Investment traffic lights

Our tactical and strategic view

Global market view

August did not fully deliver on its promise to be the ultimate holiday month for investors. However, they would be well advised to now concentrate on the latter half as noted in the old market adage: "Sell in May and go away. But remember to come back in September." Admittedly, there has been some dullness in stock markets. Trading volumes for shares in the MSCI World Index, for example, have been the lowest in more than 15 years. The S&P 500 only returned 0.3% in August.

At the same time, August was only the latest in several unusually calm months this year. Just look at the average monthly volatility of the S&P 500 (as expressed by the Vix) since 1997. So far this year, seven out of the eight trading months of 2017 make it into the top 20 of calmest months we have seen during the past 20 years. That August was one of them might seem rather strange to avid news watchers.

In terms of headlines there were few signs of summer slumber. The month ended with hurricane Harvey. And it started with the growing tensions on the Korean peninsula. South Korea, an important player in global trade, would be amongst the first victims, should the sabre rattling between the U.S. and North Korea culminate in military action. This is not our base scenario. On August 11th, the re-escalation of this conflict, however, helped push the Vix to its highest level since November 16, and has reduced investors' risk appetite. Whether this was the reason for 10-year U.S. Treasury yields to plunge again, or whether this was caused by an ongoing muted inflation outlook, remains to be anyone's guess. Muted inflation certainly contributed to the prospect of a less aggressive Fed. Together with further benign macro data, this helped the S&P 500 to almost reach its record levels again by month-end. Year to date, the index has climbed more than 10%. From a European perspective, this looks much less impressive, however, as the index lost a couple of percentage points in euro terms. Once again, the strong euro also helps explain the lackluster performance of European indices in August.

Looking forward, we do not expect the dollar to continue to weaken and the euro to strengthen at the pace we have seen over the past few months. This is one of the reasons why we still prefer European over U.S. equities. While, ironically, hurricane Harvey contributed to avoiding a government shut-down in the U.S. for September (a discussion likely to re-emerge by year-end), we fear that U.S. stocks are priced for perfection, and are more prone to a set-back in autumn than to further appreciation. European equities, on the other hand, might benefit from any proof of French president Macron delivering on his election promises, and certainty about

German politics after the September 24th elections. Our base case is for a continuation of the grand coalition.

Against this backdrop, we would expect central banks to once again be the main focus of market attention heading into year-end. The Fed and the ECB will communicate their plans to normalize policies despite few tangible signs of inflation pressures on September 20th and October 26th, respectively.

Changes in positioning

We generally expect a continuation of the synchronous economic growth in developed and emerging markets. While inflation might struggle to grind higher, we still expect a solid U.S. labor market to push the Fed to increase rates one more time this year, while the ECB is likely to become more precise on its tapering process. We currently think it unlikely that the ECB will prolong the time for tapering beyond 2018, and would expect cuts in its purchase programs from January 2018 onwards. With this in mind, we are cautious on 10- and 30-year U.S. Treasuries while being neutral on 2-years. We also turned negative on 10-year UK Gilts - already in mid-August - as British inflation regained pace. But with the hawkish Bank of England's communication of September 15th, 10-year Gilts jumped considerably and now have probably made their biggest moves already. Hence we returned to neutral. As for Bunds, we keep our strategic view that rates are set to rise. From a tactical perspective, we wait for better entry points for 10- and 30-year Bunds as a strong euro and reduced ECB inflation projections for 2018 and 2019 are weighing on rates.

Within the credit space, we have neutralized our positive views on U.S. high yield (HY) and investment grade (IG). This is because we are concerned that, while well flagged, a couple of events still due this year could prove to be negative catalysts for credit spreads once they happen: the upcoming Fed and ECB meetings, the debate about the succession of Janet Yellen as Fed chair, as well as the debt-ceiling issue. Within euro credit, we remain positive for IG, but reduce HY to neutral as we expect a strong increase of new issuance which, in combination with outflows, geopolitical uncertainty and a relatively expensive valuation level, raise the risk of a correction. On U.S. municipals, we went from neutral to negative as valuation became rich especially for shorter maturities.

All major currency pairs remain neutral tactically going forward as the mix of rate differentials, economic data, politics, and risk trades seems to balance each other or make it difficult to predict short-term trends.

Within equity markets, we stick to our preference for Europe and emerging markets, foremost the Asian ones. For the U.S. we rather fear a short-term correction as stocks are richly valued, and owe much of their recent run to the weakening dollar. Within the sectors, we keep our cyclical bias, overweighting IT, materials and financials while underweighting rate-sensitive sectors such as real estate, utilities and telecoms.

Equities*

	1 to 3 months	until June 2018
Regions		
United States	🔴	→
Europe	🟢	↗
Eurozone	🟢	↗
Germany	🟢	↗
Switzerland	🟡	→
United Kingdom (UK)	🟡	↗
Emerging Markets	🟢	→
Asia ex Japan	🟢	→
Japan	🟡	↗
Latin America	🔴	↘
Sectors		
Consumer staples	🟡	
Healthcare	🟡	
Telecommunications	🔴	
Utilities	🔴	
Consumer discretionary	🟡	
Energy	🟡	
Financials	🟢	
Industrials	🟡	
Information technology	🟢	
Materials	🟢	
Real Estate	🔴	
Style		
Small and mid cap	🟢	

Fixed Income**

	1 to 3 months	until June 2018
Rates		
U.S. Treasuries (2-year)	🟡	↗
U.S. Treasuries (10-year)	🔴	↗
U.S. Treasuries (30-year)	🔴	↗
UK Gilts (10-year)	🟡	↗
Italy (10-year)[1]	🟡	→
Spain (10-year)[1]	🟡	→
German Bunds (2-year)	🟡	↗
German Bunds (10-year)	🟡	↗
German Bunds (30-year)	🟡	↗
Japanese government bonds (2-year)	🟡	→
Japanese government bonds (10-year)	🟡	→
Corporates		
U.S. investment grade	🟡	→
U.S. high yield	🟡	→
Euro investment grade[1]	🟢	↘
Euro high yield[1]	🟡	→
Asia credit	🟡	→
Emerging-market credit	🟡	↘
Securitized / specialties		
Covered bonds[1]	🔴	↗
U.S. municipal bonds	🔴	↗
U.S. mortgage-backed securities	🟡	↗

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Currencies		
EUR vs. USD	●	↘
USD vs. JPY	●	↗
EUR vs. GBP	●	→
GBP vs. USD	●	↘
USD vs. CNY	●	↗
Emerging markets		
Emerging-market sovereigns	●	→

Alternatives*

	1 to 3 months	until June 2018
Infrastructure	●	↗
Commodities	●	↗
Real estate (listed)	●	↗
Real estate (non-listed) APAC	●	↗
Real estate (non-listed) Europe	●	↗
Real estate (non-listed) United States	●	→
Hedge funds	●	↗
Private Equity[2]	●	→

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.
- For bonds not denominated in euros, the illustration depicts the spread in comparison with U.S. Treasuries. For bonds denominated in euros, the illustration depicts the spread in comparison with German Bunds.
- For emerging-market sovereign bonds, the illustration depicts the spread in comparison with U.S. Treasuries.
- Both spread and yield trends influence the bond value. Investors who aim to profit only from spread trends should hedge against changing interest rates.

Key

The tactical view (one to three months):

- ●
  Positive view
- ●
  Neutral view
- ●

Negative view

The strategic view up to June 2018

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 ↘ .

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
- ↘ Negative return potential for long-only investors for long-only investors

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 U.S. Treasuries: ↗ depicts a rising spread, → a sideways trend and ↘ a falling spread.

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

- ↘ Positive return potential for long-only investors
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- ↗ Negative return potential for long-only investors for long-only investors

Footnotes:

* as of 9/8/17

** as of 9/14/17

[1] Spread over German Bunds in basis points

[2] These traffic-light indicators are only meaningful for existing private-equity portfolios

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Glossary

Bank of England (BoE)

The Bank of England (BoE) is the central bank of the United Kingdom.

Bunds

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

CBOE Volatility Index (Vix)

The **CBOE Volatility Index (Vix)** is a trademarked ticker symbol for the Chicago Board Options Exchange Market Volatility Index. It is a popular measure of the volatility of the S&P 500 as implied in the short term option prices on the index.

European Central Bank (ECB)

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

Gilts

Gilts are bonds that are issued by the British Government.

High Yield (HY)

High-yield bonds are issued by below-investment-grade-rated issuers and usually offer a relatively high yield.

Investment Grade (IG)

Investment-grade (IG) refers to a credit rating from a rating agency that indicates that a bond has a relatively low risk of default.

MSCI World Index

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

S&P 500

The **S&P 500** is an index that includes 500 leading U.S. companies capturing approximately 80% coverage of available U.S. market capitalization.

U.S. Federal Reserve (Fed)

The **U.S. Federal Reserve**, often referred to as "the **Fed**", is the central bank of the United States.

Risk warning

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

Investments in Foreign Countries – Such investments may be in countries that prove to be politically or economically unstable. Furthermore, in the case of investments in foreign securities or other assets, any fluctuations in currency exchange rates will affect the value of the investments and any restrictions imposed to prevent capital flight may make it difficult or impossible to exchange or repatriate foreign currency. Foreign Exchange/Currency – Such transactions involve multiple risks, including currency risk and settlement risk. Economic or financial instability, lack of timely or reliable financial information or unfavorable political or legal developments may substantially and permanently alter the conditions, terms, marketability or price of a foreign currency. Profits and losses in transactions in foreign exchange will also be affected by fluctuations in currency where there is a need to convert the product's denomination(s) to another currency. Time zone differences may cause several hours to elapse between a payment being made in one currency and an offsetting payment in another currency. Relevant movements in currencies during the settlement period may seriously erode potential profits or significantly increase any losses.

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

Hedge Funds – An investment in hedge funds is speculative and involves a high degree of risk, and is suitable only for "Qualified Purchasers" as defined by the US Investment Company Act of 1940 and "Accredited Investors" as defined in Regulation D of the 1933 Securities Act. No assurance can be given that a hedge fund's investment objective will be achieved, or that investors will receive a return of all or part of their investment. Commodities – The risk of loss in trading commodities can be substantial. The price of commodities (e.g., raw industrial materials such as gold, copper and aluminium) may be subject to substantial fluctuations over short periods of time and may be affected by unpredicted international monetary and political policies. Additionally, valuations of commodities may be susceptible to such adverse global economic, political or regulatory developments. Prospective investors must independently assess the appropriateness of an investment in commodities in light of their own financial condition and objectives. Not all affiliates or subsidiaries of Deutsche Bank Group offer commodities or commodities-related products and services.

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