

Efficient Access to Commodities

Only a couple of years ago, investing in commodities was a complicated matter involving a futures account or an indirect approach through equities. Invesco PowerShares and Deutsche Bank now provide a more efficient access to an area that's not correlated to equities. Investors can choose between diversified, leveraged, or inverse exposure, depending on their view, or lack of such, in each of the major commodity sectors.

Could you explain your investment philosophy?

According to modern portfolio theory, diversifying the portfolio into low-correlation buckets lowers the overall risk. We believe that the commodities represent a very attractive investment for money managers who want to diversify their holdings, and we have seen a large inflow into commodities in the past years.

There is academic research that deals with commodity returns over the years, such as the paper "Facts and Fantasies About Commodity Futures," by K. Geert Rouwenhorst and Gary Gorton. The paper proves that investments in commodities with a long allocation provide S&P-like returns with very low correlation to equities. That's opposite to the common belief that commodities are mean-reversion instruments, or a "zero-sum" game, where no real returns can be gained. Overall, for most investors it is recommended to look for 1% to 5% exposure to the commodities sector.

At Deutsche Bank, we bring investment tools that provide a very cheap and efficient access to commodities. Over the long run, our products move very much in line with the commodities they track. Until two years ago, you could not buy such products on the exchange. If you wanted to invest in commodities, you had to do it indirectly, through owning the equities involved in the sector. The other possibility was to open a futures account, which is quite difficult for most investors.

What are the core features of the PowerShares Deutsche Bank commodity products?

We launched the first of our 11 commodity exchange traded products in 2006. These

products provide either a broad exposure to different commodities through our commodity index, or sector investments in energy, metals, agriculture, etc. The products have been very successful and, over the last two years, have attracted approximately \$4.5 billion across our platform. The investors were well rewarded for investing in the sector as most commodities, with the exception of base metals, garnered solid returns in 2007.

These products were the next logical step after our long commodity funds, and we brought them in a note structure, not in a fund structure. They provide short or inverse exposure to the commodities, as well as leveraged exposure. For instance, in gold we recently brought DB Gold Double Short ETN, which gives two times the inverse movement of gold.

Another product, the DB Gold Double Long ETN, gives twice the positive move of gold for the investors who were still very bullish on the asset class and wanted to increase their exposure. Also, the investors who like their long exposure, recognize that going into a double long product can cut your asset capital investment in half. Basically, you get the same return for half of your capital allocation.

That philosophy refers to the short side as well. The inverse product allows investors to take the inverse view in a much simpler way than short-selling the ETFs. If you short sell an ETF, you need a margin account and your dealer has to locate a borrower. Sometimes ETFs are hard to borrow once you are short, and once you have borrowed, there is no guarantee that it will not be recalled. It is often complicated to short sell ETFs, and through our short products, we



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Prior to joining Deutsche Bank, Rich was a Regional Vice President from 2002 through 2003, in Product Distribution for Claymore Securities, Inc., responsible for distribution of closed-end funds and unit investment trusts in the State of New York. Previously, he worked at Lehman Brothers, Inc., supporting the equities, fixed income and investment banking product lines.

Rich received his MBA in Finance from the NYU Leonard N. Stern School of Business in 1996, and a BS in Business Administration from Taylor University, Upland, Indiana, in 1983.

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Product Name	Ticker Symbol	Inception Date	Market Price Returns Since Inception
PowerShares DB Funds Commodity			
PowerShares DB Agriculture Fund	DBA	01/05/07	14.09%
PowerShares DB Base Metals Fund	DBB	01/05/07	-7.61%
PowerShares DB Commodity Index Tracking Fund	DBC	02/03/06	17.30%
PowerShares DB Energy Fund	DBE	01/05/07	35.44%
PowerShares DB Gold Fund	DGL	01/05/07	21.31%
PowerShares DB Oil Fund	DBO	01/05/07	34.50%
PowerShares DB Precious Metals Fund	DBP	01/05/07	16.86%
PowerShares DB Silver Fund	DBS	01/05/07	-1.28%
Currency			
PowerShares DB G10 Currency Harvest Fund	DBV	09/18/06	0.83%
PowerShares DB US Dollar Bearish Fund	UDN	02/20/07	6.77%
PowerShares DB US Dollar Bullish Fund	UUP	02/20/07	-1.10%

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have given investors a simpler way to take a bearish view on these sectors.

Can you explain the difference between ETN and ETFs in terms of structure?

They are both exchange-traded products and the ETNs offer the benefits that people have appreciated in the ETFs. They have intraday liquidity and are very cost effective compared to other wrappers. There is tremendous price transparency at any point in the day versus the underlying asset. So, there isn't a lot of distinction between the two products in terms of look, feel, and trading capability.

The difference is that the ETNs always guarantee the index returns, while some ETFs have a tracking error. The flip side is that with an ETN you take the credit risk of the issuer as the ETNs are issued off the shelf platform from a major financial institution or a bank. We use the Deutsche Bank shelf, which has an S&P rating AA- and Moody's rating of Aa1.

Another distinction between the funds and the notes is related to tax reporting. With some fund structures set as partnerships, especially in commodities and currencies, we can give you a K-1 for your tax reporting. At the same time, the ETNs are going to be 1099 issuers, and some people with taxable accounts prefer the 1099 reporting over the

K-1.

How are these individual products designed? What can the products in agriculture, for example, deliver to the investor?

We were the first in the U.S. market with exchange-traded agriculture product that referenced futures contracts, not the basket of equities in the food industry. Our agriculture ETF is a basket of wheat, corn, soybeans, and sugar, where each of them represents 25%, and we rebalance back to the 25% every November. This product has already reached \$1.2 billion in assets.

An investment in PowerShares DB Agriculture Fund (DBA) represents a movement in the agriculture futures plus an underlying three-month T-bill yield on investments. We brought four agriculture notes in April: a single long, a double long, a single short, and a double short product. Both the ETF and the ETNs reference to the same basket of agricultural products.

The DB Agriculture Long is similar to the DBA, only in a note form. That product will always give you the index, knowing the tracking error, but gaining back to the point you take the credit risk of the issuer.

We also brought DAG, our agriculture double kong ETN, which gives one time the T-bill move and two times the agriculture

move. If the basket of agriculture products is up 3% in one day, you would expect the DAG to move up 6% in that day. Overall, it provides twice the movement of the underlying basket. However, if agriculture is down 3% in a day, the DAG will probably be down 6% that day. Leverage is a double-edged sword, so the product amplifies your returns both on the upside and on the downside.

If you have a bearish view on agriculture, we also have a single short product. If the basket of agricultural products is up 3% in a day, you will be down 3% that day. Conversely, if the basket is down 3%, you will be up 3%. Therefore, the product gives the inverse movement of the basket. Our amplified version of that product, the DB Agriculture Double Short ETN, should be up 6% that day.

We have developed the inverse and the leveraged agriculture ETNs due to demand from both retail and institutional investors, who use them as tools to portray their views on agricultural movements.

Could you explain your diversified commodity products?

They are similar to the agricultural products. Over the last two years, one of our biggest is funds is DBC, the PowerShares DB Commodity Index Tracking Fund. With this product you get a basket of the futures it references, namely, oil and heating oil, gold, aluminum, corn, and wheat. Basically, it is a diversified investment across all the commodity sectors - precious metals, base metals, energy and agriculture. This product is for investors without a strong view on one commodity versus another, but recognizing the diversification benefit of investing in commodities.

We reference the index with the most liquid futures contract rolled into global production. Instead of trading all the different oil contracts, we try to focus on the most liquid ones, such as oil and heating oil, because they will give the movement of that sector.

Alongside DBC, there is a long ETN, which should perform just like the DBC fund, but always giving the index and providing

1099 tax reporting. That's important for investors with taxable accounts, and not that important for the investors with tax deferred accounts. The other diversified commodity products are single long, single short, double long, and double short ETNs.

Are the commodities and the products priced in dollars? How do you deal with the currency issue?

All of these commodities and the underlying futures are priced in dollars. These are U.S. registered securities and there is no foreign currency element.

We do have currency exposure products, but not in a leverage form. We have PowerShares DB US Dollar Index Bullish & Bearish Funds, which provide the dollar moves against the basket of the G6 currencies. However, we don't have an inverse strategy. If the dollar moves up and you are in the bearish fund, you will be moving down. That means placing a bearish view on the dollar, but we do not have leverage versions of those products yet.

Many people lack understanding of how these markets work. How the rising oil and food prices are related to trading?

The press claims that the speculative money in the commodity markets is pushing up the prices. However, recent research on investable commodities versus commodities that don't have a futures market, shows that there is a higher run up on the non-tradable commodities. That would lead you to the conclusion that investors in commodities actually help to bring prices slightly down.

Despite the sentiment that speculators are pushing the prices up, the majority of the economists feel that it is the fundamentals driving the markets. It is the excessive demand relative to the supply.

What's your approach towards investments in gold?

Most people usually invest in gold either as a hedge to inflation or as a counter investment against the dollar. The dollar is weakening and investors expect gold prices to go up. Over the last three to four years, \$25 billion have flowed into the gold ETFs. Gold nearly has doubled its price,

providing an annual return of approximately 17% over that period.


Now gold is 17% off the highs it hit in March, but it is flat on the year. We brought tools for investments in gold for the same reason as in other commodities—people like to take bullish and bearish views, and to leverage. We referenced a gold index that points to futures, but in this case, it is a single gold futures contract.

What should investors expect from the ETNs and the ETFs? Would you like to warn investors about the possible pitfalls?

It is important to compare apples to apples. You have to know what exactly the ETF or the ETN is tracking, where is the underlying reference, when does it stop trading, etc. A lot can happen in a two-hour period. Many times gold will close flat at 1:30 p.m., and then news will come out on the dollar. In the next two hours, the price of gold may go up. Depending on the product, you may not be able to move with that news, and there will be a difference between the futures closing price at 1:30 and the exchange closing price.

So, I would warn the investors to make sure that they know what they are investing in. The commodities have higher volatility than the equities or the fixed income products. That is why most people use them as part of their alternative investment allocation. They would allocate 1% to 10% depending on their view, recognizing that these investments will move in a more volatile fashion.

What is your view and strategies on risk control?

Leverage is a difficult concept to grasp, and it is sometimes even more difficult to implement. You have to figure out how often you reset your levels to keep that leverage where it is. If you launched a double long at \$25 and the price is rising, then your leverage levels decrease if you do not reset. If the price is decreasing, your leverage is increasing with the falling price, unless you reset. However, resetting the products daily may lead to strange compounding over a long-term period. We do a monthly reset to keep the leverage level in our double products at two to one. 

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