CANDY GPS REPORT

The Global Prime Sector and beyond

Research produced by savills

CANDY & CANDY LONDON

In partnership with Deutsche Asset & Wealth Management

WELCOME...

In the latest issue of the Candy GPS Report, produced in partnership with Deutsche Asset & Wealth Management and with exclusive research from Savills, we look at the global prime residential sector and beyond. For many ultra-high-net-worth individuals (UHNWIs) real estate has become a unique asset class with investment to date focusing on prime property in the top tier world cities, which have shown record market growth. However, as these cities start to show signs of becoming fully valued investors are looking at alternatives, both in secondary and second tier cities. We have identified 12 rising stars with the potential to show strong residential property price growth in the coming years.

Nicholas Candy
CEO, Candy & Candy

Hong Kong

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REAL ESTATE: A UNIQUE ASSET

After years on the outskirts of asset allocation, property is starting to move into the prime investment arena traditionally occupied by stocks and bonds. Mark Roberts and Jamaila Patel from Deutsche Asset & Wealth Management's Alternatives and Real Assets team explain why

Johann Wolfgang von Goethe, one of Germany's foremost thinkers, once remarked that: "Many people take no care of their money till they come nearly to the end of it, and others do just the same with their time." Capital markets are also subject to periods of what former Fed Chairman Alan Greenspan called irrational exuberance: excessive optimism that comes just before a crash. When it comes to capital markets, we believe there is always room for optimism – provided that it is tempered with a measure of caution. A robust investment strategy should consider all possible outcomes and be equipped to respond to all eventualities. Asset allocation is at the heart of the investment process which, in its classic form, might divide investments into three categories: cash, core, and speculative.

London, UK

ASSET ALLOCATION

With the exception of periods of extreme inflation, the value of cash is relatively stable; cash is also the most liquid asset class. Cash is an integral part of any wealth portfolio: while returns are minimal, particularly in a low interest environment, there is very little risk. Investors need cash to meet their day-to-day spending obligations and for unforeseen events, ranging from financial shocks to investment opportunities. However, cash should not comprise too much of an overall asset allocation as, over time, even low levels of inflation will erode its value.

The allocation to core investments is designed to deliver steady growth over a defined period of time, in line with the client's risk tolerance. Typically, this core asset allocation comprises the more traditional investment asset classes: stocks and bonds.

Finally, part of an investor's portfolio may be reserved for speculative investments. These opportunities can offer relatively high potential returns, but many also carry high levels of risk and illiquidity. For example, an investment in private equity can deliver big returns, but capital can be locked in for long periods of time. An investment in a hedge fund of funds may be more liquid, but, depending on the manager's strategy, exposures to certain market segments may increase overall value at risk.

Ultimately, it is important to remember that asset allocations are highly personal. Investors in different geographies and with different risk appetites will need different asset allocations. Moreover, markets and economies are always evolving – meaning that asset allocations will need to change over time. Given these fluctuations, it is essential that investors have total transparency over the process used to determine their asset allocation.

UNIVERSAL EXPOSURE

Real estate is unique among asset classes. There is almost universal exposure to it: home owners and tenants alike are impacted by shifts in the property market. What's more, there are personal and political drivers of real estate asset prices: it is hard to imagine people getting quite so emotional about 10 year treasury bonds, for example.

However, from an investor's perspective, real estate is far more than bricks and mortar, home and hearth: it is a dynamic asset class that combines capital appreciation with significant income potential. Asoka Wöhrmann, Deutsche Asset & Wealth Management's Co-Chief Investment Officer, believes that property is moving into the investment world's mainstream: "People are looking for stable investments and real estate looks good from a total return perspective." Wöhrmann credits recent under-performance in fixed income markets with the move of real estate to centre stage: "Equities are performing well, but people are still cautious, and fixed income does not look as compelling any more. Real estate is looking far better from a volatility and risk reward perspective."

CORE INVESTMENT STRATEGY

For many UHNWIs property is more than an asset class: it is a livelihood. Real estate is the fourth most common industry sector amongst UHNWIs, according to the Wealth-X and UBS World Ultra Report 2013. With so many fortunes made from real estate, it is no surprise that it has always been a core asset class. Carlos Arrizurieta, a Managing Director in Deutsche Asset & Wealth Management's Florida office, finds that his clients have as much as 75% of their investment portfolio dedicated to direct real estate. "My clients always see opportunities in real estate, either buying or selling," Arrizurieta remarks. "The only difference I've noticed between today and pre-crisis is that, today, people are far more likely to stick with what they know." ▶

> With so many fortunes made from real estate, it is no surprise that it has always been regarded as a core asset class

Jakarta, Indonesia

Michael Darriba, Head of Deutsche Asset & Wealth Management's Lending and Deposit Products team in the UK, agrees. "Our UHNW clients aren't often concerned about liquidity. Should the market drop, they'll typically choose to hold onto the asset until prices correct themselves, whilst retaining sufficient liquidity to meet lending value shortfalls should they occur." London remains the world's capital for overseas property investors, attracting buyers with its track record of capital appreciation. In fact because of restricted supply of high quality assets in prime locations, Darriba has seen an increasing number of clients shift their focus to more secondary locations.

Asian clients have a similar view on real estate and its role in an overall investment strategy. Lynn Hermijanto in Singapore observes: "Real estate has always been a core asset class for Asian clients. A number of our clients buy assets overseas to increase portfolio diversification; recently, we've seen clients buying high-value properties in cities such as London and Paris, and countries such as Australia and the United States. What's more, investor sophistication is increasing – clients are employing hedging strategies to limit their exposure to currency and interest rate fluctuations."

INVESTMENT OPTIONS

There are two options available to investors looking for exposure to property markets. Direct stakes in real estate provide investors with control over asset level decisions and the ability to impact asset performance directly, for example, through change of use, refurbishment, or revising tenancy arrangements. It is possible to match cash flow with anticipated liabilities through the selection of property type and leasing structure. Investors can control the management and financing of each individual property transaction, so there's a high degree of transparency and flexibility.

On the flip side, direct property investments require a significant degree of expertise . Real estate assets require constant maintenance and oversight; if the investor doesn't have the time or inclination to manage a property, a third party will need to be engaged. Transaction costs are high and there are significant tax and legal considerations. Finally, the liquidity of real estate investments varies significantly by market; liquidity can also dry up very quickly, making it difficult to divest unwanted assets.

Investors also have the option of indirect exposure to real estate, for example through Real Estate Investment Trusts (REITs) – publicly traded companies that invest in income-producing real estate on behalf of investors. REITs allow investors to manage sector rebalancing without having to sell individual properties and to maintain higher levels of liquidity while accessing long-term cash flow profiles. Typically, REITs invest in only one property type or region, allowing active investors to tailor allocations to their own regional and sector preferences.

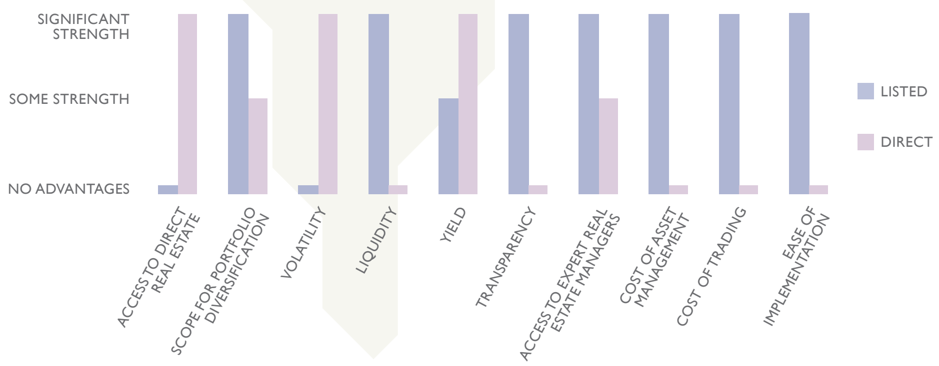
While investors in listed real estate do not have control over property level decisions, there are a number of advantages to consider. There is a much lower knowledge prerequisite, as the property selection and management decisions are made on the investor's behalf. As REITs are publicly listed, investments are liquid and transaction costs are low. Minimum investment lot sizes are much smaller than for direct property investment, making it possible for smaller investors to have equity exposure to multiple large real estate assets which provides diversification.

Even experienced real estate developers can benefit from exposure to REITs. A number of Arrizurieta's Florida clients use REITs to increase portfolio diversification: "My clients rely on me to bring them opportunities that they couldn't otherwise access: international real estate funds and properties elsewhere in the US."

WHAT'S NEXT?

The transition of real estate to the mainstream of investing looks set to continue. As a key source of income in a world where income is hard to come by, we believe real estate will play an important part in the global investment story for years to come.

COMPARATIVE FEATURES OF LISTED AND DIRECT REAL ESTATE



ASSET CHARACTERISTIC

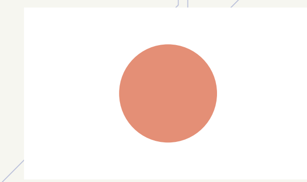
Source: Deutsche Asset & Wealth Management

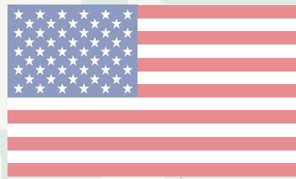
UHNWI INVESTMENT: SOURCES OF CAPITAL

The property purchasing habits of UHNWIs demonstrate that a handful of nations dominate global real estate investment says **Yolande Barnes**, Director, Savills World Research

The number of UHNWIs, those with wealth exceeding US$30 million, reached almost 200,000 in 2013. Their combined wealth of $27.8 trillion is forecast to exceed $40 trillion by 2020, according to Wealth X. The growth in the ultra-rich and their predilection for real estate investments is opportune. At a time when credit markets have been shrinking in the wake of the 2008 global financial crisis, UHNWIs have provided equity in real estate deals that may otherwise not have taken place.

Savills has analysed the real estate holdings of these individuals, and discovered that a small number of countries dominate global real estate investment. Three markets: Germany, Japan and the United States top the list as the global locations with the highest value direct real estate investment by UHNWIs. Together they account for 39% of all UHNWI global real estate holdings.





GERMANY

Germany is the biggest source of UHNWI investors in real estate globally, with holdings totalling some US$945 billion, 18% of the world total. With the most UHNWIs in Europe, the country tops both Switzerland and the UK, which are both often perceived as the major European centres of wealth. Germany outstrips Japan as the single biggest UHNWI real estate investing country, despite its smaller overall UHNWI population of 17,820 individuals. Germans are highly domestic in their real estate holdings – focus cities for German UHNWIs include Frankfurt, Munich and Hamburg, which correspond with the major wealth-generating industries of finance, engineering, manufacturing and the media.

Munich, Germany

JAPAN

Japan is the second biggest source of UHNWI real estate investment globally ($621bn, 12% of the world total), and is global in its reach. It is symptomatic of what happens when domestic markets stagnate, but the opportunity and financial cost of money is cheap. Overseas real estate has been an attractive asset class for the past 20 years while domestic markets have faltered, and as a consequence, Japanese UHNWIs are major cross-border, outward investors. That said, with Abenomics taking effect, Japan's real estate markets are gaining momentum and recording price rises. We expect more focused investment to follow.

> JAPANESE UHNWIs ARE MAJOR CROSS-BORDER, OUTWARD INVESTORS

Japan is Asia's top country for UHNWIs, and with 14,270 individuals it is no surprise that Japanese UHNWI direct real estate holdings are among the largest for any single country.

The rest of Asia's UHNWI real estate investment is dominated by the major powers of China ($379.7bn) and India ($310.3bn), which are both overwhelmingly domestic markets. Hong Kong ranks particularly high in terms of direct real estate investment per UHNWI, in part due to the exceptionally high capital values in the Special Administrative Region.

UNITED STATES

The US is home to the largest number of UHNWIs in the world, a total of 65,505 in 2013, but American UHNWIs have a lower propensity to invest in property so they do not hold the most real estate in the world by value. Averaging just $8.1 million of real estate per UHNWI, their holdings total $530.8 billion, second to the Japanese and Germans. This reflects less interest in real estate investment over other assets such as financial instruments and the relatively low average property values in the US. The majority of American UHNWIs hold their property in the US. Indeed few of them venture outside their own country to buy property. This partly reflects the incredible breadth of real estate on offer in the United States. It is possible ▶

New York City, US

to own a property in a top tier world city, an international ski resort, on a world-class golf course or prized beach, complemented with commercial assets and productive agricultural land – all in the same country.

By contrast, Canadian UHNWIs, although dwarfed by the US in their number, are far more significant real estate investors. With an average value of $20.6 million per UHNWI, together their holdings total $102.5bn, on a par with the French, Canadian UHNWIs are much more likely to own property outside Canada, particularly in the United States.

THE NEW CONTENDERS

Asian UHNWI numbers and wealth are forecast to grow faster than any other global region in the next five years. China, India and Hong Kong are poised to strengthen their positions in the top 10 real estate investing nations.

Downside risks emerging from the Eurozone crisis may put pressure on German UHNWIs along with other major European UHNWI groups, but it would take a major shock to displace Germany from the top, particularly given the resilience of the German real estate market. It seems likely though that the "Rest of Europe", a collection of smaller European nations, may forfeit their collective position to ultra rich groups in the emerging nations.

Shanghai, China

BEST ADDRESSED: ALPHA CITIES

Real estate investment by UHNWIs has moved markets in the top tier Alpha Cities, says **Paul Tostevin**, Associate Director, Savills World Research

New York City, US

The best addresses in the world are urban; real estate investment is a world city phenomenon, so a disproportionately large amount of UHNWI investment goes into a disproportionately small number of top cities. Global cities are where wealth is made, stored and invested so the selection of a city as a home often reflects other financial commitments there.

Our analysis suggests that just under half of all UHNWI real estate investment by value, some 48%, has been into Alpha Cities, the world's top tier of global urban centres as defined by Globalization and World Cities Research Network (GaWC). These are the world's 45 most interconnected and significant cities to the global economy. They include all the major world cities, such as London, New York and Hong Kong, as well as important regional centres such as Taipei, Jakarta and Barcelona. They account for just 5% of the world's population, but attract half of the real estate investment of the richest people on the planet.

ALPHA CITIES

The two major UHNWI investors in global real estate by value, Europeans and Asians, have different purchasing habits. Some 65% or $1.2 trillion of Asian UHNWI's real estate holdings are focused in Alpha Cities. While the number of Asian UHNWIs has grown rapidly, leisure pursuits are typically urban, and consequently the demand for super luxury real estate in the region has been a city phenomenon rather than a rural one. This buying behaviour has concentrated capital in certain markets, particularly new-build ones, and into the prime sector where investment has been for "safe haven store of wealth" with an eye on capital appreciation. European UHNWIs, by contrast, have their real estate wealth more evenly distributed between world cities (46% or $1.1 trillion) and second tier and non-city locations (54% or $1.3 trillion), as they seek to complement their city base with a rural or coastal retreat.

TOP CONURBATIONS

We have also analysed the biggest city recipients of this UHNWI investment. Five cities, Hong Kong, London, Moscow, Singapore and New York, account for 40% or $2.2 trillion of all global UHNWI real estate holdings, by value. All five cities have seen in excess of a hundred billion dollars of UHNWI real estate investment.

Hong Kong is home to the largest amount of direct real estate holdings by value ($798 billion), more than anywhere else in the world. The value of Hong Kong holdings are high because of the weight of mainland Chinese investors pushing into this market, combined with the extremely high property values found in that city. The investment behaviour of the ultra rich is different from that of corporate and institutional investors. The most active commercial markets in the twelve months to February 2014 were New York and London, with Hong Kong making only tenth. But direct ownership by UHNWIs shows that it has been a much more popular market in the world of private wealth.

> An international centre at the confluence of global time zones, London is arguably the world's most global city

London, at $676 billion has been the second most invested real estate city and this echoes its position among big ticket corporate investors too. London is a city that we identify as having the broadest reach in attracting UHNWIs from across the entire globe. An international centre of business and culture at the confluence of global time zones, London is arguably the world's most global city. Unlike Hong Kong, which is reliant on Asia for its wealth, London is unique in attracting a volume of real estate (and other) investment from every single global region.

The remaining UHNWI real estate holdings, by value, are concentrated in the world cities of Moscow ($263 billion), Singapore ($217 billion) and New York ($164 billion), all important on the global stage for the wealthy.

Moscow is Russia's centre of wealth and although highly domestic, it boasts a mature and expanding prime residential market.

Singapore is highly regarded as an international centre of business and finance, and attracts real estate investors from across the Asia Pacific region, with particular concentrations from China, Malaysia and Indonesia.

New York, meanwhile, stands out as the real estate investment capital of the Americas – only standing in fifth place in the world city rankings due to its comparatively low average capital values by the standards of the other top tier world cities.

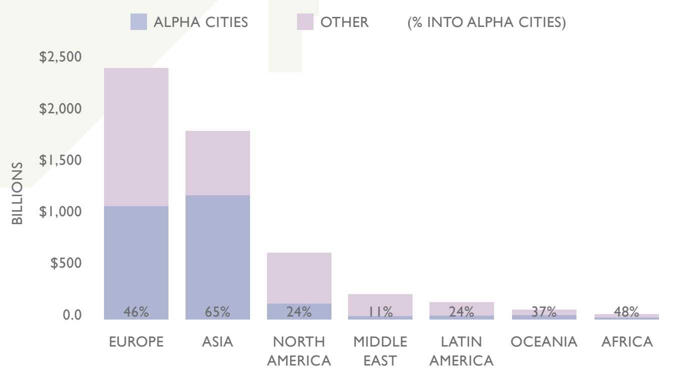
The concentration of this wealth into such a small group of major cities has moved the top tier real estate in these elite cities. According to Savills World Cities index, global city markets have outperformed leisure real estate markets with average annual growth of 11% between 2006 and 2012, against 5% average annual growth outside the major urban centres.

Already, canny investors with an already full "trophy asset" portfolio are looking with more interest at the yields available from real estate. Those looking for income-producing properties are more likely to find high and rising rental incomes in the places where capital values have not been driven by UHNWI inward investment.

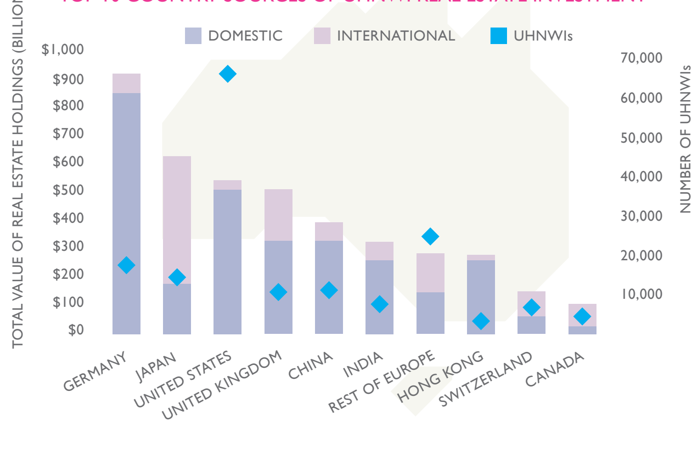
In practice, this means secondary locations within existing world cities, as well as an increased focus of attention on the residential real estate of those second tier cities around the world that have not yet seen substantial capital growth.

Singapore

UHNWI REAL ESTATE INVESTMENT INTO ALPHA CITIES



TOP 10 COUNTRY SOURCES OF UHNWI REAL ESTATE INVESTMENT



Source: Savills World Research, Wealth-X

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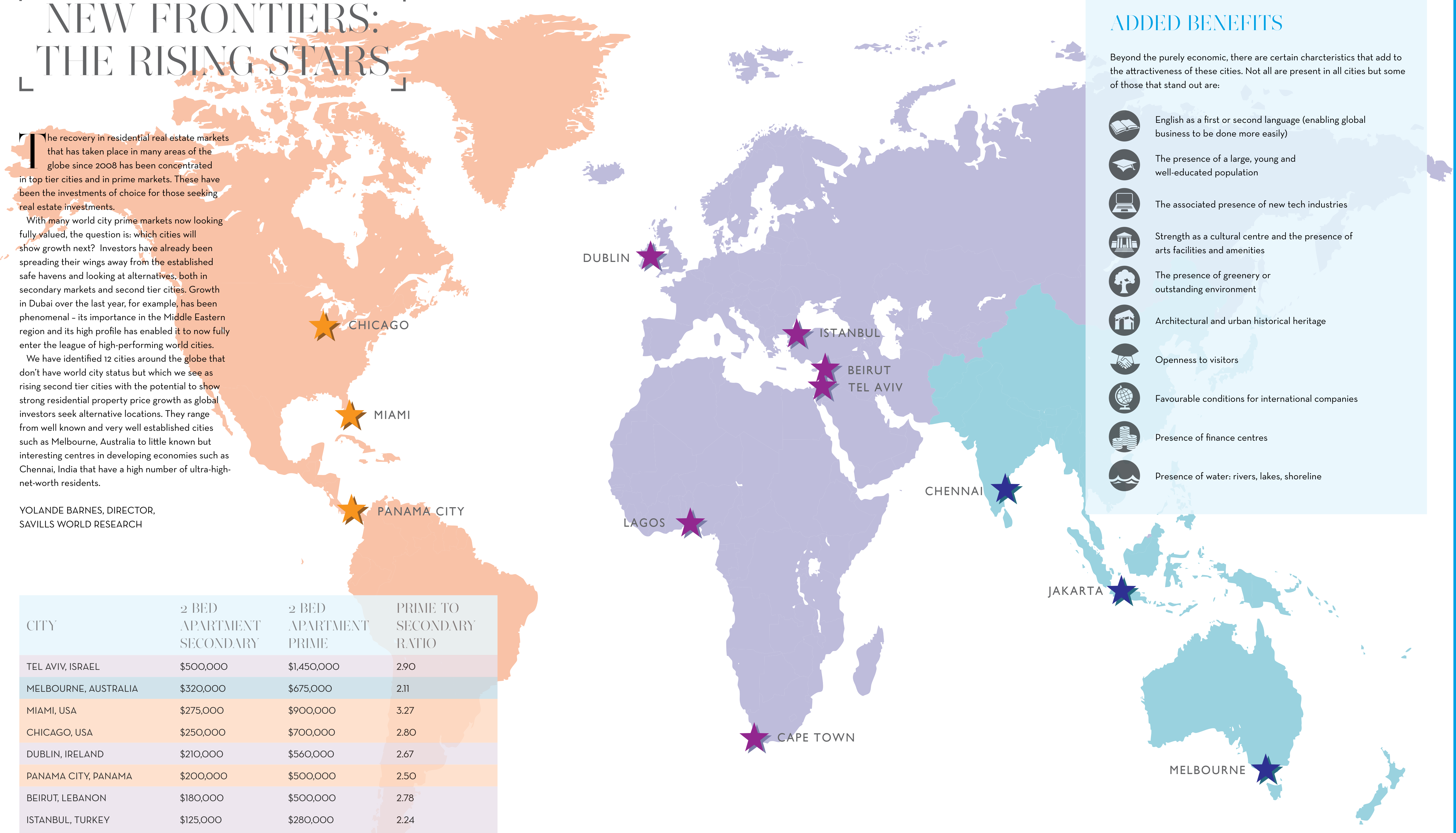
NEW FRONTIERS: THE RISING STARS

The recovery in residential real estate markets that has taken place in many areas of the globe since 2008 has been concentrated in top tier cities and in prime markets. These have been the investments of choice for those seeking real estate investments.

With many world city prime markets now looking fully valued, the question is: which cities will show growth next? Investors have already been spreading their wings away from the established safe havens and looking at alternatives, both in secondary markets and second tier cities. Growth in Dubai over the last year, for example, has been phenomenal – its importance in the Middle Eastern region and its high profile has enabled it to now fully enter the league of high-performing world cities.

We have identified 12 cities around the globe that don't have world city status but which we see as rising second tier cities with the potential to show strong residential property price growth as global investors seek alternative locations. They range from well known and very well established cities such as Melbourne, Australia to little known but interesting centres in developing economies such as Chennai, India that have a high number of ultra-high-net-worth residents.

YOLANDE BARNES, DIRECTOR,
SAVILLS WORLD RESEARCH



CITY	2 BED APARTMENT SECONDARY	2 BED APARTMENT PRIME	PRIME TO SECONDARY RATIO
TEL AVIV, ISRAEL	$500,000	$1,450,000	2.90
MELBOURNE, AUSTRALIA	$320,000	$675,000	2.11
MIAMI, USA	$275,000	$900,000	3.27
CHICAGO, USA	$250,000	$700,000	2.80
DUBLIN, IRELAND	$210,000	$560,000	2.67
PANAMA CITY, PANAMA	$200,000	$500,000	2.50
BEIRUT, LEBANON	$180,000	$500,000	2.78
ISTANBUL, TURKEY	$125,000	$280,000	2.24
CAPE TOWN, SOUTH AFRICA	$110,000	$370,000	3.36
JAKARTA, INDONESIA	$90,000	$260,000	2..89
LAGOS, NIGERIA	$70,000	$300,000	4.29
CHENNAI, INDIA	$40,000	$160,000	4.00

ADDED BENEFITS

Beyond the purely economic, there are certain charcteristics that add to the attractiveness of these cities. Not all are present in all cities but some of those that stand out are:

- English as a first or second language (enabling global business to be done more easily)
- The presence of a large, young and well-educated population
- The associated presence of new tech industries
- Strength as a cultural centre and the presence of arts facilities and amenities
- The presence of greenery or outstanding environment
- Architectural and urban historical heritage
- Openness to visitors
- Favourable conditions for international companies
- Presence of finance centres
- Presence of water: rivers, lakes, shoreline

Source: Savills World Research

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SPOTLIGHT: CITIES ON THE RISE

We have selected 12 cities that are likely to out-perform the prime world cities with growth from a low base as they become more fully invested. Prices in these rising cities are generally much lower than in the world cities, according to **Yolande Barnes**, Director, Savills World Research, which makes them more accessible and potentially attractive to yield-seeking real estate investors

BEIRUT

POP. **1.9M**

CITY GDP (BILLIONS) : N/A
CITY GDP PER CAPITA : $15,557

Prices for a 2 bed apartment typically from $180,000-$500,000

Few of our rising stars here have ever fallen as low as Beirut did during the Lebanese Civil War of the 1970s and 1980s. Since then, the city's story has been one of reconstruction and repair that has left it looking surprisingly strong in the Middle East region. It is an outward-looking Mediterranean coastal city with a strong culture and nightlife, attracting a young population. Beirut is a regional financial centre and has as strong service sector with potential to become more internationally renowned. Real estate in the city still looks very cheap by international standards so there is considerable growth potential.

CAPE TOWN

Prices for a 2 bed apartment typically from $110,000-$370,000

The high quality of the lifestyle in the Cape and the relative safety of the city have attracted residents and investors in the region. Cape Town is a high profile and easily recognisable city with strong international company presence. Current market conditions are poor due to the weak Rand, high inflation and high interest rates but this means that bargain hunting is possible and the city looks cheap on an international scale.

POP. **3.7M**

CITY GDP (BILLIONS) : $56.8
CITY GDP PER CAPITA : $15,721

CHENNAI

POP. **4.3M**

CITY GDP (BILLIONS) : $44
CITY GDP PER CAPITA : $4,902

Prices for a 2 bed apartment typically from $40,000-$160,000

This city (formerly known as Madras) is already a magnet to UHNWIs in the region and is therefore already a recognised and fashionable enclave. It has a diverse economic base, strong cultural life and arts base, including cinema and film production. Chennai has a national park within its boundaries and the nearby Mahabalipuram UNESCO world heritage site further enhances its status.

CHICAGO

Prices for a 2 bed apartment typically from $250,000-$700,000

Chicago is a very American city with an overwhelmingly domestic real estate market that, in common with most of the US, has seen substantial price reductions since 2008. The city is a major US base for multinationals and does have a very high number of international companies located there. Its wealthy suburbs are also home to a significant number of UHNWIs. Residential prices are now beginning to recover but it still looks cheap in relation to world cities and offers high yields. Chicago's growth is likely to be in line with the economic growth of the US so it is an American recovery play.

POP. **2.7M**

CITY GDP (BILLIONS) : $524.6
CITY GDP PER CAPITA : $54,953

> A large, young, well-educated population and the associated presence of new tech industries adds to the attractiveness of these cities

DUBLIN

POP. **527,612**

CITY GDP (BILLIONS) : $87.4
CITY GDP PER CAPITA : $52,123

Prices for a 2 bed apartment typically from $210,000-$560,000

Having seen some of the worst affects of the Eurozone crisis after 2008, Dublin saw some very severe price corrections in its real estate markets. Having taken its economic medicine deep and early, cities like Dublin are now poised for recovery and benefiting from improving economic conditions. Property is still discounted and could be said to offer good value in the context of strengthening industry and growing employment.

ISTANBUL

Prices for a 2 bed apartment typically from $125,000-$280,000

Another city with a young and growing population in a country that is becoming increasingly prosperous, Istanbul has the culture and heritage associated with some of the most desirable real estate in the world and a growing economic base upon which to justify investment. One of the largest urban agglomerations in Europe, Istanbul is a transcontinental city, straddling Europe and Asia.

POP. **13.85M**

CITY GDP (BILLIONS) : $301.1
CITY GDP PER CAPITA : $22,765

JAKARTA

POP. **9.5M**

CITY GDP (BILLIONS) : $224.9
CITY GDP PER CAPITA : $7,247

Prices for a 2 bed apartment typically from $90,000-$260,000

This major urban centre in a fast growing economy is reflecting the growing strength of the country as a whole and has already seen rapid real estate price growth. A growing population and increasing wealth mean that there is probably more to come. Lack of market transparency and quality housing stock may be a problem for those wishing to enter the market.

LAGOS

Prices for a 2 bed apartment typically from $70,000-$300,000

This very fast growing city is generating a large and growing number of UHNWIs. The sheer size and power of the city, fuelled by oil and natural resources points to real estate growth, as does the increasing productivity of its young population. But lifestyle, safety and quality of the housing product is still an issue. Prime residences are particularly scarce and therefore show the highest price multiple over secondary stock in any of our cities.

POP. **21M**

CITY GDP (BILLIONS) : $90
CITY GDP PER CAPITA : $7,500

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> Favourable conditions for international foreign companies include a cultural and historical heritage and an openness to visitors

MELBOURNE

POP. **4.25M**

CITY GDP (BILLIONS) : $166.2
CITY GDP PER CAPITA : $41,374

Prices for a 2 bed apartment typically from $320,000-$675,000

An Australian city that vies hard with Sydney for dominance, Melbourne is one of the most highly developed and high-functioning cities on our list. An important financial centre in the Oceania region, it has strong claims to world city status but a very strong rival in its more prominent neighbour. Like many of our rising stars, it has a strong tech and R&D sector which positions it well for future economic development and prosperity. Given its premier status and the strength of the Australian economy in recent years, it has one of the highest priced real estate markets of our cities but would provide strong "safe haven" status and is likely to become more heavily invested under Australia's "Golden Visa" scheme.

MIAMI

Prices for a 2 bed apartment typically from $275,000-$900,000

Residential property values in Miami are now beginning to recover following severe price corrections after 2008. Prime residential markets in the city have recovered to the extent that they are now virtually in line with their former peaks but other markets remain significantly discounted and offer buying opportunities. Miami offers some exposure not only to the US economy but, due to its high proportion of Latin American buyers, to that region also. It is therefore a dollar denominated investment in a safe jurisdiction with good title and recovery prospects with a Latino flavour.

POP. **419,777**

CITY GDP (BILLIONS) : $246.1
CITY GDP PER CAPITA : $42,915

PANAMA CITY

POP. **880,691**

CITY GDP (BILLIONS) : $19.9
CITY GDP PER CAPITA : $15,500

Prices for a 2 bed apartment typically from $200,000-$500,000

Panama is forecast to be one of the fastest growing economies in Latin America in coming years and is uniquely placed to reflect the growth of world trade as all types of shipping pass through its famous canal. Multinational companies are attracted to Panama city by stable governance and a favourable tax regime so demand for rental accommodation is high. Meanwhile, low residential values mean yields in excess of 8% are obtainable making Panama City a very attractive income play.

TEL-AVIV

Prices for a 2 bed apartment typically from $500,000-$1,450,000

Tel Aviv displays a large number of the characteristics we have identified as boding well for residential property markets and looks an attractive potential investment destination. It has the highest residential property prices of any of our cities reflecting both these attractions and the physical limits to growth that restrict supply in the face of inward migration. Everything from its young, growing and well-educated population, its tech and research based economic growth, the presence of foreign embassies, coastal location and even its UNESCO world heritage site status mark it out as a typical "rising second-tier" world city.

POP. **419,777**

CITY GDP (BILLIONS) : $132
CITY GDP PER CAPITA : $37,767

INVESTMENT OUTLOOK: HOMEWORK REQUIRED

The world's wealthy started this year in a strong financial position. But managing ultra-high-net-worth portfolios is about to get a lot more sophisticated. **Nav Gupta**, a Managing Director in Deutsche Asset & Wealth Management's Key Client Partners team, identifies some intriguing market trends

Most investors will admit that making the right calls is rarely easy. But at least the question was straightforward last year: in or out? With the S&P500 returning over 30%, the correct answer was clearly "in". These days, investors need to be much more subtle about where, when and how they deploy their capital. The smart money is doing its homework.

STARTING FROM STRENGTH

The good news is that ultra-high-net-worth investors start from a position of strength. The years since Lehman's collapse have been turbulent in global markets, but they have been kind to the world's wealthy, who bounced back strongly after 2008 – far better than most other investor groups. Today, the combined wealth of the world's UHNWIs is estimated at $27.8 trillion.

Recent surveys indicate risk appetites are increasing, suggesting wealthy investors will seek to make the 28% of their financial assets held in cash and deposit products work a little harder. How to go about it?

As the slow-paced recovery grinds forward and markets stabilize, we do not expect a repeat of the stellar gains we saw in major global equity indices in 2013. Nevertheless, beneath the relatively flat progression of markets overall, there are a number of intriguing dynamics and dislocations that could offer opportunities to alert investors.

A targeted and diversified investment approach will be crucial to tap into them. As Asoka Wöhrmann, Co-Chief Investment Officer of Deutsche Asset & Wealth Management, has observed: "It's not too late to invest in markets, but investors will have to differentiate. Today's economic environment is all about choosing where and when to play."

Above all, market participants will need access to the full set of tools, across regions, asset classes, and products. Deutsche Asset & Wealth Management's Key Client Partners team is dedicating significant resources to searching for market distortions. Our proprietary models analyse prices across almost every major asset class to identify the best returns available. Below, we highlight six themes to keep an eye on.

THE LONG AND SHORT OF IT

With the panics of recent years fading from memory, developed world stocks will increasingly reflect company fundamentals rather than broad market sentiment. In place of the rising tide that lifted all boats last year, we expect 2014 to be an environment for stock pickers. Investors will again be rewarded for the quality of their analysis of individual companies.

But as major equity markets have already pretty much priced in continued improvement of the global economy, generating returns will be tougher for even the most skilled long-only managers. For this reason, we expect the best long/short equity managers – who buy stocks they think will rise and sell short those they think will fall, giving them the potential to profit in relatively flat markets – could outperform their long-only peers.

THE RETURN OF M&A

In many industry sectors, companies are sitting on substantial piles of cash. With macro confidence growing, management teams are under pressure to use the money or return it to shareholders. Corporate deal flow is increasing.

Consequently, another investment strategy we particularly like at the moment is risk arbitrage. These managers aim to take advantage of changes in equity prices driven by M&A (Mergers & Acquisitions) activity – ie, the buying and selling of companies. If M&A continues to pick up as we expect, it should present risk arbitragers with a wide opportunity set.

PROSPECTS FOR OIL

Oil is a particularly interesting market at the moment. Thanks to fracking – a new technology that makes it possible to extract oil and gas from previously unusable shale deposits – the supply of these fossil fuels is expected to ramp up substantially in the coming years. This has depressed the forward price of oil to an unusual degree: West Texas Intermediate for delivery in five years' time is trading at a 25% discount to oil for delivery today, even factoring in the cost of storing the commodity.

Fracking has also pushed down to historical lows the price of call options on oil – financial instruments that increase in value if oil prices rise above a set level. This is because oil producers are selling lots of call options to hedge their future revenues, in case the surge in supply causes prices to dip below the cost of getting the oil out of the ground.

Producers don't necessarily expect prices to fall; rather, with margins already slender, they can't afford to take the risk that they might. The result is that calls are priced to suggest there is only a tiny chance oil prices will rise over the next five years or so. For investors who think the true odds are different, it is a buyers' market for call options. ▸

> Today's economic environment is about choosing where and when to play. The smart money is doing its homework

CHINESE DEBT SQUEEZE

Much ink has been spilled on the question of whether Chinese banks have lent too much to business entities that might not be able to pay them back. The curious thing is that equity and debt markets seem to have reached markedly different conclusions.

Some investors think Chinese bank stocks have bargain basement valuations, with the average price/earnings ratio of the biggest eight institutions just 4.9 – far less than the 9 to 11 you would pay in the US or Europe. The broad consensus among international equity investors is that they are cheap for good reasons, chief among them the difficulty of getting reliable data on the quality of bank loan books.

In contrast, credit markets appear to have barely registered these concerns. There is relatively little differential between the yields on bonds issued by strong banks, banks perceived to be risky, and the Chinese sovereign itself. The issue for investors is whether debt or equity markets have correctly assessed the risk. They can't both be right, which suggests that at least one type of security is wrongly priced.

RESEARCH AND DUE DILIGENCE

Contingent convertible securities – commonly known as CoCo bonds – are a fairly new class of junior debt. Offering yields of 5%-7%, these bonds convert into equity if a bank's capital ratio falls below a pre-set level – a feature that should mitigate the risk of bank collapses and the need for further taxpayer bailouts. Encouraged by regulators, CoCo issuance by European banks is set to soar over the next few years.

Today these bonds are priced at quite a healthy discount to fair value. The discount reflects three main concerns: the big supply coming down the pipe; investor scepticism about the quality of banks' balance sheets; and the fact that CoCos are not standardized – in fact, no two are alike.

This is an asset class that could reward detailed research. Careful due diligence should enable investors to identify relative value among the 150 CoCo bonds currently outstanding. At the same time, the European Central Bank's Asset Quality Review later this year – a wide-ranging health check on Europe's banking sector – should give investors much better insights into the strength of bank balance sheets. For those with the research resources, CoCos could merit a closer look.

ABENOMICS PAY OFF

For international investors, Japan has been all but a no-go zone for years. But after flat-lining for two decades, the country's economy is on the move at last. Yet despite the fact that Prime Minister Abe's three-pronged approach to stimulating growth has changed Japan's growth trajectory, yields on Japanese Government Bonds (JGBs) remain floored at 0.6%.

These rock-bottom yields are looking increasingly odd. As quantitative easing further weakens the Yen, Japanese investors will have to find another home for the approximately US$10 trillion they hold in cash and deposits – most of which ultimately finds its way into purchases of JGBs – or risk the gradual erosion of their savings.

Admittedly, markets have been waiting for The Great Rotation out of JGBs and into domestic equities and international capital markets for some time. But with some major Japanese institutional investors apparently on the brink of making the move, 2014 could see JGB's at last pick themselves up off the bottom and further gains on the Nikkei.

KEY INVESTMENT THEMES AND HOW TO PLAY

EQUITY MARKETS

After strong returns in 2013, stock markets are more likely to creep up than soar. We're still cautiously bullish on equities this year, as the limited alternatives on offer will keep investors in the market. But the returns for traditional long-only equity managers could be limited. Long/short and risk arbitrage managers may be better placed.

COCO BONDS

Contingent convertible bonds are a relatively new, fast-growing asset class. They're priced at a healthy discount to fair value, partly because of investors' unfamiliarity with them. Consequently, in-depth research could be rewarded. As supply increases, periodic bouts of cheapening could offer attractive entry points for those looking to invest.

CHINESE BANKS

Bond and equity markets have reached different conclusions about the risks associated with Chinese banks. If the equity market is right, we would expect to see much bigger variation in the yields on debt issued by strong banks, weaker banks and the Chinese sovereign. We think investors should lean toward the view of the equity market but, considering balance sheet opacity, they will need to do some research.

OIL CALL OPTIONS

Fracking has enabled oil producers to tap previously inaccessible shale deposits. But the surge in supply is arguably distorting prices of oil-related financial instruments. Buying a call option is a non-consensus hedge against higher inflation and energy costs, and geopolitical risk.

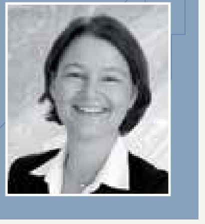
JAPAN

Japan is at last emerging from its long hibernation. With economic growth and an end to the era of deflation, Japanese households and companies may be forced to find new homes for their large cash holdings. If so, both the Nikkei and Japanese Government Bond yields could rise; concurrently, the Yen may fall further.

THE BIG QUESTION

With a notional $10 million to invest, we asked our panel of experts which emerging or second tier city they would choose and why

"In terms of value investing, I'd put my $10 million in Bangkok. It has a balanced economy with tourism, local business and a lot of foreign investment. Thailand has recently experienced some political turbulence but, due to habitual unrest, this is already priced into local real estate valuations. If I were to invest in a holiday destination, DaNang, Vietnam and Niseko, Japan would be at the top of my list. DaNang has gorgeous beaches and is still relatively untouched through prices are increasing. I also love Niseko – for me, it has some of the world's best snow and it's accessible from Hong Kong and China. Valuations came down after Fukishima, but I've noticed a boost in prices recently."



Elke Schoeppl-Jost
CIO – APAC, Deutsche Asset & Wealth Management

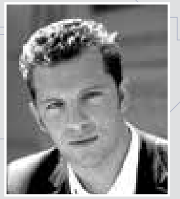
"Despite its small size, Panama is one of the fastest growing economies in Latin America where the prospects for real estate value and rental growth are strong. With its stable government, dollar-based economy, low taxes and positive migration policy, it has become the top destination of multi-national companies. Unlike many other emerging economies, income returns are high with gross yields in excess of 8%. Rents are underpinned by a strong domestic and corporate tenant base, so it shows good prospects for growth. Straddling North and South America, I believe that Panama is ideally placed to benefit long term from global real estate investment."

Charles Weston-Baker
Director, Savills International Residential

"Brazil is one of the world's strongest performing real estate markets and demand continues to rise. The market is largely driven by Brazilian residents and therefore does not suffer as a result of European or North American issues. With an economy that has grown rapidly, Brazil looks set to continue offering investors high emerging market returns at low risk. Two major global events are also on the horizon for Rio de Janeiro – the FIFA World Cup and 2016 Olympic Games – and the city will experience vastly increased footfall as a result. I would choose to put my $10 million here."

Chris Candy
Founder, CPC Group

"There are many opportunities across Europe due to its established and transparent markets but my European pick would have to be Barcelona. It's a great time to invest in Spain – following five years of double-dip recession the economy seems to have finally stopped sinking. Barcelona is perceived as a magnet to visitors due to its rich culture and history, magnificent architecture, beautiful beaches, parks and exceptional food – the city offers a great lifestyle. Outside the EU, Melbourne is most attractive to me. Australia has enjoyed a phenomenal 21 year run of solid economic growth and the property market is diversifying quickly as it continues to attract increasing levels of capital, from Australia itself, China and overseas."



Nicholas Candy
CEO, Candy & Candy

"It's Miami for me – it's the playground for South and Central America and with some superb new developments from Zaha Hadid's One Thousand Museum to The Miami Surf Club we have seen an ongoing regeneration of rundown areas with a chic fashion and art scene. Prices are still affordable and I would personally invest in The Surf Club which combines the architectural genius of Richard Meier with the excellence of Four Seasons on a 1,000 ft of beach front."

David Forbes
Director, Savills Private Office

"In the UK, Birmingham offers some interesting opportunities. The city benefits from strong infrastructure as well as relatively close proximity to London – and HS2 would make it even closer. In France, I like Lyon. It has a solid economic base, great infrastructure and a diversified tenant base. There is also increasing interest in Marseille and Lille, as well as Hamburg and Stuttgart in Germany. There are a lot of opportunities across Southern Europe, as well – and the world's investors are taking notice. US-based hedge funds are targeting Spain and there's interest in Italy's Veneto too. I'm just back from Wraclaw in Poland, where I made a couple of commercial investments on behalf of clients – a location that no one would have considered a few years ago."

Gianluca Muzzi
Head of Real Estate Europe (ex Germany)
Deutsche Asset & Wealth Management

Real estate will continue to play an important part in global investment with investors looking beyond the prime world cities

Nicholas Candy, CEO, Candy & Candy

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