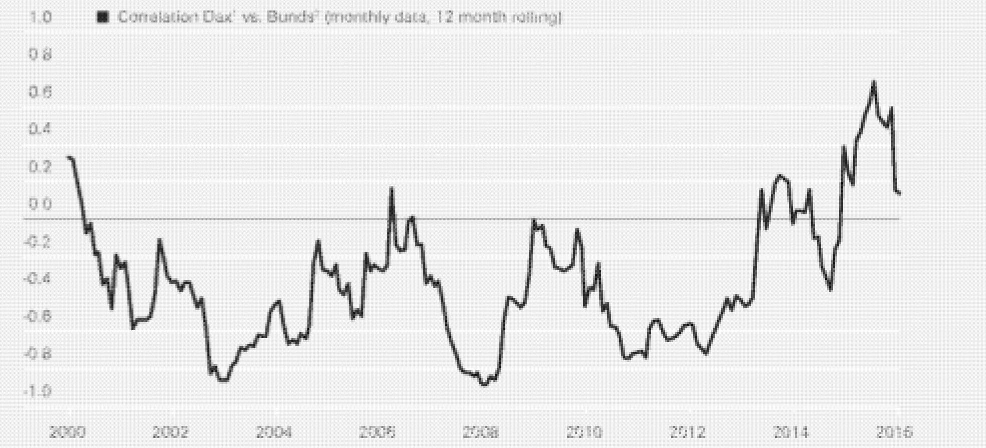
### Historical relationship between the Dax and government bonds




Sources: Bloomberg Finance L.P., Deutsche Asset Management Investment GmbH; as of 03/2016
[1] Dax Price Index [2] BofA Merrill Lynch 7-10 Year German Government Index

### Old correlations are breaking down

Until recently, investors could count on returns from equities to be negatively correlated with returns on government bonds for most of the time. As the chart comparing the German Dax and 10-year Bunds illustrates, this relationship was not stable, but the tendency was clear. In recent months, by contrast, correlations have turned positive. This meant that adding government bonds to an equity portfolio has become a much less effective tool to reduce the overall risk profile.

These are early signs that QE euphoria has come at a cost. It may have assisted generating high returns in financial markets in recent years, but investors should expect leaner times ahead.

In the meantime, there are likely to be dramatic swings – in both directions. Over the medium term, it appears likely that confidence in the ability of central banks to stabilize financial markets will continue to erode. Just because this is likely to happen eventually, however, does not mean we are quite there yet. Central banks still have options – and willingness too, it would seem, to creatively use any readily available tool remaining.

However, betting on their magic touch is getting riskier. Look at how last December, the ECB caught investors on the wrong foot. Markets had grown used to its President Mario Draghi over-delivering. Instead the ECB underwhelmed in the short term. It only tinkered on the edges of its existing QE program, focusing instead on cutting (its already negative) deposit rate further in the wake of similar decisions in several smaller European economies. Sweden, Denmark and Switzerland have increasingly relied on negative interest rates to discourage capital inflows (see box).

### Beyond the zero bound

Negative interest-rate policies (NIRP) have always been controversial in the academic community, and even less systematic research has been done on their effectiveness than with respect to QE. We believe, their growing use raises at least three issues:

#### 1. What's the point of negative nominal interest rates?

The answer to this question should be clear from section 2. If they can be implemented without too many detrimental side-effects, NIRP offer a neat way out of the liquidity trap. Monetary policy regains its power to push real interest rates lower, even in a low-inflation environment.