

CABEI Central American Fund Investment Policy for the Fourth Quarter of 2009

October 2009



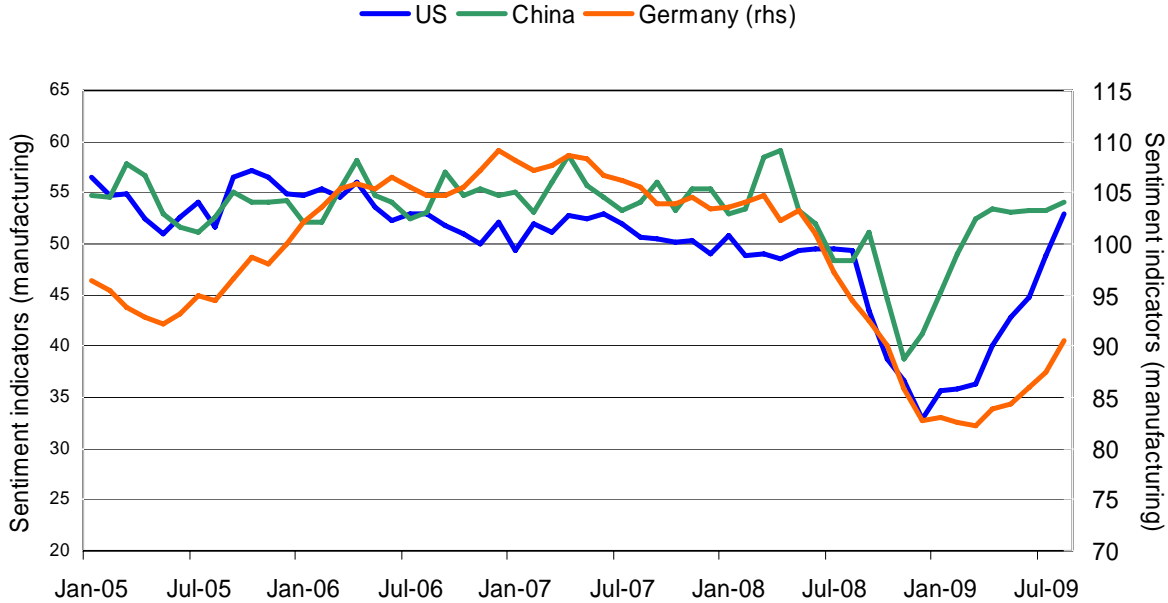
Relative Value Analysis



Global economic situation and outlook

The global economic environment continued to improve during the past months. Sentiment and real economic indicators in the US showed a reasonable stabilization in the reporting period, and some parts of the economy even started to move upwards. A similar trend was observed in Western Europe, at least in the bigger EMU countries. Central banks in G4 countries have proceeded with a loose stance in monetary policy, which often included buyback programs of domestic Treasury and mortgage bonds or similar measures of quantitative easing. Fiscal policy also remains accommodative, though many industrial countries cannot pursue aggressive fiscal easing due to vast resources needed for the stabilization of the banking system in the second half of 2008. So far, there has not been any indication from G4 central banks that they think about monetary tightening, which is also supportive for the real economy and market sentiment. To add more, the global economy benefits from a strong recovery in important emerging market countries. GDP growth in China is already heading towards double digit levels, again, and the authorities are busier with thinking about selective tightening measures than worrying about the general stance of economic growth.

Chart 1: Sentiment indicators turning



Source: Bloomberg

Talking about the global environment, there are still some risks which deserve ongoing analysis. One important issue is the outlook for economic growth. We are constructive on latest developments in China, but some negative factors could affect the outlook for the US. Some real estate sectors (like commercial property) are still struggling with negative impact from the crisis, and defaults by private households on credit card loans could also become an issue for the banking system. In Western Europe, we might see some positive momentum for

economic growth from the new German government (which is in general more market-oriented). But the negative effects from the crisis on labor markets and domestic consumption can also be a drag on next quarters' economic growth.

The biggest risk could arise from global monetary policy. So far, there are no indications that important central banks are planning to tighten policy and soak up the liquidity which was pumped into global financial markets during the global crisis. But once investors might become cautious that monetary policy would become more restrictive, we could see negative impact on risk assets. The latter very much depends on how policy could be tightened. If this would happen due to an improving outlook for the global economy and would be pursued in a slow and orderly manner, there should be some relief for risk assets. But if policy tightening would take place in a surprising way, we could see negative impact on risk asset classes, especially in those segments where vast liquidity has led to relatively tight valuations.

Central American economic situation and outlook

Over the course of 2008/09, the global financial and economic turmoil has left its mark on Central America and the Caribbean. Intense linkages with the global economy made the region vulnerable to contagion. Growth has slowed markedly, primarily on the back of the US economy in recession. The latter absorbs most of the region's exports and accounts for most of its foreign direct investment, tourism and remittance flows.

With energy and food prices down sharply, inflation concerns no longer dominate headlines. Net-commodity-importers in Central America and the Caribbean experience significant relief, as many of them allowed full pass-through of higher international commodity prices to domestic prices. However, not only inflation has moderated, lower import bills also have been bound to narrow current account deficits.

In general, focus has clearly shifted to worries about growth and authorities' ability to balance the impact of negative external and internal developments. A number of countries in the region already printed record low levels of economic indicators in past months. Reduced exports, declining tourism flows and less foreign direct investment re-present the main factors leading to a significant economic slowdown. Foreign direct investment inflows not only slow down because of economic deceleration, but also due to tighter credit conditions, which makes financing of projects for companies much more difficult. Declining FDI inflows also make the closing of the external gap challenging.

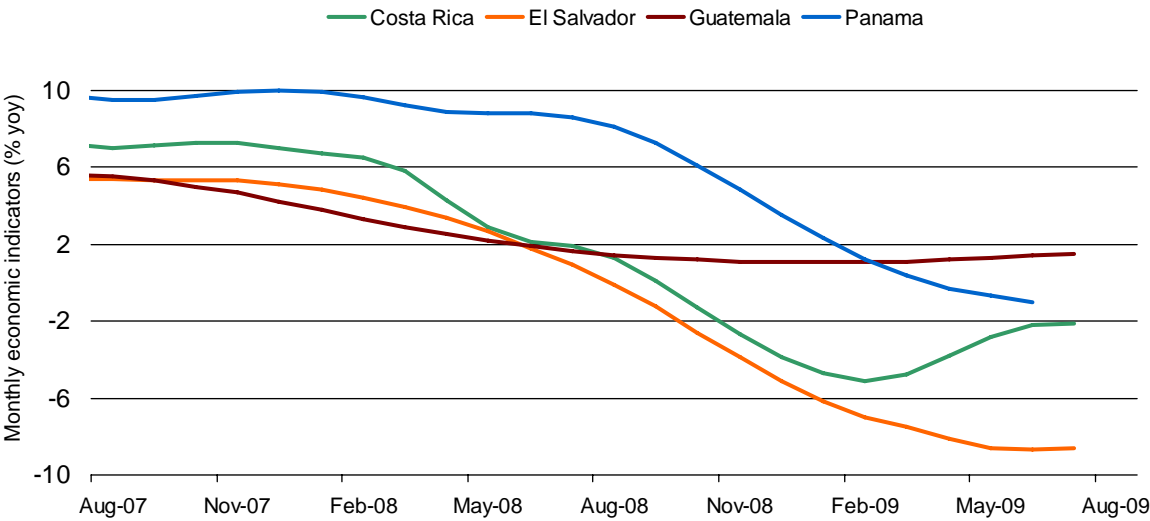
Family remittances and hence private consumption also feel the pinch. In this context, Costa Rica and Panama are not immune, but are least affected as these countries showed less dependence on remittance inflows during past years.

Within the region of Central America and the Caribbean, Guatemala, Costa Rica and Panama seem to be best-prepared to weather a severe slowdown. Guatemala's and Costa Rica's solid fiscal balances have equipped the government with the flexibility necessary to stimulate the economy. Panama has kind of its individual growth story, which is to a large degree related to the Canal expansion project. Authorities in El Salvador and Dominican Republic have less fiscal resources available. Consequently, fiscal deficits are about to deteriorate significantly on the back of financing measures to stimulate the faltering economies.

However, broad financial support by international institutions prevents too severe damage to occur.

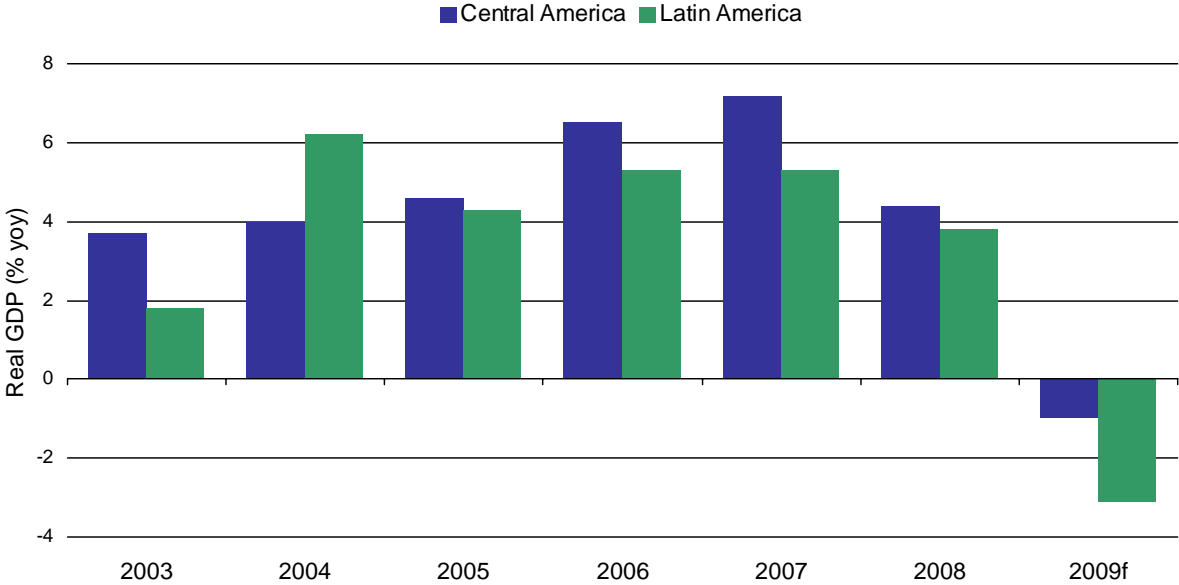
Almost all the countries signed pre-cautionary agreements with the IMF over the past months. Thereby, they do not only have access to IMF money but it also opens the door for loans from other financial institutions (e.g. IADB, CAF). Besides, monthly economic activity indicators seem to have bottomed out somewhat. On a last note, Chart 3 below shows that even during current crisis, Central American economies manage to outperform the bigger South American countries.

Chart 2: Economies bottoming out somewhat



Source: National Institutions

Chart 3: Central America outpacing the rest of Latin America



Sources: JP Morgan, DWS

On the back of high dependence on external demand, especially the US, **Costa Rica** has been severely affected by the global downturn. Economic activity significantly shrank over the past months. The trade deficit contracted due to the decline in imports substantially outpacing the decrease in exports. However, most recent leading indicators point to some bottoming out of the economy. The manufacturing component of the country’s monthly economic activity indicator in June increased for the first time in 13 months. The improvement in the manufacturing sector is expected to continue as a number of Asian high-tech industries are about to shift production to Costa Rica. Other good news is that inflation has entered a consistent downward trend since November 2008, primarily driven by lower commodity prices, though. Fiscal discipline in 2007 and 2008 paid off, providing the government with a comfortable cushion in the current crisis. Nevertheless, the central government will likely incur fiscal deficits in next few years as a large share of the stimulus to the economy has come from the fiscal and not the monetary side. May 2010 presidential elections should neither cause significant uncertainties nor change the current economic strategies in place. Although spreads and absolute yields of Costa Rican external debt have tightened already heavily we still like the bonds of the country.

El Salvador’s economy was sharply hit by the global recession, with remittances and maquila exports suffering most. Workers’ remittances are projected to fall by 20% in 2009, maquila exports have contracted as much as 22% so far this year. Another critical topic is the increase in the fiscal deficit. The root of the problem was the overestimation of revenues by almost 8% prior to the electoral process in 2008. Lower economic activity and higher levels of tax evasion even let revenues shrink in the past two years. President Funes intends to raise revenues via a fiscal reform. However, the political environment is not as supportive of pas-

sage of a comprehensive reform. In general, El Salvador will likely take relatively more time to recover from the recession as dollarisation and tight fiscal conditions reduce the margin of maneuver. On the positive side, the IMF announced a preliminary agreement on a three-year, USD 800 million Stand-By Arrangement. Authorities plan to treat the new agreement as precautionary. Anyway, it will trigger additional loans by the IADB and World bank for USD 1.3 billion. On the back of substantial financing needs in 2010, deteriorating fiscal dynamics and a weaker debt profile, we have turned a bit cautious on El Salvadorian external debt and do not intend to add exposure at the moment.

Economic activity in **Guatemala** has also decelerated. However, the adverse impact of the global crises has not been as severe as in other Central American countries. First, the country is a less open economy. Second, the government has implemented countercyclical fiscal policies. The latter has come at a price, though: the 0.5% of GDP fiscal surplus for the seven months of 2008 turned into a 0.9% of GDP deficit between January and July of this year. On the back of falling commodity prices and lower demand pressures, inflation decreased from a peak of 12.5% in December 2008 into actually deflationary territory (-0.8% in July 2009). The current account deficit has improved as the value and volume of exported goods (sugar, bananas) have fallen and imports have also contracted. The solid economic situation of Guatemala makes us stick to our exposure there.

Panama is not only the best-positioned country to weather the global downturn in the region of Central America and the Caribbean, but also belongs to the most robust names in all of Latin America. Construction is the most dynamic sector of the economy. Nevertheless, it has not been fully insulated against negative effects, real GDP growth slowed to 2.4% in the first half of the year from 10.7% in 2008. Lower demand but also tighter credit conditions forced the suspension of some construction projects. Public construction has maintained its momentum, specifically the expansion of the Panama Canal. Revenues from the Canal have increased due to higher traffic fees. The new President Ricardo Martinelli has promoted some fiscal adjustments aimed at simplifying the tax system. In addition, the government is about to design a fiscal reform to increase tax revenues. Latest economic indicators point to a stabilization of the economy. June's IMAE number showed a return to positive territory. Although valuations of Panamanian external are already fairly tight, we keep exposure there due to the sound fundamental development of the country.

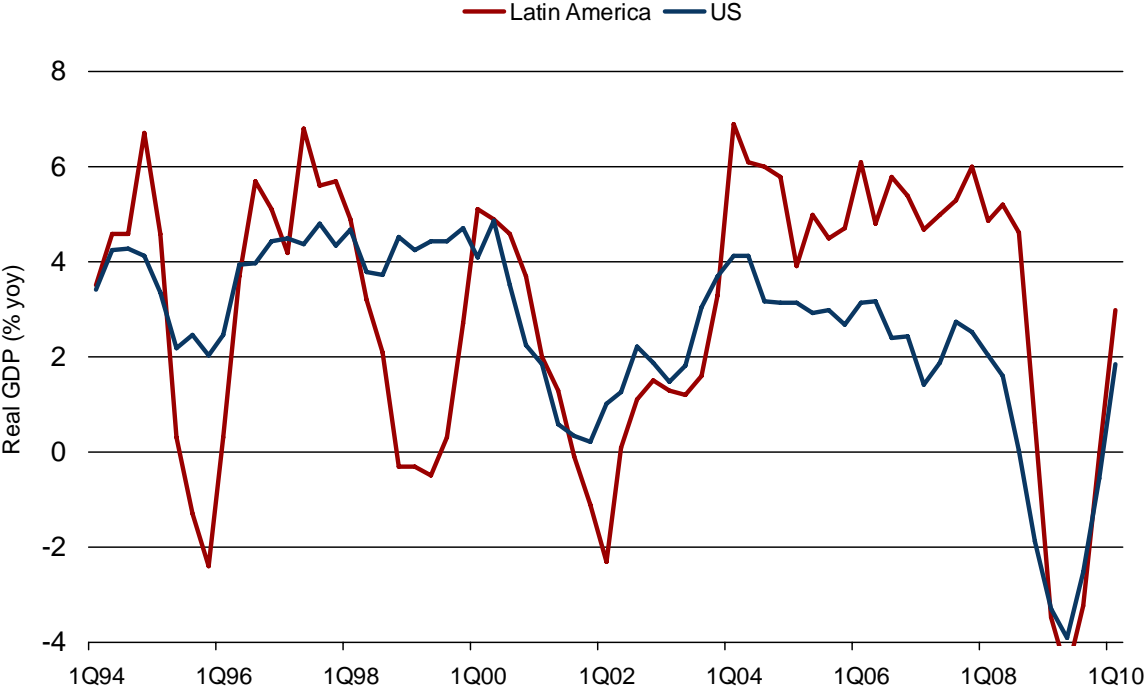
In **Dominican Republic**, positive performance in the telecommunications, agricultural and financial services sector prompted better-than-expected 2009 economic performance. It has offset contractions in the tourism and construction sector. Lower oil prices have led to declining inflation and decreasing import bills. The government finally decided to reverse its previous stance and pursued a formal IMF Stand-By Agreement. It allows the country to secure much needed financing of the fiscal gap and to stimulate the economy. The IMF arrangement delayed issuance of a bond in international markets until 2010. Short-dated USD paper of Dominican Republic is most attractively valued.

The global recession combined with political instability has badly hurt **Nicaragua's** economic performance. The deceleration has been broad-based, construction, manufacturing, financial services and commerce have been most affected. The difficult political situation further affected already weak investment climate.

Latin American economic situation and outlook

Latin America experienced a significant downturn in the first half of 2009, just as bad as most other emerging and developed economies. The collapse of world trade caused most of the damage, but also diminishing capital flows and falling remittances clouded the region's outlook. Nevertheless, activity is about to recover slowly but steadily in the more resilient countries: Brazil, Chile, Peru and Uruguay. The latter took advantage of fiscal discipline in previous years which provided them with vast financial resources to stimulate the faltering domestic economies. Mexico and Colombia will likely lag the recovery somewhat as those countries have been relatively more pummeled by US recession than others in the region. Even there, though, early signs of bottoming out are observable. In general, the recovery in Latin America will likely become both a cause and effect of renewed capital flows into the region, in the form of foreign direct investment and portfolio investment. Central banks are expected to normalize monetary conditions over the course of 2010. Politics will start playing a bigger role and might lead to some volatility. Election outcomes in Chile and Uruguay are unlikely to change the current macroeconomic course of the countries. In Colombia, not the election outcome itself but rather the potential referendum allowing President Uribe to run for a third term will be subject to some noise. In Brazil, volatility could pick up a bit more as there are a number of uncertainties about the candidates. In Argentina and Venezuela, political noise promises to remain high.

Chart 4: Latin America to recover faster than the US

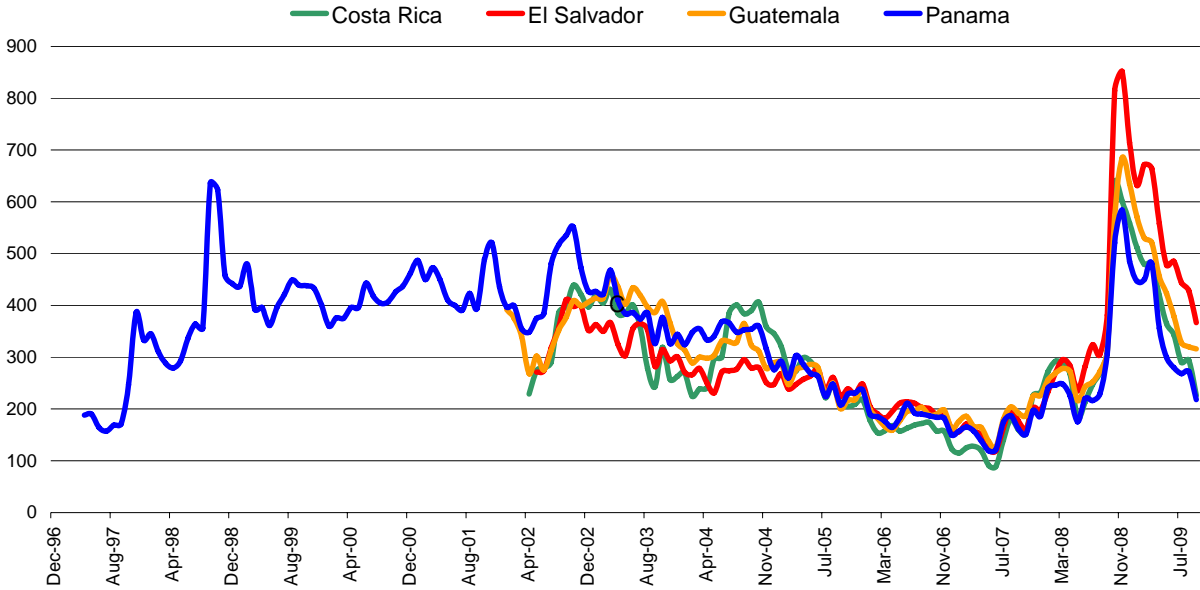


Sources: JP Morgan, DWS

Sovereign spreads

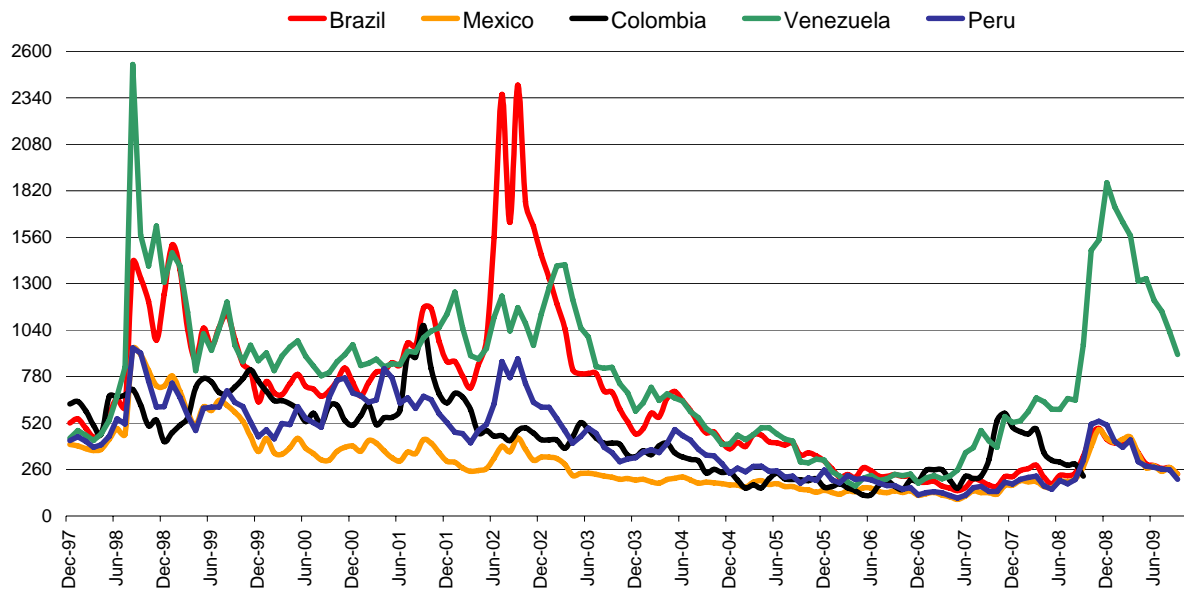
Amid steadily improving investor sentiment and accordingly also increased risk appetite, spreads tightened massively and liquidity improved significantly over the past few quarters. Since the beginning of 2009, spreads of El Salvador and Guatemala have tightened about 470 and 380 bps, respectively. In the case of El Salvador, political noise around presidential elections put some pressure on bonds. However, as President Funes more and more distanced himself from his radical left-wing party, local as well as international investors started to build up positions again. Spreads of Costa Rica compressed 390 bps between January and September 2009, while those of Panama tightened 320 bps during the same period. In all of Latin America, Brazil and Mexico were the first countries to experience significant spread compression after the peak of the crisis last autumn. Peru and Colombia followed and with some delay, also more volatile countries like Venezuela and Argentina saw tighter spreads.

Chart 5: Significant spread tightening



Source: JP Morgan

Chart 6: Significant spread tightening



Source: JP Morgan

CABEI Central American Fund: Investment strategy

In autumn 2008, bond markets of Central and South America were severely affected by the global financial market turmoil, deteriorating investor sentiment and worries about global growth outlook. However, since last December, investor sentiment and hence risk appetite have been continuously improving, leading to significant flows into riskier assets again. Hence, Latin and Central American debt markets have experienced a strong recovery rally in the course of 2009, reflected by strong performance of the CABEI Central American Fund. Regarding the fund's strategy, we switched to a more cautious investment approach after the fund had heavily benefited from solid bond markets in the first half of the year. That was primarily done via reduction of spread duration.

In detail, we increased holdings in Costa Rica and kept significant exposure in Panama. In El Salvador, we slightly increased our absolute exposure after the presidential election, but at the same time switched from longer dated bonds into shorter dated ones in order to partly avoid volatility resulting from political headline noise. Mexico's structural fiscal problems and a potential rating downgrade made us reduce holdings in external debt and cut positions to zero in local debt of the country. Substantial depreciation of the Mexican Peso was another reason for selling local bonds there. In turn, we built up exposure in Colombian USD-paper which offered an attractive yield pick-up. In Dominican Republic, we increased holdings in the country's 2011 bond, since it paid a nice yield compared to yields of its rating-peers. No exposure was taken in Colombia's local market since good performance of global COP-denominated TES bonds was not sufficient to compensate for massive currency volatility. The fund has not built up a position in Argentina as political and economic uncertainty is still considered very high. Corporate exposure is low and primarily focused on less-correlated names (like ICE-linked note or Guatemala's electricity company). Furthermore, the fund holds a defensive CABEI-security that pays a nice spread over Libor and has an appealing

amortizing structure. In February 2009, exposure to Nicaragua dropped by one third due to the bond's amortizing structure.

On the back of the countries not being out of the woods yet, we continue to follow a cautious investment approach, focusing on bonds of countries which have a relatively better fundamental outlook.

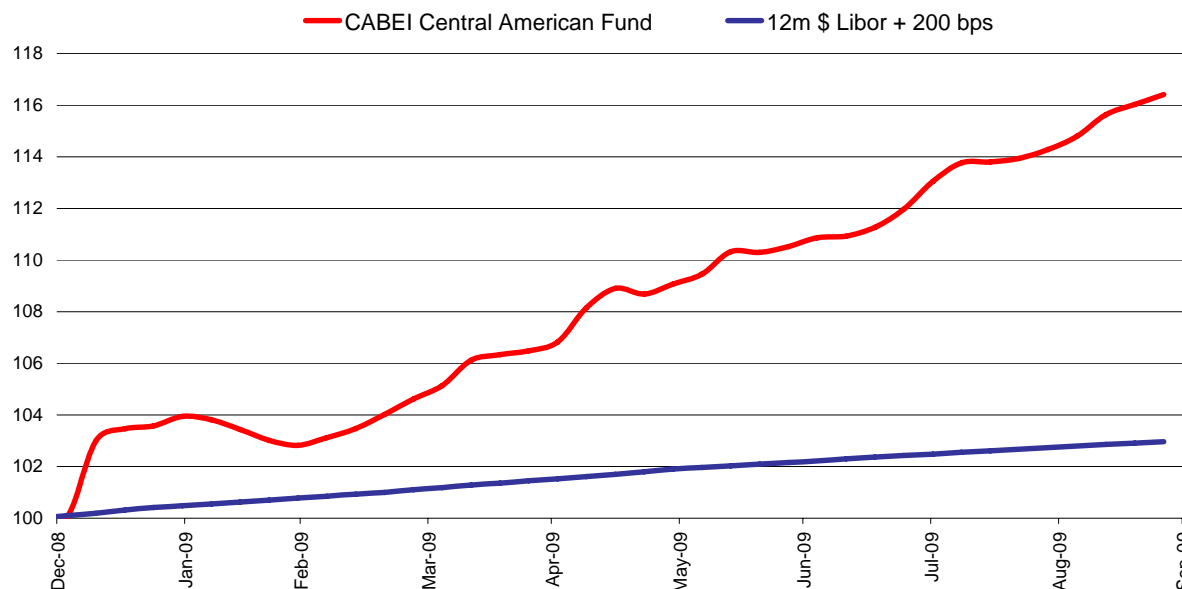
CABEI Central American Fund: Performance

	2009 year-to-date	2008	2007	2006	2005
Performance	16.81 %	-13.78 %	4.72 %	9.02 %	7.30 %

Sources: Bank of Ireland, DWS

As at 30 September 2009

**Chart 7: CABEI Central American Fund
Performance 2009 year-to-date**



Source: Bloomberg

Scenario Analysis

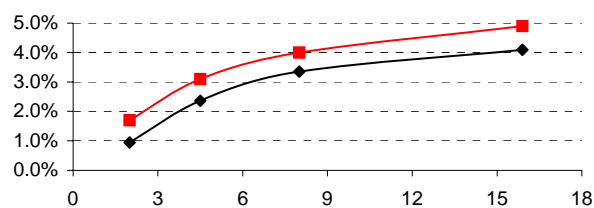


CABEI Fund - Spread Forecast and Scenario Analysis

Time of Analysis		Risk-free	Probabilities		
Start	Horizon	Rate	A	B	C
9/30/2009	9/30/2010	0.25%	15%	70%	15%

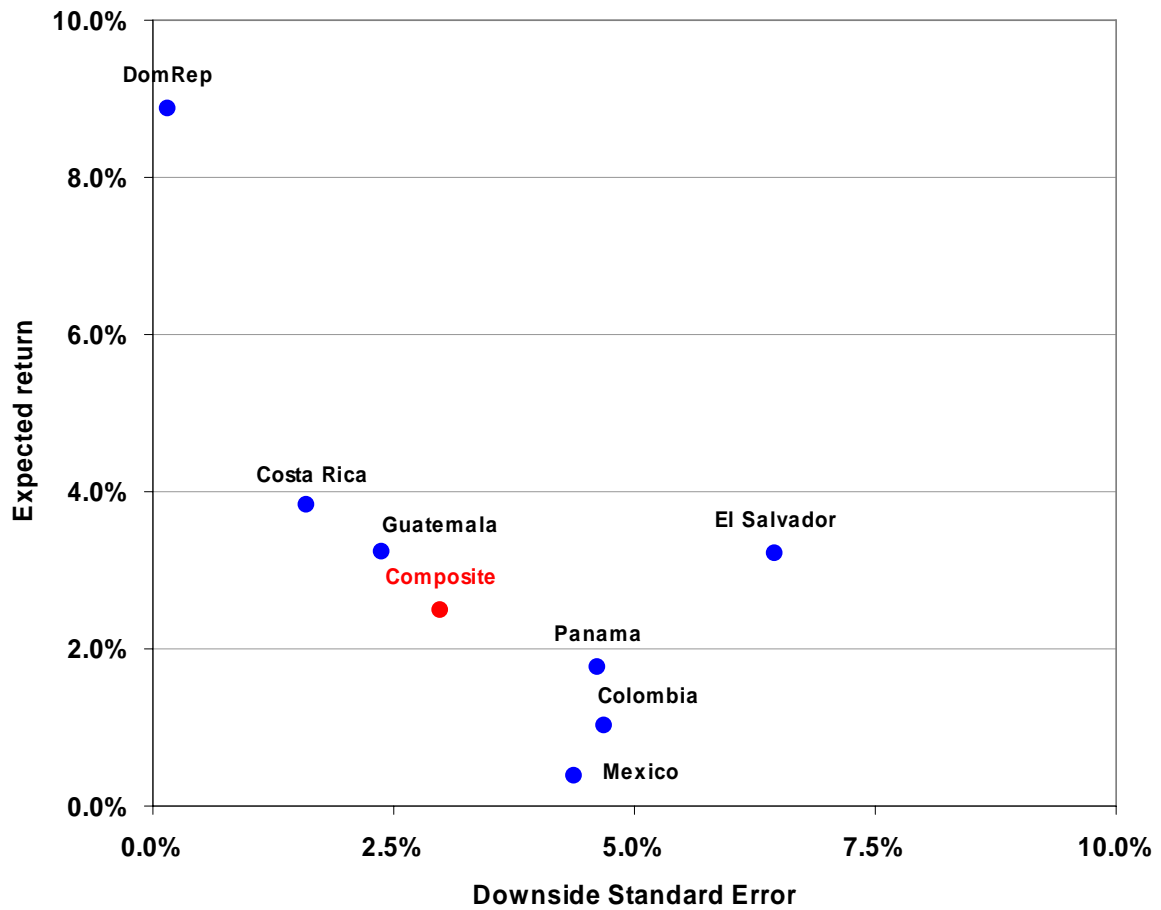
Country	CACI Weight	Stripped Spread	Spread Forecast			Expected Total Return			DSSE
			A	B	C	A	B	C	
Belize	0.3%	1175 bps	1000 bps	1600 bps	2200 bps	22.3%	-17.2%	-56.7%	26.4%
Colombia	5.5%	210 bps	150 bps	180 bps	400 bps	4.9%	2.9%	-11.8%	4.7%
Costa Rica	19.0%	277 bps	170 bps	200 bps	450 bps	6.1%	5.0%	-3.9%	1.6%
Dominican_F	1.0%	449 bps	350 bps	400 bps	650 bps	12.2%	10.1%	-0.1%	0.2%
El Salvador	42.0%	362 bps	270 bps	310 bps	600 bps	9.2%	6.1%	-16.4%	6.5%
Guatemala	15.5%	294 bps	210 bps	260 bps	450 bps	7.1%	4.4%	-5.9%	2.4%
Mexico	13.0%	195 bps	140 bps	180 bps	350 bps	4.9%	1.9%	-11.1%	4.4%
Panama	3.8%	213 bps	140 bps	170 bps	350 bps	6.3%	3.7%	-11.7%	4.6%
Composite	100.0%	599 bps	178 bps	216 bps	425 bps	6.2%	3.8%	-7.5%	3.0%

Treasury Benchmark bonds	Yield at Start	Yield at Horizon	Modified Duration
2yr On-the-run Treasury	0.94%	1.70%	2.0
5yr On-the-run Treasury	2.36%	3.10%	4.5
10yr On-the-run Treasury	3.35%	4.00%	8.0
30yr On-the-run Treasury	4.09%	4.90%	15.9



Note:

This table shows the expected return of CABEI Fund's benchmark over a twelve-month horizon under three different spread scenarios. We expect US Treasury yields to move higher in the next 12 months, which would result in a negative return contribution of 4.5% on average. This will lower the positive return delivered by the running yield and, in some cases, by expected spread tightening.



Belize was left out, as it has a high outcome for DSSE (26%) and negative expected return (-17%), which would distort the chart.

Allocation Ranges



Country	Index 09/30/09*	09/30/09	Minimum**	Maximum**
Argentina***	0.00 %	0.00 %	0 %	10 %
Belize	0.25 %	0.00 %	0 %	5 %
Colombia external	5.50 %	4.37 %	0 %	10 %
Colombia domestic	0.00 %	0.00 %		
Costa Rica external	19.00 %	19.53 %	15 %	30 %
Costa Rica domestic	0.00 %	2.68 %		
Dominican Republic***	1.00 %	3.57 %	0 %	10 %
El Salvador	42.00 %	26.40 %	15 %	40 %
Guatemala	15.50 %	21.31 %	10 %	30 %
Mexico external	13.00 %	3.75 %	5 %	15 %
Mexico domestic	0.00 %	0.0 %	0 %	10 %
Nicaragua***	0.00 %	1.12 %	0 %	5 %
Panama	3.75 %	9.21 %	5 %	15 %
Supranationals	0.00 %	3.45 %		
Cash	0.00 %	4.62 %		

* JP Morgan provides a customised version of its new Central America and Caribbean Index which is very similar to the previous modified BSCAX, but is based on fixed weights.

** The policy ranges were changed last time in July 2008 (lower policy range of El Salvador was decreased from 20 % to 15 %).

*** The combined allocation to Argentina, the Dominican Republic, and Nicaragua should not exceed 20 % of the fund's assets.

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