Key points

- As widely expected, the European Central Bank (ECB) yesterday announced “public” (i.e. sovereign-bond purchase) quantitative easing (QE).
- The size of the QE program (at least EUR 1.1 trillion) was at the top end of market expectations.
- Under the program euro-denominated investment-grade securities issued by Eurozone governments and agencies and European institutions will be purchased in the secondary market. Inflation-indexed and floating-rate securities may also be purchased. Maturities will be 2 to 30 years.
- The ECB will also buy negative-yielding assets and agencies.
- The program will initially involve monthly purchases of EUR 60 billion over 19 months (March 2015 – September 2016) and may be extended. This “expanded asset-purchase program” will include existing programs for asset-backed securities and covered bonds.
- Purchases will be made by national central banks as well as the ECB.
- The ECB kept its key interest rates at current levels. There was also a change to the pricing of the remaining targeted longer-term refinancing operations (TLTROs). They had previously carried a 10bp spread over the Eurozone’s main refinancing operations; this spread is now removed.

Surprises/points of interest

- The ECB has clearly learnt the merits of expectations management; any surprises were generally to the upside.
- One surprise was to link the longevity of the program to an explicit inflation commitment. ECB president Mr. Draghi has pledged to continue it until we see “a sustained adjustment in the path of inflation” to being “below, but close to” the ECB’s target of 2% over the medium term.
- The involvement of national central banks was not a surprise, although Mr. Draghi was very keen to stress that the ECB would co-ordinate the purchases and retain control of the design features of the program.
- Most of the central banks’ purchases will not, however, be subject to “risk sharing.” Only the purchases of securities of European institutions (equivalent to 12% of the new purchases) will be subject to “risk sharing.” The ECB will itself hold 8% of the new purchases, implying that a total 20% of purchases will be under “risk sharing”.
- As the inclusion of very long maturities was encouraging – 30yr in particular had been an open question – the curve is flattened.
- The decision to delay the start of the program until March 2015 was not a surprise and did not appear to concern the markets.
- Sensibly, Greece was given no explicit special treatment but, with the country being under review, purchases are not possible at the moment. Note also that ECB holdings are already close to 33% of the total amount outstanding so the room for future maneuver is limited.

Investment implications

- The size of the program ensured an immediate short-term market reaction – the Euro fell sharply, European shares rose, German bund yields fell to record lows and peripheral Eurozone bond spreads fell further. Such euphoria may not last, but we continue to believe that the longer-term market reaction will be positive. Rather more detail on the program was provided than some had expected and this will help douse down market uncertainties. We expect that the ECB’s commitment to continue with the program until inflation normalizes will offset concerns that this might be the last shot in the ECB’s policy locker. ECB action also needs to be complemented by structural reform in individual Eurozone economies, which could be complicated by a weaker Euro.
- Equities: We expect the longer-term impact of the QE announcement on equities to be positive and mainly via foreign exchange rates; it will support our forecasts of a continued weakening in the Euro, so improving the competitiveness of Eurozone companies. For major parts of Europe, currency is likely to become a major tailwind in 2015, supporting earnings upgrades. Conversely, it is becoming a headwind for U.S. companies. As a result, global equity investors may look more favorably on German and other Eurozone companies. Also, with QE likely to maintain lower interest rates for longer, given the attractive dividend yields of equities, the yield differential between bonds and equities might draw additional funds into risky assets in general. QE is already discounted to a certain extent in Eurozone equities’ prices, given their strong recent performance. But history suggests that the actual expansion of central-bank balance sheets – as QE gets underway – is likely to give a further positive impetus. Price-to-earnings expansion in the Eurozone is possible. However, the effects of a generous QE program and the economic stimulus from lower oil prices need to be consolidated by Greece’s election returning a coalition of parties that are unlikely to deviate too much from the current reform agenda. We still expect global equity markets to offer mid-to-high single-digit returns in 2015. Equity investors should consider currency hedging where appropriate.
- Fixed Income: As expected, the positive reaction from the government bond market to QE was broad-based with an acceptance of “lower for longer.” The resulting cash will eventually be invested back into other fixed-income asset classes; corporates, covered bonds and others could benefit as well. Longer-term, if the Euro depreciates as expected, a reassessment of inflation expectations could cause yields to gently move upwards. The market may, however, have not yet fully digested the implications of this scale of QE for market supply/demand and possible negative yields across a range of maturities.
- FX: The Euro fell sharply immediately after the QE announcement and further weakening is likely. In the immediate future, it will remain under pressure in the run-up to Sunday’s Greek elections. Near-term EUR/USD target: 1.12.

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.
Glossary

Explanation of terms

Asset-backed securities (ABS) – A security whose income payments, and thus its value, is derived from and collateralized (or "backed") by a specified pool of underlying assets.

Bunds – Commonly used term for bonds issued by the German federal government with a maturity of 10 years.

Covered bonds – Securities similar to ABS which are covered with public sector- or mortgages loans and remain on the issuer’s balance sheet.

European Central Bank (ECB) – the central bank of the Eurozone. It administers the monetary policy of the Eurozone, which consists of 19 European Union member states.

Eurozone – an economic and monetary union of 19 European Union member states that have adopted the euro as their common currency and sole legal tender.

ECB main refinancing operations – Most important monetary-policy instrument of the ECB to provide liquidity for the Eurozone's money market.

EUR/USD – an abbreviation for the exchange rate of the U.S. Dollar against the Euro.

Floating-rate securities – Securities whose coupon rate is tied to a specified market rate and can change periodically.

Inflation – Continuous and sustained increase of an economy's overall price level.

Inflation-indexed securities – Securities whose coupon payments are tied to a inflation rate.

Investment Grade (IG) – A rating that indicates that a municipal or corporate bond has a relatively low risk of default.

Key interest rates – Interest rates stated by central banks to determine the most important rates of borrowing.

Liquidity – In this context liquidity is referring to the ECB providing markets with additional central-bank money by buying securities through its QE program.

Outright Monetary Transaction (OMT) – a sovereign bond purchase program of the ECB.

Price-to-Earnings (P/E) Ratio – compares a company’s current share price to its per-share earnings.

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

Risk sharing – the pooling of the risk associated with some assets bought by national banks and the ECB as part of its QE program. The burden of any losses would be shared across these entities.

Secondary market – a market where investors purchase securities or assets from other investors, rather than from the issuers themselves.

Sovereign bonds – bonds issued by governments.

Spread – The term refers to the excess yield various bond sectors offer over financial instruments with similar maturities. When spreads widen, yield differences are increasing between the two sectors being compared. When spreads narrow, the opposite is true.

Targeted longer-term refinancing operations (TLTROs) – The European Central Bank's targeted long-term refinancing operations are actions by the ECB to provide financing to Eurozone’s banks.
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.
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 us 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.

Additional information for wealth management clients: For investors in the United States: Wealth-management services are offered through Deutsche Bank Trust Company Americas (member FDIC) and Deutsche Bank Securities Inc. (member FINRA, NYSE, SIPC), a registered broker-dealer and investment adviser which conducts investment banking and securities activities in the United States. Deutsche Bank AG, including its subsidiaries and affiliates, does not provide legal, tax or accounting advice. This communication was prepared solely in connection with the promotion or marketing, to the extent permitted by applicable law, of the transaction or matter addressed herein, and was not intended or written to be used, and cannot be relied upon, by any taxpayer for the purposes of avoiding any U.S. federal tax penalties. The recipient of this communication should seek advice from an independent tax advisor regarding any tax matters addressed herein based on its particular circumstances. Deutsche Bank AG is authorised under German Banking Law (competent authority: BaFin - Federal Financial Supervisory Authority) and by the Prudential Regulation Authority and subject to limited regulation by the Financial Conduct Authority and Prudential Regulation Authority. Details about the extent of our authorisation and regulation by the Prudential Regulation Authority, and regulation by the Financial Conduct Authority are available from us on request. © 2015 Deutsche Bank AG. All rights reserved. R-32727-2 (01/15) 020219 012315 WM-PUBLIC RETAIL-PUBLIC