

NEW GERMANY FUND INC
Form N-CSR
March 07, 2017
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

FORM N-CSR

Investment Company Act file number: 811-05983

The New Germany Fund, Inc.

(Exact Name of Registrant as Specified in Charter)

345 Park Avenue

New York, NY 10154-0004

(Address of Principal Executive Offices) (Zip Code)

Registrant's Telephone Number, including Area Code: (212) 250-3220

Paul Schubert

60 Wall Street

New York, NY 10005

(Name and Address of Agent for Service)

Date of fiscal year end: 12/31/2016

Date of reporting period: 12/31/2016

ITEM 1. REPORT TO STOCKHOLDERS

December 31, 2016

Annual Report to Shareholders

The New Germany Fund, Inc.

Ticker Symbol: GF

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The Fund seeks long-term capital appreciation primarily through investment in middle-market German equities.

Investments in funds involve risks, including the loss of principal.

The shares of most closed-end funds, including the Fund, are not continuously offered. Once issued, shares of closed-end funds are bought and sold in the open market. Shares of closed-end funds frequently trade at a discount to net asset value. The price of the Fund's shares is determined by a number of factors, several of which are beyond the control of the Fund. Therefore, the Fund cannot predict whether its shares will trade at, below, or above net asset value.

This Fund is diversified, but primarily focuses its investments in Germany, thereby increasing its vulnerability to developments in that country. Investing in foreign securities, particularly those of emerging markets, presents certain risks, such as currency fluctuations, political and economic changes and market risks. Any fund that concentrates in a particular segment of the market will generally be more volatile than a fund that invests more broadly.

The European Union, the United States and other countries have imposed sanctions on Russia as a result of the Russian military intervention in Ukraine. These sanctions have adversely affected Russian individuals, issuers and the Russian economy, and Russia, in turn, has imposed sanctions targeting Western individuals, businesses and products including food products. The various sanctions have adversely affected, and may continue to adversely affect, not only the Russian economy but also the economies of many countries in Europe, including Germany. Potential developments in Ukraine, and the continuation of current sanctions or the imposition of additional sanctions may materially adversely affect the value of the Fund's portfolio.

In June 2016, citizens of the United Kingdom voted that the United Kingdom should leave the European Union. Significant uncertainty exists regarding the timing and terms of the United Kingdom's anticipated withdrawal from the European Union and the effects such withdrawal may have on the United Kingdom, other European countries and the global economy.

Deutsche Asset Management represents the asset management activities conducted by Deutsche Bank AG or any of its subsidiaries.

NOT FDIC/NCUA INSURED NO BANK GUARANTEE MAY LOSE VALUE NOT A DEPOSIT NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY

Letter to the Shareholders (Unaudited)

Dear Shareholder,

For the year 2016, European stock markets had another positive year in local currency terms. In euro terms, the MSCI Europe Index had a total return of +3.1% and the German DAX +6.9%.¹ The euro depreciated against the USD by 3.1%.

During the 12 months ended December 31, 2016, the New Germany Fund, Inc's. total return in U.S. dollars (USD) was 0.61% based on net asset value and -3.25% based on market price. During the same period, the total return in USD of the Fund's benchmark, the Midcap Market Performance Index, was 1.65%.²

In Germany, the equity market suffered significant volatility in the first half of 2016. Britain's referendum on whether to exit the European Union triggered dramatic volatility in the equity markets in the first half. At the end of June, the surprising "Leave" vote resulted in a sharp setback for European equity markets. However, the German equity market recouped its post-Brexit losses in the second half to close the year with a strong gain. Hopes of a pro-growth policy under President Trump, the extension of the European Central Bank's quantitative easing until the end of 2017 and government support for Italian banks were especially supportive for the market.³ Also, a supportive Q3 earnings season and lively merger & acquisition activity boosted equity markets in the fourth quarter. Rising leading economic indicators in the Eurozone offered tailwinds for equity markets. The Eurozone PMI jumped to the five-year high of 54.9.⁴ German third quarter GDP grew 0.2% quarter over quarter, and Eurozone GDP grew 0.3%.⁵ Eurozone

consumer price inflation rose 0.5% year over year, the biggest price increase in two years.

The Fund's slight underperformance in 2016 was driven by a negative sector allocation and a negative stock selection. Detractors to performance were the result of underweights in Lanxess AG and GEA Group AG and the overweight in United Internet AG. Due to the announcement of an interesting acquisition by Lanxess, we moved our underweight in the stock to an overweight in the second half. We also changed our opinion on United Internet AG and sold our overweight.⁶ Positive attributions to performance were generated by overweights in Covestro AG and Siltronic AG and the underweight in Hugo Boss. Siltronic was newly added during the second half of the year. From a sector perspective, the biggest negative attributions came from the industrials and the financials sectors. We increased our weight in the industrials during 2016 to gain more exposure to capital expenditure (capex) linked to investments in logistic infrastructure. Increases in U.S. interest rates hurt the yield-sensitive real estate sector during the second half of the year and, as a result, we reduced our weight in the sector over the course of the second half. On the flip side, the banking segment benefited from the move, and we increased our weight in banks. The strongest positive attributions on the sector side came from the materials and information technology sectors. Over the course of the year the overweight in the materials sector had been increased, whereas the weight in information technology had been decreased.

Economic Outlook

The leading indicators for Germany are still pointing toward healthy levels of growth in the coming year. The German Composite PMI surged back to levels over 55 by the end of 2016 after dropping below 53 in the September release.⁷ The Services PMI had triggered the increase as it saw a bounce back to levels over 54 in the fourth quarter. The Manufacturing PMI showed further strength and closed the year over 55.⁸ Also, German business sentiment is at a favorable level. After showing some weakness over the summer, the IFO Business Climate index continued its surprisingly strong trend in the fourth quarter, reaching a two-year high of 111.⁹

German consumption is still a major driver of growth. The German consumer climate index dipped slightly during the fourth quarter, however, the level is still close to the peak level of 10.2 and signals a still very robust demand from German consumers. A rebound in the November numbers on retail sales of +3.2% support this positive view after a dip in October. Record real income gains are still paying off and Germans remain confident of their future. The labor market is still in a very healthy condition with a further decline of unemployment rates to 5.8% in December and with the number of unemployed people at a 25-year low. However, rising inflation coupled with slowing wage growth could dampen German consumer sentiment in 2017.

Ten Largest Equity Holdings at December 31, 2016 (52.0% of Net Assets)	Percent
1. Airbus Group SE	11.7%
2. QIAGEN NV	5.1%
3. Brenntag AG	5.1%
4. METRO AG	4.6%
5. Steinhoff International Holdings NV	4.5%
6. MTU Aero Engines AG	4.4%
7. Covestro AG	4.3%
8. Zalando SE	4.2%
9. OSRAM Licht AG	4.2%
10. Symrise AG	3.9%

Portfolio holdings and characteristics are subject to change and not indicative of future portfolio composition.

For more details about the Fund's Schedule of Investments, see page 11. For additional information about the Fund, including performance, dividends, presentations, press

releases, market updates, daily NAV and shareholder reports, please visit deutschefunds.com.

Economists expect German GDP growth to slow in 2017, following considerable momentum over the last two years. However, given the political uncertainty in the Euro area, the German economy still offers investors an underlying robust domestic economic growth path. We expect private consumption, government spending and the construction industry to be the main growth drivers once again. Political uncertainty arising from elections in France, the Netherlands and Germany might still dampen exports and investments. Even though a pick-up in U.S. growth and the end of recession in Russia are increasing global growth expectations, European growth that is burdened by political uncertainty and lower credit growth is weakening.

President Trump's election and a subsequent rise in Treasury yields triggered a rotation out of "low volatility" stocks into financials and cyclical sectors. We remain underweight in defensive sectors such as real estate and telecoms. We remain overweight in consumers, industrials and materials. We expect a U.S. dollar strengthening versus the EUR to become a tailwind for German companies. We are overweighting German stocks benefiting from USD strength. Last, but not least, we are sticking to our preference for companies benefiting from structural growth trends, such as the increasing online penetration in retail and media markets, increasing investments in e-commerce, increasing global aviation passenger trends or health care innovation spending.

The Fund's discount to net asset value averaged 11.4% for the period in review.

The Fund recently announced changes to its portfolio management and to the membership of its board. Valerie Schueler has replaced Philipp Schweneke as the portfolio manager of the Fund. Mr. Schweneke now serves as the Fund's deputy portfolio manager. In addition, Dr. Friedbert Malt and Mr. Joachim Wagner retired as Directors of the Fund, effective October 24, 2016 and January 13, 2017, respectively. The Board thanks Dr. Malt and Mr. Wagner for their service to the Fund.

Sincerely,

Christian Strenger		Brian Binder
Chairman	Philipp Schweneke	President and Chief
	Portfolio Manager	Executive Officer

The views expressed in the preceding discussion reflect those of the portfolio management team generally through the end of the period of the report as stated on the cover. The management team's views are subject to change at any time based on market and other conditions and should not be construed as recommendations. Past performance is no guarantee of future results. Current and future portfolio holdings are subject to risk, including geopolitical and other risks.

¹ The DAX tracks the performance of the 30 major German companies trading on the Frankfurt Stock Exchange.

² The Midcap Market Performance Index is a total-return index that is composed of various mid-cap securities across all sectors of the MDAX and TecDAX. The MDAX is a total-rate-of-return index of 50 mid-cap issues that rank below the DAX. The DAX is a total-rate-of-return index of 30 selected German blue chip stocks traded on the Frankfurt Stock Exchange. The TecDAX is a total-return index that tracks the 30 largest and most liquid issues from the various technology sectors of the Prime Standard Segment beneath the DAX. Index returns assume reinvestment of dividends and, unlike Fund returns, do not reflect any fees or expenses. It is not possible to invest directly in the Midcap Market Performance Index.

³ Quantitative easing (QE) is a monetary policy tool, in which a central bank conducts a broad-based program of asset purchases.

⁴ The Eurozone PMI tracks business trends across both the manufacturing and service sectors in the Euro area, based on data collected from a representative panel of over 5,000 companies (60 percent from the manufacturing sector and 40 percent from the services sector). The index tracks variables such as sales, new orders, employment, inventories and prices.

⁵ The gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period.

⁶ A particular security is underweight in a portfolio when it holds a lower weighting in comparison with the security's weight in the underlying benchmark portfolio.

⁷ The German Composite PMI tracks business trends across the manufacturing and service sectors, based on data from over 1,000 companies (50% from manufacturing and 50% from services). The Index tracks variables such as sales, new orders, employment, inventories and prices.

⁸ The German Manufacturing Purchasing Managers' Index (PMI) measures the activity level of purchasing managers in the manufacturing sector.

⁹ The IFO Business Climate Index is a monthly survey that measures the business climate in Germany.

Outlook Interview with the Portfolio Manager (Unaudited)

Portfolio Manager

Philipp Schweneke

Question: What are your near-term expectations for the German consumer, and how is the Fund currently positioned?

Answer: Economists are expecting a growth of German retail sales of over 2% year over year. This would mark the seventh consecutive year of a growth rate above 1%, which has not been seen in recent history. German consumption has been supported by a booming labor market that has reached the lowest unemployment rate since reunification. Wage growth, coupled with low inflation, led to increasing disposable incomes in Germany over the last few years. For 2017, we expect German retail sales growth to slow, but still remain at decent levels. The key dampening factor is expected to come from lower real income growth. Rising inflation, coupled with slowing wage growth, is likely to take its toll on consumer sentiment. The Fund is positioned overweight in retail; however, there is a strong focus on online exposed business models, as online is still showing a strong growth rate due to increasing penetration levels. We are skeptical about retail models with a strong reliance on a physical store base.

Question: 2017 will be an election year for Germany. How would you assess the impeded risks from this event?

Answer: European equity markets could become volatile with any deviation from the currently expected outcome. Current surveys are suggesting that Angela Merkel will be elected chancellor for the fourth consecutive time. Merkel's CDU/CSU party alliance currently appears to have a clear lead over the SPD.¹ However, if Angela Merkel remains chancellor, it is not clear which party she will choose as her coalition partner. The current parliamentary diversity should give Merkel the option to enter into another grand coalition with the SPD, or form a three-party alliance with the Greens and the FDP.² Close attention will also be given to the results of the AfD, Germany's right-wing populist and Eurosceptic party. However, the AfD appears to have reached its peak, likely due to the fact that the number of newly registered refugees has been stable since April 2016. However, a renewed surge in the number of refugees, an ongoing threat to the internal security or critical developments in the European Union (EU) could support the AfD winning markedly over 10% of the votes. We will be closely monitoring trends going into the election.

¹ The CDU/CSU is the alliance of two political parties in Germany, the Christian Democratic Union of Germany (CDU) and the Christian Social Union in Bavaria (CSU). The SPD is a social democratic political party in Germany.

² The Alliance'90/The Greens is a green political party in Germany formed from the German Green Party founded in West Germany in 1980 and Alliance 90 founded during the Revolution of 1989–1990 in East Germany in 1993. The Free Democratic Party (FDP) is a liberal and classical liberal party in Germany.

Performance Summary December 31, 2016 (Unaudited)

All performance shown is historical, assumes reinvestment of all dividend and capital gain distributions, and does not guarantee future results. Investment return and principal value fluctuate with changing market conditions so that, when sold, shares may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. Please visit deutschefunds.com for The New Germany Fund, Inc.'s (the "Fund") most recent performance.

Fund specific data and performance are provided for information purposes only and are not intended for trading purposes.

Average Annual Total Returns as of 12/31/16

	1-Year	5-Year	10-Year
Net Asset Value ^(a)	0.61%	16.46%	7.62%
Market Price ^(a)	(3.25)%	16.19%	7.27%
Midcap Market Performance Index ^(b)	1.65%	15.55%	6.31%

^a Total return based on net asset value reflects changes in the Fund's net asset value during each period. Total return based on market value reflects changes in market value during each period. Each figure includes reinvestments of income and capital gain distributions, if any. Total returns based on net asset value and market price will differ depending upon the level of any discount from or premium to net asset value at which the Fund's shares trade during the period. Expenses of the Fund include investment advisory and administration fees and other fund expenses. Total returns shown take into account these fees and expenses. The annualized expense ratio of the Fund for the year ended December 31, 2016 was 1.21%.

^b The Midcap Market Performance Index is a total-return index that is composed of various mid-cap securities across all sectors of the MDAX and TecDAX. The MDAX is a total-rate-of-return index of 50 mid-cap issues that rank below the DAX. The DAX is the total-rate-of-return index of 30 selected German blue chip stocks traded on the Frankfurt Stock Exchange. The TecDAX is a total-return index that tracks the 30 largest and most liquid issues from the various technology sectors of the Prime Segment beneath the DAX.

Index returns do not reflect any fees or expenses and it is not possible to invest directly in the Midcap Market Performance Index.

Net Asset Value and Market Price

	As of 12/31/16	As of 12/31/15
Net Asset Value	\$ 14.97	\$ 16.19
Market Price	\$ 13.07	\$ 14.70

Prices and Net Asset Value fluctuate and are not guaranteed.

Distribution Information

	Per Share
Twelve Months as of 12/31/16:	
Income	\$.39

Capital Gains \$.59
 Return of Capital \$.21
 Distributions are historical, not guaranteed and will fluctuate.

Schedule of Investments as of December 31, 2016

	Shares	Value (\$)
Germany 84.2%		
Common Stocks 79.6%		
Aerospace & Defense 4.4%		
MTU Aero Engines AG	90,252	10,449,747
Chemicals 14.2%		
Covestro AG 144A	149,735	10,291,632
K+S AG (Registered)†	202,700	4,849,923
LANXESS AG	135,432	8,904,393
Symrise AG	149,920	9,142,382
		33,188,330
Commercial Services & Supplies 0.6%		
Bilfinger SE*†	36,695	1,415,265
Construction & Engineering 1.6%		
HOCHTIEF AG	27,549	3,865,158
Diversified Telecommunication Services 0.6%		
Telefonica Deutschland Holding AG	349,663	1,500,689
Electrical Equipment 4.2%		
OSRAM Licht AG	189,283	9,945,016
Electronic Equipment, Instruments & Components 0.9%		
Jenoptik AG	122,743	2,125,929
Food & Staples Retailing 4.6%		
METRO AG	322,208	10,731,583
Food Products 0.8%		
Suedzucker AG	78,382	1,875,415
Health Care Technology 0.7%		
CompuGroup Medical SE	41,494	1,704,055
Independent Power & Renewable Electricity Producers 1.7%		
Uniper SE*	297,622	4,116,043
Industrial Conglomerates 0.5%		
Rheinmetall AG	18,417	1,240,984
Insurance 2.8%		
Hannover Rueck SE	10,983	1,190,586
Talanx AG	162,615	5,447,840
		6,638,426
Internet & Direct Marketing Retail 4.2%		
Zalando SE 144A*	260,178	9,956,441
Internet Software & Services 3.7%		
Scout24 AG 144A*	101,075	3,605,190
United Internet AG (Registered)	100,580	3,934,355
XING AG	6,192	1,145,594
		8,685,139
IT Services 2.3%		

Wirecard AG [†]	125,655	5,418,056
Life Sciences Tools & Services 1.0%		
Evotec AG*	125,975	988,600
MorphoSys AG*	26,540	1,364,339
		2,352,939
Machinery 5.2%		
GEA Group AG	154,629	6,233,642
KION Group AG	108,837	6,066,669
		12,300,311
Media 1.2%		
CTS Eventim AG & Co. KGaA	53,964	1,704,306
Stroeer SE & Co. KGaA [†]	26,971	1,186,129
		2,890,435
Metals & Mining 3.9%		
Aurubis AG	79,630	4,601,547
Salzgitter AG	129,931	4,596,761
		9,198,308
Pharmaceuticals 1.5%		
STADA Arzneimittel AG	66,002	3,423,232
Real Estate Management & Development 6.6%		
ADO Properties SA 144A	36,711	1,239,163
Deutsche Wohnen AG	213,095	6,705,307
LEG Immobilien AG*	82,158	6,393,708
TLG Immobilien AG	61,810	1,166,698
		15,504,876
Semiconductors & Semiconductor Equipment 2.8%		
Siltronic AG*	142,427	6,612,083
Software 0.8%		
Software AG	54,456	1,980,261
Thriffs & Mortgage Finance 1.6%		
Aareal Bank AG	98,059	3,698,216
Trading Companies & Distributors 5.1%		
Brenntag AG	214,719	11,955,039
Transportation Infrastructure 2.1%		
Fraport AG Frankfurt Airport Services Worldwide	82,875	4,908,791
Preferred Stocks 4.6%		
Auto Components 1.7%		
Schaeffler AG (Cost \$ 3,709,688)	269,001	3,986,863
Health Care Equipment & Supplies 1.2%		
Sartorius AG (Cost \$ 2,014,562)	38,939	2,894,813
Machinery 1.7%		
Jungheinrich AG (Cost \$ 3,359,586)	135,316	3,889,749
Total Germany (Cost \$160,375,161)		198,452,192
Netherlands 21.3%		
Common Stocks		
Aerospace & Defense 11.7%		
Airbus Group SE	416,986	27,631,486
Household Durables 4.5%		
Steinhoff International Holdings NV [†]	2,063,418	10,670,488
Life Sciences Tools & Services 5.1%		

QIAGEN NV*	425,529	11,971,858
Total Netherlands (Cost \$31,915,204)		50,273,832

Securities Lending Collateral 6.4%

Government & Agency Securities Portfolio "Deutsche Government Cash Institutional Shares", 0.41% (Cost \$15,208,193) (a) (b)	15,208,193	15,208,193
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Cash Equivalents 0.1%

Deutsche Central Cash Management Government Fund, 0.50% (Cost \$99,120) (b)	99,120	99,120
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% of Net Assets Value (\$)

Total Investment Portfolio (Cost \$207,597,678)**	112.0	264,033,337
Other Assets and Liabilities, Net	(12.0)	(28,193,890)
Net Assets	100.0	235,839,447

* Non-income producing security.

** The cost for federal income tax purposes was \$209,042,636. At December 31, 2016, net unrealized appreciation for all securities based on tax cost was \$54,990,701. This consisted of aggregate gross unrealized appreciation for all securities in which there was an excess of value over tax cost of \$75,273,947 and aggregate gross unrealized depreciation for all securities in which there was an excess of tax cost over value of \$20,283,246.

†All or a portion of these securities were on loan. The value of all securities loaned at December 31, 2016 amounted to \$14,573,619, which is 6.2% of net assets.

(a) Represents collateral held in connection with securities lending. Income earned by the Fund is net of borrower rebates.

(b) Affiliated fund managed by Deutsche Investment Management Americas Inc. The rate shown is the annualized seven-day yield at period end.

144A: Securities exempt from registration under Rule 144A of the Securities Act of 1933. These securities may be resold in transactions exempt from registration, normally to qualified institutional buyers.

For purposes of its industry concentration policy, the Fund classifies issuers of portfolio securities at the industry sub-group level. Certain of the categories in the above Schedule of Investments consist of multiple industry sub-groups or industries.

Securities are listed in the country of domicile. For purposes of the Fund's investment objective policy to invest in German companies, non-Germany domiciled securities may qualify as German companies as defined in the Fund's Statement of Investment Objectives, Policies and Investment Restrictions.

Fair Value Measurements

Various inputs are used in determining the value of the Fund's investments. These inputs are summarized in three broad levels. Level 1 includes quoted prices in active markets for identical securities. Level 2 includes other significant observable inputs (including quoted prices for similar securities, interest rates, prepayment speeds and credit risk). Level 3 includes significant unobservable inputs (including the Fund's own assumptions in determining the fair value of investments). The level assigned to the securities valuations may not be an indication of the risk associated with investing in those securities.

The following is a summary of the inputs used as of December 31, 2016 in valuing the Fund's investments.

Assets	Level 1	Level 2	Level 3	Total
Common Stocks and/or Other Equity Investments (c)				
Germany	\$ 198,452,192	\$ —	\$ —	\$ 198,452,192
Netherlands	50,273,832	—	—	50,273,832
Short-Term				
Instruments	15,307,313	—	—	15,307,313
(c)				
Total	\$ 264,033,337	\$ —	\$ —	\$ 264,033,337

There have been no transfers between fair value measurement levels during the year ended December 31, 2016.

(c) See Schedule of Investments for additional detailed categorizations.

The accompanying notes are an integral part of the financial statements.

Statement of Assets and Liabilities

as of December 31, 2016

Assets

Investments in non-affiliated securities, at value (cost \$192,290,365) — including \$14,573,619 of securities loaned	\$ 248,726,024
Investment in Deutsche Central Cash Management Government Fund (cost \$99,120)	99,120
Investment in Government & Agency Securities Portfolio (cost \$15,208,193)*	15,208,193
Total investments, at value (cost \$207,597,678)	264,033,337
Foreign currency, at value (cost \$8,428)	8,565
Foreign taxes recoverable	202,383
Interest receivable	9,603
Other assets	51,733
Total assets	264,305,621

Liabilities

Payable upon return of securities loaned	15,208,193
Distributions payable	12,554,711
Payable for Fund shares repurchased	331,378
Investment advisory fee payable	146,207
Administration fee payable	43,973
Accrued expenses and other liabilities	181,712
Total liabilities	28,466,174