

NEW GERMANY FUND INC
Form N-CSR
March 03, 2016
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

Date of reporting period: 12/31/2015

ITEM 1. REPORT TO STOCKHOLDERS

December 31, 2015

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 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.

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 12 months ended December 31, 2015, the New Germany Fund, Inc.'s total return in U.S. dollars (USD) was 15.38% based on net asset value and 14.31% based on market price. During the same period, the total return in USD of the Fund's benchmark, the Midcap Market Performance Index, was 12.88%.¹ The Fund's discount to net asset value averaged 9.33% for the period in review, compared with 9.56% for the year 2014.

The German stock market had a positive year in local currency terms. In euro terms, the benchmark Midcap Market Performance Index had a total return of 25.7% and the Fund's net asset value returned 26.7%. The euro depreciated by over 10% versus the U.S. dollar.

Within the Fund, the largest positive attributions to performance, particularly in the second half of 2015, were generated by Hugo Boss AG, Stroeer SE and ADO Properties SE, while detractors included Vonovia SE,* Draegerwerk AG & Co. and Evonik Industries AG.

* Not held in the portfolio as of December 31, 2015.

German consumer confidence decreased somewhat over the second half of the year after reaching a multiyear high in June 2015. However, the consumer confidence level overall is still very high. Income expectations as well as economic expectations began increasing again towards the end of the year, a strong sign that Germans are more confident about the future. The main drivers of this confidence were a record-high workforce number (more than 43 million persons) and significantly increasing disposable income, as well as record-low interest rates that acted to

reduce any propensity to save. Encouraged by the low unemployment rate, German employees saw wage increases at multiyear high levels of 2% to 3%. As Germans became more confident about maintaining their jobs and wage increases, their willingness to buy bigger ticket items also increased. We believe domestic demand will continue to be a key pillar of the economy, likely driving over 50% of gross domestic product (GDP) growth for 2016. We remain constructive on the German consumer as the trends in wages, employment, price inflation and interest rate levels continue to support private consumption.

German macroeconomic data remained robust against a backdrop of some worrisome trends such as risks to the growth of emerging markets and the resulting stock market weakness over the summer. Following this weakness, German economic data recovered towards the end of the year. After German industrial orders dropped for three consecutive months over the summer, there was a reversal of the trend in October and November, especially as demand from the Eurozone improved markedly. More short-term macroeconomic indicators showed further solid near-term growth, signaling strong autumn activity.

The German IFO index ended the year on a slightly weaker note.² While companies assessed their current situations as slightly more negative, expectations overall remained unchanged following rises for three months in a row. The IFO Institute highlighted the continuing favorable outlook for German exports, stressing the strength of companies' current positions despite the drop. IFO indices for the domestic sectors (construction, wholesale and retail trade) all declined moderately towards the end of the year, while the more export-dependent manufacturing IFO rose. Moreover, after four consecutive index increases, manufacturing expectations are now solidly above their historic average again.

Overall, macroeconomic and consumer data point toward improvements after signs of temporary weakness over the summer, when emerging-markets growth concerns were burdensome. However, the declines over the summer months were small and the overall still-high data point levels are consistent with positive quarterly GDP growth. Germany's GDP grew in the first three quarters of 2015 by 0.3% to 0.4% compared with the preceding quarter and likely continued this pace, which points towards a decent annualized growth.

To benefit from this underlying strength, positions in consumer-related companies, especially with a focus on Germany and Europe, were increased through, e.g., Scout24, the leading German classifieds business, and Stroeer, the leading German outdoor advertising company. Consumer stocks are the key overweight position in the Fund. On the other hand, taking account of the weakening global data points over the summer, we selectively reduced positions in industrials.

Ten Largest Equity Holdings at December 31, 2015 (46.0% of Net Assets)		Country	Percent
1. Airbus Group SE		Netherlands	11.9%
2. United Internet AG		Germany	4.7%
3. Zalando SE		Germany	4.1%
4. QIAGEN NV		Netherlands	3.8%
5. Evonik Industries AG		Germany	3.8%
6. Symrise AG		Germany	3.8%
7. MTU Aero Engines AG		Germany	3.6%
8. METRO AG		Germany	3.5%
9. LEG Immobilien AG		Germany	3.5%
10. ProSiebenSat.1 Media SE		Germany	3.3%

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 9. For additional information about the Fund, including performance, dividends, presentations, press releases, market updates, daily NAV and shareholder reports, please visit deutschefunds.com.

Economic Outlook

Seven years after the start of the financial crisis, markets have entered a more mature phase. For this reason, we expect 2016 and beyond to yield only the potential for modest total returns. However, we also have to acknowledge a higher risk that annual returns could easily turn negative.

We remain constructive on the German equity market, based on expected moderate earnings growth. German GDP growth is expected to be greater in 2016 than in 2015, driven by a further pickup in domestic demand. In addition to favorable consumer confidence levels based on a solid labor market, government spending on services for the numerous refugees is set to further support consumption. On the other hand, we see German manufacturing exposed to the risk of continuing weakness in global trade due to low growth in key emerging markets. However, support could be forthcoming from a sustained depreciation of the euro. Although the German manufacturing sector has done well relative to its international competitors in recent years, a renaissance in manufacturing as a whole remains improbable in the short term. Therefore, selective equity investment will be key for 2016. As an upside scenario, corporate margins in Europe are still depressed and below long-term averages. Therefore, the combination of ECB policy and economic recovery could potentially lead to greater pricing power and earnings upside.

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 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.

² 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: How is German domestic consumption developing, and is the Fund positioned for this?

Answer: Having grown by about 2% in 2015, German private consumption registered its highest increase in 15 years. Consumption thus contributed about 60% of total German GDP growth. For Germany, this can certainly be called a boom, although the growth rate might look weak when compared to the credit-fuelled consumption increases in

Britain and many peripheral European countries. The German consumer is expected to remain confident, and private consumption should continue to be an important part of German economic growth over the course of 2016. We believe the main drivers — a record-high workforce and significantly increasing disposable income, as well as record-low interest rates — should remain in place. The Fund is relevantly positioned in businesses that focus on the German consumer, such as Zalando SE, Scout24 and Stroer SE, enabling it to take advantage of the strong German consumer.

Question: Why is the German IPO market important?

Answer: The year 2015 was a strong one for IPOs in the European market. The Nordic countries saw the strongest activity, but the activity level in Germany was also quite high. A total of €7.1bln in IPO capital was raised in 15 deals. This is twice the amount raised in 2014 and is the highest volume seen over the last eight years. The top 10 of the largest German IPOs by deal volume in 2015 were: 1) Covestro LLC, €1.5bln; 2) Deutsche Pfandbriefbank AG, €1.15bln; 3) Scout24, €1.02bln; 4) Schaeffler Group, €938mln; 5) Tele Columbus, €510mln; 6) ADO Properties, €415mln; 7) Siltronic AG, €380mln; 8) Hapag-Lloyd, €304mln; 9) Sixt Leasing, €239mln; and 10) Edag Engineering, €191mln. The performance of the IPOs has been mixed in Germany. Nevertheless, the pipeline for further deals in 2016 seems well filled. At least 15 candidates are said to be ready for an IPO. We expect utilities carve-outs and placements by private equity firms and technology companies to make up the bulk of the pipeline.

Performance Summary December 31, 2015 (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 12/31/15

	1-Year	5-Year	10-Year
Net Asset Value^(a)	15.38%	11.65%	11.54%
Market Price^(a)	14.31%	12.17%	11.63%
Midcap Market Performance Index ^(b)	12.88%	11.08%	9.97%

^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, 2015 was 1.16%.

^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 12/31/15	As of 12/31/14
Net Asset Value	\$ 16.19	\$ 15.32
Market Price	\$ 14.70	\$ 14.04

Prices and Net Asset Value fluctuate and are not guaranteed.

Distribution Information

	Per Share
Twelve Months as of 12/31/15:	
	\$ 0.08
Income	
Capital Gains	\$ 1.15

Distributions are historical, not guaranteed and will fluctuate. Distributions do not include return of capital or other non-income sources.

Schedule of Investments as of December 31, 2015

	Shares	Value (\$)
Germany 87.8%		
Common Stocks 85.3%		
Aerospace & Defense 3.6%		
MTU Aero Engines AG	95,152	9,304,489
Auto Components 1.2%		
Hella KGaA Hueck & Co.	37,554	1,570,381
Leoni AG	39,109	1,546,908
		3,117,289
Chemicals 12.2%		
Covestro AG 144A*	106,415	3,884,580
Evonik Industries AG	293,729	9,759,575
LANXESS AG	110,195	5,104,299
Symrise AG	146,013	9,718,837
Wacker Chemie AG	34,588	2,909,973
		31,377,264
Commercial Services & Supplies 0.7%		
Bilfinger SE†	38,687	1,825,175
Communications Equipment 1.4%		
ADVA Optical Networking SE*	308,404	3,721,985
Construction & Engineering 1.3%		
HOCHTIEF AG	35,859	3,341,869
Diversified Financial Services 0.6%		
GRENKELEASING AG	7,936	1,589,949
Diversified Telecommunication Services 2.9%		
Telefonica Deutschland Holding AG	1,428,369	7,582,072
Electrical Equipment 3.9%		
Nordex SE*	74,797	2,658,553
OSRAM Licht AG	177,138	7,457,295
		10,115,848
Electronic Equipment, Instruments & Components 0.6%		
Jenoptik AG	103,472	1,615,970

Food & Staples Retailing 3.5%		
METRO AG	283,490	9,094,775
Food Products 0.6%		
Suedzucker AG	82,637	1,644,840
Health Care Equipment & Supplies 1.4%		
STRATEC Biomedical AG	55,390	3,667,001
Health Care Technology 1.7%		
CompuGroup Medical AG	115,824	4,248,788
Industrial Conglomerates 2.2%		
Indus Holding AG	53,775	2,597,693
Rheinmetall AG	46,153	3,079,524
		5,677,217
Insurance 3.0%		
Hannover Rueck SE	41,209	4,725,104
Talanx AG	93,882	2,908,454
		7,633,558
Internet & Catalog Retail 4.1%		
Zalando SE 144A*	267,970	10,586,133
Internet Software & Services 7.1%		
Scout24 AG 144A*	152,911	5,480,973
United Internet AG (Registered)	220,916	12,206,188
XING AG	3,335	617,845
		18,305,006
IT Services 3.3%		
Wirecard AG†	166,862	8,420,933
Life Sciences Tools & Services 2.0%		
Evotec AG*	101,842	460,906
Gerresheimer AG	37,866	2,966,718
MorphoSys AG*	27,981	1,750,703
		5,178,327
Machinery 1.1%		
KION Group AG	55,333	2,763,635
Media 7.0%		
CTS Eventim AG & Co. KGaA	56,893	2,268,547
ProSiebenSat.1 Media SE	169,860	8,621,084
Stroer SE	114,316	7,183,488
		18,073,119
Metals & Mining 0.7%		
Salzgitter AG	69,877	1,723,407
Pharmaceuticals 1.4%		
STADA Arzneimittel AG	91,302	3,700,023
Real Estate Management & Development 7.0%		
ADO Properties SA 144A*	87,818	2,525,685
Deutsche Wohnen AG	169,049	4,699,555
LEG Immobilien AG*	109,442	8,967,694
TLG Immobilien AG	99,916	1,879,245
		18,072,179
Semiconductors & Semiconductor Equipment 3.0%		
AIXTRON SE*	124,937	559,733
Dialog Semiconductor PLC*	176,011	5,943,735
SMA Solar Technology AG*†	22,634	1,270,485

7,773,953

Software 0.7%

Software AG 64,221 1,841,449

Technology Hardware, Storage & Peripherals 0.7%

Wincor Nixdorf AG 36,445 1,834,306

Textiles, Apparel & Luxury Goods 1.0%

Elumeo SE* 51,290 1,391,626

HUGO BOSS AG 13,325 1,107,760

2,499,386

Thrifts & Mortgage Finance 1.3%

Aareal Bank AG 44,013 1,391,939

Deutsche Pfandbriefbank AG 144A* 152,420 1,852,720

3,244,659

Trading Companies & Distributors 2.5%

Brenntag AG 120,659 6,322,324

Transportation Infrastructure 1.6%

Fraport AG Frankfurt Airport Services Worldwide 65,057 4,161,539

Preferred Stocks 2.5%**Health Care Equipment & Supplies 1.3%**

Draegerwerk AG & Co. KGaA (Cost \$859,802) 9,047 673,662

Sartorius AG (Cost \$2,125,546) 10,263 2,678,236

3,351,898

Machinery 1.2%

Jungheinrich AG (Cost \$2,679,947) 37,813 3,128,771

Total Germany (Cost \$183,065,948) 226,539,136**Netherlands 15.7%****Aerospace & Defense 11.9%**

Airbus Group SE 454,578 30,587,917

Life Sciences Tools & Services 3.8%

QIAGEN NV* 360,229 9,818,874

Total Netherlands (Cost \$19,246,450) 40,406,791**Luxembourg 1.0%****Media 1.0%**

RTL Group SA (Cost \$2,253,981) 31,109 2,601,408

Switzerland 0.8%**Automobiles 0.8%**

EDAG Engineering Group AG* (Cost \$1,877,518) 82,781 2,003,661

Securities Lending Collateral 4.7%

Daily Assets Fund, 0.36% (Cost \$11,989,950) (a) (b) 11,989,950 11,989,950

% of Net Assets Value (\$)**Total Investment Portfolio (Cost \$218,433,847)** 110.0 283,540,946****Other Assets and Liabilities, Net (10.0) (25,716,351)****Net Assets 100.0 257,824,595**

* Non-income producing security.

** The cost for federal income tax purposes was \$219,486,703. At December 31, 2015, net unrealized appreciation for all securities based on tax cost was \$64,054,243. This consisted of aggregate gross unrealized appreciation for all securities in which there was an excess of value over tax cost of \$86,411,478 and aggregate gross unrealized depreciation for all securities in which there was an excess of tax cost over value of \$22,357,235.

†All or a portion of these securities were on loan. The value of all securities loaned at December 31, 2015 amounted to \$11,354,626, which is 4.4% 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.

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, 2015 in valuing the Fund's investments.