

**ETF Note: DB X-Tracker Euro ETF**

JSE Code: DBXEU	Tracks: 50 Large Cap European stocks	Last updated: 02 August 2010
Issuer: Deutsche Bank	Risk level: High, equity	Performance YTD: -16%

Characteristics:

The aim of this **ETF** is to give the investor direct exposure to the Dow Jones Eurostoxx 50 Index. This index is made up of 50 of the largest and most freely traded European shares.

As the underlying shares are held in Euros, the instrument also provides a viable way of **hedging** one's exposure to the Rand/Euro exchange rate as well as allowing investors to gain the benefits of offshore diversification without having to utilise your offshore investment allowance.

When purchasing the ETF in Rands, you are effectively locking in an exchange rate and a level of the index simultaneously (please see the example of how this works below). You are then entitled to your share of all the dividends that flow from these companies during the term of your investment. These dividends are aggregated and distributed to owners of the ETF twice a year. The current dividend yield is 3.08%.

The index is based on a free float market capitalization methodology, which selects the shares that go into the index based on the size of a company's free float. A company's free float is considered to be the average number of shares that are readily available to trade by the investing public.

The companies that make up the index are headquartered in 12 of the 16 countries that make up the Eurozone: Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal and Spain. However the index is heavily biased towards companies based in France, Germany and Spain which combined form 78% of the index. The index does not include any companies based in the UK.

Some of the well known companies in the index include: Total, which is also the single biggest constituent of the index at 5.76%, Daimler, Nokia, Unilever, Allianz and Volkswagen. The index is heavily weighted towards Banks and Insurance companies which make up over a quarter of the index from a sector classification view, and are

What the bulls say:

- Markets have priced in much of the bad news, and companies in the index are at relatively cheap levels historically. This is a good time to get exposure to some of the world's largest and most well known companies.
- Protects your wealth against any depreciation in the Rand.
- No need to use your offshore allowance to invest in the product.

What the bears say:

- The Eurozone has pretty depressed long-term growth potential.
- The Rand will remain strong for some time to come.
- Are we headed for a double dip recession?



An example of how the DB-X Trackers reflect the movement in the exchange rate and index, in its Rand price:

On the 1st of May you decide to buy 1 ETF. It costs R40.

On the date and time you buy the ETF:

The Rand/EU exchange is R11 to 1 Euro. Your ETF in Euros is therefore worth €3.64.

The DJ Eurostoxx Index is at 3000 points.

On the 31st of May you decide to sell your ETF.

The index is now at 3300 points, an increase or return of 10%. This would mean that the price for your ETF has moved from €3.64 to €4. However:

The R/€ exchange rate is now at R10.45, an appreciation of 5% by the Rand. Your €4 ETF converted back to Rands is now R41.80. Which represents a total return on your original investment of 4.5%.

This demonstrates how the gain in the index can often be offset against a loss in the exchange rate. The price of the ETF in Rands, continually reflects the changes in the two variables.

represented by such giants as Bank Santander, BNP Paribas and Deutsche Bank.

Fundamental View

Events in Europe have dominated the investment markets over the last few months, as the credit crisis of 2007/2008 spread from Banks to Governments. The market got wind of problems with Greece repaying its debts towards the end of last year and the full effects of this began to be felt in February 2010. This has weighed heavily on the performance of the underlying index as investors, worried about the prospects for economic growth in the Eurozone, absorbed the effects of 'austerity' measures being implemented by Governments across Europe to get to grips with their overspending, and implement the 'belt tightening' measures so necessary to return budget deficits to more acceptable levels.

A brief look at the graph below will show how the index (which is priced in Euros) has declined over the year due to these doubts. The other element affecting the performance of the ETF has been the impressive appreciation of the Rand against the Euro, which has further exacerbated the negative performance of the ETF (which is priced in Rands – the mechanism underlying the price of this ETF is described in the adjacent table).

Consequently if we look at the performance of the DJ Eurostoxx 50 Index, which this ETF aims to track, we note that the annualised return for the last 5 years has been a -4.10%. This low performance can be attributed largely to the sharp fall in equity markets following the sub-prime disaster, (as can be seen in the graph below) and the recent issues around sovereign debt. If we look at the annualised return since the index was

created back in 1991 we see that the compound annual return is modest 5.17% p.a.

Europe has long been regarded as the 'Rich Old man' of the world economy, and consequently any broad investment in her economies and markets will be less politically risky, but unlikely to provide the superior returns that can be found elsewhere in the world. A look at the long-term performance of the underlying economies reveals that the average GDP growth rate for the Eurozone in this decade (2001 – present) has been 1.75%, and in the decade before this, GDP growth averaged 2.2%. We think these low rates of growth are expected to continue.

We do however think that the market has priced in much of the bad news as many of the companies that are included in the index, are trading at levels that are historically quite cheap -



so we are expecting the index to recover slowly in the medium term, but due to constraints highlighted above, we don't expect any amazing returns over the long-term.

The Rand has appreciated by 15% against the Euro over the last year, and we certainly would not be surprised if this reversed somewhat in the coming months. But for investors worried about the Rand, this investment will serve to protect you against any depreciation in our local currency against the Euro. This ETF is therefore suitable for those wanting insurance against any adverse movement in the Rand/Euro exchange rate.



1 Year performance of Dow Jones Eurostoxx 50 Index (grey) vs DBX Euro ETF (black). The divergence is caused by the Rand/Euro exchange rate (see below).



1 Year performance of the Rand vs the Euro. The graph shows the remarkable appreciation of the Rand from R11.26 to R9.58 against the Euro in the last year.

Source: Profile Media

**Portfolio construction:**

Investors looking for offshore diversification would use this product to gain exposure to the broad performance of the established (western) European equity markets, and implicitly the long-term growth prospects of the Eurozone. In many ways this instrument is comparable to the aims of our local Top 40 index.

The key benefit of the DB X Trackers is that you do not need to use your off-shore investment allowance (which has now been increased to R4m per individual) to invest in the product.

The idea would therefore be to use the X Trackers as part of a broader offshore diversification strategy whereby any asset class or exposure not covered by the X trackers would be utilised by your actual offshore investment allowance. The inclusion and weighting of a product like this in your portfolio would need to be discussed with a registered financial advisor.

We are great fans of the benefits that come from Rand cost averaging as a result of purchasing ETFs on a regular basis through an investment scheme, and this can be done with the X – Trackers as well, through an investment scheme offered by AOS on behalf of Deutsche Bank, or through ETFSA.

If you decide you would like to invest in this ETF through the investment scheme, there will be some additional costs involved. These include:

Monthly debit order fee of R4.50.

For acquiring the ETFs: 0.1% of the monthly amount.

Then there is an ongoing /management fee based on the value of your total portfolio:

Amounts < R1m 1% p.a

Amounts > R1m 0.55% p.a

For selling your ETFs: 0.1% of the value of the transaction.

Fees and alternatives:

This is the only ETF of its kind available in South Africa that covers this particular index of stocks or any European shares in general. The TER (Total Expense Ratio) of 1.14% is the same for all five of the products offered by Deutsche Bank and ranks third highest when compared with its peers on the JSE. However this is a crude comparison as there are no other ETFs available locally (outside of the DB X Trackers) that give exposure to any offshore equity markets.

When compared with its peers overseas, for example the Barclays iShares DJ Eurostoxx 50, the TER of 0.15% is a lot lower than the DB X Tracker's 1.14%. Much of this difference can be explained due to the Foreign Exchange conversion Deutsche Bank must enter into every time Rands are shipped across to Europe.



If you have Sterling or Euros available overseas you could look to invest in the Deutsche Bank version of the ETF (www.dbxtrackers.co.uk) which lists its TER at 0%.

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