

Turkish troubles persist

Turkish troubles and market nervousness are likely to persist. But economic contagion should be limited.

The crisis in Turkey is deepening. We do not expect any rapid improvement, but as this crisis is largely homemade, we believe the risk of contagion to other countries should be mitigated. However, there is good reason to expect markets to remain cautious and volatile.

That there were structural imbalances in Turkey's economy was well known. But it has taken a number of negative steps from the government to turn a smoldering crisis into a fierce one. The election promises ahead of the parliamentary and presidential elections in June this year looked unaffordable. President Erdogan's rejection of high interest rates and his statement that high interest rates caused high inflation troubled investors. The further curtailment of central-bank independence and the appointment of Erdogan's son-in-law as finance minister eroded investors' confidence even more. Finally, last week's open dispute between Ankara and Washington fanned the flames. The continuing imprisonment of American Pastor Brunson led Washington to tighten its diplomatic thumbscrews, culminating in last week's statement by U.S. President Trump that the United States will double the tariffs on steel and aluminum from Turkey to 50 and 20% respectively. The lira then plunged, taking its annual loss against the dollar to almost 50%.

After this sudden ratcheting up of the crisis, we believe that Turkey's most pressing problems are:

- An overheating economy with 7.4% economic growth last year, but an estimated inflation rate of 14% for this year – and this rate may well have to be revised upwards in the course of the year.
- An estimated current-account deficit of 6.4% of gross domestic product (GDP) and a budget deficit of 3.0% of GDP this year.
- Short-term financing equivalent to almost the entirety of the current-account deficit.
- 25% of GDP need to be refinanced in the current year.
- A lira that has depreciated by almost 50% against the U.S. dollar and the euro since the beginning of the year.
- An abrupt rise in the yield of 5-year government bonds from 11% to 21% (for lira) and from 4% to 8% (for hard currency) since the beginning of the year.
- A markedly consumer-driven upswing in the past few years, supported by a large number of debt-financed state benefits.
- An increase in corporate debt (excluding banks) from 20% of GDP in 2004 to almost 70% in 2017, more than half of it in foreign currency.

All opinions and claims are based upon data on 13/8/18 and may not come to pass. This information is subject to change at any time, based upon economic, market and other considerations and should not be construed as a recommendation. Past performance is not indicative of future returns. Forecasts are based on assumptions, estimates, opinions and hypothetical models that may prove to be incorrect. Deutsche Asset Management Investment GmbH

CRC 059940 (08/2018)

On the positive side, however, there are also a number of points to be noted:

- The low government debt of 31% of GDP. However, history shows that even such a cushion does not protect against a crisis.
- The positive impact of a weakening currency on exports and tourism.
- Turkey's experience in dealing with crises, which should not be underestimated. Past decades have offered the country plenty of opportunities to learn crisis-management techniques.
- Turkey can bring its NATO membership and its geostrategically important position to bear in the coming negotiations.

There are, moreover, remedies available to treat Turkey's crisis. But we fear the country may be unwilling at present to take the medicine. Two policy steps are advisable:

- A strong interest-rate hike to curb inflation and capital flight and attract back foreign capital.
- Negotiation of an International Monetary Fund (IMF) loan sufficiently large to alleviate the short-term concerns of foreign lenders.

However, Erdogan's aforementioned aversion to high interest rates and the pain they would mean for the domestic economy suggest that a big interest-rate rise will be avoided. Erdogan may also show strong aversion to the usual IMF medicine, which would mean an end to fiscal gifts to the electorate, among other things. Moreover, the United States has already signaled that it would not support a rescue operation by international institutions for Turkey. Elke Speidel-Walz, Chief Economist Emerging Markets at DWS, sums up: "Turkey's financial crisis was not caused by the United States, but at most triggered by it. The fact that Ankara let inflation get out of control and relied on short-term foreign loans to finance the current-account deficit is essentially the reason for the crisis."

For the time being, therefore, there is no alternative but to wait and see which external pressure Erdogan yields to. Though it is also possible he will stick to his unorthodox line. Support from China or Russia could possibly enable him to persist with the current situation for longer.

Asset-class implications

Due to the size of the Turkish economy (2017: 850 billion dollars, calculated at exchange rates at the beginning of the year), we are not too worried about the risk of contagion. The Eurozone exports less than 0.6% of its GDP to Turkey. Nevertheless, we are not taking events in Turkey lightly. Although global macroeconomic figures continue to be robust overall, keeping investors positive, the accumulation of a series of idiosyncratic events could provoke an increase in risk aversion. The rise in yields of Italian government bonds to over 3% on Monday could be interpreted in this way. Diplomatic disputes could worsen quickly this year – though they

All opinions and claims are based upon data on 13/8/18 and may not come to pass. This information is subject to change at any time, based upon economic, market and other considerations and should not be construed as a recommendation. Past performance is not indicative of future returns. Forecasts are based on assumptions, estimates, opinions and hypothetical models that may prove to be incorrect. Deutsche Asset Management Investment GmbH

CRC 059940 (08/2018)

can also quickly calm, as Juncker's visit to Washington has shown. We continue to assume, however, that the peak of the trade dispute has not yet been reached.

We expect market fluctuations to worsen for the time being, having subsided at the beginning of the summer. We remain somewhat more cautious, but differentiate precisely and also see some opportunities in the recent swings. From a tactical perspective, for example, we have reduced European corporate bonds to neutral, but we view selected emerging-market bonds in hard currency more positively than the market. We expect support from lower refinancing requirements in the second half of the year, for example.

With regard to equities, we assume that the situation in Turkey at the individual stock level is primarily reflected in those banks that have larger activities in Turkey.

On the currency side, we expect further pressure on other emerging markets. In our opinion, the flight into the dollar could lead to further gains against the euro, for example, and thus move even further away from our target of 1.15 in the short term.

All opinions and claims are based upon data on 13/8/18 and may not come to pass. This information is subject to change at any time, based upon economic, market and other considerations and should not be construed as a recommendation. Past performance is not indicative of future returns. Forecasts are based on assumptions, estimates, opinions and hypothetical models that may prove to be incorrect. Deutsche Asset Management Investment GmbH

CRC 059940 (08/2018)

Glossary

Current account

The **current account** includes trade in goods and services, a net-factor-income balance (e.g. earnings on foreign investments and cash transfers from individuals working abroad) and transfers (e.g. foreign aid). It is a part of the balance of payments.

Emerging markets (EM)

Emerging markets (EM) are economies not yet fully developed in terms of, amongst others, market efficiency and liquidity.

Eurozone

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

Gross domestic product (GDP)

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

International Monetary Fund (IMF)

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

Turkish lira

The currency of Turkey

All opinions and claims are based upon data on 13/8/18 and may not come to pass. This information is subject to change at any time, based upon economic, market and other considerations and should not be construed as a recommendation. Past performance is not indicative of future returns. Forecasts are based on assumptions, estimates, opinions and hypothetical models that may prove to be incorrect. Deutsche Asset Management Investment GmbH

CRC 059940 (08/2018)

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

All opinions and claims are based upon data on 13/8/18 and may not come to pass. This information is subject to change at any time, based upon economic, market and other considerations and should not be construed as a recommendation. Past performance is not indicative of future returns. Forecasts are based on assumptions, estimates, opinions and hypothetical models that may prove to be incorrect. Deutsche Asset Management Investment GmbH

CRC 059940 (08/2018)

or subsidiaries of Deutsche Bank Group offer commodities or commodities-related products and services.

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

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

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

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

Hong Kong

The contents of this document have not been reviewed by any regulatory authority in Hong Kong. You are advised to exercise caution in relation to the investments contained herein. If you are in any doubt about any of the contents of this document, you should obtain independent professional advice. This document has not been approved by the Securities and Futures Commission in Hong Kong nor has a copy of this document been registered by the Registrar of Companies in Hong Kong and, accordingly, (a) the investments (except for investments which are a "structured product" as defined in the Securities and Futures Ordinance

All opinions and claims are based upon data on 13/8/18 and may not come to pass. This information is subject to change at any time, based upon economic, market and other considerations and should not be construed as a recommendation. Past performance is not indicative of future returns. Forecasts are based on assumptions, estimates, opinions and hypothetical models that may prove to be incorrect. Deutsche Asset Management Investment GmbH

CRC 059940 (08/2018)

(Cap. 571 of the Laws of Hong Kong) (the "SFO") may not be offered or sold in Hong Kong by means of this document or any other document other than to "professional investors" within the meaning of the SFO and any rules made thereunder, or in other circumstances which do not result in the document being a "prospectus" as defined in the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32 of the Laws of Hong Kong) ("CO") or which do not constitute an offer to the public within the meaning of the CO and (b) no person shall issue or possess for the purposes of issue, whether in Hong Kong or elsewhere, any advertisement, invitation or document relating to the investments which is directed at, or the contents of which are likely to be accessed or read by, the public in Hong Kong (except if permitted to do so under the securities laws of Hong Kong) other than with respect to the investments which are or are intended to be disposed of only to persons outside Hong Kong or only to "professional investors" within the meaning of the SFO and any rules made thereunder.

Singapore

Singapore Interests in the funds mentioned herein are not allowed to be made to the public or any members of the public in Singapore other than (i) to an institutional investor under Section 274 or 304 of the Securities and Futures Act (Cap 289) ("SFA"), as the case may be, (ii) to a relevant person (which includes an Accredited Investor) pursuant to Section 275 or 305 and in accordance with other conditions specified in Section 275 or 305 respectively of the SFA, as the case may be, or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA.

Important Information

DWS is the brand name of DWS Group GmbH & Co. KGaA. The respective legal entities offering products or services under the DWS brand are specified in the respective contracts, sales materials and other product information documents. DWS Group GmbH & Co. KGaA, its affiliated companies and its officers and employees (collectively "DWS Group") are communicating this document in good faith and on the following basis.

This document has been prepared without consideration of the investment needs, objectives or financial circumstances of any investor. Before making an investment decision, investors need to consider, with or without the assistance of an investment adviser, whether the investments and strategies described or provided by DWS Group, are appropriate, in light of their particular investment needs, objectives and financial circumstances. Furthermore, this document is for information/discussion purposes only and does not constitute an offer, recommendation or solicitation to conclude a transaction and should not be treated as giving investment advice.

DWS Group does not give tax or legal advice. Investors should seek advice from their own tax experts and lawyers, in considering investments and strategies suggested by DWS Group. Investments with DWS Group are not guaranteed, unless specified.

All opinions and claims are based upon data on 13/8/18 and may not come to pass. This information is subject to change at any time, based upon economic, market and other considerations and should not be construed as a recommendation. Past performance is not indicative of future returns. Forecasts are based on assumptions, estimates, opinions and hypothetical models that may prove to be incorrect. Deutsche Asset Management Investment GmbH

CRC 059940 (08/2018)

Investments are subject to various risks, 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. Furthermore, substantial fluctuations of the value of the investment are possible even over short periods of time. The terms of any investment will be exclusively subject to the detailed provisions, including risk considerations, contained in the offering documents. When making an investment decision, you should rely on the final documentation relating to the transaction and not the summary contained herein. Past performance is no guarantee of current or future performance. Nothing contained herein shall constitute any representation or warranty as to future performance.

Although the information herein has been obtained from sources believed to be reliable, DWS Group does not guarantee its accuracy, completeness or fairness. No liability for any error or omission is accepted by DWS Group. Opinions and estimates may be changed without notice and involve a number of assumptions which may not prove valid. All third party data (such as MSCI, S&P, Dow Jones, FTSE, Bank of America Merrill Lynch, Factset & Bloomberg) are copyrighted by and proprietary to the provider. DWS Group or persons associated with it ("Associated Persons") may (i) maintain a long or short position in securities referred to herein, or in related futures or options, and (ii) purchase or sell, make a market in, or engage in any other transaction involving such securities, and earn brokerage or other compensation.

The document was not produced, reviewed or edited by any research department within Deutsche Bank and is not investment research. Therefore, laws and regulations relating to investment research do not apply to it. Any opinions expressed herein may differ from the opinions expressed by other Deutsche Bank departments including research departments. This document may contain forward looking statements. Forward looking statements include, but are not limited to assumptions, estimates, projections, opinions, models and hypothetical performance analysis. The forward looking statements expressed constitute the author's judgment as of the date of this material. Forward looking statements involve significant elements of subjective judgments and analyses and changes thereto and/or consideration of different or additional factors could have a material impact on the results indicated. Therefore, actual results may vary, perhaps materially, from the results contained herein. No representation or warranty is made by Deutsche Bank as to the reasonableness or completeness of such forward looking statements or to any other financial information contained herein.

This document may not be reproduced or circulated without DWS Group's written authority. The manner of circulation and distribution of this document may be restricted by law or regulation in certain countries, including the United States.

This document is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, including the

All opinions and claims are based upon data on 13/8/18 and may not come to pass. This information is subject to change at any time, based upon economic, market and other considerations and should not be construed as a recommendation. Past performance is not indicative of future returns. Forecasts are based on assumptions, estimates, opinions and hypothetical models that may prove to be incorrect. Deutsche Asset Management Investment GmbH

CRC 059940 (08/2018)

United States, where such distribution, publication, availability or use would be contrary to law or regulation or which would subject DWS Group to any registration or licensing requirement within such jurisdiction not currently met within such jurisdiction. Persons into whose possession this document may come are required to inform themselves of, and to observe, such restrictions.

Unless notified to the contrary in a particular case, investment instruments are not insured by the Federal Deposit Insurance Corporation ("FDIC") or any other governmental entity, and are not guaranteed by or obligations of DWS Group.

© 2018 Deutsche Asset Management (Asia) Limited

Publisher: Deutsche Asset Management Investment GmbH,
Mainzer Landstraße 11-17, 60329 Frankfurt am Main, Germany

All opinions and claims are based upon data on 13/8/18 and may not come to pass. This information is subject to change at any time, based upon economic, market and other considerations and should not be construed as a recommendation. Past performance is not indicative of future returns. Forecasts are based on assumptions, estimates, opinions and hypothetical models that may prove to be incorrect. Deutsche Asset Management Investment GmbH

CRC 059940 (08/2018)