

## OUR MONTHLY MARKET ANALYSIS AND POSITIONING

IN A NUTSHELL

- \_ Most asset classes made significant gains in May.
- \_ In addition to the support packages from central banks and governments, the gradual lifting of lockdown measures also give investors some encouragement.
- \_ We remain cautiously optimistic for markets, though they have in our view already largely priced in the recovery.

### MARKET OVERVIEW

Thanks to an astonishing final spurt, the global stock markets took another big step in May away from their mid-March lows. The MSCI AC World Index rose by an impressive 35% from March 23 to the end of May, the same level as in October 2019. Other assets such as corporate and emerging-market bonds also performed well in May. However, by far the biggest gain came from oil, where the price of West Texas Intermediate (WTI) rose by almost 80% to around 33 dollars per barrel, although many producers are still unlikely to make a profit at these levels.

The economic data and news on the Covid-19 pandemic make this market euphoria certainly seem surprising. But a glance at government aid packages and the balance sheets of the central banks explains a lot. France and Germany surprised with a joint push for a trillion-euro European aid package, which some quickly interpreted as an about-face turn in German policy, as the design shows clear features of a transfer union and joint liability, to which the German government had been opposed. However, some Nordic European-Union (EU) countries and Austria are still critical of the plan.

In May, meanwhile, the major central banks again gave numerous indications that there would be no lack of support. The aid provided so far has had some impacts that will certainly be long-lasting. The U.S. Federal Reserve (Fed) now has a balance sheet totaling 7.1 trillion dollars, up from 4.1 trillion dollars in early March. As a reminder, during the banking crisis at the end of 2008, the Fed reacted with less than half this level of balance-sheet expansion, and even at the end of 2010 its balance sheet was only 2.5 trillion dollars. Ten years on, we expect total assets to rise to over 10 trillion dollars by the end of 2020. The increase in the European Central Bank (ECB) balance sheet from 4.7 trillion to 5.6 trillion euros during the crisis so far seems relatively modest, but the bank had already doubled its balance sheet since 2015.

Government debt has also reached new record levels world-

wide. In the United States alone, it is likely to increase by around 20 percentage points this year in relation to gross domestic product (GDP) to exceed 100%, and in Europe by around 10 percentage points, according to our estimates. It is no secret that the upturn in markets reflects this monetary impetus and is therefore perhaps shaky, and this too is reflected in market developments. Value stocks have historically always been the first choice when a new upswing begins but they have had only a few strong days. The rally is once more being driven by growth stocks, which in May gained 6.5%, whereas value stocks gained only 2.9%<sup>1</sup>. A typical month, therefore, because the value stocks have only managed to outpace growth stocks in two months in the past two years, and then only minimally. The weakness of value stocks over the past few months suggests the markets know that the current upswing is very atypical.

This brings us to the economic data which remained at record lows in May in many countries, though some of the data also showed improvements over April. The Purchasing Managers' Indices (PMIs) can be taken as an example. They stabilized at a low level in May and improved in some cases. As the course of the pandemic, mobility data and consumption correlate very strongly, it is not surprising that the low point in many cases occurred in April, especially in Europe. In the United States, consumption slumped by a full 13.6% in April, and May may have been better according to some indications. In Germany, on the other hand, the decline was only 6.5% in April, possibly supported by a 2.5% year-on-year increase in gross earnings. Other data, such as unemployment figures, continue to show a negative trend. In the United States the unemployment rate at the end of May is likely to be close to the 20% mark. Global growth forecasts for 2020 are also still being revised down. At the end of the month, ECB President Christine Lagarde pointed out that she expects a decline in economic output for the Eurozone this year at the lower end of ECB expectations of -8% to -12%. In China the PMIs improved slightly and thus remain above 50, but the sub-indicator for new orders from abroad was only 35.3 points. As in many parts

<sup>1</sup>Bloomberg as of 5/31/20

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of the world, there is more produced than is currently consumed, inventories are likely to build up.

The fact that it will still take some time before global supply chains run smoothly again is due to the slow global spread of the pandemic. New hotspots are still emerging. In May, Latin America joined the United States as the center of the pandemic, according to the World Health Organization. In the United States, the number of new infections per day is still over 20,000, while in France, Spain, Italy and Germany, the combined figure fell below 1,000 for the first time at the end of May, despite greater easing measures. Worldwide, the number of daily new infections rose from around 80,000 to 100,000 in the course of May.

In the midst of the pandemic there are new and old rifts opening. The most worrying for the markets is likely to be the resurgent trade conflict between the United States and China. The United States has commented on the protests in Hong Kong and the crackdown by the Chinese government and is simultaneously increasing the pressure on the Chinese technology sector. But unrest is also taking place in the United States, possibly to a greater extent than at any time since 1968. This is leading President Donald Trump to consider sending the National Guard to those cities where he believes mayors and governors are not being tough enough on protesters. A development that goes remarkably unnoticed by markets.

## OUTLOOK AND CHANGES

As we held our quarterly strategy meeting at the end of May, we will now discuss both strategic and tactical assessments. In June, we believe three themes should dominate markets: 1. the Chinese-American trade conflict; 2. the course of the pandemic in the wake of easing lockdown measures, and consumers' reaction; and 3. the progress of the European aid package. In addition, there is Brexit. As London can only unilaterally obtain an extension of the transition period this month. In the midst of UK's comparatively chaotic response to the pandemic and the internal party squabbles over the further handling of Boris Johnson's most important advisor – Dominic Cummings (who did not adhere to the lockdown rules) – it is more difficult than ever to assess how far London and Brussels will take their tactical games in this round of negotiations. An unintended slide into a no-deal Brexit also remains a possible scenario. However, this may not affect global markets substantially.

The results of the strategy meeting can be summarized as follows: After the sharp downturn in the first half of the year, we expect a slow recovery, which will likely bring a return to end-2019 output levels by the end of 2022. We expect further outbreaks of Covid-19 infections but no need for lockdowns seen in March / April. We expect further support from central banks, which in turn should keep government-bond yields extremely low. We see support for corporate bonds, also in the high-yield segment, despite higher expected default rates in the latter. We still do not see any weakness emerging in the U.S. dollar.

After the recent rises, we expect only limited price potential for equities, with no geographical preference.

From a tactical perspective, we have made small changes. Even though, we are aware of the fragility of the upswing, we believe some cyclical sectors that previously suffered particularly badly can regain some ground. We have therefore upgraded the basic materials sector to "neutral." We believe that a significant recovery is possible for the mining sector in particular, due to the recovery in demand combined with the sector's ability to sell at relatively high prices because of its oligopolistic structure. In the industrial sector, we also expect significantly better figures, especially in machinery, due to catch-up effects. By contrast, we are downgrading the real-estate sector to underweight. Apart of that, we maintain our preference for the technology and healthcare sectors.

In the bond segment we remain optimistic about some corporate and emerging-market bonds from a tactical point of view. Compared with the previous month we have also now returned U.S. investment-grade corporate bonds to positive. The fact that the Fed is ready to buy in this segment provides clear support. However, as strong demand resurfaces, including from the private sector, there should be somewhat less pressure from the supply side. The amount of capital raised so far this year in excess of one trillion dollars was almost double the level of the same period last year.

We have a largely neutral position on government bonds. Although progress on the European aid fund (the Merkel-Macron Initiative) could in the future lead to higher Bund yields and lower premiums in the peripheral countries, the markets have already anticipated most of this.

As far as currencies are concerned, we see the euro-dollar pair trading sideways for the time being, while we expect further pressure on the renminbi and pound sterling.

## THE MULTI-ASSET PERSPECTIVE

From a portfolio perspective, two different worlds must be reconciled. On the one hand, the fundamentals: An economic upswing that after a short-term catch-up could easily drag on for an agonizingly long time. In addition, political risks have risen significantly. Together these suggest that markets have recovered too fast and too much. Another complicating factor is that the rescue packages and liquidity injections implemented by governments and central banks, and the continuing prospect of ultra-low government-bond yields, means there seems to be no way around equities. The exception to that may be corporate bonds, which also still look interesting, especially since they are still trading at a significant discount compared to the pre-crisis period. But the past has shown that central-bank measures in particular are priced in early, i.e. when they are announced. And that if implementation of these measures proves problematic or is less effective for the real economy than expected, disillusionment may set in. There might also be a risk from another angle: a better than expected economic recovery. Why is

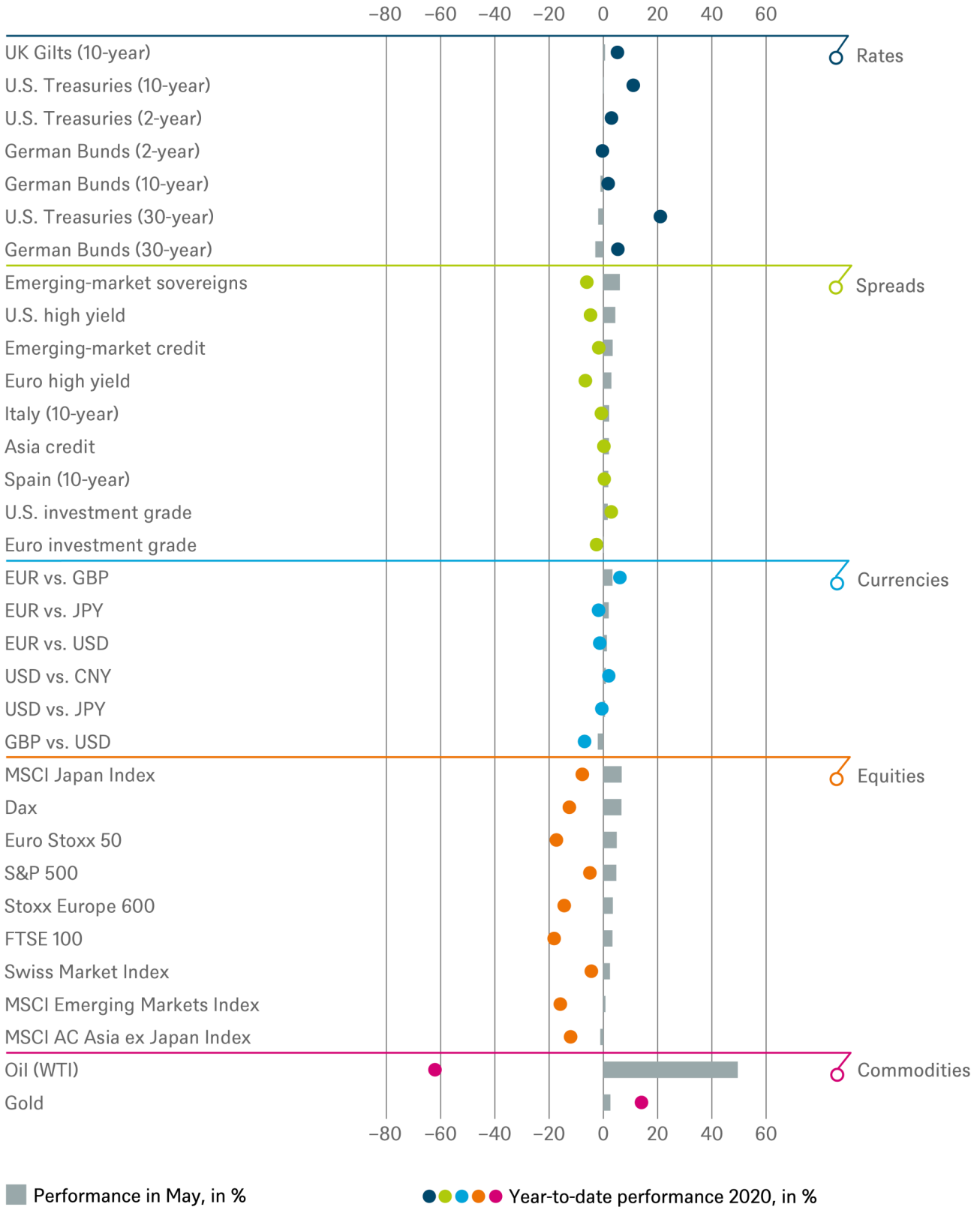
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this a risk? Because it could lead to the record aid packages being cut back. Overall, looking at the broad picture, the fact that markets are high when fundamentals look poor and

risks both economic and political are high argues in favor of a slightly more defensive stance.

### PAST PERFORMANCE OF MAJOR FINANCIAL ASSETS

Total return of major financial assets year-to-date and past month



Past performance is not indicative of future returns.

Sources: Bloomberg Finance L.P., DWS Investment GmbH as of 5/31/20

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## TACTICAL AND STRATEGIC SIGNALS

The following exhibits depict our short-term and long-term positioning.

## FIXED INCOME

Rates	1 to 3 months		Spreads	1 to 3 months	
	until June 2021	until June 2021		until June 2021	until June 2021
U.S. Treasuries (2-year)	●	●	Spain (10-year) <sup>1</sup>	●	●
U.S. Treasuries (10-year)	●	●	Italy (10-year) <sup>1</sup>	●	●
U.S. Treasuries (30-year)	●	●	U.S. investment grade	●	●
German Bunds (2-year)	●	●	U.S. high yield	●	●
German Bunds (10-year)	●	●	Euro investment grade <sup>1</sup>	●	●
German Bunds (30-year)	●	●	Euro high yield <sup>1</sup>	●	●
UK Gilts (10-year)	●	●	Asia credit	●	●
Japan (2-year)	●	●	Emerging-market credit	●	●
Japan (10-year)	●	●	Emerging-market sovereigns	●	●
<b>Securitized / specialties</b>			<b>Currencies</b>		
Covered bonds <sup>1</sup>	●	●	EUR vs. USD	●	●
U.S. municipal bonds	●	●	USD vs. JPY	●	●
U.S. mortgage-backed securities	●	●	EUR vs. JPY	●	●
			EUR vs. GBP	●	●
			GBP vs. USD	●	●
			USD vs. CNY	●	●

## EQUITIES

Regions	1 to 3 months <sup>2</sup>		Sectors	1 to 3 months <sup>2</sup>	
	until June 2021	until June 2021		until June 2021	until June 2021
United States <sup>3</sup>	●	●	Consumer staples <sup>12</sup>	●	
Europe <sup>4</sup>	●	●	Healthcare <sup>13</sup>	●	
Eurozone <sup>5</sup>	●	●	Communication services <sup>14</sup>	●	
Germany <sup>6</sup>	●	●	Utilities <sup>15</sup>	●	
Switzerland <sup>7</sup>	●	●	Consumer discretionary <sup>16</sup>	●	
United Kingdom (UK) <sup>8</sup>	●	●	Energy <sup>17</sup>	●	
Emerging markets <sup>9</sup>	●	●	Financials <sup>18</sup>	●	
Asia ex Japan <sup>10</sup>	●	●	Industrials <sup>19</sup>	●	
Japan <sup>11</sup>	●	●	Information technology <sup>20</sup>	●	
			Materials <sup>21</sup>	●	
			Real estate <sup>22</sup>	●	
			<b>Style</b>		
			U.S. small caps <sup>23</sup>	●	
			European small caps <sup>24</sup>	●	

<sup>1</sup> Spread over German Bunds, <sup>2</sup> Relative to the MSCI AC World Index, <sup>3</sup> S&P 500, <sup>4</sup> Stoxx Europe 600, <sup>5</sup> Euro Stoxx 50, <sup>6</sup> Dax, <sup>7</sup> Swiss Market Index, <sup>8</sup> FTSE 100, <sup>9</sup> MSCI Emerging Markets Index, <sup>10</sup> MSCI AC Asia ex Japan Index, <sup>11</sup> MSCI Japan Index, <sup>12</sup> MSCI AC World Consumer Staples Index, <sup>13</sup> MSCI AC World Health Care Index, <sup>14</sup> MSCI AC World Communication Services Index, <sup>15</sup> MSCI AC World Utilities Index, <sup>16</sup> MSCI AC World Consumer Discretionary Index, <sup>17</sup> MSCI AC World Energy Index, <sup>18</sup> MSCI AC World Financials Index, <sup>19</sup> MSCI AC World Industrials Index, <sup>20</sup> MSCI AC World Information Technology Index, <sup>21</sup> MSCI AC World Materials Index, <sup>22</sup> MSCI AC World Real Estate Index, <sup>23</sup> Russel 2000 Index relative to the S&P 500, <sup>24</sup> Stoxx Europe Small 200 relative to the Stoxx Europe 600

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## ALTERNATIVES

Alternatives	1 to 3 months	until June 2021
Commodities <sup>1</sup>	●	●
Oil (WTI)	●	●
Gold	●	●
Infrastructure	●	●
Real estate (listed)	●	●
Real estate (non-listed) APAC	●	●
Real estate (non-listed) Europe	●	●
Real estate (non-listed) United States	●	●

<sup>1</sup> Relative to the Bloomberg Commodity Index

## LEGEND

### Tactical view (1 to 3 months)

\_ The focus of our tactical view for fixed income is on trends in bond prices.

- \_ ● Positive view
- \_ ● Neutral view
- \_ ● Negative view

### Strategic view until June 2021

\_ The focus of our strategic view for sovereign bonds is on bond prices.

\_ For corporates, securitized/specialties and emerging-market bonds in U.S. dollars, the signals depict the option-adjusted spread over U.S. Treasuries. For bonds denominated in euros, the illustration depicts the spread in comparison with German Bunds. Both spread and sovereign-bond-yield trends influence the bond value. For investors seeking to profit only from spread trends, a hedge against changing interest rates may be a consideration.

\_ The colors illustrate the return opportunities for long-only investors.

- \_ ● Positive return potential for long-only investors
- \_ ● Limited return opportunity as well as downside risk
- \_ ● Negative return potential for long-only investors

## GLOSSARY

A **balance sheet** summarizes a company's assets, liabilities and shareholder equity.

The **Bloomberg Commodity Index (BCOM)** traces 23 commodities and reflects commodity futures price movements.

**Brexit** is a combination of the words "Britain" and "Exit" and describes the exit of the United Kingdom of the European Union.

**Bunds** is a commonly used term for bonds issued by the German federal government with a maturity of 10 years.

A **central bank** manages a state's currency, money supply and interest rates.

The **Chinese yuan (CNY)** is legal tender on the Chinese mainland and the unit of account of the currency, Renminbi (RMB).

A **corporate bond** is a bond issued by a corporation in order finance their business.

**Cyclical** is something that moves with the cycle.

The **Dax** is a blue-chip stock-market index consisting of the 30 major German companies trading on the Frankfurt Stock Exchange.

**Emerging markets (EM)** are economies not yet fully developed in terms of, amongst others, market efficiency and liquidity.

The **euro (EUR)** is the common currency of states participating in the Economic and Monetary Union and is the second most held reserve currency in the world after the dollar.

The **Euro Stoxx 50** is an index that tracks the performance of blue-chip stocks in the Eurozone.

The **European Central Bank (ECB)** is the central bank for the Eurozone.

The **European Union (EU)** is a political and economic union of 28 member states located primarily in Europe.

The **Eurozone** is formed of 19 European Union member states that have adopted the euro as their common currency and sole legal tender.

The **FTSE 100** is an index that tracks the performance of the 100 major companies trading on the London Stock Exchange.

**Fundamentals** are data giving information about the general well-being of companies, securities or currencies and serving for the subsequent valuation of these as an investment opportunity.

**Gilts** are bonds that are issued by the British Government.

**Government (sovereign) debts/bonds** are debt/bonds issued and owed by a central government

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.

**Growth stocks** are stocks from companies that are expected to grow significantly above market average for a certain period of time.

**High-yield** bonds are issued by below-investment-grade-rated issuers and usually offer a relatively high yield.

**Investment grade (IG)** refers to a credit rating from a rating agency that indicates that a bond has a relatively low risk of default.

**Japanese Government Bond (JGB)** is issued by the government of Japan.

**Liquidity** refers to the degree to which an asset or security can be bought or sold in the market without affecting the asset's price and to the ability to convert an asset to cash quickly.

The **MSCI AC World Communication Services Index** captures large- and mid-cap securities across 23 developed- and 26 emerging-markets classified in the Communications Services sector.

The **MSCI AC World Consumer Discretionary Index** captures large- and mid-cap securities across 23 developed- and 26 emerging-markets classified in the Consumer Discretionary sector.

The **MSCI AC World Consumer Staples Index** captures large- and mid-cap securities across 23 developed- and 26 emerging-markets classified in the Consumer Staples sector.

The **MSCI AC World Energy Index** captures large- and mid-cap securities across 23 developed-markets classified in the Energy sector.

The **MSCI AC World Financials Index** captures large- and mid-cap securities across 23 developed- and 26 emerging-markets classified in the Financials sector.

The **MSCI AC World Health Care Index** captures large- and mid-cap securities across 23 developed- and 26 emerging-markets classified in the Health Care sector.

The **MSCI AC World Index** captures large- and mid-cap companies across 23 developed- and 24 emerging-market countries.

The **MSCI AC World Industrials Index** captures large- and mid-cap securities across 23 developed- and 26 emerging-markets classified in the Industrials sector.

The **MSCI AC World Information Technology Index** captures large- and mid-cap securities across 23 developed- and 26 emerging-markets classified in the Information Technology sector.

The **MSCI AC World Materials Index** captures large- and mid-cap securities across 23 developed- and 26 emerging-markets classified in the Materials sector.

The **MSCI AC World Real Estate Index** captures large- and mid-cap securities across 23 developed- and 26 emerging-markets classified in the Real Estate sector.

The **MSCI AC World Utilities Index** captures large- and mid-cap securities across 23 developed- and 26 emerging-markets classified in the Utilities sector.

The **MSCI AC Asia ex Japan Index** captures large- and mid-cap representation across 2 of 3 developed-market countries (excluding Japan) and 8 emerging-market countries in Asia.

The **MSCI Emerging Markets Index** captures large- and mid-cap representation across 23 emerging-market countries.

The **MSCI Japan Index** is designed to measure the performance of the large- and mid-cap segments of the Japanese market.

The **pound sterling (GBP)**, or simply the pound, is the official currency of the United Kingdom and its territories.

The **Purchasing Managers Index (PMI)** is an indicator of the economic health of the manufacturing sector in a specific country or region.

**Renminbi (RMB)** is the currency of the People's Republic of China.

The **risk premium** is the expected return on an investment minus the return that would be earned on a risk-free investment.

The **Russell 2000 Index** is an index that captures the 2,000 smallest stocks of the Russell-3000 index, which again comprises 3,000 small- and mid-cap U.S. listed stocks.

The **S&P 500** is an index that includes 500 leading U.S. companies capturing approximately 80% coverage of available U.S. market capitalization.

The **spread** is the difference between the quoted rates of return on two different investments, usually of different credit quality.

The **Stoxx Europe 600** is an index representing the performance of 600 listed companies across 18 European countries.

The **Stoxx Europe Small 200** is an index representing the performance of 200 small capitalization companies across 17 European countries.

The **Swiss Market Index (SMI)** is Switzerland's most important equity index, consisting of the 20 largest and most liquid large- and mid-cap stocks.

**Treasuries** are fixed-interest U.S. government debt securities with different maturities: Treasury bills (1 year maximum), Treasury notes (2 to 10 years), Treasury bonds (20 to 30 years) and Treasury Inflation Protected Securities (TIPS) (5, 10 and 30 years).

The **U.S. dollar (USD)** is the official currency of the United States and its overseas territories.

The **U.S. Federal Reserve**, often referred to as "**the Fed**", is the central bank of the United States.

**Value stocks** are stocks from companies that are trading at prices close to their book value and that are therefore cheaper than the market average on that metric.

**West Texas Intermediate (WTI)** is a grade of crude oil used as a benchmark in oil pricing.

**Yield** is the income return on an investment referring to the interest or dividends received from a security and is usually expressed annually as a percentage based on the investment's cost, its current market value or its face value.

## APPENDIX: PERFORMANCE OVER THE PAST 5 YEARS (12-MONTH PERIODS)

	05/15 - 05/16	05/16 - 05/17	05/17 - 05/18	05/18 - 05/19	05/19 - 05/20
Asia credit	4.7%	4.7%	0.0%	7.7%	4.9%
Covered bonds	1.8%	0.3%	0.3%	2.6%	1.1%
Dax	-10.1%	22.9%	-0.1%	-7.0%	-1.2%
EM Credit	2.2%	9.0%	0.2%	8.4%	4.6%
EM Sovereigns	4.5%	9.8%	-0.6%	7.5%	0.4%
Euro high yield	0.6%	9.5%	1.5%	2.2%	-1.6%
Euro investment grade	2.0%	2.8%	0.6%	3.1%	-0.2%
Euro Stoxx 50	-10.9%	20.2%	-0.8%	-0.1%	-4.9%
FTSE 100	-7.2%	25.5%	6.3%	-2.6%	-11.8%
German Bunds (10-year)	4.4%	0.0%	0.8%	5.0%	1.3%
German Bunds (2-year)	0.2%	-0.3%	-0.6%	-0.5%	-0.9%
German Bunds (30-year)	6.5%	-2.7%	3.0%	10.6%	6.8%
Italy (10-year)	6.6%	-2.5%	-2.9%	6.2%	9.3%
Japanese government bonds (10-year)	4.7%	-1.2%	0.4%	1.5%	-0.6%
Japanese government bonds (2-year)	0.4%	-0.4%	-0.1%	-0.1%	-0.3%
MSCI AC Asia ex Japan Index	-17.5%	28.1%	17.3%	-11.1%	0.0%
MSCI AC World Communication Services Index	-4.3%	0.5%	-10.4%	5.3%	9.3%
MSCI AC World Consumer Discretionary Index	-5.7%	16.0%	12.5%	-4.2%	11.0%
MSCI AC World Consumer Staples Index	4.1%	8.0%	-7.0%	4.7%	1.0%
MSCI AC World Energy Index	-16.1%	3.2%	17.8%	-15.5%	-32.3%
MSCI AC World Financials Index	-13.5%	19.1%	8.8%	-7.4%	-17.6%
MSCI AC World Health Care Index	-8.0%	6.0%	5.3%	2.5%	21.3%
MSCI AC World Industrials Index	-4.5%	18.1%	8.1%	-5.3%	-5.0%
MSCI AC World Information Technology Index	-2.6%	33.0%	24.9%	-1.1%	31.6%
MSCI AC World Materials Index	-15.4%	21.3%	14.9%	-13.2%	-1.9%
MSCI AC World Real Estate Index	-2.0%	3.6%	2.7%	4.8%	-12.5%
MSCI AC World Utilities Index	-1.8%	7.9%	-3.5%	7.8%	0.3%
MSCI Emerging Market Index	-17.6%	27.4%	14.0%	-8.7%	-4.4%
MSCI Japan Index	-8.2%	15.0%	14.6%	-10.0%	7.0%
Russel 2000 Index	-7.4%	18.7%	19.2%	-10.3%	-4.9%
S&P 500	1.7%	17.5%	14.4%	3.8%	12.8%
Spain (10-year)	6.2%	2.3%	2.2%	8.9%	2.1%
Stoxx Europe 600	-10.0%	16.1%	1.5%	0.0%	-2.4%
Stoxx Europe Small 200	-5.8%	17.4%	6.7%	-4.4%	1.2%
Swiss Market Index	-7.9%	13.5%	-3.0%	16.4%	6.7%
U.S. high yield	-0.8%	13.6%	2.3%	5.5%	1.3%
U.S. investment grade	3.3%	3.9%	0.1%	7.4%	9.5%
U.S. MBS	0.0%	44.4%	7.7%	57.1%	65.9%
U.S. Treasuries (10-year)	4.4%	-0.4%	-2.4%	8.6%	14.2%
U.S. Treasuries (2-year)	0.7%	0.6%	-0.1%	3.5%	4.6%
U.S. Treasuries (30-year)	8.4%	-1.6%	0.1%	11.0%	26.9%
UK Gilts (10-year)	5.5%	5.2%	-0.4%	4.8%	6.7%

Past performance is not indicative of future returns.

Sources: Bloomberg Finance L.P., DWS Investment GmbH as of 6/1/20



## IMPORTANT INFORMATION

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