

Strategy Insights

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## Xpert Spotlight



### Thought Leadership, Exchange Traded Funds

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After locking in its first full year of positive performance against the Russell 1000 Index in 2016, DEUS, our Russell 1000 Comprehensive Factor ETF posted a market-like start to 2017. In the first quarter, the fund returned 5.75% compared to 6.03% for the Russell 1000, underperforming by  $-0.28\%$ .

#### Spotlight on DEUS' Q1 2017 performance: A quiet start to the year

Following a quarter of muted relative—but solid absolute—performance, we'll review how an IT overweight detracted and an Energy underweight contributed to overall results, as well as share stock highlights for the quarter.

#### Q1 2017 sector contribution

From a sector perspective there were really two main stories. Let's first start with the performance detractor. As it has been on a few prior occasions, DEUS' differentiated position in Information Technology (IT) was a crucial part of the first quarter story.

The fund's average weighting to the IT sector in Q1 was 13.07%. That compares to the 20.89% that the Russell 1000 Index averaged in the sector over the same time. Unfortunately, the sector has performed very well so far this year, generating a total return of 12.30% compared to the 6.03% for the market as a whole. So it's not hard to see why our underweight to IT was the biggest drag on our performance at the sector level this quarter.

Figure 1: ETF (DEUS) 2017 performance

	Q1 2017	2016	Since inception
NAV	5.75%	12.81%	12.70%
Market price	5.66%	11.39%	12.75%
Russell 1000 Index	6.03%	12.05%	11.92%

Source: Deutsche Asset Management 3/31/17. Gross expense ratio for DEUS is 0.19%. DEUS inception date is 11/24/15. Performance data quoted represents past performance and does not guarantee future results. Investment returns and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. To obtain the most recent month-end performance data visit [www.deutsche-etfs.com](http://www.deutsche-etfs.com) or call 855-329-3837.

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## Q1 2017 sector contributions (continued)

Why does our multifactor strategy tend to underweight IT stocks? Well, the sector has historically scored poorly on Value, Quality and Low Volatility which implies that IT stocks are, on average, more expensive, less profitable and riskier than the market. Hence, the tendency of our factor approach to systematically underweight the sector. It may not have worked this quarter but multifactor investing is a strategic approach that requires a long-term perspective.

Turning to a more positive story, the sector that helped us the most in the first quarter was Energy. Here we had an average weighting of just 0.94% in the first quarter, compared to 6.66% for the Russell 1000 Index. Given the sector's -6.58% return over this period, it's not hard to see why we won due to this underweight. What was the reason for the underweight in Energy? The sector has performed poorly over time on Low Volatility and Size, meaning that the stocks tend to be a little bigger and a little riskier than the market as a whole over longer periods. And that, of course, accords with intuition when one thinks about some of the oil majors that are dependent on a volatile oil price.

## Q1 2017 stock contributions

At the individual stock level our biggest detractor in the quarter was Apple. Compared to an average weight of 0.04% held by DEUS in the IT behemoth, it was the largest position in the Russell 1000 Index, averaging 3.22% over the course of the first quarter. And the stock had stellar performance the first few months of 2017, returning 24.57% following a strong earnings release in January. The reason for the underweight is our inclusion of a Size factor, where stocks with larger market capitalizations are necessarily given poorer scores. Apple, as the biggest stock in the index, receives the lowest score for Size and is very significantly underweighted as a result. Indeed it is only its very large starting weight to begin with that prevents it from being removed altogether.

Turning our attention to the stock that had the largest positive contribution to return, the happy title went to Symantec Corporation. This stock returned 28.76% in Q1 and had an average weight of 0.94% in DEUS vs. just 0.08% in the Russell 1000 Index. It's clear that the strategy is prepared to very heavily overweight stocks that exhibit strong scores in our favored five factors.

How did Symantec look in that regard? At the December rebalance (our most recent, the fund rebalances semi-annually every June and December), Symantec was in the 82nd percentile for Quality, the 91st percentile for Momentum and the 73rd percentile for Value. On the remaining two it scored a little better than average for Low Volatility and a little worse on Size. The stock's combination of inexpensive profitability and positive price trend is what really drove its overweight (the stock was our largest holding during the quarter).

## The FANG stocks: some thoughts to sink your teeth into

The focus on Apple in this report actually raises the wider question of the FANG stocks and the way that DEUS looks at them (FANG is a widely used acronym for Facebook, Amazon, Netflix and Google). These four stocks generally garner a strong degree of attention for a number of reasons (including their products, business models, the wealth creation of their founders and the stocks' past performance). However, DEUS tends to keep its lips sealed when it comes to the FANG stocks. While they accounted for 5.24% of the entire market cap of the Russell 1000 Index in the first quarter, they were just 0.013% in DEUS (a little over one basis point). And, while they all also score poorly on Size, there are other reasons too for the systematic underweight.

Figure 2 shows the FANG stocks, along with their market cap weights, their size in DEUS, their individual factor scores (read these as percentiles) and the headline reason for the different

active weights they are assigned in our multifactor fund (aside from their large sizes which was a reason to underweight in every case).

Figure 2: Relative weightings, factor scores and headline rationales for the FANG stocks (as of 12/16 rebalance).

FANG stock	Weighting			Factor scores (Percentiles)					Headline (Relative to Russell 1000 Stocks)
	Benchmark %	DEUS %	Active weight	Quality	Momentum	Value	Size	Low Vol	
Facebook	1.25%	0.00%	-1.25%	0.74	0.46	0.14	0.00	0.07	Expensive and volatile
Amazon	1.38%	0.01%	-1.37%	0.77	0.49	0.18	0.00	0.41	Expensive
Netflix	0.22%	0.00%	-0.22%	0.05	0.24	0.08	0.08	0.00	Unprofitable, less positive price trend, expensive, volatile
Google	2.13%	0.01%	-2.12%	0.80	0.31	0.24	0.00	0.64	Less positive price trend, expensive

### Conclusion

The first quarter of 2017 was a relatively muted one for DEUS, our Russell 1000 Index multifactor fund, with an underperformance to the Russell 1000 of about -0.28%. However, even with a relatively market-like showing, there are key insights to take away from this quarter's results.

To summarize:

- The fund is less systematically risky than the vanilla index, with a beta of about 0.90. Once that is taken into account its small underperformance actually results in some Q1 alpha generation.

- DEUS tends to underweight the IT and Energy sectors, because of their poor scores on Value, Quality and Low Volatility, in the case of IT stocks, and Size and Low Volatility, in the case of Energy.
- Our significant underweight in Apple hurt the fund, given the stock's strong Q1 performance but there are reasons why multifactor funds, such as DEUS, tend to underweight Apple and other FANG stocks.
- As always with these approaches, long-term strategic considerations are key.

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DESC	Deutsche X-trackers Russell 2000 Comprehensive Factor ETF	Small-cap domestic equities
DEEF	Deutsche X-trackers FTSE Developed ex US Comprehensive Factor ETF	Developed international equities
DEMG	Deutsche X-trackers FTSE Emerging Comprehensive Factor ETF	Emerging market equities

**Alpha** refers to returns in excess of a benchmark's return. **Beta** measures a security's sensitivity to the movements of the fund's benchmark or the market as a whole. A beta of greater than one indicates more volatility than the benchmark or market, while a beta of less than one indicates less volatility. One **basis point** equals 1/100 of a percentage point. The **Russell 1000 Comprehensive Factor Index** is a benchmark designed to capture exposure to five factors—Quality, Value, Momentum, Low Volatility and Size. These factors represent common factor characteristics for which there is a broad academic and practitioner consensus, supported by a body of empirical evidence across different geographies and time periods. The **Russell 1000 Index** tracks the performance of the 1,000 largest stocks in the Russell 3000 Index, which consists of the 3,000 largest U.S. companies as measured by market capitalization.

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