

Our monthly market analysis and positioning

IN A NUTSHELL



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- With inflation numbers becoming slightly less menacing in November, the markets decided to go into year-end rally mode.
- But the better we end the year, the easier it will be for markets to suffer disappointment in early 2023 if inflation, China's reopening and corporate earnings don't meet expectations.
- For our FY2023 forecasts, however, we are mildly optimistic as we believe the recession will be shallow, employment will be resilient and inflation won't stay high in the longer term. Bonds are once again a viable investment alternative.

1 / Market overview

In November, concerns about inflation and interest rate hikes peaked, for now...

November was certainly not uneventful. But it felt a little less hectic than some previous months. Stock market volatility (as measured by the S&P 500's Vix index) fell from 35 at its peak in October to 20 at the end of November. And the Move Index, which tracks the implied volatility of the U.S. Treasury market and has been particularly nervous this year, also fell from 150 to 130 on average for the month. Probably the most important development during the month was that government bond yields finally went into reverse. 10-year U.S. yields fell from over 4% to slightly over 3.5%, while the Bund yield dropped from 2.14% to 1.93%. This was primarily triggered by slightly better inflation figures from the U.S., with the annual rate down to 7.7%, the lowest since January. At the same time, however, central bankers did their best to make it clear to investors that even if inflation might have peaked, the problem is far from over. The central bankers are right in our view, but it is also important for them to get their message across because complacency in the markets might generate better financing conditions, which would be detrimental to the fight against inflation. What already is making it difficult to fight inflation is the extremely tight and resilient labor market – with labor and skills shortages persisting in both the U.S. and Europe.

.. which gave almost all asset classes a good month.

The markets, however, were apparently happy to interpret the easing of inflation in November as a good sign and liked too that the Fed and ECB's 0.75% moves in early November were beginning to look their last. That the inflation medicine should be coming in smaller doses, with 0.5% rises likely in December, was encouraging.

And even the weather helped. The unusually mild November made a winter energy shortage in Europe even less likely. All of this resulted in a fairly good investment month overall, with the S&P 500 up 5.6% (total returns) and the Stoxx 50 up 9.7%, driven by cyclical stocks. But the strongest market was China, where the announcement of a slight shift away from strict zero-covid policies and a package of measures to support the real estate sector made investors cheer, despite the protests in the country. The Hang Seng Index rose 26.8% (strongest month since 1998), pushing the overall MSCI Emerging Markets

index up nearly 15%. Investors' "risk-on" mood also precipitated a move out of the U.S. dollar, which is seen as a safe haven. The dollar index lost 5%, its biggest monthly decline since 2010.¹

The rally in markets contrasts with many troubling events of the past month. Russia is attacking and destroying Ukrainian energy infrastructure thus further harming civilian life-conditions. The protests in China reflect serious discontent. The U.S. has implemented its sanctions package against China's chip industry. And the spectacular bankruptcy of the cryptocurrency exchange, FTX, has helped deflate this highly speculative asset class.

Meanwhile, both in the U.S. and, even more so, in Europe, sentiment, whether expressed in Purchasing Managers' Indices (PMIs) or consumer confidence measures, is regularly proving to be worse than real data such as GDP growth or retail sales. Remember that only a few months ago some strategists were calling for a substantial GDP contraction by the end of the year in Germany.

2 / Outlook and changes

Entering the season of the typical year-end rally, easing inflation and rate hike worries, China easing its lockdowns – all these views food for optimists ahead of Christmas. But pessimists will say that markets are getting ahead of themselves. A possible peak in headline inflation should not distract from the potential stickiness of core inflation rates. And in China even a willingness to end the zero-Covid regime might prove challenging, as there is no herd immunity, not enough vaccinations (and these seem less effective than their Western equivalents) and not enough intensive care beds and medicines. Although it is understandable that investors are looking at the direction, Beijing has taken. Especially when taking a longer-term perspective. And this is what we are doing here, as this is the quarterly edition, in which we concentrate on our strategic, and not tactical view. And in December, that means: our 2023 outlook.

2.1 Fixed Income

We believe 2023 will likely be a good year for corporate bonds and the bonds of some governments as we believe markets' implied forecasts for central banks' terminal rates are realistic. At the same time, markets will probably be starting in 2023 to price in rate cuts, even if they may only be realized in 2024 or 2025. We look here at what this means for different regions.

Sovereign bond yields have stopped their ascend



Source: Bloomberg Finance L.P., DWS Investment GmbH as of 11/30/22

¹Source of all the figures above: Bloomberg Finance L.P.; as of 11/30/22

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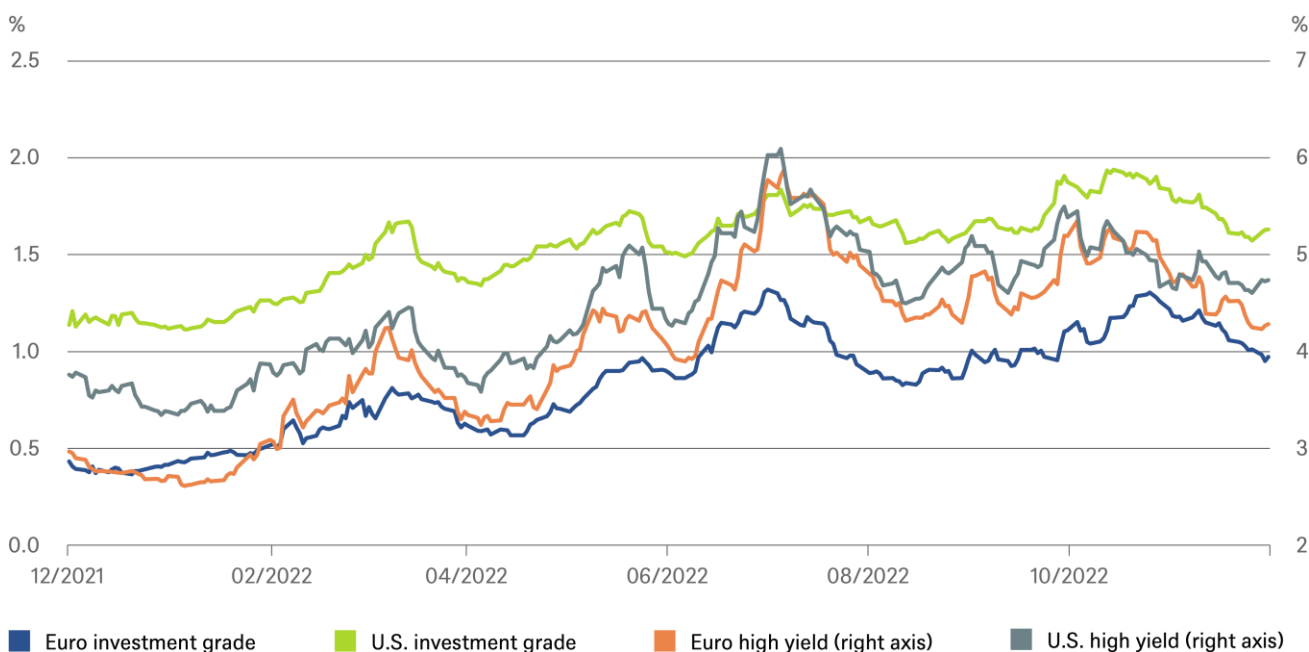
U.S.: In the U.S. the Fed is on track to reach its terminal rate in spring 2023 at 5-5.25%. Inflation, meanwhile, seems to have peaked. That's why we, in line with markets, expect 50 to 25 basis-point steps from now on to reach the terminal rate. This limits the likely further rise in U.S. Treasury yields. The 2y-10y-30y yield curve is expected to steepen a bit again on our strategic investment horizon. We believe that U.S. high yield (HY) has solid return expectations and will likely deliver excess returns over Treasuries.

Europe: In Europe the ECB is obliged to hike further to fight inflation that, unlike in the U.S., has not yet peaked. We expect a 3% terminal deposit rate (and a 3.5% main refi-rate) to be reached next summer. The remaining upside potential in Bund yields is roughly 0.5% across the curve and our new strategic forecast is lifted to 2.4% for 10Y Bunds by end 2023. Going forward, we do not expect strong quantitative tightening measures. The ECB is forecasted to keep the EU periphery in mind and try to avoid destabilization there. In our view, EUR IG & HY have compelling return potential and will likely offer excess returns over Bunds as they have already priced in a substantial weakening of the economy and most companies have strong fundamentals.

EM: Emerging markets should enjoy broadly stable spreads over Treasuries from here and solid return potential given their current very attractive yields. The easing in the U.S. dollar now reflects the Fed's intention to hike less quickly and is supportive. It also seems likely that the embattled Chinese government will ease its Covid restrictions going forward and support the real estate market.

Currency: We leave our EURUSD forecast unchanged at 1.05.

The risk premiums on corporate bonds have also eased slightly recently



Source: Bloomberg Finance L.P., DWS Investment GmbH as of 11/30/22

2.2 Equities - From TINA to TAPAs - bonds are back; Europe and health care preferred

During the past five years interest rates have been the single most important driver for equity markets. Until one year ago, there was no alternative to equities (so-called TINA), with U.S. real yields falling below -1.2% in late 2021. Since March 2022, however, the Fed has unwound its loose monetary policy in order to fight inflation. This has lifted U.S. real- and nominal yields, resulting in a 20% compression of PE multiples and share prices. Investors have realized that There Are Powerful Alternatives (TAPAs) to equities in the (corporate/municipal) bond market again.

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Our forecasts for 2023 are based on a shallow recession in the U.S. and Europe and a soft landing for labor markets in both regions. Chinese growth is expected to accelerate, supported by gradual reopening. We predict mid-single digit total returns for global equities, mostly driven by dividend yields and small multiple expansions. An expected real bond yield of around 1.5% and an equity risk premium of 4% should limit the trailing PE to around 18x for the S&P 500. Corporate revenues will again benefit from inflation, but we predict that net profit margins have seen their cyclical peak, as the ability to pass on higher prices to consumers is fading while the interest and tax burden should rise from here. Therefore, our outlook for global earnings growth in 2023 is 0% in U.S. dollar terms, requiring consensus earnings forecasts to drop by another 5%. As the economy slows and with earnings likely to disappoint near-term, we expect the S&P 500 to trade during most of 2023 below our December 2023 S&P target of 4,100. Life in Silicon Valley has changed a lot in recent months. "Hiring" has become "firing". CFOs need to find a new skill: containing costs.

Tactically we prefer pan-European equities. The war in Ukraine has raised the PE discount to the U.S. market above the record 30% threshold. We expect the gap to shrink as international investors realize that European consumers, governments and corporations can cope with higher energy prices. Most investors have capitulated on Europe; this is reflected in fund flows and positioning despite improving earnings per share (EPS) revisions in Europe. We like pan-European banks; they are benefiting from rising interest income and stable balance sheets. Our December 2023 Dax target of 15,000 reflects a balanced view on the German market. Finally, the ultimate value market, UK equities, seems particularly cheap.

Global Healthcare still remains our preferred sector. Here, reasonable valuations combine with defensive growth characteristics. We feel the coming year will offer significant additional revenue potential for new Alzheimer's and obesity drugs.

Japanese equities offer good value and robust earnings but lack catalysts to lure investors back into this region. The demand-supply balance in the equity market is an issue, with the Bank of Japan a major owner, but participation from local investors low and demand from foreign buyers weak.

We have recently upgraded our tactical signal "expected next 5% move in the MSCI EM" to "up". Valuations in emerging markets have become very attractive (currently 11.9x last twelve months PE). We like India structurally, see ASEAN as a reopening play and like Asian semiconductors in Korea and Taiwan. However, for emerging markets to outperform developed markets they need a Fed pivot and improved EPS revisions.

After a disappointing year, markets seem to enter the year-end rally modus



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2.3 Alternatives

Oil: The forward curve reflects pessimistic demand expectations as recessions appear to loom. But our forecast continues to reflect a more balanced supply-demand view. We expect the incremental supply gain to be offset by more OPEC+R output cuts, and potential increase in demand from China. We expect Brent to trade at USD 100 per barrel in 12-month time.

Gold: The Fed's decision to front load rate hikes has caused the gold price to correct sharply in the short term. Physical demand from central banks and jewelry demand from India and China have helped to put a floor under prices. We expect demand for gold to rise again towards the end of the first half of 2023, in a more stable rate environment. Our forecast is for a gold price of USD 1,850 per ounce in 12 months' time.

Listed Real Estate: Fundamentals across selected real estate sectors are decelerating from the strength witnessed in 2021. There is potential for a bottoming out in the sector's relative performance in early 2023 as the global central bank tightening cycle approaches its end. Balance sheets are generally solid, but we expect equity to be raised in Europe where debt levels are unsustainable given the current level of interest costs.

Non-listed Real Estate: The price correction has intensified in response to higher debt costs and reduced investment activity. Performance is set to diverge over coming quarters. We believe residential and logistics, as well as the repriced Europe/APAC region could outperform in 2023. Strong fundamentals, fewer new developments, and discounts on older stock are laying the ground for stronger value add returns.

Listed Infrastructure: Volatility will likely continue, aggravated by the war in Ukraine, central bank tightening, and slowing economic growth. Infrastructure stocks should benefit given their inflation pass through capabilities and necessity-based assets. The fundamentals for U.S. utilities are improving. Communications should benefit if long-duration bond yields moderate.

A good year for oil, a not so great one for gold

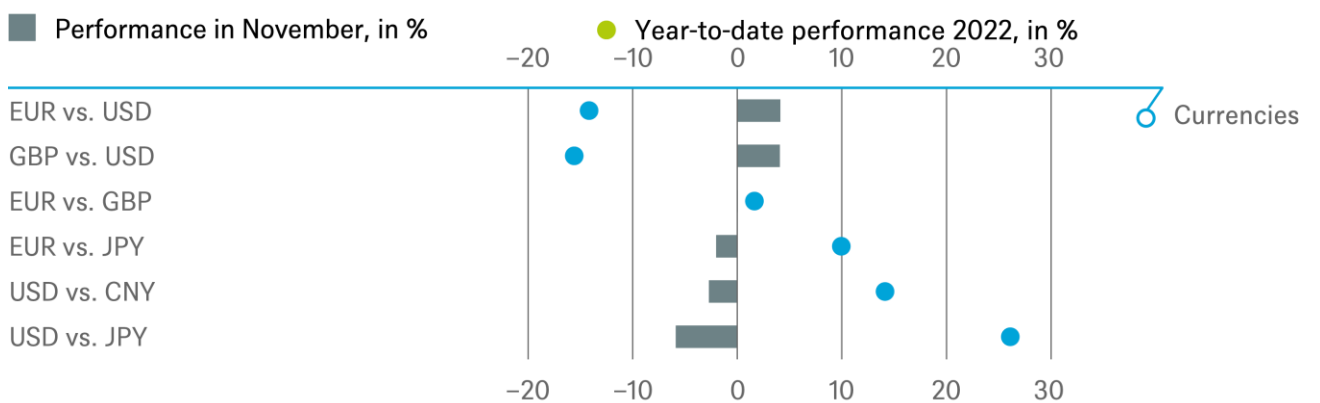
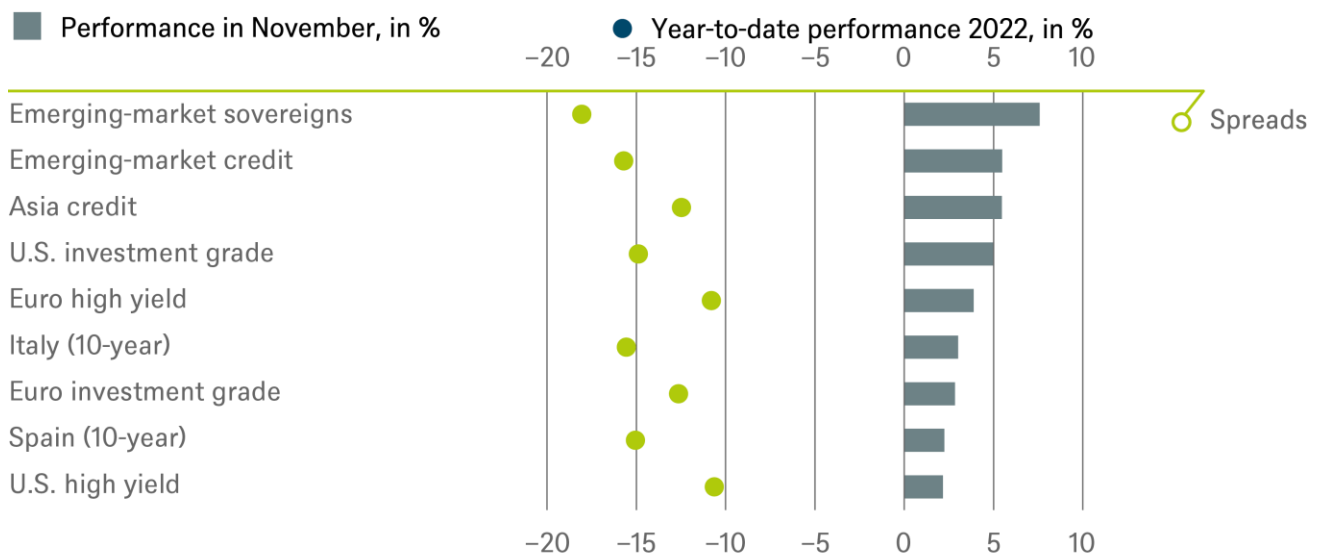
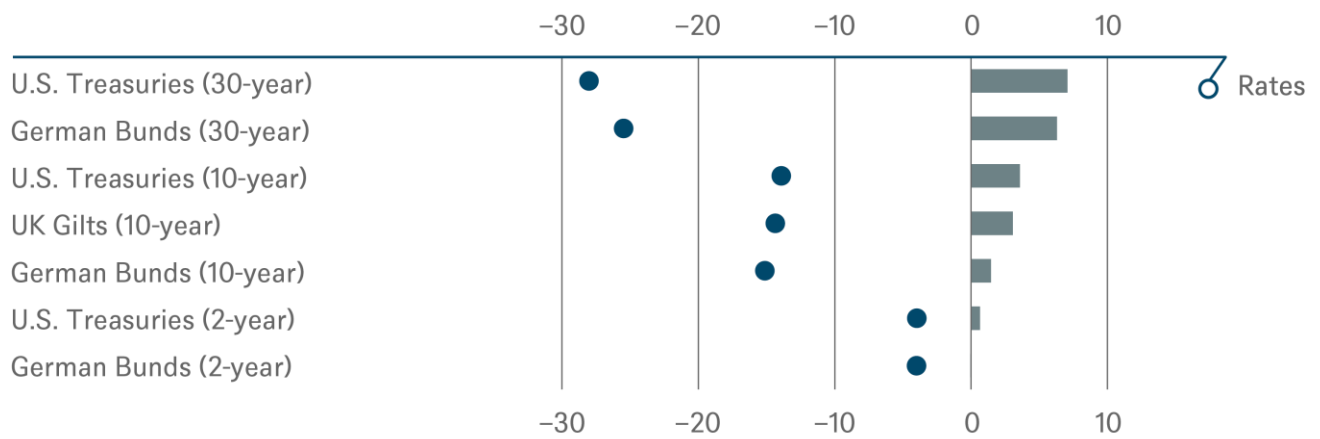


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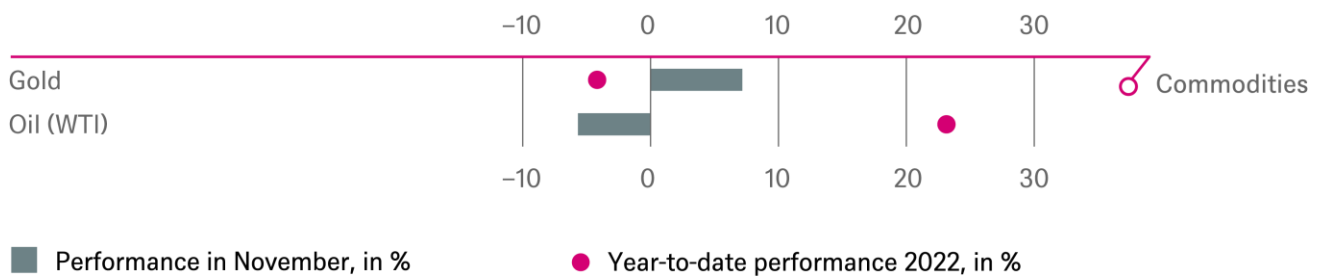
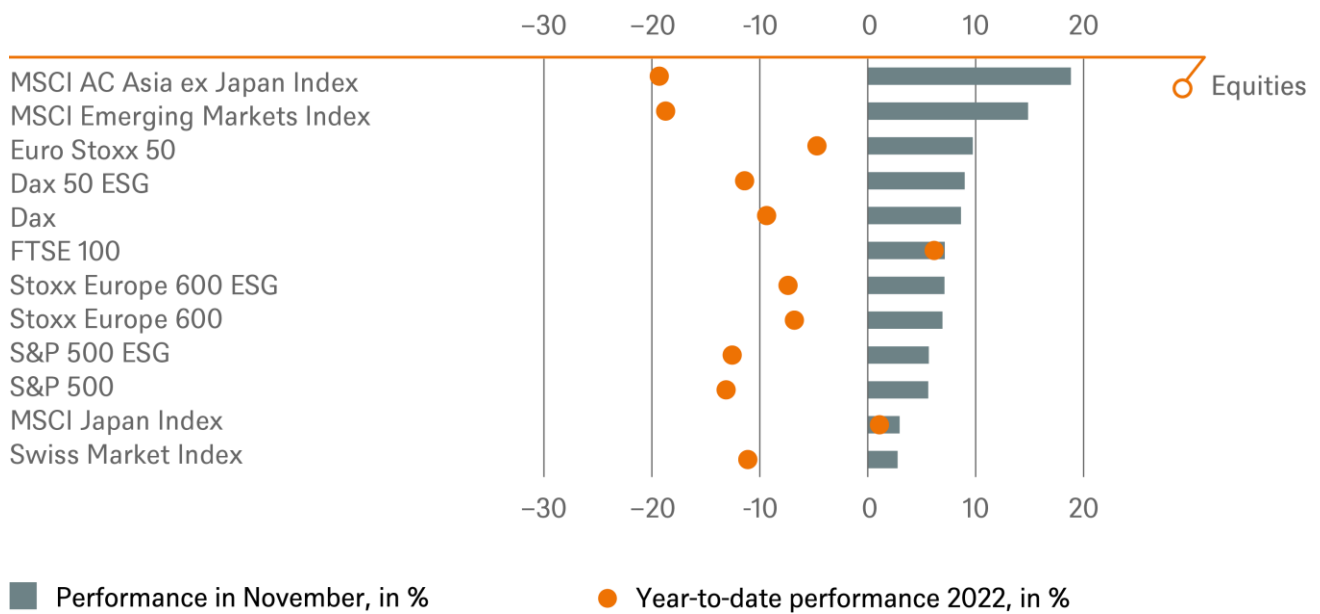
3 / Past performance of major financial assets

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



Performance in November, in % Year-to-date performance 2022, in %

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4 / Tactical and strategic signals

The following exhibit depicts our short-term and long-term positioning.

4.1 Fixed income

Rates	1 to 3 months	until Dec 2023
U.S. Treasuries (2-year)	●	●
U.S. Treasuries (10-year)	●	●
U.S. Treasuries (30-year)	●	●
German Bunds (2-year)	●	●
German Bunds (10-year)	●	●
German Bunds (30-year)	●	●
UK Gilts (10-year)	●	●
Japanese government bonds (2-year)	●	●
Japanese government bonds (10-year)	●	●

Securitized / specialties	1 to 3 months	until Dec 2023
Covered bonds ¹	●	●
U.S. municipal bonds	●	●
U.S. mortgage-backed securities	●	●

4.2 Equities

Regions	1 to 3 months ²	until Dec 2023
United States ³	●	●
Europe ⁴	●	●
Eurozone ⁵	●	●
Germany ⁶	●	●
Switzerland ⁷	●	●
United Kingdom (UK) ⁸	●	●
Emerging markets ⁹	●	●
Asia ex Japan ¹⁰	●	●
Japan ¹¹	●	●

Style	1 to 3 months	until Dec 2023
U.S. small caps ²²	●	●
European small caps ²³	●	●

Spreads	1 to 3 months	until Dec 2023
Spain (10-year) ¹	●	●
Italy (10-year) ¹	●	●
U.S. investment grade	●	●
U.S. high yield	●	●
Euro investment grade ¹	●	●
Euro high yield ¹	●	●
Asia credit	●	●
Emerging-market credit	●	●
Emerging-market sovereigns	●	●

Currencies	1 to 3 months	until Dec 2023
EUR vs. USD	●	●
USD vs. JPY	●	●
EUR vs. JPY	●	●
EUR vs. GBP	●	●
GBP vs. USD	●	●
USD vs. CNY	●	●

Sectors	1 to 3 months ²
Consumer staples ¹²	●
Healthcare ¹³	●
Communication services ¹⁴	●
Utilities ¹⁵	●
Consumer discretionary ¹⁶	●
Energy ¹⁷	●
Financials ¹⁸	●
Industrials ¹⁹	●
Information technology ²⁰	●
Materials ²¹	●

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4.3 Alternatives

Alternatives	1 to 3 months ²	until Dec 2023
Commodities ²⁴	●	●
Oil (WTI)	●	●
Gold	●	●
Infrastructure	●	●
Real estate (listed)	●	●
Real estate (non-listed) APAC ²⁵		●
Real estate (non-listed) Europe ²⁵		●
Real estate (non-listed) United States ²⁵		●

¹Spread over German Bunds. ² Relative to the MSCI AC World Index (only for the tactical signals). ³ S&P 500, ⁴ Stoxx Europe 600, ⁵ Euro Stoxx 50, ⁶ Dax, ⁷ Swiss Market Index, ⁸ FTSE 100, ⁹ MSCI Emerging Markets Index, ¹⁰ MSCI AC Asia ex Japan Index, ¹¹ MSCI Japan Index, ¹² MSCI AC World Consumer Staples Index, ¹³ MSCI AC World Health Care Index, ¹⁴ MSCI AC World Communication Services Index, ¹⁵ MSCI AC World Utilities Index, ¹⁶ MSCI AC World Consumer Discretionary Index, ¹⁷ MSCI AC World Energy Index, ¹⁸ MSCI AC World Financials Index, ¹⁹ MSCI AC World Industrials Index, ²⁰ MSCI AC World Information Technology Index, ²¹ MSCI AC World Materials Index, ²² Russell 2000 Index relative to the S&P 500, ²³ Stoxx Europe Small 200 relative to the Stoxx Europe 600, ²⁴ Relative to the Bloomberg Commodity Index, ²⁵ Long-term investments.

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 December 2023

- 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

The **Bank of Japan (BoJ)** is the central bank of Japan.

A **barrel (bbl)** is the commonly used unit to measure crude oil. One barrel is about 159 liters.

One **basis point** equals 1/100 of a percentage point.

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

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

The **CBOE Volatility Index (Vix)** is a trademarked ticker symbol for the Chicago Board Options Exchange Market Volatility Index. It is a popular measure of the volatility of the S&P 500 as implied in the short term option prices on the index.

Core inflation excludes items which can be susceptible to volatile price movements, e.g. food and energy.

The **Dax** is a blue-chip stock-market index consisting of the 40 major German companies trading on the Frankfurt Stock Exchange.

Earnings per share (EPS) is calculated as a company's net income minus dividends of preferred stock, all divided by the total number of shares outstanding.

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

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

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.

The **Hang Seng Index (HSI)** is a freefloat-adjusted market-capitalization-weighted stock-market index in Hong Kong. It tracks the 50 biggest and most traded companies on the Hong Kong stock exchange.

Headline inflation is the raw inflation figure based on the consumer price index (CPI) and not adjusted for seasonality or for the often-volatile elements of food and energy prices.

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

Inflation is the rate at which the general level of prices for goods and services is rising and, subsequently, purchasing power is falling.

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

The **Merrill Lynch Option Volatility Estimate (MOVE)** Index reflects a market estimate of future U.S. Treasury bond yield volatility.

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 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.

[OPEC+](#) is an informal alliance of OPEC members and other oil-producing countries, led by Russia, aiming to coordinate their production strategies.

[Periphery](#) countries are less developed than the core countries of a specific region. In the Eurozone, the euro periphery consists of the economically weaker countries such as Greece, Portugal, Italy, Spain and Ireland.

The [price-to-earnings \(P/E\) ratio](#) compares a company's current share price to its earnings per share.

The [Purchasing Managers' Index \(PMI\)](#) is an indicator of the economic health of the manufacturing sector in a specific country or region.

In economics, a [real](#) value is adjusted for inflation.

A [recession](#) is, technically, when an economy contracts for two successive quarters but is often used in a looser way to indicate declining output.

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 [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. Federal Reserve](#), often referred to as "[the Fed](#)," is the central bank of the United States.

[Volatility](#) is the degree of variation of a trading-price series over time. It can be used as a measure of an asset's risk.

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