COMMERZBANK
The bank at your side

Your Asset Management

Additional information on your 2017 reporting

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Your reporting at a glance

This publication is intended to give you an overview of the various records you receive from your Commerzbank in connection with the end-of-year reporting for 2017. Please file these pages in your personal correspondence folder. This will enable you to refer to this supplemental information whenever you might need it. On the following two pages we provide you with some additional information regarding the current reporting for your asset management and, in particular, your statement of assets held. Furthermore, we discuss the end-of-year portfolio statement and your tax records.

The market report compiled by Asset Management is an essential element of this publication. It comprises a review of capital market trends in 2017 and an outlook for next year, compiled by our Chief Investment Officer Chris-Oliver Schickentanz. Beyond that, Michael Kohl, Head of Commerzbank Asset Management, will inform you about our stance for the coming months and provide you with an initial insight into our asset allocation in Asset Management for 2018. Finally, your personal advisor will be pleased to provide you with additional information regarding all investment themes.

When will you receive which records?

Reported records		Date
1	Regular reporting / Statement of assets held / Market report	With this letter
2	End-of-year portfolio statement	Will be sent out early in January
3	Your tax records	
	3.1 Annual tax certificate	Will be sent under separate cover, presumably in May
	3.2 Statement of income	Will be sent under separate cover, presumably in May

Your reporting documents

1 Regular reporting

1.1 End-of-year reporting

End-of-year reporting comprises, among others, your portfolio statements, income credited and your statements of account for the last reporting period of the past year.

1.2 Statement of assets

Your statement of assets provides you with a full overview of your financial assets. In addition to the current prices of your securities, the statement also reflects prorated accrued interest on fixed-income securities and the credit balance of your investment account. Furthermore, the income generated as well as fees and charges incurred within the reporting period are shown in the statement of assets. The performance overview reflects your investment performance for the reporting interval as well as for the year as a whole. You will also find the performance of a benchmark in relation to your securities portfolio for comparison purposes.

2 End-of-year portfolio statement

The end-of-year portfolio statement, which we are obliged to prepare and send to investors in accordance with the Securities Account Act, will be sent to you in early January. The individual portfolio account items are valued on the basis of the so-called uniform valuation prices. These are determined and published by a working group of the association of German banks in cooperation with the securities information data service. This may lead to minor valuation differences in relation to the end-of-year statement of assets (cf. no. 1.2). The end-of-year portfolio statement contains neither prorated accrued interest on fixed-income securities nor a report of your credit balance as at the reference date. It is intended to provide you with assistance in verifying the securities held with our Bank.

If you maintain an O&F portfolio for options and futures contracts with us, you will receive a separate O&F end-of-year portfolio statement.

Portfolio account items valuation in the statement of assets

In rare cases the statement of assets may show slight valuation differences in relation to the end-of-year portfolio statement (cf. no. 2). The uniform valuation prices for tax purposes are determined in accordance with coordinated guidelines of the banking industry associations. Since the statement of assets should be as up to date as possible for you, when preparing the report we do not wait for the so-called uniform valuation prices, which are only available at a later date. Therefore, in the end-of-year portfolio statement the securities are valued at the end-of-year prices available at the time of preparing the report. The following principles apply for the valuation of the securities held in your portfolio with respect to the preparation of the statement of assets. Every banking day the underlying portfolio of the asset management mandate will be valuated by the Bank. The valuation is based on current prices at security exchanges or over-the-counter prices at which the securities can be sold. When no current market prices or prices determined or confirmed by an independent party other than the issuer are available, the valuation of portfolio securities is made by using relevant historic prices or other available indicative prices.

3 Tax records

Your private capital gains as well as net proceeds of sales are reflected in the annual tax certificate and in the statement of income. For detailed explanations on the structure and content of the tax records, please refer to the reference material accompanying your documents.

3.1 Annual tax certificate

You will receive your annual tax certificate presumably in March. In accordance with the statutory provisions and an official specimen laid down by law, in particular the tax certificate reflects the extent of the capital income generated in the past calendar year 2017 on your securities, forward transactions and interest earned on your investment accounts as well as withholding tax (capital gains tax, solidarity surcharge and church tax, if applicable) as well as foreign (withholding) tax already or still to be taken into account. In the event that you did file an application for a certificate on the extent of losses not yet settled with Commerzbank AG at the end of the year, this loss certificate will be part of the annual tax certificate.

If you submitted an application to us for exemption from income tax for your investment income in the past year, the income will be exempted from withholding tax up to the extent of your saver's allowance. Only investment income beyond this is liable to deduction of tax at source. On account of statutory regulations, the extent of your saver's allowance claimed is likewise included in your annual tax certificate.

If an application for tax exemption is in hand for different accounts/securities portfolios with an identical account holder, losses will be netted once only at the end of the year. Nettable losses (negative capital gains) or withholding tax amounts still to be taken into account are netted against profits (positive capital gains) of another account of the same client. This may result in a capital gains tax credit and/or a reduced utilisation of the tax allowance. Losses are reported in accordance with this loss netting that extends to include all the client's account numbers. If spouses/registered partners submitted a joint application for exemption from taxation, the losses will be reported after the netting of losses has been carried out for both spouses/registered partners. Please note that the netting of losses may have already reduced or even completely settled any previously existing losses.

3.2 Statement of income

The statement of income serves to explain the annual tax certificate or – if applied for – the loss certificate along with detailed information on income on capital assets you generated in the income period from 01.01.2017 to 31.12.2017. In addition to current income, such as interest payments on investment accounts, dividends paid out, interim profits collected as well as income from investment fund units, this statement also reflects profits and losses (including accrued interest on bonds) from the sale of securities and capital growth realised, along with gains and losses of sales resulting from forward transactions. Moreover, the statement of income includes premiums collected on options.

Expenses are only certified to the extent that they arose in connection with the account and/or portfolio management (securities custody fees and remuneration for management services). Actual other expenses incurred (such as securities custody fees) are not deductible. Ancillary costs of acquisition and sale (such as charges or expenses) are taken into account in determining the assessment basis for tax purposes. In the case of agreed all-in fee models, for instance, the transaction cost share specified in the Asset Management Agreement may be taken into account as a lump sum for tax purposes provided it does not exceed 50% of the all-in fee.

In this case, individual costs of sale – apart from third-party charges being passed on – may not be taken into account. If you have entered into the appropriate supplementary agreement with Commerzbank AG then 50% of your all-in fee will be taken into account as a deductible expense, if you are subject to unlimited income tax liability in Germany – subject to a change in opinion of the tax authorities.

3.3 Church tax

For church members we will automatically pay the church tax on capital gains tax to the inland revenue if the capital gains exceed the lump sum for savers (single persons: €801; jointly assessed persons: €1,602). To simplify the process, we request information on your religious affiliation each year from the Federal Central Tax Office (Bundeszentralamt für Steuern – BZSt).

If you would not like the Federal Central Tax Office to send encrypted information on your religious affiliation, you may object to this procedure by 30 June each year (www.formulare-bfinv.de, "Kirchensteuer" = church tax). A blocking notice already applied for remains in force until revoked; we will not withhold any church tax in this event. In the following year, you will be obliged to submit a tax return for assessment of church tax.

2017 Asset Management Guide Information on the Investment Tax Reform Act

In July 2016 the German legislature enacted the Investment Tax Reform Act (Investmentsteuerreformgesetz – InvStRefG). The new provisions will be applicable as of 1 January 2018.

The objectives of the legislative amendments to taxation of investment funds include equal treatment for tax purposes of domestic and foreign investment funds (adjustment to EU law), the avoidance of special tax constructions and simplified taxation of income derived from investment funds. In future, mutual investment funds and investors will be taxed separately from one another – much like stock corporations and their shareholders.

At investor level, in future the following income from investment funds (investment income) will be taxable:
- Distributions
- Advance lump sums
- Capital gains on the sale of investment fund units

Essentially, an investor still needs four pieces of information for tax purposes:
- Level of distributions during the calendar year
- The first and last redemption price fixed in the calendar year for the investment fund
- Type of investment fund (equities, mixed, real estate, other investment fund)

We wish to provide you with an overview of the essential content of the Investment Tax Reform Act from the perspective of a private investor domiciled in Germany who is fully liable to taxation. Please contact your tax consultant if you should have any further questions on the impacts of the Investment Tax Reform Act on your personal situation.

1. Fictitious sale of investment fund units as at 31 December 2017

According to the parameters laid down by the Investment Tax Reform Act, all investment fund units will be deemed to have been fictitiously sold at the close of 31 December 2017 and newly acquired as at 1 January 2018. The tax values determined in the case of the fictitious sale are saved and only taxed at the point in time at which the investment fund units are actually sold.

You will receive the records of the tax values under the fictitious sale in the course of your regular reporting as of January 2018. If you arranged for quarterly postal dispatch of your records, for instance, you will receive these records along with the other reporting material as at 31 March 2018.

2. Non-recurring profit retentions of investment funds as at 31 December 2017

Ordinary income that the investment fund earned during the 2017 calendar year must be fully distributed up to and including 31 December 2017. If not (probably the usual case), such income will be subjected to “forced profit retention” and the investor will be required to pay taxes in accordance with the regulations of the past Investment Tax Act. This may lead to a non-recurring mandatory assessment for the assessment period 2017 for units held in foreign non-distributing investment funds as well as foreign distributing investment funds.

3. Partial exemptions

At investment fund level, in future taxes will be payable on domestic participation income (for example, dividend income), other domestic income (such as interest income on convertible bonds) and domestic real estate income. All other income (such as interest, profits on the sale of securities and all foreign income) are tax exempt at investment fund level.

At investor level – in compensation for certain income being subjected to corporation tax as well as the lack of accountability of foreign withholding taxes at the investment fund level – parts of the distribution of the advance lump sum and profit on the sale of investment fund units will remain tax exempt (referred to as a partial exemption).

The extent of the partial exemption rate depends on the type of fund and its investment focus in accordance with the investment terms and conditions.

The extent of the partial exemption of all investment income is as follows for private investors:
- 30% for equity funds (investment of at least 51% in capital participations, e.g. equities)
- 15% for mixed funds (investment of at least 25% in capital participations)
- 60% for real estate funds (investment of at least 51% in real estate and real estate companies)
- 80% for real estate funds (investment of at least 51% in foreign real estate and real estate companies
- 0% for all other investment funds

Example of a partial exemption:

A private investor receives a distribution from an equity fund amounting to EUR 1,000.00.

Assumptions: The exemption order is fully utilised, the loss settlement fund "miscellaneous" is down to zero, and no non-assessment certificate exists.

Of the EUR 1,000.00 payout, 30% (EUR 300.00) is tax-exempt due to the partial exemption for equity funds.

For investors, EUR 700.00 therefore is liable to taxation and subject to German capital gains tax (KESt) plus the solidarity surcharge (SolZ) as well as church tax (KiSt), if applicable.

4. Advance lump sum

From the year 2019, a so-called "advance lump sum" will be charged annually at the close of the preceding calendar year. This is intended to supersede the past taxation of non-distributed income and capital gains. An advance lump sum is to be applied as a "minimum tax base" if the distributions in the calendar year are lower than the risk-free market interest income.

The extent of the advance lump sum is limited to the increase in value of the investment fund during the calendar year (taking account of disbursements, if any) and cannot be negative.

In the calendar year of the fund unit acquisition, the advance lump sum decreases by 1/12 for each full month preceding the month of acquisition. No advance lump sum applies to the calendar year of the sale of investment fund units since non-distributed income may already be included in the proceeds of the sale and, therefore, in the taxable proceeds of the sale in question.

The advance lump sum is deemed to have been paid to the investor on the first working day of the following calendar year. Accordingly, it will be applied for the first time on 2 January 2019 for the calendar year 2018. The tax burden resulting from this is imposed without a prior liquidity inflow (non-cash capital gains). Existing waiver rules and regulations, such as exemption orders, non-assessment certificates as well as any losses possibly taken into account (settlement fund "miscellaneous") are taken into account for tax deduction purposes.

Advance lump sum = basic income less distributions

Basic income = redemption price of the investment fund unit at the beginning of a calendar year x risk-free basic interest rate* x 70%, but no more than the increase in value of the investment fund unit in the calendar year plus distributions within the relevant calendar year.

Example of an advance lump sum:

Assuming the basic interest rate for 2018 amounts to 1.0% and an investor purchases part of a non-distributing bond fund (no partial exemption) on 5 January 2018, which the investor holds for a number of years. The unit price at the beginning of the calendar year 2018 amounts to EUR 100.00. The last unit price fixed in 2018 is to amount to the following:

a) EUR 99.00
b) EUR 100.50
c) EUR 102.00

The advance lump sum to be applied on 2 January 2019 is as follows:

a) EUR 0.00
EUR 100.00 x 1% x 70% = EUR 0.70 EUR but the maximum increase in value in calendar year 2018. Owing to the loss in value, no advance lump sum is to be applied.

b) EUR 0.50
EUR 100.00 x 1% x 70% = EUR 0.70 EUR but the maximum increase in value in calendar year 2018 amounts to EUR 100.50 – EUR 100.00.

c) EUR 0.70
EUR 100.00 x 1% x 70% = EUR 0.70, since the basic income is lower than the increase in value in calendar year 2018.

At the time of sale of the investment fund units, the advance lump sums already applied during the holding period are deducted in the course of determining the proceeds of the sale in order to avoid double taxation.

*The basic interest rate is derived from the long-term government bond yield. It relies for guidance on the interest rate calculated by Deutsche Bundesbank according to the term structure of interest rates data for the first day of securities exchange trading of the year. The Federal Ministry of Finance publishes the relevant interest rate in the Federal Tax Gazette.

5. Right of objection

In addition to the tax payment based on an advance lump sum as of 2019, tax burdens already exist due to other non-cash capital gains for which no cash flow actually takes place. This is the case with bonus shares for instance, as well as non-gratuitous securities account transfers involving a change in creditors.

From 1 January 2018, in these cases the office managing the securities account may withhold capital gains tax (KESt), the solidarity surcharge (SolZ) and church tax (KiSt), if applicable (tax amounts), from a customer account of the investor. The Bank may also collect tax amount from a current account of the investor unless the latter objected to this in advance.

If the amounts of tax cannot be forwarded, the bank in charge of the securities account is required to notify the revenue office for operating units (Betriebsstättenfinanzamt) accordingly. The investor is obliged to specify non-cash capital amounts for which no tax deduction amounts were withheld in his or his income tax return.

6. Protected legacy units

Protection for legacy units (i.e. purchase of investment fund units prior to 1 January 2009 and, therefore, prior to the introduction of the withholding tax) ends effective as at 31 December with the fictitious sale of the relevant units. The performance up to this point in time is and also remains tax-free in the event of a sale of the investment fund units at a later date.

For price gains applicable as of 1 January 2018 until the sale of the investment fund units, private investors are granted an exemption limit amounting to EUR 100,000.00 per person. This personal exemption limit cannot be taken into account by the bank in charge of the securities account. The investor is required to claim the exemption limit as part of his or her personal income tax return filed with the revenue office.

7. Asset management and investment funds

Commerzbank AG Asset Management uses a stringent process to select investment funds for its service lines, including exchange traded funds (ETFs). This selection process is aligned on the basis of a “best-in-class approach” to the design of a successful investment strategy, and is thus closely linked to risk management.

Against this backdrop, while Asset Management will take account of the structural changes due to the investment tax reform in its selection decisions, the market and instrument-related optimisation of the investment strategy remains in the foreground as the primary objective.

Execution policy

In December 2017 you were informed of changes to the securities business with regard to MiFID II; for instance, you received the brochure "Customer Information on the Securities Transactions – excerpt/update 2018". In supplementation of this publication, we hereby wish to inform you of the update of the principles relating to the execution of orders in financial instruments within the scope of Financial Portfolio Management (Asset Management) at Commerzbank AG.

Execution policy of Commerzbank AG for orders placed regarding financial instruments within the scope of Financial Portfolio Management (Asset Management)

A Preliminary note

Commerzbank AG (hereinafter referred to as "the Bank") executes orders within the scope of its individual financial portfolio management (Asset Management) on behalf of its customers for the purchase or sale of financial instruments (e.g. shares and bonds).

As part of financial portfolio management, the Bank's customers place an order for the opening of a current/securities account and for management of the assets booked or managed with the Bank under the relevant customer number on the customer's behalf. In the process, the customers authorise the Bank to manage the assets in accordance with the investment guidelines previously agreed with the customer at the Bank's own equitable discretion without obtaining any previous instruction and to take all measures in this regard that the Bank may consider to be expedient in managing the relevant assets. Individual instructions by the customer are excluded in the mandate agreement.

1. Scope of application

These principles apply to the execution of orders within the scope of individual financial portfolio management, which the Bank executes for private or professional customers (hereinafter referred to as "the Customer") as contemplated by the German Securities Trading Act (Wertpapierhandelsgesetz). An order execution means that the Bank enters into an execution transaction based on the Customer mandate, either for the account of the Customer with another party (commission transaction) or that the Bank and the Customer directly enter into a purchase agreement for financial instruments (fixed-price transaction). Within the scope of the commission business, this execution policy also allows for mandates in which orders are executed neither on an exchange*, an exchange like Execution Venue* nor by concluding a transaction with a systematic internaliser** (collectively referred to below as the "Execution Venue"). Section E applies to fixed-price transactions.

Within the scope of asset management, the Bank continually adjusts the Customer's security account structures in line with the investment guidelines for optimal control of the opportunities and risks of the capital markets as part of the mandate conferred. To this end, the Bank enters into purchase and sale orders for financial instruments on the part of the Customer, which may have the following backgrounds:

(1) Purchase and sale orders for an individual customer or a limited number of customers, generated by a single employee within Financial Portfolio Management (the "portfolio manager") in the course of discretionary allocation decisions.

(2) Combined orders (block orders) for purchase or sale of financial instruments executed within the scope of an adjustment to the total allocation of securities accounts of numerous customers within one or several product lines or one or several requirements profiles of financial portfolio management. This aggregation can also be made by bundling orders for a number of customers as part of initial allocations, mandates reversed as well as the processing of deposits and withdrawals.

2. Objective of order execution

Customer orders within the framework of the individual financial portfolio management can be executed on a regular basis at various domestic or foreign Execution Venues. The Bank itself may likewise constitute an Execution Venue. Section B contains a description of the execution channels and Execution Venues in the relevant classes of financial instrument that, as a rule, carry expectations of best possible execution in the interests of the Customer and via which channels and Execution Venues the Bank will execute the Customer's orders.

In determining a specific Execution Venue with regard to an order, the Bank will assume that the Customer primarily intends to achieve the best possible price – taking into account all costs in connection with the execution of the transaction. Moreover, above all those Execution Venues will

*Regulated market, multilateral trading system or organised trading system.

**A systematic internaliser is an investment firm that systematically trades for its own account on a regular basis by executing customers' orders. Commerzbank may also execute orders as a systematic internaliser in selected financial instruments.

be taken into consideration at which full execution is probable and possible on a timely basis and against the backdrop of technical custody (see Section A.6) (in terms of the feasibility, likelihood and speed of execution). Furthermore, within the scope of the standards outlined above, the Bank will take into account other criteria of relevance, especially secure and certain settlement of the order, the value thereof and the nature of the order placed.

3. Forwarding of orders

If the Bank has no direct electronic access to an Execution Venue it will not execute the Customer's order itself. Next and in line with the asset management agreement, the Bank will forward this order for execution to a specialised financial services provider with direct access to the Execution Venue. An overview of the Execution Venues to which the Bank forwards customer orders via a financial services provider is published on the Internet under the designation "Overview of Execution Venues", www.commerzbank.de/geschaeftsbedingungen.

4. Exceptional market conditions

In the event of the principles described herein not being applicable due to extraordinary market conditions or continued market disturbances, the Bank will execute the orders on the Customer's behalf as discretionary orders, avoiding any preferential or unfavourable treatment of an individual customer, or it will postpone the order execution as a whole until such time as market conditions indicate that due and proper execution is possible. Without prejudice to the above, the rules and regulations individually arranged in the mandate agreement are applicable nevertheless.

5. Execution Venues

An overview of the current Execution Venues is published on the Internet under the designation "Overview of Execution Venues", www.commerzbank.de/geschaeftsbedingungen. The Bank will make this overview available to the Customer upon request. The Bank may modify the selection of Execution Venues listed in the overview; the latter is not the subject matter of the mandate agreement in place between the Bank and the Customer.

6. Custodians abroad

When purchasing a financial instrument at a foreign Execution Venue, the financial instrument will be taken into custody by a foreign custodian assigned to the Execution Venue. An order for sale of such financial instruments is therefore possible only at those Execution Venues that provide for processing and settlement for the foreign place of custody.

B Execution principles in different classes of financial instruments

1. Equity instruments (in particular, shares and subscription rights), bonds, securitised derivatives (certificates (Zertifikate) including other structured bonds, warrants) and other exchange-traded financial instruments such as Exchange-Traded Funds (ETFs), Exchange-Traded Commodities (ETCs) or Exchange-Traded Notes (ETNs).

1.1 Discretionary allocation decisions by an individual portfolio manager

In connection with allocation decisions that an individual portfolio manager exclusively applies to an individual customer's securities account or takes for a limited group of associated customers (associations), the portfolio manager makes discretionary decisions with the aid of the information systems available to him via the relevant suitable Execution Venue. In doing so, the portfolio manager especially takes aspects of the correct time of trading (market timing) into consideration along with possible impacts of own trading decisions on the market (market impact) of the order in question. If a financial instrument is traded at multiple Execution Venues at the same time, the portfolio manager will decide which Execution Venue is expected to yield the best result, taking account of the criteria specified in Section A.2. In this context, the suitable Execution Venue may be both an exchange as well as an over-the-counter Execution Venue.

If the order cannot be executed by way of a transaction (e.g. for lack of liquidity at the Execution Venue), the portfolio manager will execute the order via the Bank as a discretionary order (see Section C), taking account, if applicable, of the day of trading (and a possible intra-day trading time window), of price limits (cheapest/best/volume-weighted average price "vwap"), on an exchange/over-the-counter Execution Venue or within regulated markets and multilateral trading systems (MTF) or outside regulated markets and MTF.

1.2 Execution of aggregated customer orders (block orders)

Block orders arising from the aggregation of numerous individual customer orders can be executed by the Bank both directly on an exchange, processed as a fixed-price transaction or forwarded to an external intermediary for execution. When taking a decision, the Bank will take the special features of the individual order (order size, market liquidity of the financial instrument) into consideration. External intermediaries are required to execute the order on a "discretionary" basis (see Section C) and possibly taking account of other aspects stipulated, e.g. day of trading (and possibly intra-day trading time window), of price limits (cheapest/best/vwap), the Execution Venue (exchange/over-the-counter) and/or within regulated markets and multilateral trading systems (MTFs) or outside regulated markets and MTFs.

2. Investment fund units (excluding Exchange-Traded Funds)

The acquisition and sale of units in investment funds admissible for distribution in Germany and which are issued and redeemed by the custodian in conformity with the German Capital Investment Code (Kapitalanlagegesetzbuch) are not subject to the provisions for best possible execution.

The Bank executes Customer orders regarding investment funds by selling the units to or acquiring them from investment funds by way of fixed-price transactions. In such cases the purchase price will not exceed the issue price determined according to the provisions of the German Capital Investment Act. Sell and/or redemption orders are forwarded to the capital investment company/custodian bank.

3. Financial derivatives (interest rate, credit, currency, equity, commodity derivatives as well as derivatives of emissions certificates)

The Bank executes Customer orders in financial derivatives traded according to standardised terms and conditions on a futures exchange, depending on contract availability on the relevant futures exchange. If a contract is offered on more than one futures exchange, the portfolio manager will make a discretionary decision in each case on the suitable Execution Venue at which the best result can possibly be achieved for the Customer, taking account of the criteria under Section A.2, and will forward the contract to the relevant Execution Venue.

C Discretionary orders

If the Bank issues a discretionary order to the external intermediary, this will also constitute an instruction. A discretionary order is an order to be executed in an individual case in which the intermediary can execute the securities order in the interests of the Customer's best possible outcome – in line with customary usage and practice – both on an exchange or over-the-counter. A decision is taken on a case-by-case basis, depending on the prevailing market situation, as to how the order can be executed in the best possible manner. Execution in this context can be carried out partly or fully over-the-counter. In the process, the order can also be executed at Execution Venues not published under the designation "(Overview of Execution Venues)", ((www.commerzbank.de/(geschaeftsbedingungen)).

D Assignment after bundling (aggregation) of customer orders into block orders and how to deal with partial allotments

Within the scope of individual financial portfolio management, purchase and sale orders of a number of customers can be passed to the market in bundled form (block contracts or orders). The bundling of orders can affect a large number of customers (e.g. in connection with adjustments to the overall allocation).

The essential aim of bundling orders (block order formation) is equal treatment of customers as all will receive the same settlement price. Purchase and sale orders are executed either via the Bank or an external intermediary since direct execution of orders on an exchange would always result in different settlement prices. The aggregation of individual orders to form block orders has many and various benefits for customers:

Benefits for customers:

(1) Speedy implementation of transaction decisions of portfolio management (time to market) for the entire volume of all customer securities accounts concerned. Disadvantages (time-related) sustained by individual customers are avoided.

(2) Order aggregation facilitates counter transactions without market risk (swap operations by selling security A and simultaneously purchasing security B).

(3) Homogeneous investment results within the same investment profile. No unfavourable treatment of individual customer security accounts compared with those of customers with the same investment profile (no preferred treatment either).

(4) By executing orders at a mixed price determined according to the arithmetic mean, extreme prices for individual customers are avoided, especially at times of volatile markets.

(5) Additional costs due to possible partial execution are eliminated as block orders are always executed at only one price via the intermediary. No additional costs due to partial executions are incurred.

(6) Unlike the compressed placement of a large number of individual orders (possibly with negative price effects for customers), block orders via the Bank or an external intermediary are placed on a discretionary basis on an exchange or over-the-counter in the defined trading time windows.

Disadvantages for customers:

(1) The execution of block orders via the Bank or an external intermediary increases the costs of the transaction by the costs of order execution by the Bank or the external intermediary.

(2) The costs of using the intermediary may not be directly obvious to the Customer, as these costs are not itemised separately but are included in the execution price.

(3) A consolidation of orders may be detrimental with regard to an individual order. The Bank will bundle or aggregate orders only if disadvantageous treatment of individual customers is unlikely.

E Fixed-price transactions

With regard to a fixed-price transaction, the Bank and the Customer will enter into a purchase agreement for financial instruments at a fixed or determinable price. In order to exercise the agreement entered into with the Customer to execute financial portfolio management transactions, the Bank is entitled to represent the Customer in relation to third parties and to conclude fixed-price transactions in the customer's name.

According to the relevant contractual arrangements, the Bank and the Customer are obliged to deliver the financial instruments owed and to pay the purchase price for them, as the case may be. This will apply if the Bank offers securities for subscription or if it and the Customer enter into mutual agreements concerning financial instruments not tradable on an Execution Venue.

Block orders in relation to the Customer can also be settled via fixed-price transactions. To this end, the individual transactions underlying the block order at the same or different Execution Venues are initially consolidated within a pool. In order to ensure uniform execution and the same settlement prices for the respective customers, a mixed price for the individual transactions within the pool is determined according to the arithmetic mean and assigned to the Customer by way of the fixed-price transaction.

If the Bank is the Execution Venue within the scope of executing the block orders, it will meet its requirements relating to the best execution of fixed-price transactions by offering a price that corresponds to the market prices, taking account of the costs and fees incurred.

F Supplementary information

The Bank will monitor and review the implementation and effectiveness of the execution principles. A review will be performed annually or whenever the Bank identifies any material changes that require the execution principles to be adjusted accordingly.

Market report

Review and outlook – Chris-Oliver Schickentanz, CIO

More of the same?

After a spectacular year 2017 for equities and other risky assets, we expect the fundamental environment to remain positive. The global economy will probably continue to grow at an elevated rate, while central banks will barely take the foot off the accelerator. Thus, investors will keep chasing returns. However, as sentiment is already optimistic, institutional liquidity positions have dropped and valuations are no longer inexpensive, 2018 will probably bring less performance joy to investors than 2017. This does not change the fact, though, that investors will have to keep their money invested in equities and other securities if they wish to preserve their real capital.

2017 with stellar market returns

Exactly 12 months ago we painted a positive view for capital market trends in 2017. One of our core theses was that global economic growth will gain significant momentum. This forecast was spot on! The global economy expanded by an estimated 3.5% in 2017, which is the highest growth rate since the outbreak of the 2008 financial and economic crisis. Our monetary policy forecast was also quite accurate, as we predicted the ECB to keep its main policy rate at zero during 2017 and start reducing its monthly bond purchases in 2018. A number of analysts were quite pessimistic at that point in time, which is why it might not be too much of a surprise that the optimistic performance outlook for equities and selected commodities for 2017 was even exceeded. Fixed-income markets delivered a mixed performance which was in line with our predictions as well. On balance, investors can be pleased with the significant market returns in 2017.

Where we were wrong: US dollar

Not all of our predictions for 2017 came true. The US dollar, for example, was much weaker in 2017 than we had anticipated. We reacted and downgraded our bullish dollar view in March, but the downside momentum of the US dollar surprised us regardless. In part, it can be explained by economic trends, as euro area economic growth surprised to the upside. Political trends provide another explanation, with a pro-EU Dutch and French election outcome and elevated US policy uncertainty under President Trump as a headwind for the US dollar. As we lowered our allocation to US equities and bonds during 2017, we strongly mitigated the negative performance impact for the portfolios as a whole.

What will 2018 bring?

While looking in the rear-view mirror might bring some insights and can be useful for improving forecast accuracy, only by looking into the future will we be able to help you to reap some extra returns in 2018. The 2018 outlook is quite favourable as the positive fundamental picture is likely to remain in place. We forecast global economic momentum to stay strong in 2018.

Thesis 1: Global economic momentum will remain high, but will stop improving

Global leading economic indicators suggest that the current high economic momentum will persist for now. In most major economies growth is well-balanced with net trade, private consumption and, increasingly, investments contributing to growth. The current economic upswing is one of the longest in recent history (the longest in the US), which might not be such a big surprise as it started from a depressed level after the severe dip in economic activity during the financial and economic crisis. The main difference with 2017 is that by now a consensus of economists expects high economic growth. Unlike in the first half of 2017, this leaves very little room for market-moving upside surprises.

Thesis 2: The ECB will lag behind other central banks – still no policy rate increase in sight

The ECB will continue to purchase government and corporate bonds at least until the end of 2018, which also means it will extend its zero interest rate policy. We do not expect it to raise policy rates before the second half of 2019. This means the ECB (as well as the Bank of Japan) will be lagging

Market report

behind all other major central banks. The US Federal Reserve and central banks in other developed economies will continue on their path to interest rate normalisation which means that for the first time in many years, global liquidity conditions will deteriorate.

Thesis 3:
Conservative investors will have to adjust

Longer-maturity German Bund yields are likely to keep rising in 2018. We expect them to move above the 1% level. This would result in lower bond prices, which is why we maintain our "strong underweight" recommendation for German Bunds. The search for yield had pushed investors into euro area government bonds, corporate bonds or foreign currency denominated bonds, a strategy which we recommend only on a very selective basis as these bonds have become expensive.

Thesis 4:
Equities still core of the riskier portfolio part

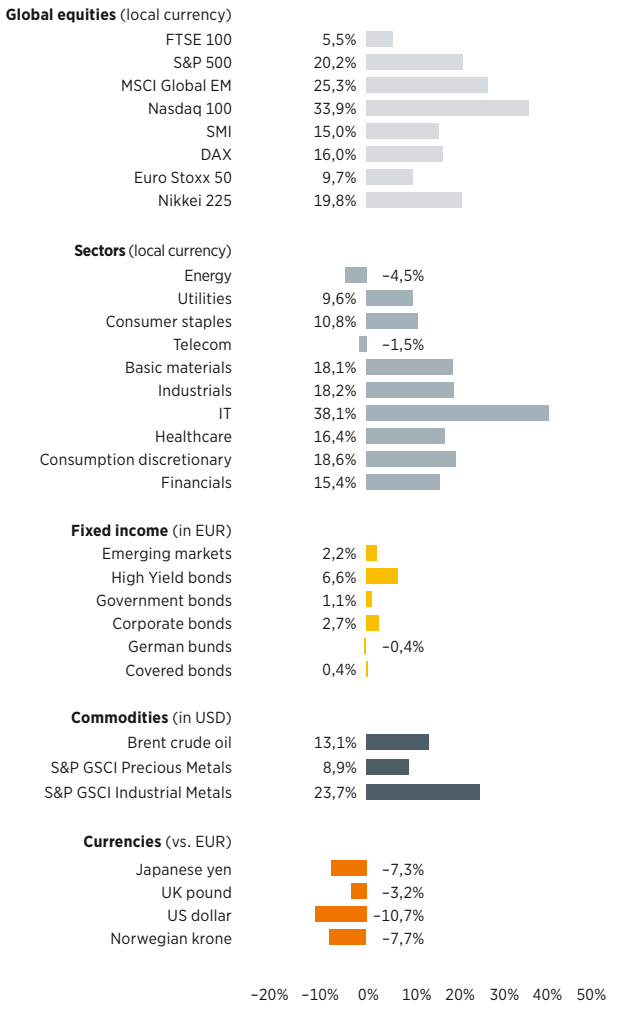
Economic conditions will remain favourable in 2018, which is why corporate earnings will keep rising. Earnings growth momentum will soften, though, compared to 2017, as earnings margins might contract somewhat. Valuations are already at elevated levels as well, particularly in the US, and we see no room for rising multiples, with multiples remaining at current levels, at best. In addition, institutional investors are much more aggressively positioned than early in 2017, which leaves the equity markets vulnerable to some short-term profit-taking. We expect to make a number of adjustments in equity allocation during 2018. We start the year with a significant overweight in European equities on a regional level and of financials on a sector level. While equity returns will be lower than in 2017, investors can still expect a decent performance in the mid-to-high single digits. With respect to commodities, we expect the different price trends observed in 2017 to continue. We see price risks in the energy segment and for selected industrial commodities because of rising supply. Some metal prices will be supported, though, by rising demand for battery solutions driven by growth in renewable energy and e-mobility. Precious metals remain a good hedge against rising inflation.

Thesis 5:
Active asset management adds performance

Investors will have to maintain an active and tactical approach to their portfolio management in order to increase performance. Volatility is likely to increase, which will open up significant performance opportunities. Every investor needs to find a level of activity he or she feels comfortable with. It all starts with active asset allocation or a market-oriented weighting of the single asset classes of bonds, currencies, real estate, equities, commodities and liquidity. The next level – taking active positions within the different asset classes – might not be suitable for every investor. Instead, investors might choose a passive solution through ETFs, which replicate the asset class as a whole.

Asset classes in 2017 at a glance

Year-to-date performance as at 31.12.2016 to 18.12.2017



Status: 18.12.2017 Source: Commerzbank, Bloomberg

Guidelines for our asset management mandates in 2018

1. **Global economic growth remains strong**
A global perfectly diversified portfolio is comprised of bonds, equities and commodities. This broad allocation provides investors with the perfect exposure for current growth opportunities as well as diversification protection.

2. **Policy rate differentials remain high**
We expect interest rate differentials to remain high in 2018. While short-term rates will keep rising in the US, they will be firmly anchored for the foreseeable future in the euro area and in Japan. This will have an impact on foreign exchange rates.

3. **Active management can boost bond performance**
In response to the low interest rate environment, we actively manage maturities and exposure in riskier bond market segments (high-yield bonds or emerging market bonds). Foreign currencies can be an attractive addition to portfolios.

4. **The equity outlook remains promising – upside is more limited, though**
We still favour equities in 2018 – particularly from Europe and the emerging markets. Our active approach is as follows: we take advantage of regional and sector opportunities, stay invested when markets move higher, but limit losses.

5. **Commodities are an ideal supplement for a diversified portfolio**
We favour broad-based investments in our commodity sleeve and add targeted positions when buying opportunities arise, based on technical indicators.

6. **Liquid alternative investments provide a market hedge at attractive returns**
We supplement our equity and bond exposure with market-neutral strategies – these strategies offer solid return potential even in a weak market environment and still reduce portfolio risks.

7. **Stringent, but active risk management as the most important performance driver**
An optimal asset allocation comprising bonds, equities, commodities and currencies provides a perfect portfolio diversification, thus minimising market risks by taking advantage of different asset class correlations.

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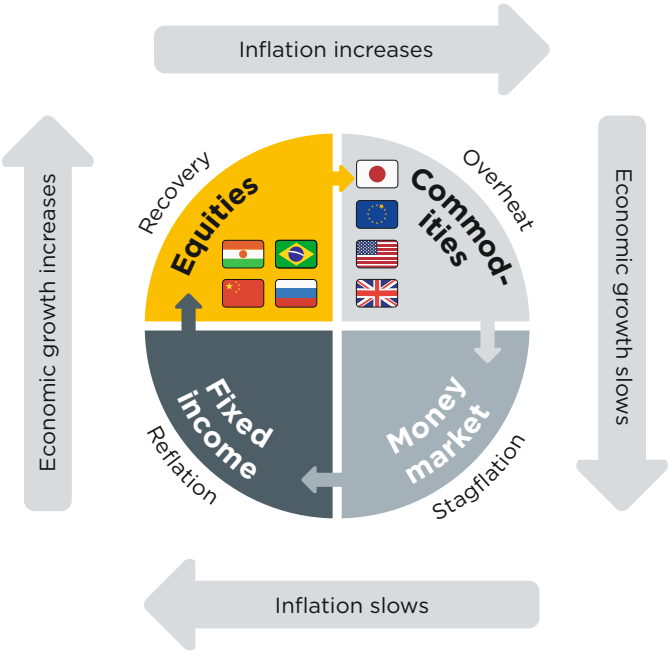
Michael Kohl
Head of Commerzbank
Asset Management

Asset Management:
Our positioning for 2018

Will we remain in the economic overheat stage in 2018? What are other possible scenarios?

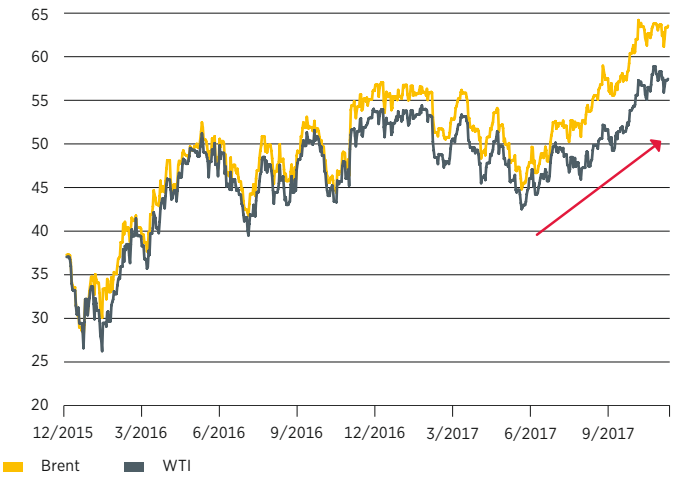
In December 2016 we deliberately aligned our strategic asset allocation with the economic overheat stage, despite the fact that economists had significant doubts that the global economy would experience a strong economic upswing. Scepticism was fuelled by geopolitical conflicts and the political situation in the euro area. In addition, the euro area economy still seemed fragile and economic growth was moderate in early 2017. In the US, equity markets were boosted by President Trump's economic agenda, but soon after his inauguration doubts grew whether he would be able to push the intended fiscal stimulus through Congress. Some market observers were also doubtful whether the recent improvement in economic growth in the emerging markets would be sustainable. The sceptics were wrong, though, and many major emerging economies registered a strong economic rebound, including China, Brazil and, more recently, Russia. This makes us confident for 2018, particularly taking into account the commodity price rebound.

Outlook 2017/2018 – overheat stage; emerging market economies further improved



Source: Commerzbank

Oil price trend since end-2015 in US dollars

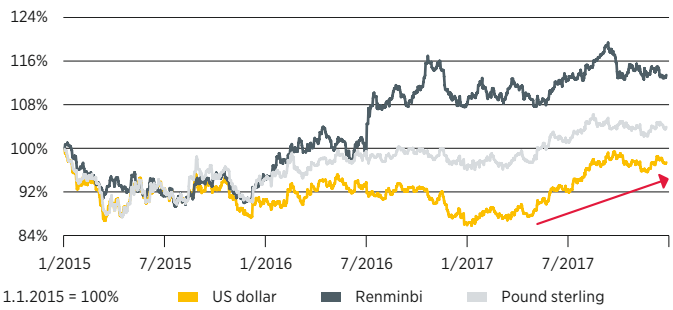


Source: Commerzbank, Bloomberg

Central banks will also keep the economies afloat: inflation is only slowly creeping higher, which means that the central banks will be in no hurry to raise policy rates in a meaningful way. Thus, capital markets will continue to enjoy a favourable environment. In addition to low interest rates, the euro area economy will benefit from the successful implementation of structural reforms, which is also increasingly improving the leading economic indicators.

This – and a decline in political risks – also explains a big part of the recent remarkable euro strength. The economic outlook has clearly improved, but the euro area economy is not yet in an overheat stage.

Euro strengthens significantly during 2017



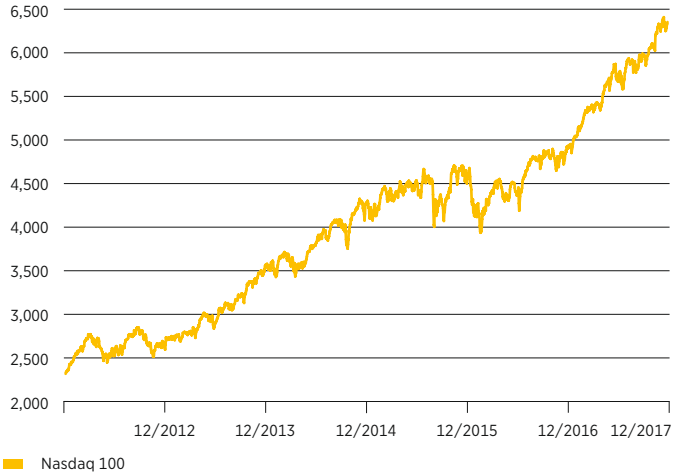
Source: Commerzbank, Bloomberg

Global economic trends (e.g. purchasing manager indices) are extremely robust, which means the economy overheat stage might well continue for a few more years. However, unknown political and economic shocks, which could occur at any time, pose a permanent risk to this benign scenario, which is why investors need to prepare and be ready for other scenarios as well. This is exactly how we have been preparing our portfolios so they can withstand sudden negative trends. One potential market risk, for example, is a sudden and significant Chinese economic growth slowdown. Beyond that, a sudden reversal of extremely easy monetary policies in response to an unexpected, strong inflation increase would certainly spoil the party in risky asset markets. Finally, high global debt levels and geopolitical risks are triggers that are always able to change the current positive market sentiment for the worse.

Which sectors and regions benefit the most from the global economic upswing?

Digitisation has turned into a megatrend. Nearly all sectors and industries are affected by a shift from analogue to more efficient digital processes. This has caused profound structural changes in many business models. The trend is moving towards autonomous management of processes, which is performed online. This is bringing many benefits to our daily life as well.

The megatrend continues: technology stocks outperformance



Source: Commerzbank, Bloomberg

Thus, it is no surprise that technology stocks were among the best performing stocks in 2017, despite the fact that December brought some profit-taking after a long bull run. And some themes are still at an early stage, such as autonomous driving and robotics. The development surrounding these topics promises to be breathtaking in the coming years.

On balance, earnings estimates have been upgraded for many companies in 2017. This also pushed demand for cyclical stocks. Aside from industrial companies and infrastructure and mining companies, they included financial companies in particular. While this trend will slow down somewhat in 2018, selected stocks still enjoy upside potential. Given the rebound in commodity prices, selected sectors, which have been lagging, such as energy stocks, still have potential to catch up. Consumer stocks (consumer staples/consumer discretionary) should also benefit from steady consumption growth.

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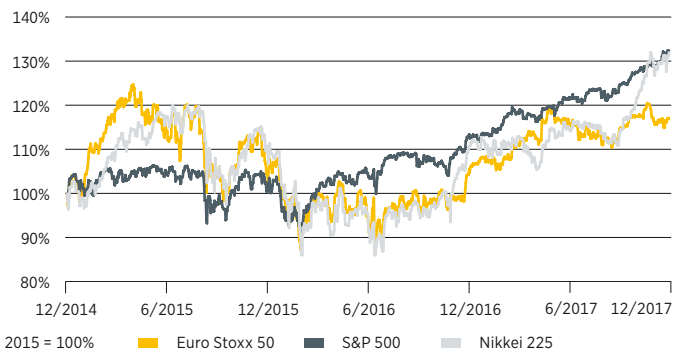
What will be the main political events in 2018 and how will you prepare for them?

Unlike in previous years, the political agenda is quieter in 2018. In Europe, market observers are likely to focus on how the next German government will be formed and on the Italian parliamentary election outcome, with the latter clearly being the more critical event. There are few doubts that Germany will get a stable government, either with or without new elections. In contrast, this outcome is not guaranteed in Italy. Following recent parliamentary reforms, though, it is less likely that populist anti-EU parties, even if they do fairly well in the upcoming elections, would have enough power to push for an Italian exit from the euro or the EU. Brexit negotiations will be another market focus. On the one hand, a "hard" Brexit in March 2019 would clearly be negative for market sentiment and could turn into a headwind as early as autumn 2018. On the other hand, positive Brexit news, such as the calling of a second referendum or a soft Brexit with positive compromises between the EU and the UK, would boost market sentiment. Finally, in November 2018 the US will hold mid-term elections for the House of Representatives and a third of the Senate.

In recent years, we were able to prepare well in advance for known political events and actively manage the resulting risks (e.g. Brexit referendum in 2016, elections in Europe and the US, Italian referendum in 2016). This allowed us to hedge the risks, limit losses and take advantage of buying opportunities. It is much more difficult to prepare for unknown political risks (e.g. Crimea invasion by Russia, Fukushima nuclear disaster in Japan, terror attacks such as September 11). However, our investment concept and our risk management have worked well even when these unknown risks materialised.

Bull market remains intact



Source: Commerzbank, Bloomberg

In March 2019 the equity bull market will turn ten years old, having started soon after the 2008 financial crisis. Will investors remain bullish on equities after such a long time?

A bull market does not die of old age, but because of a necessary rebalancing of unsustainable imbalances in certain economic regions, often triggered by short-term external shocks. In the recent past, major sell-offs such as in August 2015 and in early 2016 have proved short-lived and turned out to be excellent buying opportunities. Five factors argue for the continuation of the equity bull market:

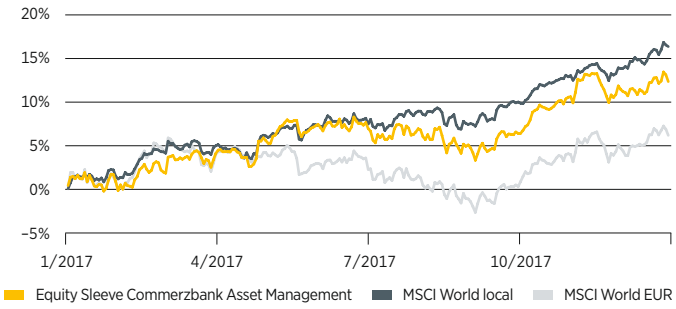
1. The global economic upswing is very robust.
2. The euro area has caught up and still has further room to go.
3. The emerging economies have left their recessions behind – driven by a commodity price rebound in particular.
4. Digitisation and automation are megatrends that have only just begun.
5. Not all equities or sectors have moved higher; selection remains key and market participants are far from being complacent.

Some factors point to a likely increase in equity market volatility in coming years. This argues for taking advantage of a professional asset management solution that allows us to quickly and actively adjust portfolios to changing market conditions. We have supplemented our strategic equity positioning with a rules-based investment system. In addition, we manage our equity allocation according to economic trends, sometimes focusing on cyclical and sometimes on defensive equities, when appropriate.

Some equity markets reached historic highs in 2017. Why is asset management not positioned more aggressively? Why has the cash position been relatively high at times?

There are several reasons for this. A broad portfolio diversification offers the best risk protection, and this includes diversification between risky assets. Thus, our moderately aggressive asset allocation stance is not just to build on equities but also includes other risky assets, such as commodities and riskier bonds. In addition, we make sure that the risk profile of each mandate is managed in line with the contractually agreed individual risk budget. Equities are just one asset class, using this risk budget. As mentioned above, we also invest in other risky assets that are highly correlated to equities. Furthermore, we also take into account currency market trends when making risk allocation decisions. While US equities, for example, reached numerous historic highs measured in local currency, the returns were much less stellar when calculated in euros.

MSCI Global in local currency and in euros; compared to equity sleeve Dynamic Capital Accumulation Global (projected to a 100% portfolio allocation)



Source: Commerzbank, Bloomberg

History shows that setback risks in the equity markets grow when market participants turn increasingly optimistic and finally become complacent.

This is why in early 2017 we started working with a rules-based system to flexibly manage our equity allocation. This required a higher cash position, allowing us to take advantage of buying opportunities without having to sell other promising investments. During 2018 we will be able to optimise this process and hold lower cash levels, which will help to optimise performance.

Would it be appropriate to raise the exposure to bonds in order to protect portfolio performance?

Bonds continue to be a core investment for every portfolio. High-quality government bonds offer protection in times of crises, which usually see their prices rise, while equity prices drop sharply.

Government bond yields since end-2007

Source: Commerzbank, Bloomberg

However, in the current low-yield environment, we hold a smaller exposure in government bonds and use several other strategies: these include active duration or maturity management. In addition, we make sure to run balanced bond portfolios with an adequate addition of higher-yielding, higher-risk subsegments. Finally, attractive foreign currency denominated bond positions round off the portfolio, supporting diversification and returns.

What other investment instruments are suitable in the current low-yield market environment, aiming at boosting returns without taking too much risk?

Aside from riskier assets and bonds, we also take advantage of so-called alternative investments in Commerzbank Asset Management. In order to efficiently select the most attractive investments, we created a Liquid Alternatives expert team some time ago, which underscores the growing importance of these types of investment. The main objective for using these investment instruments is to add additional options to traditional asset classes, thus additionally fine-tuning portfolio diversification. Correlation between equities and bonds often increases downturns. During these market stages, market-neutral strategies with their absolute return approach offer additional return opportunities without adding extra risks. One example: we usually hold single equity positions over a multi-year investment period. In contrast, specialised funds are constructed in a way that they can take short positions in specific equity indices through corresponding futures positions. This allows us to implement a more adequate portfolio structure and thus reduce single equity risks.

Gold is first and foremost a risky investment, just like equities or other risky securities: the gold price is very volatile – even more volatile at times than equity prices. However, when added to portfolios, gold is an excellent hedge for extreme risks whenever investors demand it as a “safe haven” asset.

Digitisation is also having a huge impact on Commerzbank Asset Management. How do clients benefit from this trend?

Commerzbank Asset Management has been embracing the service opportunities arising from digitisation. Aside from comprehensive review options with respect to portfolio structures within our asset management through our online banking, for about two years now we have been offering our customers access to digital customer reporting through an electronic mailbox, which also helps to lower paper consumption. In addition we offer our customers a comfortable option to increase their investment volumes at the push of a button.

Commerzbank AG
Kaiserplatz
Frankfurt am Main
www.commerzbank.de

Postal address
60261 Frankfurt am Main

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