Deutsche
Asset Management

CIO Flash
Chinese equities and currency suffer – what else?
January 7, 2016

+++ CIO FLASH +++ CIO FLASH +++ CIO FLASH +++ CIO FLASH +++ CIO FLASH +++ CIO FLASH +++ CIO FLASH +++ CIO FLASH +++ CIO FLASH

Hefty equity market and currency moves in China send global shockwaves

— The CSI 300 index hit the daily down limit of 7% twice this week. Removal of the major-shareholder selling ban and new circuit-breaker rules added to volatility, as did a weaker-than-expected manufacturing PMI on Monday and the depreciation in the Chinese yuan (CNY) vs. the U.S. dollar (USD). Investors have been taken aback by the speed of the currency moves and the spill over into other asset classes.

— The offshore-traded yuan (CNH) fell to a five-year low. China's foreign-exchange (FX) reserves fell by a record USD 108bn in December to a three-year low. During 2015 reserves fell by roughly half a trillion USD and stood at USD 3.33tn at year-end. This suggests FX intervention by the People's Bank of China (PBoC) last year. However, the PBoC's lack of intervention this week and the impact of the shift in late December from a USD peg towards a currency-basket orientation has increased concerns about further depreciation as well as additional capital outflows.

— Investors may remain unconvinced about the effectiveness of the co-ordination between the PBoC, the regulator and the government. Although China's sovereign debt is mostly in CNY, concerns are centered on the foreign-currency debts of Chinese corporates.

— Fears surrounding China have taken some toll on stock markets across the world. The DAX, for example, is down 8% year to date (January 7, 2016). Oil is trading at its lowest price for 11 years after having broken the price floors set during the financial crisis in 2008. Some fear that the rise in Saudi-Iranian tensions will lead to even more output by gulf producers.

No need to adjust our cautious forecast as of yet – but cautious review warranted

— **At 6%, we already have a relatively conservative growth forecast for Chinese gross-domestic-product (GDP) growth in 2016.** Our forecasts for the major economies already factor in continued weakness in Chinese data.

— **China's domestic equity market is of limited use in gauging the country's longer-term fundamentals, but is rather a measure of Chinese (retail) speculation.** The three periods of turmoil seen since July 2015 followed a steady rise. Since July 2014, the recently battered CSI 300 Index is still up more than 50% (January 7, 2016).

— **The Chinese market should remain policy driven and therefore volatile** – we remain moderately bearish on the China growth picture but expect more reforms and look to the next National Peoples' Congress (NPC) meeting in March to gain more clarity.

— **On a global perspective, recent economic data has been somewhat mixed, but generally constructive.** U.S. households are supported by the improving labor market and household finances as well as real-income gains (cheap oil). Given market jitters, tomorrow's U.S. non-farm-payroll release will be a critical one with any weakness likely to intensify market concerns, but strength potentially helping to stabilize sentiment. The United States' direct exposure to China is less than 1% of GDP (Deutsche AM calculation). Ongoing and persistent market turmoil would of course justify revisiting our currently constructive U.S. growth forecast.

— **Members of the Eurozone are big beneficiaries of the oil-price weakness which is supportive of domestic consumption,** while European consumption is less dependent on the performance of financial markets than U.S. consumption. Within Europe, Germany remains the most exposed to Chinese demand via exports but we have already factored a weak China growth profile into our German GDP forecast for 2016.

— **The picture is similarly mixed across emerging markets.** To be sure, we expect Chinese demand weakness will have substantial knock-on effects for trade- and commodity-dependent countries. At the same time, commodity importers (most of Asia and central Europe) usually benefit from commodity weakness.

Deutsche AWM expectations 2016. Forecasts are based on assumptions, estimates, opinions and hypothetical models or analysis which may prove to be incorrect. No assurance can be given that any forecast or target will be achieved; Deutsche AWM Investment GmbH, CIO Office; Deutsche Bank AG; As of January 7, 2016

Glossary

Explanation of terms

A **circuit breaker** is intended to allow investors to determine whether a situation is really as bad as it looks. The idea is to prevent panic selling by stopping trading after a security or an index has fallen by a certain amount.

With **China‘s five-year plan** the Chinese Communist Party sets out growth and other economic and social targets, helping define government policy priorities.

CNH is the abbreviation for **Chinese yuan** traded offshore, e.g. in Hong Kong.

The **CSI 300 Index** includes the 300 largest companies of the Chinese mainland, that is companies listed on the Shanghai and Shenzhen Stock Exchange (so called A-shares).

A **currency basket** is a weighted collection of select foreign currencies used as the basis for setting the market value of another currency.

The **DAX** is a blue-chip stock-market index consisting of the 30 major German companies trading on the Frankfurt Stock Exchange.

FX or **foreign exchange** is the currency — literally foreign money — used in the settlement of international trade between countries.

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.

The **Purchasing Managers Index** (PMI) is an indicator of the economic health of the manufacturing sector and is based on five major indicators: new orders, inventory levels, production, supplier deliveries and the employment environment.

The Chinese yuan (CNY) is legal tender on the Chinese mainland, also referred to as the Renminbi, RMB.

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

Important Information

Deutsche Asset & Wealth Management represents the asset management and wealth management activities conducted by Deutsche Bank AG or any of its subsidiaries. Clients will be provided Deutsche Asset & Wealth Management products or services by one or more legal entities that will be identified to clients pursuant to the contracts, agreements, offering materials or other documentation relevant to such products or services. Deutsche Asset & Wealth Management offers wealth management solutions for wealthy individuals, their families and select institutions worldwide. Deutsche Asset & Wealth Management, through Deutsche Bank AG, its affiliated companies and its officers and employees (collectively "Deutsche Bank") 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 Deutsche Bank, 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 and is not intended to constitute an offer, recommendation or solicitation to conclude a transaction or the basis for any contract to purchase or sell any security, or other instrument, or for Deutsche Bank to enter into or arrange any type of transaction as a consequence of any information contained herein and should not be treated as giving investment advice. Deutsche Bank 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 Deutsche Bank. Investments with Deutsche Bank are not guaranteed, unless specified. Although information in this document has been obtained from sources believed to be reliable, we do not guarantee its accuracy, completeness or fairness, and it should not be relied upon as such. All opinions and estimates herein, including forecast returns, reflect our judgment on the date of this report, are subject to change without notice and involve a number of assumptions which may not prove valid.

Investments are subject to various risks, including market fluctuations, regulatory change, counterparty risk, possible delays in repayment and loss of income and principal invested. The value of investments can fall as well as rise and you may not recover 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. Further, investment in international markets can be affected by a host of factors, including political or social conditions, diplomatic relations, limitations or removal of funds or assets or imposition of (or change in) exchange control or tax regulations in such markets. Additionally, investments denominated in an alternative currency will be subject to currency risk, changes in exchange rates which may have an adverse effect on the value, price or income of the investment. This document does not identify all the risks (direct and indirect) or other considerations which might be material to you when entering into a transaction. The terms of an investment may 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 investment and not the summary contained in this document.

Deutsche
Asset Management

Important Information (continued)

This publication contains 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. We assume no responsibility to advise the recipients of this document with regard to changes in our views.

This 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.

No assurance can be given that any investment described herein would yield favorable investment results or that the investment objectives will be achieved. In general, the securities and financial instruments presented herein are not insured by the Federal Deposit Insurance Corporation („FDIC"), and are not guaranteed by or obligations of Deutsche Bank AG or its affiliates. We or our affiliates or persons associated with U.S. may act upon or use material in this report prior to publication. DB may engage in transactions in a manner inconsistent with the views discussed herein. Opinions expressed herein may differ from the opinions expressed by departments or other divisions or affiliates of Deutsche Bank. This document may not be reproduced or circulated without our written authority. The manner of circulation and distribution of this document may be restricted by law or regulation in certain countries. 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 United States, where such distribution, publication, availability or use would be contrary to law or regulation or which would subject Deutsche Bank 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.

Past performance is no guarantee of future results; nothing contained herein shall constitute any representation or warranty as to future performance. Further information is available upon investor‘s request. This document contains information not intended solely for the recipients. The information has been considered in investment decisions of our asset management division. All third party data (such as MSCI, S&P & Bloomberg) are copyrighted by and proprietary to the provider.