Deutsche Asset
& Wealth Management

Europe, Middle East & Africa Edition
August 2014

CIO View

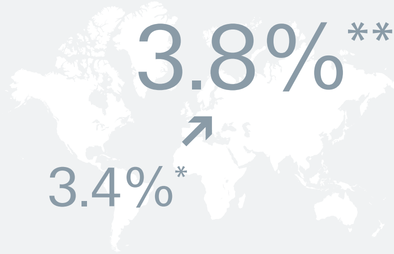
Opening the sluice gates

ECB channels liquidity flow

Nine positions

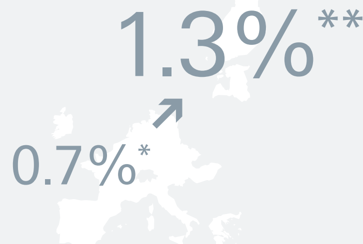
Our key forecasts

The global economy is growing at a stable, moderate pace.



* DeAWM Forecast 2014 GDP growth in %
** DeAWM Forecast 2015 GDP growth in %

Inflation will remain low in the Eurozone.



* DeAWM Forecast 2014 inflation (CPI) in %
** DeAWM Forecast 2015 inflation (CPI) in %

High liquidity is calming markets.

Eurozone bond yields have hit bottom.

* Yield of 10-year German Bunds

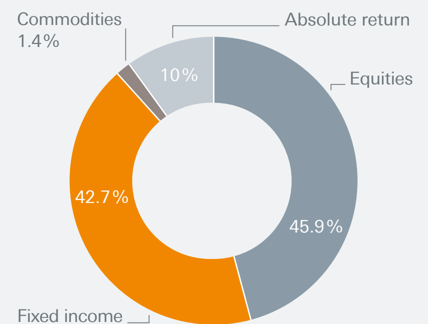
Equities offer an escape hatch from low yields.

First hints of the Fed starting to seek an exit from low interest rates.

Concerns about higher interest rates could cause equities to dip briefly.

Investors holding quality stocks should get through this phase unscathed.

Asset allocation of our balanced model portfolio:



Important terms are explained in our glossary at the end of this edition.

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Source: Deutsche Asset & Wealth Management, as of end of July 2014.

Letter to investors

Welcome to the turtle cycle

As the global recovery just inches along, investors are faced with a challenge. Only those willing to take risks may be able to generate attractive returns.

The turtle named Cabeção was worshipped by Brazilian soccer fans for several weeks. The reason: The turtle, a youngster at a mere 25 years of age, predicted that Brazil would win the World Cup. He was wrong. As a result, it was falsely suggested that he had ended up in a bowl of soup. But Cabeção and others of his species are expected to live a long and slow-moving life — one that certainly holds parallels with the global economy's slow-motion recovery from the financial crisis.

The recovery is now in its sixth year and economic activity in the United States, United Kingdom and especially in the Eurozone still lags behind the level achieved in past upswings. This once again shows that budget crises cast long shadows. Instead of spending or investing, the private sector is saving its money and deleveraging.

For investors, these are challenging times as well. Low interest rates and unorthodox monetary policy measures are pushing down yields on money and sovereign-bond markets. As a result, investors are increasingly focusing on corporate and mortgage-backed bonds. The yield spreads between corporate and mortgage-backed bonds and sovereign bonds have leveled off in the process. And the cushion that protects against drawdowns caused by interest-rate rises has subsequently flattened. As a result, increasing numbers of investors are turning to equity markets as a way to solve the yield dilemma.

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> "Investors should be aware that the bull market runs in phases."

But those banking on equities should be aware that the bull market runs in phases. In the first phase, which lasted from 2009 through mid-2011, equity markets profited from the fact that central banks prevented a systemic crisis with their ultra-expansionary monetary policy. In the second phase, equity valuations normalized and price-to-earnings (P/E) multiples rose. A review of historical P/E multiples reveals that equities are now more or less fairly priced. In the third phase, which has just begun, corporate earnings are likely to move into the spotlight. Quality should be the focus in this phase. Stocks of companies with above-average earnings growth in particular will be the winners, in our opinion.

By contrast, investors may want to consider underweighting bonds. The "turtle" Günther Schild, the mascot for German Bunds, was sent into retirement by the German government back in 2012. In the current low-rate environment, even this mascot would not be able to sway safe-haven-oriented investors. Equities, by contrast, are likely to remain in demand — even without a mascot pedaling them.

Asoka Wöhrmann,
Chief Investment Officer

Focus

Controlled supply

ECB emphasizes targeted liquidity

When the topic of quantitative easing (QE) comes up in the Eurozone, the language turns to firepower. In 2012, Mario Draghi, the president of the European Central Bank (ECB) used an artillery analogy to describe two three-year tenders that provided banks with long-term liquidity. A short time later, the word “bazooka” permeated the vocabulary of the banking world. The “bazooka” in question was the ECB's Outright Monetary Transactions (OMT) Program, in which the ECB granted itself the authority to purchase sovereign bonds in the event of a debt crisis in the Eurozone. But, despite the use of such words, balance not battle is the name of the game. For instance, the OMT would come into play only if a country seeks assistance from the rescue fund known as the European Stability Mechanism (ESM). In return for help, the country must agree to stringent reforms.

Fed focuses on flooding the market with money

In terms of unconventional monetary policy, the ECB is much less aggressive than central banks have been in the United States, Great Britain or Japan. The Board of the U.S. Federal Reserve System (the Fed), for example, started buying up huge amounts of sovereign bonds without any conditions attached in the end of 2008 and still continues to do so. Although it started to reduce the amount of new purchases recently, the total amount of U.S. Treasuries held by the Fed rose from 0.48 trillion U.S. dollars to 2.40 trillion U.S. dollars during this period. The Fed also bought mortgage-backed securities worth 1.66 trillion U.S. dollars.[1] By comparison, the total amount of sovereign bonds bought by the ECB as part of the Securities Markets Program launched in May 2010 looks modest, amounting to 161.7 billion euros in June 2014.[2]

ECB takes a more targeted approach

The ECB's latest monetary policy initiatives show that Europe's central bankers certainly are not firing any “big Berthas.” Instead of employing QE—an artillery barrage approach to supplying money—the ECB is taking a targeted approach. It intends to loosen a lending squeeze in the commercial sector by employing targeted longer-term refinancing operations (TLTROs) worth 400 billion euros. In this program, banks receive low-cost loans (main refinancing rate plus 10 basis points) for which the ECB established contractual conditions urging the recipients for additional lending to the private sector. With these conditionalities, the ECB is taking steps to ensure that loans are really passed on to the real economy on a long-term basis and are not invested in sovereign bonds.

Differing debt dynamics

When it comes to economic growth, the United States is well ahead of the Eurozone, thanks to its ultra-expansionary monetary policy and its expansionary fiscal policy. U.S. real gross domestic product (GDP) climbed about 10.7% between the first quarter of 2009, when the recession hit bottom, and the first quarter of 2014. By contrast, real GDP in the Eurozone rose by only 3.2% during the same period.[3] In the United States, however, the record-low interest rates created by QE have encouraged a relaxed approach to debt. As a result, government debt has climbed much faster in the United States than in the Eurozone. Today, the debt-to-GDP ratio in the United States is well above that of the Eurozone (see next page).

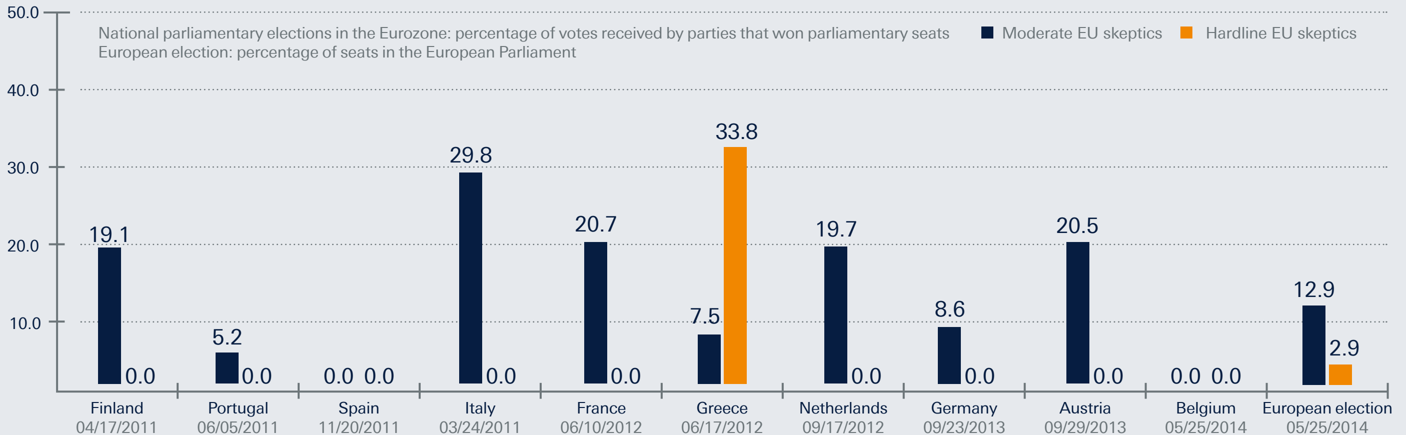
It is not just the government that is being tempted by low interest rates to boost debt loads. The corporate sector is following suit. A quick glance at balance sheets in the United States reveals that companies are replacing their equity with borrowed capital. Such financial transactions allow them to boost their return on equity while weakening their equity base. Low interest rates are also encouraging private households to purchase real estate on credit. Added to this, some see bubble-like trends in bond and in some parts of equity markets. This is a mixture that has raised worries about a debt crisis. Against this background, central banks should not leave it until too late to begin pulling their monetary-policy reins—and should not be too gentle about it either.

The ECB will hardly view itself as being the target of such concerns. Its latest monetary policy decisions show that it is not interested in QE so far and the flood of money that this approach would release. Instead, it intends to use a targeted and carefully managed system of loans—that is, liquidity—to break the lending squeeze now hurting companies, to increase investment and, as a result, to fuel long-range economic growth.

[1] Source: FED, as of July 15, 2014
[2] Source: ECB, as of July 15, 2014
[3] Source: Bloomberg Finance LP, as of July 15, 2014

EU skeptics remain in the minority

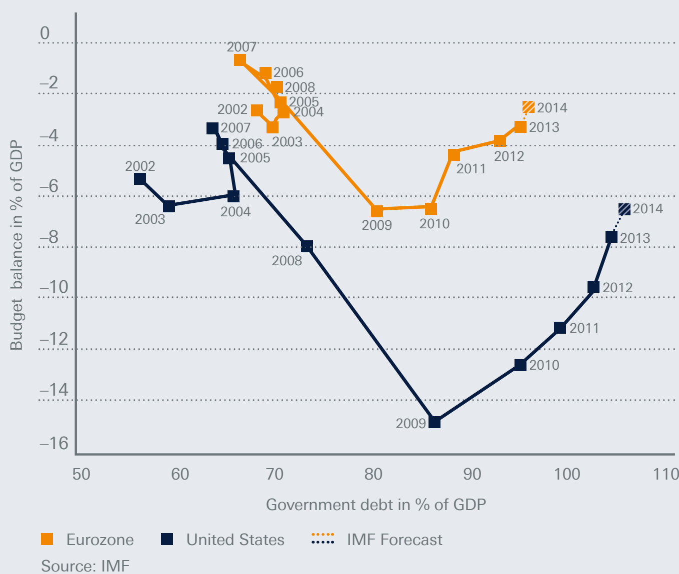
Election results of EU skeptics in parliamentary elections



The ECB's decision against pursuing a broad QE program has slowed the economic recovery since 2009. This has made fiscal consolidation more difficult and more painful for governments. As a result, many EU-skeptical parties on the right and left have made gains. In particular, moderate political parties that oppose only certain aspects of EU integration have made inroads. By contrast, hardline EU skeptics hold little sway—with the exception of those in Greece. EU skeptics are a minority in the European Parliament.

Sources: Wikipedia; Der Spiegel; Nicolaus Heinen, Florian Hartleb and Barbara Böttcher: EU skeptics get a lift. DB Research, as of 31 January, 2014

Public budget balance and government debt



Source: IMF

Deficits and debt

In 2002, the debt-to-GDP ratio of the United States was well below that of Eurozone countries. This situation began to change in 2009. As a result of QE, the U.S. government has taken on more debt. By contrast, the ECB has avoided buying up large amounts of sovereign debt. This has maintained pressure on the periphery countries to consolidate their government budgets.

–2.6%

Government budget balance forecast in % of GDP for 2014 in the Eurozone
Source: IMF, as of July 29, 2014

"We have introduced consolidation policies and a number of structural reforms. But we also realize that the impact of the structural reforms and budget consolidation will not occur until later."

German chancellor Angela Merkel discussing the state of the EU on January 1, 2014 at the World Economic Forum in Davos

–6.42%

Government budget balance forecast in % of GDP for 2014 in the United States
Source: IMF, as of July 29, 2014

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The big picture

Interview

Equities are no longer cheap, but they are also a long way from being overpriced. Nonetheless, Asoka Wöhrmann urges investors to avoid taking on more risk than they can bear.

"I would like to cordially welcome investors to the decade of equities."

Mr. Wöhrmann, in June, you lowered your growth forecast for the global economy from 3.7% to 3.4%. Is this what you are talking about when you use the term "slow-motion recovery"?
No. The two things are completely unrelated. The lowered growth forecast is really the result of the brutal winter that the United States experienced this year. The respective effects are already working their way out of economic data. The slow-motion recovery involves something much more long term, a new economic cycle. Its chief characteristic: Capital utilization in Western economies is lagging far behind the levels seen in past cycles.

What role is being played by deleveraging, or the debt-reduction activities of private households and companies?
A huge role. This is precisely where you see the difference with past cycles. The financial and economic crisis is continuing to make itself felt: Neither private households nor companies are taking on debt to finance their consumption or investments. Instead, they would rather pay off debt. Costs are being cut, worldwide, and this is exactly the problem. The normal mechanisms of economic recovery no longer apply here. Japan is only the exception to the rule.

What effect is this having on your long-time favorite form of investment: stocks?
I would like to cordially welcome investors to the decade of equities. But I expect to see considerably lower returns than we have had in the past two years—by this, I mean that we will no longer see high double-digit returns. Instead, we will have to settle for respectable single-digit ones. This is also the view we expressed in the market outlook we released at the end of 2013.

What is preventing you from being unreservedly positive about equities about equities?
Stock markets' first two major moves upward are over. Central banks were the driving force behind the first move. They ended investors' worries about a systemic crisis. The second move was based on the strong performance of many U.S. companies. In response, the rise in prices outpaced increases in corporate earnings. This development drove up the valuations of many stocks around the world. We have now entered a new phase: Stocks that actually deliver earnings are now rising. Investors are conducting a reality check to see whether the high price levels are justified. For this reason, stock-market returns are very likely to become more volatile.

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But there is no alternative to them right now?

The attractiveness of most other types of investments has fallen dramatically. The money market is no longer delivering anything at all. There are hardly any other asset classes that produce positive returns. Investors must accept the risk that comes with equities. Sure, equities are no longer cheap. But they are also a long way from being overpriced. For this reason, I am not losing any sleep over the record highs that have been reached by many indices. But investors should avoid getting a case of interest-rate blues.

And not take on more investment risk than they can bear?

Correct. That would be a big mistake. If too many people get caught in this trap, bubbles will form on stock markets. These bubbles will burst when a shock challenges expectations and these investors are forced to sell off the equities they just bought. The trick is to avoid thinking solely in terms of the highest available returns during this phase.

What is your outlook for emerging economies?

They remain diverse. But, with every successful election in important emerging countries, we gain more certainty about future political leadership. We will be listening very closely when Janet Yellen, Chair of the Board of the U.S. Federal Reserve System (Fed), talks about possible interest-rate increases in the United States for the first time. The nervousness with which investors react to a rate hike will depend on how well she prepares the market for it. At this point, we will decide whether it is once again time to exploit favorable valuations and make long-term investments in emerging economies. Right now, I would rank Asia over South America and eastern Europe.

In your presentations, you have begun using a turtle lying on its shell. The shell represents a dollar bill. What sort of point are you trying to make here?

This is a story of a currency that is waiting for someone to come along and turn it over so that it can finally start moving forward again. The fundamentals clearly indicate that the dollar should rise against other leading currencies like the euro.

Who will turn the dollar over?

The Fed, who else? The starting gun for the U.S. dollar will be fired once Yellen begins laying the groundwork for a rise in interest rates during the late fall and once Europe ends its emotionally charged discussion about quantitative easing, avoiding using further unconventional means to ease monetary policy. At this point, capital flows will no longer inundate Europe. I expect that the U.S. dollar will then begin moving against the euro to 1.30 U.S. dollar per euro and below.

The turtle cycle

Capital utilization in Western economies is lagging far behind the levels seen in past cycles—the key characteristic of the slow-motion recovery of the global economy that Asoka Wöhrmann expects over the next few years. This new cycle is symbolized by the turtle. The chief investment strategist also uses the reptile to illustrate his outlook for the U.S. dollar: As long as the Fed does not help the greenback get back on its feet, the U.S. dollar's rate against other currencies may not budge at all.

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Investment traffic lights

Our tactical and strategic view

Equities	1 to 3 months	up to June 2015
Regions		
United States	◉ orange (circled)	↗ (green)
Europe	● orange	↗ (green)
Eurozone	◉ orange (circled)	↗ (green)
Germany	● orange	↗ (green)
Japan	◉ green (circled)	↗ (green)
Asia ex-Japan	● green	↗ (green)
Emerging markets	◉ orange (circled)	↗ (green)
Sectors		
Consumer staples	● red	
Health care	● orange	
Telecommunications	● red	
Utilities	● red	
Consumer discretionary	◉ green (circled)	
Energy	● orange	
Financials	● green	
Industrials	● orange	
Information technology	◉ green (circled)	
Materials	● orange	
Style		
Small and mid-cap	● orange	

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 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

Previous traffic lights are shown in the small graphs to the right as well as on the next page.
◉ A circled traffic light indicates that there is a commentary on the topic.

The strategic view up to June 2015
Equity indices and exchange rates: The arrows signal whether we expect to see an upward trend (↗), a sideways trend (→) or a downward trend (↘) for the particular equity index or exchange rate.
Fixed income: For sovereign bonds, ↗ denotes rising yields, → unchanged yields and ↘ falling yields. For corporates, securitized/specialties and emerging-market bonds, the arrows depict the option-adjusted spread over sovereigns for each respective region. ↗ depicts an expected widening of the spread, → a sideways-spread trend and ↘ a spread reduction.

The arrows' colors illustrate the return opportunities for long-only investors
- ↗→↘ positive return potential for long-only investors
- ↗→↘ limited return opportunity as well as downside risk
- ↗→↘ high downside risk for long-only investors

Further explanations can be found in the glossary.

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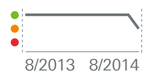
◉ United States (Equities)

Continued expansionary monetary policy and a positive earnings momentum are generating long-range momentum for U.S. stock markets. But, since equities trade at historical average valuations and some data disappointed lately, we are taking a tactically neutral position on U.S. equities.

◉ Eurozone (Equities)



In relation to their pre-crisis levels, Eurozone equities in particular still show significant recovery potential. However, in the short term, returns will remain affected by weak economic growth and Russia-linked uncertainties. Consequently we expect only modest market gains and and take a neutral stance on Eurozone equities.

◉ Japan (Equities)

The Bank of Japan continues to pursue its ultra-expansionary monetary policy. At the same time, it was decided that corporate taxes should be lowered, prices are rising, the job market is improving and base wages are climbing. These are all reasons to overweight Japanese equities.

	1 to 3 months	up to June 2015
Fixed income		
Rates		
U.S. Treasuries (2-year)	orange	↗
U.S. Treasuries (10-year)	red (circled)	↗
U.S. Treasuries (30-year)	red	↗
U.K. Gilts (10-year)	green	↗
Eurozone periphery	green	↘
German Bunds (2-year)	orange	→
German Bunds (10-year)	red (circled)	↗
Japanese government bonds (2-year)	orange	↗
Japanese government bonds (10-year)	orange	↗
Corporates		
U.S. investment grade	green	↘
U.S. high yield	orange	→
Eurozone investment grade	green	↘
Eurozone high yield	orange	→
Asia credit	green	↗
Emerging-market credit	orange	↘
Securitized/specialties		
Covered bonds	green	↘
U.S. municipal bonds	orange	↘
U.S. mortgage-backed securities	orange	↗
Currencies		
EUR vs. USD	red (circled)	↘
USD vs. JPY	orange	↗
EUR vs. GBP	orange	↘
EUR vs. JPY	red	→
GBP vs. USD	red	→
Emerging markets		
Emerging-market sovereign	orange	→
Alternatives		
Infrastructure	green	↗
Commodities	orange	→
Real estate (listed)	orange (circled)	↗
Real estate (non-listed)	green	↗

Emerging markets (Equities)

8/2013 8/2014

Emerging markets have moved in a positive direction in recent months. They have been lifted by higher growth projections and lower valuations in an international comparison. But the strengthening of emerging-market currencies is hurting corporate earnings.

Consumer discretionary (Equities)

8/2013 8/2014

Cyclical industries are among the beneficiaries of increased growth expectations and improved job markets. Furthermore, consumer confidence should improve in emerging economies in months to come. This is a reason to overweight.

Information technology (Equities)

8/2013 8/2014

Many technology companies are known for their solid balance sheets, high dividends and good market position. This internationally focused sector is also moderately valued in historical terms. A rise in technology spending is one more factor working in this sector's favor.

U.S. Treasuries (10-year)

8/2013 8/2014

Weaker economic data in Q1 than expected at the beginning of the year have driven yields down. The improving job market is a sign that the downward trend will end. We expect T-notes to give up some of their recent gains on strong data and Fed forward guidance.

German Bunds (10-year)

8/2013 8/2014

Geopolitical worries have fueled demand for Bunds. Low inflation levels have also given them a lift. Higher yields loom as economic conditions improve. This could cause prices to fall.

EUR vs. USD

8/2013 8/2014

The Fed started discussing hiking interest rates earlier and faster than expected if the U.S. job market continues to improve at the prevailing pace. The end of expansionary monetary policy is looming. This could give a boost to the U.S. dollar and put pressure on the euro to U.S. dollar exchange rate.

Real estate (listed)

8/2013 8/2014

Real estate fundamentals remain attractive in several regions. Tenant demand is improving and additions to new supply are low. In turn, vacancy rates are stable to lower and rents are rising. In the listed market, investor demand has recovered after last year's taper-tantrum. As prices increased, initial yields relative to sovereign have been reduced and the spread is trading closer to its historical average. Thus the market appears fairly valued today.

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Europe, Middle East, Africa

Portfolio

How we allocate assets

Our core portfolio allocation

With our core portfolio, we cover traditional liquid assets such as equities, fixed income and commodities. The chart shows how we would currently design a balanced portfolio.

Fixed income: the search for carry

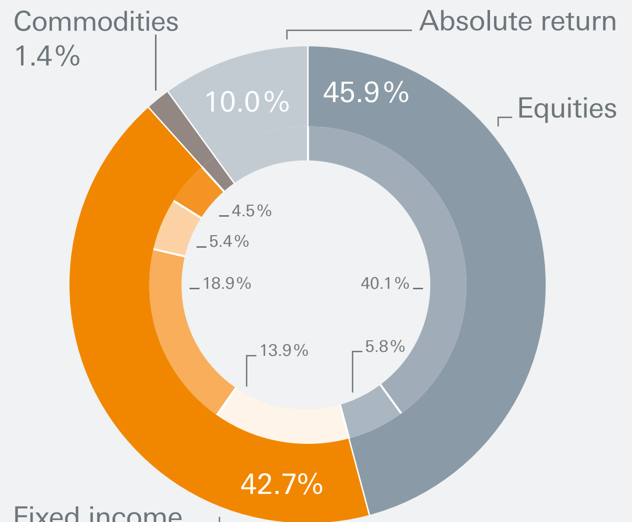
Uncertainties over U.S. growth have helped keep U.S. yields low. But, with evidence of stronger U.S. growth now mounting, U.S. yields seem set to move higher in the remaining months of 2014—although core European yields could remain "lower for longer." The search for "carry" will continue. With Eurozone core/periphery spreads already tightened and limited further opportunities in investment-grade and high-yield credit, emerging-market local-currency debt may increasingly appeal. (Emerging-market hard currency debt could be vulnerable to U.S. rate rises though.)

Equities: longer-term view positive

Our longer-term outlook on equities remains positive, although some short-term volatility is possible—as the short-lived equities market correction in early July reminded us. We believe that strengthening economic growth will boost corporate earnings, and that these will be the main driver of equity price gains. Central-bank policy will also continue to add support in many developed markets. We continue to prefer equities over bonds, and developed markets equities generally over emerging markets—although there will be selective opportunities in the latter.

Commodities: easing down

In recent months, worries about oil-supply disruption have pushed up oil prices. Such geopolitical worries, combined with concerns that the U.S. economic recovery could be faltering, have buoyed up the gold price. But an accelerating U.S. economic recovery and a strengthening U.S. dollar are now likely to start to ease the gold price down. Oil prices will also come under downward pressure from further increases in U.S. production.



Equities	Weight
Developed markets	40.1%
Emerging markets	5.8%
Fixed income	
Credit	13.9%
Sovereign	18.9%
Emerging markets	5.4%
Cash	4.5%
Commodities	
Commodities	1.4%
Absolute return	
Absolute return	10.0%

Source: Deutsche Asset & Wealth Management EMEA Regional Investment Committee (RIC). As of June 18, 2014. Suggested allocation for USD-based investors. This allocation may not be suitable for all investors. Investments in absolute-return strategies are dealt with separately on page 12.

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Stéphane Junod is the multi-asset group chief investment officer for Europe, Middle East and Africa (EMEA).

Long or short, Stéphane Junod?

Six market views from our regional chief investment officer

CIO View: Still expecting U.S. economic acceleration?

LONG This has been a very slow recovery, interrupted by some unwelcome shocks such as the contraction in first-quarter U.S. gross domestic product (GDP). But data in a number of areas are getting better now. Recent employment data have been good, with the number of jobs now back to precrisis levels. This has been reflected in growing tax receipts and consumer confidence. Most importantly, the ISM Index (new orders and production) suggests that growth could in fact now accelerate.

Is developed-economy deflation a major concern?

SHORT Elevated unemployment and a weak recovery have kept U.S. inflation at low levels. But U.S. inflation is now picking up and approaching the Board of the Federal Reserve System's (the Fed) target rate of 2%. Some specific factors – for example, the end of medical deflation – are assisting this trend. Consumer price inflation rates are much lower in the Eurozone – dropping to 0.5% in June. As a result, deflation is more of a concern here. But with steadily strengthening Eurozone growth, and a determined ECB, European inflation is now likely to move slowly upward.

Are core government bonds a credible safe haven?

SHORT A combination of sluggish recovery, low levels of inflation and persistent perceived geopolitical risk has served to keep core government bond yields very low. But this situation cannot continue indefinitely. The Fed will stop its quantitative easing program in the fourth quarter of 2014, and this could coincide with an increase in U.S. Treasury supply. German Bunds will not be immune to an increase in U.S. yields, although the rise here may not be steep. So we stay cautious on fixed income, especially on sovereigns.

European equities – further to go?

LONG Valuations are quite high. Moreover, as the mid-July consolidation demonstrated, European equities are not immune to concerns about European or other developments. But there are positive factors, too. Valuations will receive support from the European Central Bank's (ECB) commitment to monetary expansion. Apart from France, purchasing manager indices suggest that Eurozone growth is expected to pick up – and accelerating U.S. and emerging-market growth will also help. A weakening euro will provide a additional tailwind.

Is China still key to Asian equities?

SHORT Asia ex-Japan equities have performed well in recent months, helped by strong gains in India, Indonesia and Thailand. But before we become more positive on Asian equities overall, we would like to see further signs of a Chinese economic recovery. China's purchasing manager indices have recently improved, but remain low. The big question is whether the Chinese government's targeted stimulus measures can offset construction-sector and other broad-based problems.

Will the U.S. dollar strengthen?

LONG There are several positive factors likely to support the dollar – notably stronger U.S. growth and higher rates. Dollar strengthening will also be assisted by negative factors depressing other developed market currencies: In the Eurozone, these manifest in relatively slow growth and a European Central Bank clearly keen to keep rates low for several years. In Japan, the Bank of Japan is steadily increasing its balance sheet and may get more aggressive. History also suggests Japanese yen weakness when U.S. interest rates go up.

LONG represents a positive answer
SHORT represents a negative answer

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Nine positions
Focus
The big picture
Investment traffic lights
Portfolio
High-conviction ideas

Europe, Middle East, Africa

Absolute-return portfolio

Our absolute-return portfolio covers non-traditional liquid and illiquid assets. For most investors, this will represent a relatively small share of their total investments.

Liquid alternatives

Liquid alternatives delivered positive performance in the first half of 2014. The stand-out returns have been generated by event-driven (thanks to a rebound in corporate activity) and credit-related strategies (due to spread tightening in credit markets). Our outlook for performance is positive for the coming 12 months.

Private equity

Private equity returns have been solid year to date, with appreciation in unrealized values and attractive cash returns driven by strong initial public offering (IPO) and merge and acquisition (M&A) markets. As long as rates remain low and exit activity high, robust conditions in the private-equity market should continue.

Infrastructure

Investor demand for infrastructure remains solid due to the stable cash flows and growth prospects in the asset class. The risk of rising interest rates presents a headwind for slower-growth utility companies. Conversely, energy companies are seeing secular growth, which offsets the risk of rising rates.

Real estate

Globally, initial yields on property remain attractive relative to sovereign yields, while spreads offer a margin of safety should interest rates increase more than expected. To combat the risk of rising rates, we recommend an underweight to long-duration leased assets and an overweight to pro-cyclical property sectors that benefit from higher growth and rents.

Liquid alternatives	Private equity
Investments that offer exposure to hedge-fund strategies via liquid investment vehicles that are accessible to a broad range of client types.	Direct or indirect investments in private firms in various stages of development. Not quoted on a public exchange and with a medium to long time horizon.
Infrastructure	**Real estate**
Long-term defensive investment in infrastructure assets that may offer low correlation to traditional asset classes.	Direct or indirect investment in commercial real estate with the aim of delivering rental income and/or capital gains.

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Long or short, Hamish Mackenzie?

The head of infrastructure explains why there's a buzz about the asset class

CIO View: Infrastructure is in the spotlight. Does it justify the attention?
LONG Infrastructure proved itself through the financial crisis, with most assets and funds performing as investors expected. Despite the market turbulences, investments in bridges, toll roads, airports and utilities mostly continued to generate consistent returns with stable cash yields. That's one of the reasons institutions put 38 billion euros into private infrastructure funds last year, the most since 2008.*

Could investor enthusiasm be a short-term trend?
SHORT There are four reasons to think not. First, it's one of the few asset classes that provides an inflation hedge. It's also high yielding relative to assets with a similar risk profile. A third appeal is that correlations with other asset classes are pretty low. Finally, it's a growing sector. None of these features is likely to change soon.

Is the opportunity set getting bigger?
LONG About 41 trillion U.S. dollars need to be spent on infrastructure worldwide by 2030. Given the reluctance or inability of governments to meet this cost, there's a huge need for private-sector involvement. For example, there's a trend for governments to seek private funds to pay for the expansion of road networks. So the opportunity set will keep expanding for the foreseeable future.

Is it primarily an emerging-market theme?
SHORT Infrastructure is clearly a growing asset class in the emerging world, given the pace of development. But if you've ever driven on the roads in the United States or you know anything about the United Kingdom's creaking Victorian sewage system, you'll be aware the industrialized world also needs to spend heavily on infrastructure.

Is infrastructure only suitable for very large investors?
SHORT Direct investments require significant up-front capital: Airports aren't cheap! But there are multiple entry points giving investors a range of customized or off-the-shelf options. On the private-equity side, there are comingled funds, separate accounts, co-investments and funds of funds. Besides, infrastructure debt is rapidly coming of age as an asset class, and you can also invest in infrastructure equity securities. The factors to consider are investment size, diversification, fees and return potential.

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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. Some investments are not available to all investors in all jurisdictions.

* Source: Preqin Global Infrastructure Report 2014

High-conviction ideas

Possible investment ideas to complement wealth management clients' portfolios

U.S. cyclicals vs. defensives

Idea initiated
November 26, 2013

Performance

Reference measure
S&P 500 North American Cyclical Index vs. S&P 500 Consumer Staples Index*

Investment horizon
3–12 months

Performance since initiation

Historically, cyclical sectors usually outperform defensives during periods of accelerating GDP growth. There is also a high historical positive correlation between cyclicals' outperformance and rises in the 10-year U.S. Treasury yield. Although P/E ratios have risen recently, U.S. cyclical sectors generally still appear attractively valued at present. Some cyclicals could benefit from the expected increase in capital expenditure, and accelerating demand in coming quarters.

Opportunities in cloud computing

Idea initiated
November 26, 2013

Performance

Reference measure
n/a

Investment horizon
3–12+ months

Performance since initiation: no reference index

The ever-increasing volume of data available on the cloud will increase the demand for analytical software that helps businesses make better data-driven decisions. The cloud also creates a naturally efficient environment for using security software. Overall, software spending may increase at the expense of service spending. Infrastructure-level software and emerging areas (such as software-defined networking) may also take bites out of the hardware budget.

Convertibles

Idea initiated
September 24, 2013

Performance

Reference measure
Barclays U.S. Convertibles Index vs. cash**

Investment horizon
3–12+ months

Performance since initiation

Convertibles have performed well since this idea was initiated, helped by their strong correlation with the equities market. Despite these sustained gains, we still believe that convertibles could be an attractive component of a client's fixed-income exposure. Historically, convertibles also tend to outperform high yield in an environment of accelerating growth and low default rates. They may also provide a way to hedge against a rising-rate environment.

Global industrials

Idea initiated
September 24, 2013

Performance

Reference measure
MSCI World Industrials Index vs. cash**

Investment horizon
3–12 months

Performance since initiation

Developed-market industrials look set to continue to benefit from stronger global economic growth, with pent-up investment demand and the need for capital expenditure maintenance and investment aimed at reducing production costs. Catch-up potential exists in both the United States and Europe. Healthy balance sheets, with net debt to equity falling to cyclical lows, provide another tailwind for capital expenditure, which is still very low in historical terms.

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Japanese real estate investment trusts (J-REITs)

Idea initiated
August 27, 2013

Performance

Reference measure
Tokyo Stock Exchange REIT Index vs. cash**

Investment horizon
3–12 months

Performance since initiation

During 2014, deregulation of the labor market (part of Abenomics' third arrow) may help to boost rental housing markets further. At the same time, we expect further growth in housing investment by high-net-worth individuals keen to minimize tax liabilities ahead of the scheduled inheritance-tax increase on January 1, 2015. Although short-term weakness is possible, and the Tokyo Stock Exchange REIT Index has fallen back from its highs of mid-June, J-REITs are likely to continue to appeal.

Divergent trends in Asian economic policy

Idea initiated
May 21, 2013

Performance

Reference measure
Bloomberg JP Morgan Asia Dollar Index vs. JPY/USD spot*

Investment horizon
3–12 months

Performance since initiation

We continue to think that the yen is on a multiyear weakening trend—encouraged by Bank of Japan's balance-sheet expansion, a weak current-account position and big outbound foreign direct investment. Although the renminbi has been weakened recently by concerns about the Chinese economy, our view is still that it will appreciate over the longer term, as will the Korean won and a number of other Asian currencies.

Beneficiaries of China's fight against air pollution

Idea initiated
March 26, 2013

Performance

Reference measure
n/a

Investment horizon
3–12+ months

Performance since initiation: no reference index

Heavy air pollution will continue to force policy changes in China, building on initiatives already launched in 2013 and 2014. Such changes are likely to center around reductions in coal consumption, as well as a big increase in investment in clean energies and railways. Resource pricing reforms (particularly in the natural-gas sector) will have an impact. Wind and solar companies will likely enjoy higher subsidies and better access to the national grid.

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 July 10, 2014.

** 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 July 10, 2014.

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Source: Deutsche Asset & Wealth Management Multi-Asset Group. As of July 10, 2014.

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Glossary

Here we explain central terms from CIO View

Abenomics refers to the growth-oriented economic policies advocated by Japan's prime minister Shinz Abe.

The Barclays U.S. Convertibles Index tracks the performance of U.S. convertible bonds.

One basis point equals 1/100 of a percentage point.

The Bloomberg JP Morgan Asia Dollar Index tracks the performance of emerging Asia's most actively traded currency pairs valued against the U.S. dollar.

Carry is a strategy in which an investor sells a certain currency with a relatively low interest rate and then buys another, higher-yielding currency.

Correlation is a measure of the comovement of two series of data.

The European Central Bank (ECB) is the central bank for the euro. It administers the monetary policy of the Eurozone, which consists of 18 European Union member states.

The European Stability Mechanism (ESM) is an international organization established in September 2012 to provide financial assistance to member states of the Eurozone in financial difficulty.

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

The Institute of Supply Management (ISM) Indices track different areas of the U.S. economy, such as manufacturing activity and industrial production.

The ECB's long-term refinancing operation (LTRO) is a process by which the ECB provides financing to Eurozone banks.

The MSCI World Index tracks the performance of mid- and large-cap stocks in 23 developed countries around the world.

Outright Monetary Transactions (OMT) is a program of the ECB under which the bank makes purchases (outright transactions) in secondary, sovereign bond markets, under certain conditions, of bonds issued by Eurozone member states.

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

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

The Purchasing Managers Index (PMI) is an indicator of the economic health of the manufacturing sector in a specific country or region.

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

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

The S&P North American Cyclical Index tracks the performance of U.S.-traded securities under the GICS® industrials sector; automobiles and components, household durables and chemicals industries; and steel sub-industry classifications.

Spread refers to the yield difference between two comparable assets of the same unit. When spreads widen, yield differences are increasing. When spreads narrow, the opposite is true.

The Tokyo Stock Exchange REIT Index tracks the performance of all real estate investment trusts listed on the Tokyo Stock Exchange (J-REITs).

Underweight means the investment holds a lower weighting in a given sector or security than the benchmark.

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

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

Tactical view:

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

Strategic view:

— The focus of our strategic view for corporate bonds is on yields, not trends in bond prices.
— For corporates and securitized/specialties bonds, the arrows depict the respective option-adjusted spread.
— For bonds not denominated in euros, the illustration depicts the spread in comparison with U.S. Treasuries. For bonds denominated in euros, the illustration depicts the spread in comparison with German Bunds.
— For EM sovereign bonds, the illustration depicts the spread in comparison with U.S. Treasuries.
— Both spread and yield trends influence the bond value. Investors who aim to profit only from spread trends must hedge against changing interest rates.

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Publisher: Deutsche Bank AG, Taunusanlage 12, D-60325 Frankfurt am Main, Germany
Graphic Design: Vier für Texas GmbH, Frankfurt
Print: Adelmann GmbH, Frankfurt