



FINDING VALUE IN A LOW YIELD ENVIRONMENT

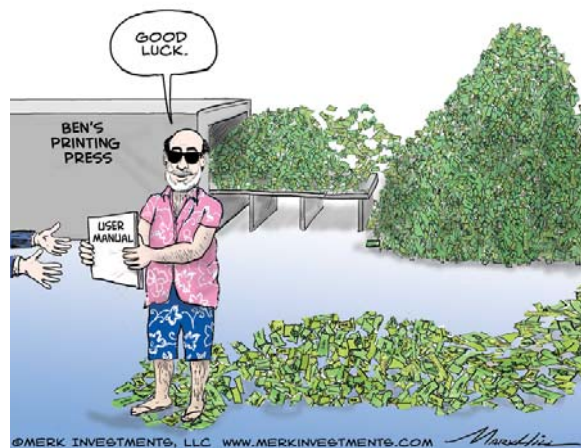
Emiel van den Heiligenberg
Head of Asset Allocation



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Free money crushing yields



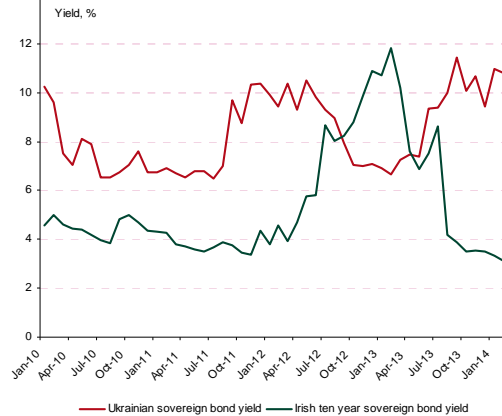
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Finding yield is not the problem ...

- It is always easy to find yield somewhere in the market
- But, finding value is more of a challenge

Yield does not always mean value



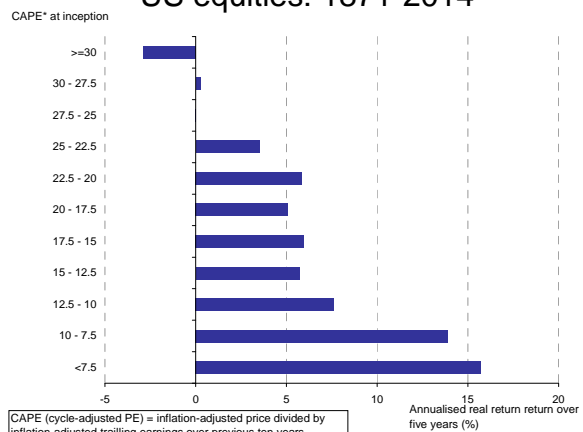
Source: Bloomberg & Datastream



Why does value matter?

"Price is what you pay, value is what you get"
Warren Buffett

US equities: 1871-2014



CAPE* (cycle-adjusted PE) = inflation-adjusted price divided by inflation-adjusted trailing earnings over previous ten years

Source: Robert Shiller & LGIM





What is value?

BRL gov bonds for Euro investor

95% 1yr VaR	29%
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Interest rate expectations
FX risk and default risk

BRL gov bonds for local investor

95% 1yr VaR	15%
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Interest rate expectations
and default risk

...in a portfolio context

Marginal contribution to risk

...with matching liabilities

95% 1yr VaR	11%
-------------	-----

Default risk



Source: Bloomberg L.P. and LGIM



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What is value?

BRL gov bonds for Euro investor		BRL gov bonds for local investor	
95% 1yr VaR	29%	95% 1yr VaR	15%
Interest rate expectations FX risk and default risk		Interest rate expectations and default risk	
...in a portfolio context		...with matching liabilities	
Marginal contribution to risk		95% 1yr VaR	11%
		Default risk	

Source: Bloomberg L.P. and LGIM




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Blowing Bubbles

- Value investing is difficult: you need to buy things no-one likes and that have gone down in price
- Contributing factors to overvaluation can include
 - low prospective returns on safer investments
 - recent good performance of assets
 - strong inflow of capital
 - a wide and easy availability of credit
 - short term performance pressures
 - and a good fundamental story (like internet or China)



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WhatsApp = \$ 19bn?!

*We view the WhatsApp deal as strategically sensible, leaving Facebook well positioned to dominate messaging and **taking out a potentially disruptive competitor.***

*While \$19bn is a large sum, the implied price to **'Monthly Active User'** is in line with comparable deals and though **monetisation is unclear** there should be opportunities in subscriptions, digital goods and content.*

*Such acquisitions admittedly appear a **'cost of doing business'** for Facebook, but at the same time highlight the advantages of scale*



Research report on Facebook from Atlantic Equities February 2014

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What is our value framework?

- Our investment process holds 3 steps:
 - Strategic returns (market efficient returns; valuation independent)
 - Medium term returns (valuation driven)
 - Tactical returns (value aware)

Low expected returns



- Equities 2000
- Credit 2007

High expected returns



- Credit 2009
- REITs 2009

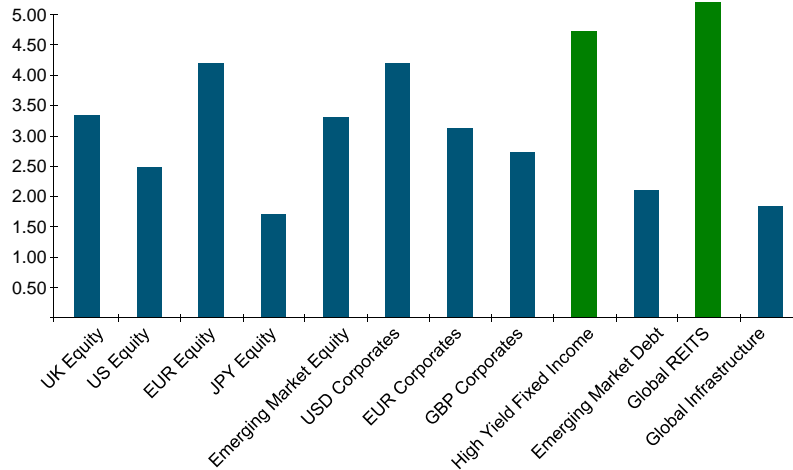


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How did this look like in 2009?

Fundamental Returns vs. Strategic Returns (less cash March 2009)

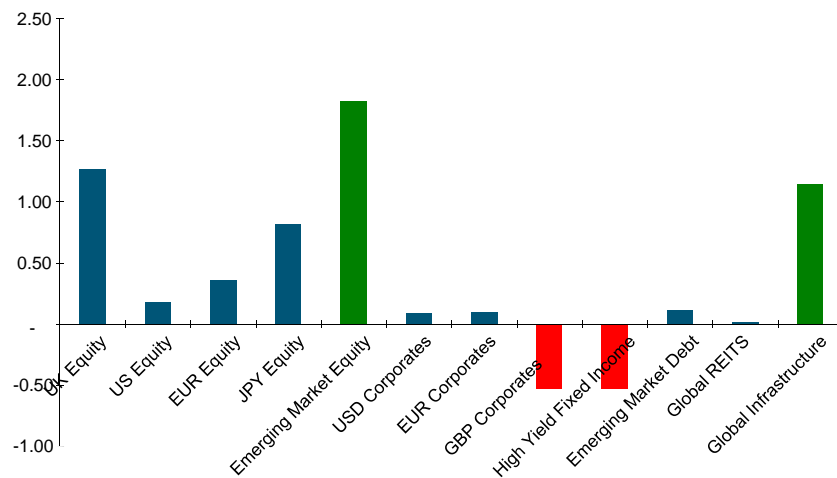


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What are our views on value?

Fundamental Returns vs. Strategic Returns (less cash March 2014)



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Don't forget your free lunch

- Asset allocation is the key driver of investment returns
- Risk Mitigation
- Return enhancement: Diversification bonus (Bernstein & Wilkinson (1997))
- Mitigation of transition and trading costs is key



Thinking beyond value

"In the long run we are all dead"
John Maynard Keynes, 1923





Where do we see opportunities?



- Cyclical upswing: Equities
- UK growth boost: long GBP, short Gilts,
- Euro growth will be ok: long Italian, Spanish and Irish bonds
- Long UK real estate (and Irish)
- Illiquid assets can be attractive

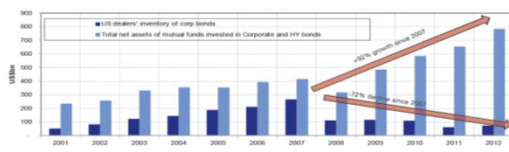


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Risks

US Net Credit Assets vs Dealer Inventory



Source: Deutsche Bank, Bloomberg Finance LP
Deutsche Bank
Credit Services

- China
- Euro zone at the next cyclical downturn
- Misperception on liquidity in Investment grade credits



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