LPs) and a third of North American LPs have aggregate commitments to private equity below their target allocations.[4] Investors, especially in North America, are on the lookout for good gas- and oil-focused private equity funds, given recent price developments.

Source: Deutsche Asset & Wealth Management Investment GmbH, Deutsche Bank AG Filiale London, as of 6/18/15
This allocation may not be suitable for all investors. In our balanced model portfolio, we currently allocate 10% to alternative investments (see "Portfolio").
[1] These portfolios may not be suitable for all investors.
[2] 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.
[3] Dealogic, M&A Analytics, as of 6/12/15
[4] Coller Capital, Global Private Equity Barometer Summer 2015, as of 6/12/15
* Commodity Trading Advisor

Long or short, Tim Gascoigne?

The head of Liquid Alternatives – Hedge Funds shares his outlook

Can discretionary macro strategies keep doing well?

LONG Diverging monetary policy between the Eurozone and the United States is likely to result in increased volatility across equities, fixed income, foreign exchange (FX) and commodities. So far in 2015 we have seen a number of clear themes that managers can trade around. These include quantitative easing (QE); exchange rate trends and their impact on equity sectors' earnings; equity-market relative-value (RV) trading based on the liquidity impact of the expected U.S. rate hike; yield-curve trading strategies driven by QE and then valuations. The persistence of these themes has allowed managers to set up, maintain and realize profits on positions rather than being forced out of them at the wrong times due to negative performance. We see the most significant opportunities as being in FX trading (in the near term), fixed-income trading (in the near and medium term) and equity RV trading (over all time frames).

Will equity-market-neutral strategies cope with a rise in U.S. interest rates?

LONG We like these strategies because this area is relatively uncrowded and should benefit from any uptick in equity-market volatility, which seems likely. In addition, certain macro-induced market dynamics (such as exchange-rate trends) can support the generation of market outperformance from fundamental analysis. Quantitative strategies are becoming more adept at generating credible signals on the basis of momentum and fundamental analysis. In summary, less correlated and more dispersed markets will help such strategies generate returns.

Are you generally positive on Commodity Trading Advisor (CTA) strategies for the remainder of 2015?

SHORT CTA strategies have had a roller-coaster performance ride over the last five months as trends have matured and in some cases broken. This has supported our neutral outlook for the strategy this year. From a fund selection point of view we would favor approaches that are diversified, run at lower levels of volatility and are not simply dependent on trend following.

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Could alternative-credit strategies be limited by credit markets trading sideways or downwards?

SHORT Many managers in this sector anticipated more difficult markets ahead in credit and have therefore restructured their approach into more of a relative-value framework. Capital-structure-arbitrage trades based on misvaluations between different components of the firm's capital structure are popular. Event-driven trades are also interesting where companies engaged in takeovers leverage up their balance sheets, impacting market value across the different levels of their capital structure.

Do you think hedge funds will deliver good returns during 2015?

LONG We remain constructive on hedge funds and think that overall returns this year are likely to be above the long-term average for this asset class. Good returns year to date have been driven by discretionary macro and event-driven managers.

LONG represents a positive answer
SHORT represents a negative answer

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Offers and sales of alternative investments are subject to regulatory requirements and such investments may be available only to investors who are "Qualified Purchasers" as defined by the U.S. Investment Company Act of 1940 and "Accredited Investors" as defined in Regulation D of the 1933 Securities Act. Alternative investments may be speculative and involve significant risks including illiquidity, heightened potential for loss and lack of transparency.

High-conviction ideas

Selected investment ideas to complement wealth-management clients' portfolios

Global Financials

New

Idea initiated
July 1, 2015

Reference measure
MSCI AC World Financials Index vs. MSCI AC World Index*

Investment horizon
3 – 12 months

Performance since initiation
n/a

Currently, the MSCI AC World Financials Index is trading at close to a 20% price-to-earnings (P/E) discount to the MSCI AC World Index. We believe that this discount is likely to narrow over time, with financial firms' improving balance-sheet quality resulting in rising dividends and share buybacks. The biggest risk is that a low-yield environment continues to limit returns. The recent increase in yields may reduce this. Another concern is the risk of increased regulation.

Indian equities

Idea initiated
May 1, 2015

Reference measure
CNX Nifty Index vs. cash**

Investment horizon
3 – 12+ months

Performance since initiation

Indian equities have struggled recently, not helped by disappointing first-quarter earnings, the oil-price recovery and some disappointing macroeconomic data. Many of these headwinds look set to continue in the short term but we remain positive on Indian equities in the medium term. Accommodative monetary policy, now-cheaper valuations and continued expectations of both fiscal and structural reforms will be positives. Increased infrastructure spending may also create opportunities.

German housing

Idea initiated
April 1, 2015

Reference measure
Dallas Fed International House Price Index Database for Germany vs. cash**

Investment horizon
24 months+

Performance since initiation
n/a (index only published quarterly)

Recent German macroeconomic data has been generally encouraging with, for example, both April industrial production and export growth coming in better than expected. Eurozone monetary policy probably remains too expansionary for the German economy and this is also likely to provide continuing support for a recovery in German home prices. Mortgage debt is, however, increasing only modestly and we do not appear to be entering into an unsustainable real-estate "bubble."

U.S. leisure and entertainment

Idea initiated
April 1, 2015

Reference measure
PowerShares Dynamic Leisure and Entertainment Portfolio vs. S&P 500 Index*

Investment horizon
3 – 12 months

Performance since initiation

U.S. restaurant and bar sales were up just 0.1% month-on-month in May but rose by 8.2% year-on-year, vs. 2.7% for retail sales overall, suggesting a continued preference for leisure and entertainment spending over that on goods. As the labor market continues to improve, wage growth accelerates and net worth remains supported (through higher home and equity prices), spending on leisure and entertainment should pick up further later this year.

High-conviction ideas may not be suitable for all investors. 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. Some investments may not be suitable for all investors and investors should seek professional advice before investing. The examples above are shown for illustrative purposes only and should not be considered to be an offer or solicitation, advice or recommendation.

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High-yield debt

Idea initiated

February 24, 2015

Reference measure

Average of Barclays U.S. High Yield and Barclays Euro High Yield indices, weighted according to market size, in U.S. dollars vs. cash**

Investment horizon

3 – 12 months

Performance since initiation

Although some short-term tactical caution on high-yield debt is warranted, we think that the longer-term outlook remains positive. In the United States, corporate credit statistics remain largely positive, for example as regards interest coverage, debt ratios and defaults. The recent rise in oil prices has also provided some support. In Europe, the positive impact of QE on economic growth and most corporates' fundamentals is favorable for high yield and should keep default rates low. Increased broad market volatility is however a risk.

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

U.S. May retail sales data was much stronger than in April, with increased spending on autos and clothes as well as building materials. In fact, consumers bought autos and trucks at the fastest seasonally-adjusted annual pace since 2005. We expect a continued pickup in consumer-discretionary spending as 2015 progresses, encouraged by further labor-market improvement, wage growth and higher household net worth. Energy prices are still well down on year-earlier levels, which will provide further impetus.

Opportunities in cloud computing

Idea initiated

November 26, 2013

Reference measure

n/a

Investment horizon

3 – 12+ months

Performance since initiation

n/a

We believe that the cloud computing model and the evolution of software technologies associated with it will continue to create opportunities. These are likely to be in several forms. Clear existing needs include analytical software to allow companies make better data-driven decisions, for example on how best to respond to client needs and manage supply chains. Security software could be another gainer. At a broad level, cloud computing may boost software spending at the expense of services spending.

High-conviction ideas key
indicates gain
indicates loss

* Relative-return idea, based on the relative performance of the two measures in U.S. dollars. Stated performance is from given entry date to 6/11/15.

** 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 6/11/15.

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Source: Deutsche Asset & Wealth Management Investment GmbH, Deutsche Bank (Suisse) SA, as of 6/11/15

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Glossary

Here we explain the main terms from the CIO View

Alternative-credit strategies are typically focused on sub-investment grade and less liquid types of fixed income.

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

Bunds is a commonly used term for bonds issued by the German federal government with a maturity of 10 years.

A buyout is a purchase of shares in order to gain controlling interest in another company.

Capital-structure arbitrage tries to exploit opportunities arising from the different risk and maturity profile of different companies' credit structure.

Cloud computing encompasses technologies and services that offer the dynamic and flexible use of a third party's IT infrastructure.

The CNX Nifty Index is a market-capitalization-weighted index that tracks India's 50 most important listed companies.

The Conservative party is a centre-right political party in the United Kingdom.

Consumer discretionary is a sector of the economy that sells non-essential goods and services.

Correlation is a measure of how closely two variables move together over time.

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

The debt ratio is a company's total debt divided by its assets.

Discretionary macro strategies are investment strategies that aim at exploiting macroeconomic, policy or political changes.

Emerging markets (EM) are those economies which are not yet fully developed in terms of market efficiency, liquidity, and other factors.

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

Equity market is a market in which equities (stocks) are traded. The term can be used to refer to an actual market (e.g. the New York Stock Exchange) or to general trends in equity trading. Equities are securities which certify rights of ownership of (parts of) a company.

The European Central Bank (ECB) is the central bank for the euro. It administers the monetary policy of the Eurozone, which consists of 19 European Union member states.

Euro periphery (bonds) are government bonds issued by countries of the Eurozone deemed to be less advanced in their economic development than core European countries such as Germany or the Netherlands. See also Periphery.

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

Event-driven investing strategies seek to exploit pricing inefficiencies that may occur before or after a corporate event, such as an earnings call, bankruptcy, merger, acquisition or spinoff.

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

Fundamentals are data giving information about the general well-being of companies, securities or currencies and serving for the subsequent valuation of these as an investment opportunity.

Grexit is the term used to describe a Greek exit from the Eurozone, either deliberately or accidentally.

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

Hard-currency bonds (debt) are bonds (debt) issued by legal entities in a hard currency such as the U.S. dollar, euro or Swiss franc.

High yield (HY) describes bonds which are sub-investment grade.

Inflation describes the increase in an economy's overall price level.

Interest coverage is calculated by dividing a company's earnings by its interest payments over a given period.

The International Monetary Fund (IMF) is an international organization which fosters global monetary cooperation and monitors economic and financial developments.

Investment Grade (IG) describes bonds judged by rating agencies to be of at least medium quality (usually BBB or above).

Investment styles refer to different sets of investor approaches, such as a focus on value stocks (those with relatively low price-to-earnings ratios) or on growth stocks (those with high expected earnings growth).

The Islamic State of Iraq and Syria (ISIS) is a Salafi jihadi militant group and self-proclaimed caliphate and Islamic state.

The labor force participation rate is the proportion of a population that either are in work or are actively looking for work, within a defined age range.

Leverage attempts to boost gains when investing through the use of borrowing to purchase assets.

Liquidity refers to the ability to sell securities quickly without having to significantly reduce the price.

Limited partnerships (LPs) are a form of partnership where one or more partners has only limited liability and no management authority. Private equity operations often exist in this form.

Mergers and acquisitions (M&A) are the 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 refers to the rate of growth of an index or security's price. Momentum investors believe that strong growth is likely to be followed by further gains.

Monetary policy focuses on controlling the supply of money with the ulterior motive of price stability, reducing unemployment, boosting growth, etc. (depending on the central bank's mandate).

A mortgage loan is used to finance the purchase of real estate.

The MSCI AC World Financials Index captures large- and mid-cap representation across 45 developed- and emerging-market countries.

The MSCI AC World Index includes stocks from 23 developed and 23 emerging market economies.

Net operating income (NOI) refers to rent and other revenues minus operating costs.

The neutral real interest rate is the official interest rate, adjusted for inflation, which is estimated to allow an economy to grow at its trend rate.

Potential growth describes the possible long-term growth rate of an economy running at full capacity with a constant inflation rate.

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

The price-to-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 investment by a financial investor in a substantial part of a company's equity. Usually the company invested in is not listed.

Pro-cyclical sectors are those throught likely to particularly benefit from an upturn in the economic cycle (i.e. stronger growth).

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.

Quantitative and qualitative easing (QQE) aims both at increasing the monetary base as well as extending the maturities held by the central bank.

Relative-value investing strategies seeks to take advantage of price differentials between financial instruments by simultaneously buying and selling the different securities, thereby allowing investors to potentially profit from the "relative value."

Risk-on/ risk-off decribes an investment behaviour that is only based on a changed risk perception.

The S&P 500 Consumer Staples Index tracks the performance of S&P 500 Index consumer staples companies.

The S&P 500 Consumer Discretionary Index tracks the performance of companies included in the S&P 500 Index that are classified as members of the GICS consumer discretionary sector.

Secular stagnation is a condition of negligible or no economic growth in a market-based economy.

The Shanghai-Hong Kong "through train" is a scheme that allows mainland Chinese investors to buy Hong Kong-listed equities and vice-versa.

A share buyback involves a company buying back its own shares.

Structural refoms aim to boost economic growth by making sectors and markets more adaptable and responsive.

The Trans-Pacific Partnership is a proposed trade and investment agreement between 12 Pacific rim economies.

Volatility is a statistical measure of the dispersion of returns for a given security or market index.

The Wishire 5000 Total Market Index is an index of all companies headquartered in the United States with actively traded stock.

Yield describes the income return on an investment. This refers to the interest or dividends received from a security and is usually expressed annually as a percentage based on the investment's cost.

Yield-curve trading strategies try to benefit from changes in the yield curve for various types of securities.

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 sovereign bonds is on yields, not trends in bond prices.

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

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

Important information – UK

In the UK this publication is considered a financial promotion and is approved by DB AG on behalf of all entities trading as Deutsche Asset & Wealth Management in the UK.

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