CABEI Central American Fund Investment Policy for the Third Quarter of 2010

September 2010

DWS
INVESTMENTS

Relative Value Analysis

Global economic situation and outlook

The development of economic growth in industrialized countries has taken centre stage in discussions among global financial market analysts. After most economies have recorded a reasonable economic recovery in the past quarters, a loss of momentum in the upward move has lately caused some concern among many analysts. In the US and in Japan, economic indicators are a mixed bag, but there are at least some areas where positive news is still hitting the headlines. In China, latest data releases have pointed to some moderation, though most indicators remained in expansionary territory. This development is not an issue of concern, as one should keep in mind that worries about an overheating of the Chinese economy have dominated discussions earlier this year. Nevertheless, the cautiousness of many global investors on the growth outlook could be an impediment for global market sentiment, even though we do not expect a "double-dip scenario" to materialize. Although the situation has calmed down somewhat in Europe, countries like Greece, Portugal and Ireland still face various uncertainties. To add more, the need for fiscal tightening in many Western European countries will weigh on the outlook for economic growth. The only positive contribution from the above-mentioned events is that inflation and worries about tighter monetary policy are not an issue these days.

The economic growth story still looks good in most emerging countries. The huge fiscal stimulus of previous quarters has worked through into domestic demand, and a moderate recovery in export demand is also helping. Private consumption has developed as a positive factor in a few countries, though this mostly refers to the bigger emerging economies. Finally, the benign inflation outlook and the related stable interest rate policy is also supportive for domestic demand in many emerging economies. External accounts of emerging economies remained in good shape. The positive development in current account balances and persistently strong capital inflows contributed to further impressive stock-piling of foreign exchange reserves by many central banks. Another positive factor worth highlighting is the sound stance of fiscal policy, which is (among others) shown by the level of public debt. A reasonable number of countries still have public debt ratios below 50% of GDP. More importantly, a stabilization of debt levels has already taken place in 2010, again, after the expansionary stance of fiscal policy led to higher public debt levels in 2009.

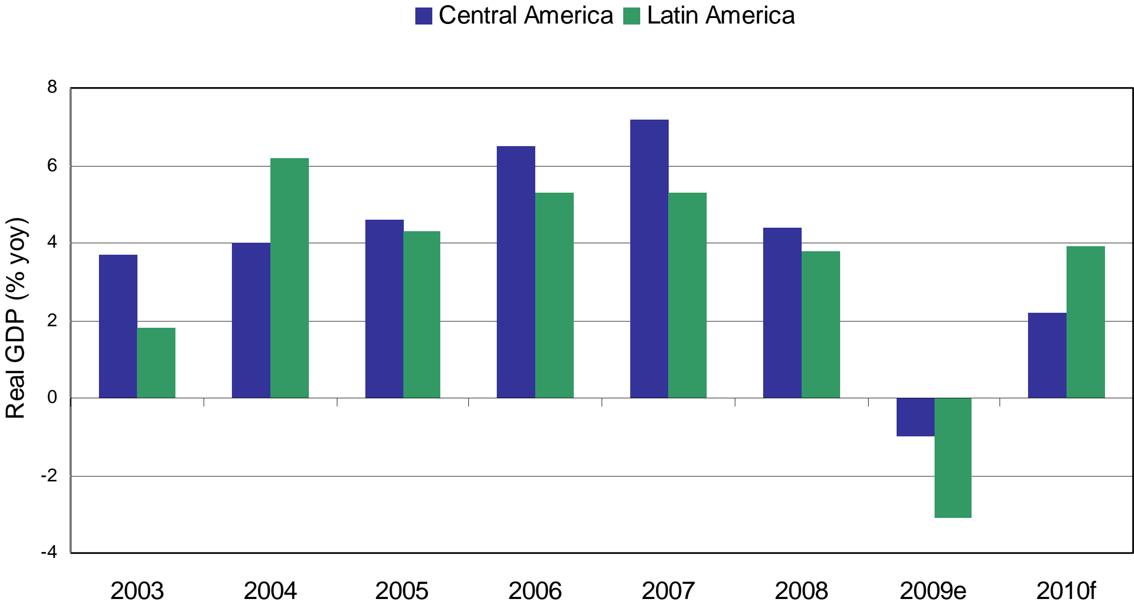
Central & Latin American economic situation and outlook

The region continues to recover, with exports rebounding and domestic demand gaining momentum. However, the future path of recovery is largely dependent on the evolution of the US economy. In all countries, the recession hammered tax revenues last year, leading to a deterioration of fiscal balances. Stronger growth in 2010/11 lets revenues increase but fiscal balances have not yet shown much improvement. In Costa Rica, increased fiscal expenditure is likely to lead to an even wider deficit in 2010. Guatemala also faces a slight deterioration in the fiscal deficit, although the finance minister already emphasized that there is no room for expenditure increases. In El Salvador, there is not much agreement on a fiscal reform. Accordingly, fiscal developments need to be closely monitored going forward.

Amid stronger domestic demand and a rebound in energy and food prices, inflation is increasing. Given the mixed outlook for the US economy, though, central banks are unlikely to aggressively tighten monetary conditions. As economic improvement and the reversal in commodity prices leads to higher import values, current accounts in the region are about to deteriorate. Hence, it is all the more important to attract foreign direct investment inflows to cover the deficit. In Costa Rica and Panama, the positive growth momentum stays intact. Guatemala is recovering at a slower pace but one has to keep in mind that the country was much less affected by the crisis than regional peers. El Salvador, Honduras and Nicaragua continue to face bigger challenges which will take the three countries longer to recover.

Most of South America's economies post a solid recovery. Domestic demand is about to pick up most rapidly in Brazil, Peru and Chile but also gains momentum in other countries. Colombia has started to pick up, too, with less momentum though. Mexico remains a laggard due to less fiscal flexibility and stubbornly weak domestic consumption. Improving international trade, especially Asian demand, supports Latin America's more open economies, primarily its commodity exporters. Last year's larger-than-expected narrowing of current account deficits is about to reverse in 2010/11. Sound fundamentals coupled with a good business environment in a number of countries will attract foreign direct investment, with Brazil and Colombia likely seeing the largest amount of flows. Fiscal accounts experience some relief on the back of increased revenues amid the rebound in GDP growth. Inflation is accelerating, but still not worrisome in most countries. Nevertheless, some central banks (Brazil, Chile, Peru) have already resumed a (precautionary) monetary tightening cycle as the output gap moves into positive territory.

Chart: Central America outpaced the rest of Latin America in 2009 but will likely lag the regional average in 2010



Sources: JP Morgan, DWS

Costa Rica's economy continues to expand but the pace of growth is about to moderate. The manufacturing sector and related exports, especially high-tech goods, pulled the country out of recession. This sector is still the main driver of the economy, albeit advancing at more modest growth rates. Although the outlook for 2010/11 is generally brighter, the recovery in tourism is likely to take somewhat longer. Some stimulus is likely to come from the telecommunications and insurance sectors. While core inflation remains under control, headline inflation started moving up amid the recovery in economic activity and higher commodity prices. The government is expected to propose a fiscal reform until year-end in order to get a grip on the high fiscal deficit. Although spreads and absolute yields of Costa Rican external debt have reached relatively low levels, we still like the bonds of the country due to its sound economic outlook coupled with good prospects for additional rating upgrades in the next 12 to 18 months.

El Salvador's economic recovery is underway. The IMF recently concluded its first review of the Stand-by Arrangement and stated that "the Salvadoran economy continues its gradual recovery from the global downturn and the medium-term outlook is also generally favorable". The IMF expects the economic program to allow the country to reduce the fiscal deficit to 3.5% of GDP in 2011. According to the IMF, this potential reduction in the fiscal deficit would stem from economic recovery, a stronger tax administration and a reform to energy subsidies. The banking sector weathered the global economic slowdown well, and most bank indicators (deposits, profitability, NPLs, liquidity/capital ratios) have improved. Domestic demand is constrained by delinquency weighing on investment. On the external front, remittances and maquila exports are also expected to stay subdued. Although President Funes targets a fiscal reform, the political environment is not overly supportive for passage of comprehensive reforms. On the back of a slight improvement in fundamentals, we are a bit more optimistic on El Salvadorian external debt.

Guatemala proved to be one of the most resilient countries during the crisis, posting positive growth even in the year of 2009. The recovery is less pronounced compared to peer countries. This is largely due to the fact, though, that the 2009 GDP base was much higher in Guatemala than it was in other countries which suffered a more severe downturn. Real GDP growth in 2010 is likely to stay below the average rate seen during the period ahead of the crisis. Improvement of business climate to attract foreign direct investment remains a major challenge. In line with the rest of countries in the region, public finances deteriorated during the crisis. The rebound in economic activity lets tax revenues rise but there also needs to be seen improvement on the expenditure side. Currently, the tax collection ratio is around 10% of GDP, one of the lowest figures in Latin America. Hence, Guatemala was already advised by the International Monetary Fund to raise taxes. Public debt is well below 30% of GDP. In general, bonds of Guatemala continue to look attractive based on the comparably sound economic fundamentals.

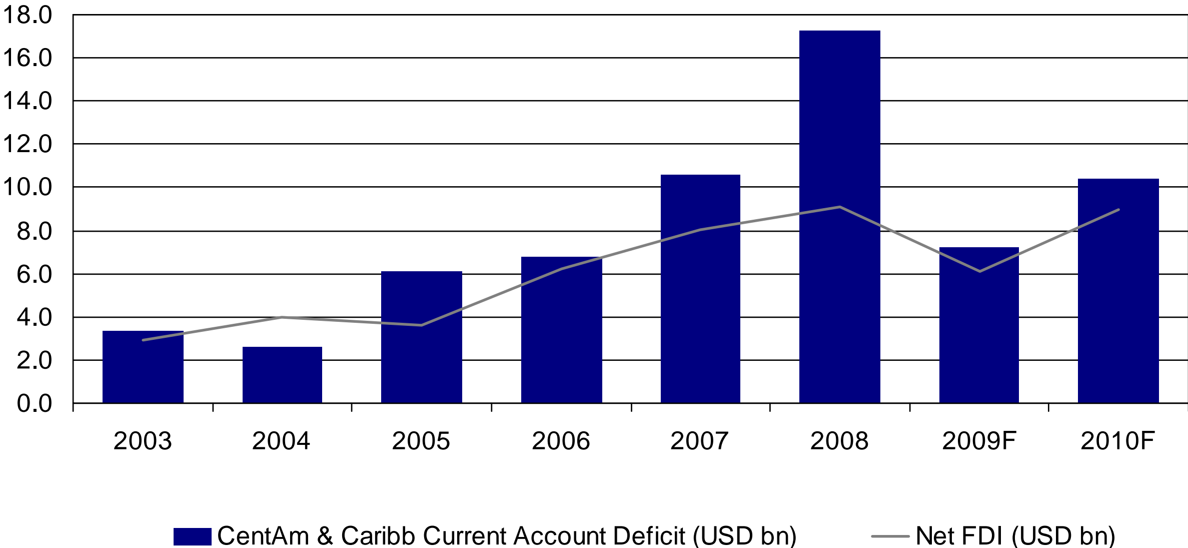
Panama shows robust economic recovery. Activity will largely take place in the area of public investment/construction but tourism is also gaining momentum. The government has an ambitious five-year investment plan and in addition, the construction of the third set of locks of the Panama Canal is due. Consumption is also expected to be strong this year, to a large

degree because of immigration of upper middle class families. The second stage of the fiscal reform, which was already approved by the National Assembly, foresees an increase in the sales tax rate on goods and services from 5% to 7% and a reduction of income tax rates for individuals and companies. Panama now holds three investment grade ratings and hence appears on the weather screen of a broader group of investors. The latter development coupled with the country's sound fundamentals make us continue to consider bonds of Panama an attractive investment.

Dominican Republic is delivering positive performance in the telecommunications, agricultural and financial services. Countercyclical monetary policies implemented by the Central Bank still support private sector credit. In addition, public spending was increased after the government had signed a Stand-By Arrangement (SBA) with the IMF in November 2009. Recent indicators point to a fast recovery, to some degree due to Haitian reconstruction activity. After a significant rally, USD paper of Dominican Republic appears a little less attractive now.

The global recession combined with political instability badly hurt **Nicaragua's** economic performance. The deceleration was broad-based, with construction, manufacturing, financial services and commerce being affected most. Although the economy touched bottom, the outlook for 2010 remains cloudy. Investment will likely continue to contract, as the difficult political situation and the lack of legal soundness bring weak business climate. In addition, the government has little room to provide fiscal stimuli to the economy. Hence, financial support from multilaterals is key for the economic recovery of the country. The last revision under the three-year Poverty Reduction and Growth Facility (PRGF) arrangement with the IMF was positive. The government shows willingness to follow IMF recommendations and to implement prudent economic policies.

Chart: Attracting FDI flows necessary in order to finance current account deficits

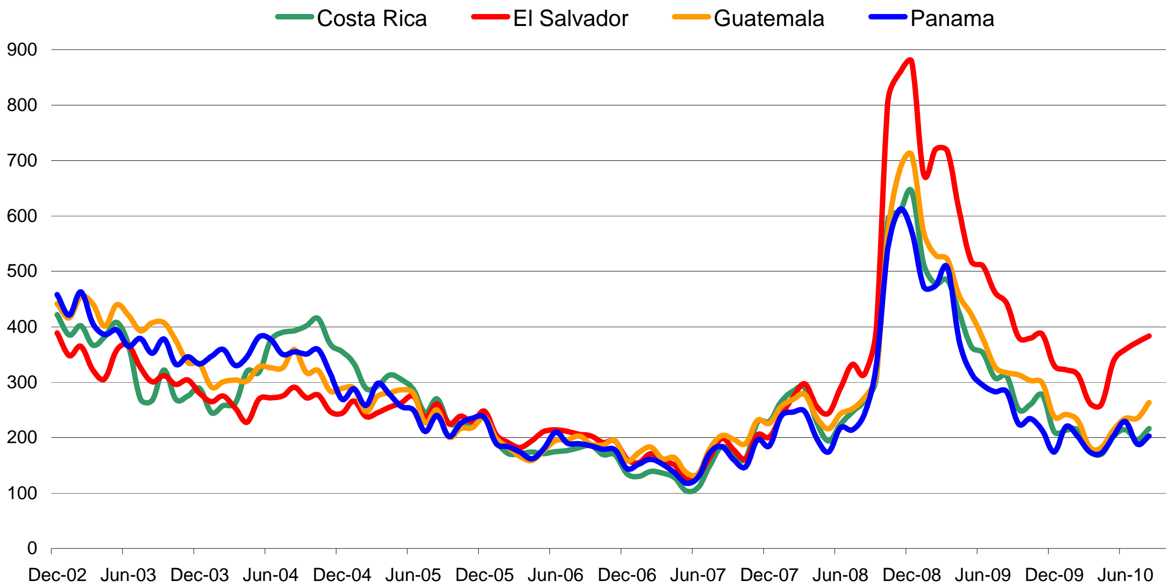


Sources: JP Morgan, DWS

Sovereign spreads

Global investors continue to show substantial interest in the asset class “Emerging Markets fixed income”. The sound economic development in a large number of countries and broad diversification opportunities across different regions are the main drivers behind the inflows to EM funds. In addition, investments in (higher rated) emerging market bonds are also considered an alternative to investments in peripheral European countries. Strong investor sentiment is reflected in continued spread tightening. Only in the month of August, spreads widened by a couple of basis points, primarily because of some profit taking after strong previous performance and ahead of anticipated new issuance in emerging markets in September. Overall, in the third quarter of 2009 spreads of Dominican Republic and Panama tightened most, 63 bps and 42 bps respectively. Costa Rica’s spreads also moved lower, triggered by the upgrade of the sovereign risk rating to investment grade space. In contrast, risk premiums of Guatemala paper remained unchanged and spreads of El Salvador’s bonds even widened somewhat. Going forward, we generally expect spreads to continue compressing, supported by investor demand for emerging market bonds. However, higher volatility and temporary setbacks cannot be ruled out given the situation in peripheral countries in Europe and the discussions about US growth. Over the next couple of months, the most solid names like Costa Rica, Panama and Guatemala will likely be favored over lower-rated and higher-yielding credits like El Salvador.

Chart: Significant spread tightening



Source: JP Morgan

CABEI Central American Fund: Investment strategy

The focus is still put on countries with solid economic development and a stable political situation (Costa Rica, Guatemala, Panama). In the third quarter, all countries eligible for investment posted positive returns. Panama, Colombia and Dominican Republic delivered a performance of 7.3%, 7.1% and 6.8%, respectively. Bonds of El Salvador and Costa Rica

yielded a return of 3.9% and 3.4%, respectively. Costa Rica especially profited from the rating upgrade to investment grade space, awarded by Moody's. Local bonds of Mexico also continued to perform well, particularly driven by increased inflows from foreign investors ahead of the country's inclusion in Citigroup's global bond index.

In Colombia and Panama, holdings were raised. In the case of Panama, the solid fundamental outlook and still attractive valuation versus peers were the main drivers for the decision. In Colombia, better-than-expected economic data and positive momentum after the presidential elections made us increase our exposure there. After the International Monetary Fund expressed some cautious optimism in the course of its first review of the Stand-by Arrangement, we took the opportunity and bought some more bonds of El Salvador. The bond maturing in 2035 is currently yielding around 6.8% which is 100 basis points above a comparable bond of Guatemala and 170 basis points above Panama. There is currently no intention to build up a position in Argentina, as political and economic uncertainty is still considered high and significant new issuance of bonds might flood the market. Corporate exposure is low and primarily focused on less-correlated names (like ICE-linked note or Guatemala's electricity company).

Uncertainties regarding peripheral European countries and a mixed outlook for the US economy continue to drive global financial markets. Fund management will continue to closely follow economic developments in Europe and the US and will also incorporate trends in global risk sentiment when setting the fund's investment strategy.

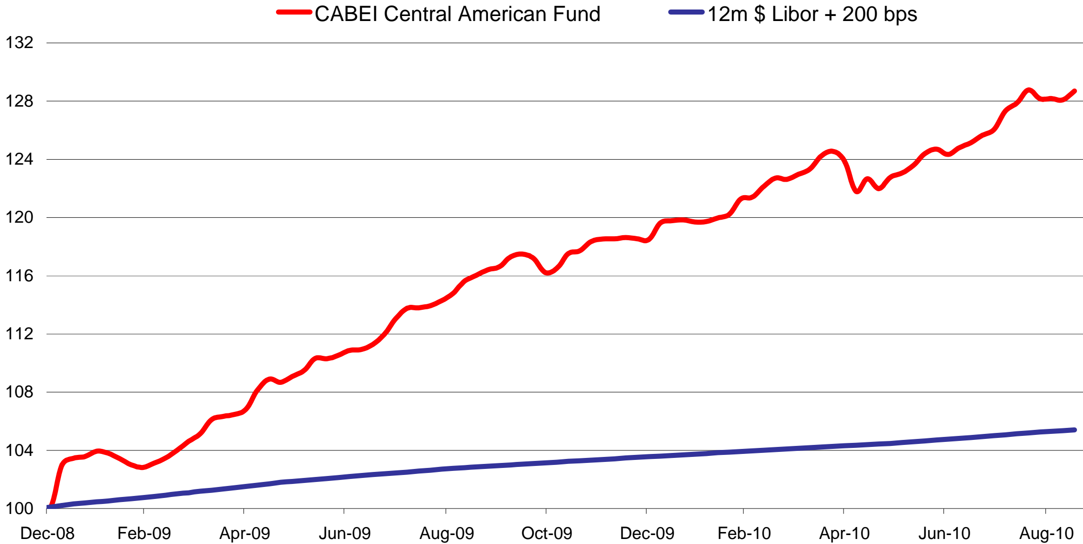
CABEI Central American Fund: Performance

	2010 year-to-date	2009	2008	2007	2006
Performance	8.86%	18.44%	-13.78%	4.72%	9.02%

Sources: Bank of Ireland, DWS

As of 23 September 2010

Chart: CABEI Central American Fund performance 2009 & 2010 year-to-date



Sources: Bloomberg, DWS

Scenario Analysis

CABEI Fund - Spread Forecast and Scenario Analysis

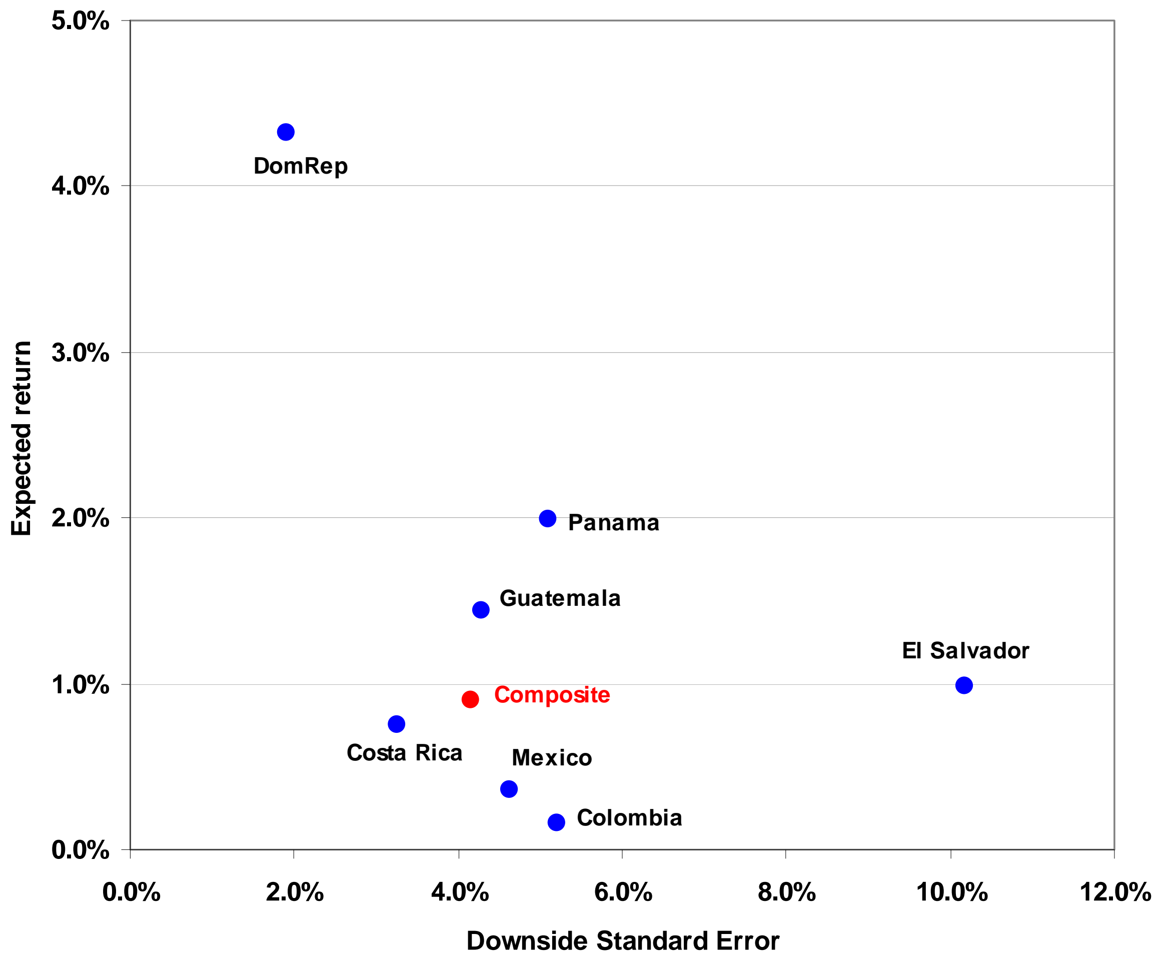
Time of Analysis Start	Horizon	Risk-free Rate	Probabilities A	B	C
27/09/2010	27/09/2011	0.25%	15%	70%	15%

Country	CACI Weight	Stripped Spread	Spread Forecast A	B	C	Expected Total Return A	B	C	DSSE
Belize	0.3%	720 bps	700 bps	900 bps	1200 bps	6.9%	-6.2%	-26.0%	11.5%
Colombia	5.5%	174 bps	120 bps	140 bps	370 bps	3.6%	2.3%	-13.2%	5.2%
Costa Rica	19.0%	181 bps	130 bps	160 bps	450 bps	3.2%	2.1%	-8.2%	3.3%
Dominican Republic	1.0%	511 bps	400 bps	450 bps	700 bps	7.6%	5.5%	-4.7%	1.9%
El Salvador	42.0%	363 bps	250 bps	300 bps	700 bps	9.0%	5.1%	-26.1%	10.2%
Guatemala	15.5%	235 bps	150 bps	190 bps	450 bps	5.4%	3.2%	-10.8%	4.3%
Mexico	13.0%	199 bps	130 bps	170 bps	350 bps	5.0%	2.0%	-11.7%	4.6%
Panama	3.8%	187 bps	120 bps	150 bps	350 bps	6.7%	4.2%	-12.9%	5.1%
Composite	**100.0%**	**273 bps**	**187 bps**	**228 bps**	**538 bps**	**4.6%**	**2.6%**	**-10.5%**	**4.2%**

Treasury Benchmark bonds	Yield at Start	Yield at Horizon	Modified Duration
2yr UST	0.42%	1.00%	2.0
5yr UST	1.29%	2.10%	4.5
10yr UST	2.54%	3.10%	8.0
30yr UST	3.72%	4.20%	16.0

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 4.4% on average. This will lower the positive return delivered by the running yield and expected spread tightening.



Belize was left out, as it has a high outcome for DSSE (11.5%) and negative expected return (-7.2%), which would distort the chart.

Allocation Ranges

Country	Index 09/27/10*	CABEI Fund 09/27/10	Minimum**	Maximum**
Argentina***	0.00%	0.00%	0%	5%
Belize	0.25%	0.00%	0%	5%
Colombia external	5.50%	6.50%	0%	10%
Colombia domestic	0.00%	0.00%		
Costa Rica external	19.00%	19.30%	15%	30%
Costa Rica domestic	0.00%	3.73%		
Dominican Republic***	1.00%	4.23%	0%	10%
El Salvador	42.00%	25.21%	15%	40%
Guatemala	15.50%	18.84%	10%	30%
Mexico external	13.00%	3.59%	5%	15%
Mexico domestic	0.00%	5.67%	0%	10%
Nicaragua***	0.00%	0.59%	0%	5%
Panama	3.75%	10.69%	5%	15%
Supranationals	0.00%	0.00%		
Cash	0.00%	1.65%		
Duration	6.1	6.0	3.0	9.0

* 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.

** In February 2010, the upper bound of Argentina's policy ranges was decreased from 10% to 5%.

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

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