CIO View

Investment Traffic Lights

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DWS

Marketing Material

OUR MONTHLY MARKET ANALYSIS AND POSITIONING

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IN A NUTSHELL

- The first three months was in many regards a dramatic quarter, and the worst for investors in two years.
- Russia's aggression turned many political certainties on their heads and exacerbated the already serious inflation concerns in the financial markets.
- The war, monetary tightening, China's weakness, supply shortages and economic fears leave the markets with little near-term potential.

1 / Market overview

The past month, and indeed the entire first quarter, has been dramatic in every respect. The invasion of Ukraine by Russian troops not only revealed that German politicians in particular had been mistaken about the Russian leader, Vladimir Putin. It also showed once again the damage that can be caused in a highly interconnected world by disruptions even in seemingly less important economies. While Russia's role as an energy exporter was well known, it took the war to reveal to many the size of Russia and Ukraine's market shares in other commodities, especially agricultural raw materials and fertilizers, but also metals and uranium. The remarkably swift and far-reaching sanctions imposed by the West have disrupted supply chains. The fighting on Ukrainian soil has caused a severe shortage of food supplies, especially of wheat and sunflower seeds, and this will worsen further. The international food price increases that have occurred, which are likely to worsen further, could cause social hardship and political unrest, especially in lower income countries in Africa and the Middle East.

The invasion has not only permanently changed the security architecture of Eurasia but also provoked some previously inconceivable political about-turns. In Germany, in particular, many long-held positions on Russia, energy and defense policy have been called into question virtually overnight. More globally the invasion is likely to have a strong environmental, social and governance (ESG) impact. Though in the near-term sustainability has been pushed into the back seat as countries turn to conventional energy production to guarantee supply, it is likely to be pushed even more strongly by politicians and business in the medium term. The expansion of renewable energies and potential savings in energy consumption would reduce dependence on supplies from less agreeable suppliers. The potential for autocratic countries to come up with ugly surprises might ultimately be interpreted as a governance problem.

Even without the war the first quarter would have been dramatic enough. With inflationary pressures continuing unabated, giving Europe and the U.S. the highest inflation for 40-50 years, central banks have been compelled to step up their monetary policy tightening. The Federal Reserve (Fed) made its first interest rate move in March and has already given full priority to fighting inflation. We await clearer signals from the European Central Bank (ECB).

While the war and the new interest rate cycle have taken the foreground, China has been somewhat forgotten. But the continuing difficulties of major Chinese real estate developers, further sector-related regulatory measures, delisting preparations for U.S.-listed Chinese tech companies, and city-wide lockdowns due to the spread of the Omicron variant have made Chinese investments a less than palatable cocktail for investors. The MSCI AC Asia ex-China Index lagged other global regions in March with a fall of 2.7%; and in the entire first quarter, with a decline of 8%, it was in second to last place behind Europe, where the Stoxx 50 declined by 8.9%. The undisputed regional winner, not least because of its geographical and economic

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distance from the war and its role as a commodity exporter, was Latin America, with an increase of 27.3% for the quarter. Globally, the energy sector clearly led the pack with a 21.5% gain, while information technology, communications and consumer cyclicals each lost more than 10%.[1] From a global perspective, what is remarkable, given the war, is that equities are once again trading as high as they were before the war began[2].

Individual commodities have seen some extraordinary trajectories, with nickel trading even suspended for a few days. Some of the quarterly price increases are impressive enough: coal up by 99%, gas (Holland) 79%, wheat 53%, oil (Brent) 37%. Gold, silver and copper, on the other hand, had to settle for single-digit gains.

Bondholders' nerves were also challenged in the first quarter, as some suffered losses not seen in many decades. In the first quarter, for example, corporate bonds and a large number of 10-year government bonds from industrialized countries lost between 4% and 7.5%. Asia did not fare any better, with a drop of 6.5%[3]. It is also worth mentioning that at the end of March, 2-year Bunds returned positive yields for the first time since 2014 and the U.S. yield curve inverted in the two- to 10-year range. This inversion is generally regarded as a good indicator of a future recession.[4] But whether this is the case now is being fiercely debated – and denied by some, among them the Fed[5].

2 / Outlook and changes

A traumatic year for the world is proving challenges for investors, too. Russia's invasion of Ukraine has brought unexpected brutality at a time when persistently high inflation, the start of the global interest rate hike cycle and further supply bottlenecks due to China's Covid policy were already a highly complex mix. The markets have already recovered significantly from their initial falls. But the economic outlook still looks complicated. It is clear that even in the event of an immediate ceasefire in Ukraine the world economy and world trade will not be able to return quickly to business as usual. Refugee flows, the destruction wrought by the war, inflation spikes, and supply bottlenecks, especially for agricultural commodities, are likely to continue for some time. So, too, are the efforts of many countries to increase their economic self-sufficiency. Russia's war is now likely to play its part in the renewed fragmentation of the world, following on from Western efforts to contain China’s economic power.

For our tactical outlook, we make two basic assumptions: the war will not be fought on NATO territory and European oil and gas supplies will not be suddenly curtailed. In our core scenario this is enough to avert a major recession. But the cumulative impact of the many problems we list above is likely to be significantly weaker economic growth this year than we had earlier assumed, especially in Europe.

2.1 Fixed income

Once market participants had abandoned the illusion that the spurts in inflation would be temporary, they could hardly have been keener to tell the central banks that they were way behind the curve in fighting inflation. This is particularly evident in the number of interest rate hikes markets are now pricing in by the end of the year. At the beginning of the year the Fed was thought likely to make three hikes in 2022; now it’s expected to make 8. In other words, investors have increased their forecasts for the Fed funds rate by the end of the year from 0.75% (at the lower end of the range) to 2.0% within just three months: a big change in expectations. The ECB, meanwhile, is now expected by markets to raise rates by 0.5% points in 2022, up from just 10 basis points at the beginning of the year. But whether this change in expectations will prove durable after the very rapid rise in many bond yields in the first quarter is not so easily answered, in our opinion.

Central banks will have to balance their inflation fight against the monetary support needed to cope with big economic uncertainties. In government bonds we are neutral overall after this turbulent first quarter, with the exception of 10-year U.S. Treasuries, in which we expect to see a further rise in yields. In corporate bonds, despite the tense situation in Europe, we have

[1] Source: Bloomberg Finance L.P.; as of: 3/31/22
[2] MSCI AC World, 3/31/22 compared to 2/18/22
[3] JP Morgan Asia Credit Composite (JACI).
[4] Since 1970 every U.S. recession has been preceded by an inverted 2y-10y yield curve.
[5] (Don't Fear) The Yield Curve, Reprise (federalreserve.gov)

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become somewhat more confident that the significantly widened yields compared to the pre-war period cover many risks. In the investment grade segment, we are still quite selective, but overall we are again positive about European high-yield bonds. The situation is different in U.S. investment grade. High market volatility, substantial issuance in the primary market and the further risk of interest rate hikes may dampen investors' appetite for a while longer.

On the currency front we expect the Chinese yuan to weaken further against the dollar. This reflects not only rising yields in the U.S. but also the fact that many international investors feel uncomfortable with large positions in China given the Ukraine war. In Europe we think the British pound is overvalued against the euro. The pound is a more cyclical currency and is therefore likely to be affected by softer growth and it has become less attractive in terms of the real interest rate differential. Against the Dollar, however, we believe the euro is more likely to weaken. High inflation in Europe, the underperforming equity markets and the only small geopolitical risk discount priced in, make the euro vulnerable in the short term in our opinion.

2.2 Equities

Given the heightened uncertainty we raised the risk premium on our 12-month index targets in early March, resulting in lower price targets, with the S&P 500 lowered from 4,800 to 4,600 for March 2023, and the Dax from 16,600 to 14,600. We believe the direct impact of Russian sanctions is likely to be economically manageable for most companies in the MSCI World given that the Russian end market and local Russian operations account for typically less than 5% of earnings. Our focus is on second- and third-round effects. With sanctions likely to continue for some time, the prices of oil, gas, wheat, and fertilizer are unlikely to decline in the foreseeable future. We expect corporate earnings forecasts to be revised downward in coming weeks, as many companies will no longer be able to pass on rising costs to consumers who themselves are facing falling real wages. Profits in Europe are most at risk, but markets have already recognized this, with EU and German stocks trading at a record discount to their U.S. counterparts.

Thematically, we have added the entire agribusiness value chain to our preferred portfolio, which we believe may offer a good hedge against inflation. Healthcare remains our preferred sector as it combines cyclical stability with the potential for growth, at reasonable valuations, and to make a strong contribution to UN sustainability goals. We also hold on to certain cyclical sub-sectors, such as oil services, basic chemicals, and select automotive stocks.

As we think purchasing managers' indices will fall in the coming months, we are reluctant to take a more constructive stance on the industrial sector and remain neutral. However, we maintain our overweight in defense stocks and also like the transportation sector, where some U.S. rail and logistics companies currently have significant pricing power. In the utilities sector, in which we are neutral, we see increasing risk of government intervention to limit the burden of rising energy prices on households but are also aware that a re-accelerated shift to renewables could provide the potential for even more investment opportunities.

"Digitization" is no longer the No. 1 priority in boardrooms. Securing fragile supply chains and controlling costs are now top of the list. The electronics sector also faces the risk that consumers may postpone major purchases. As a result, we expect greater differentiation in performance in the different cyclical components of the IT sector in coming months, even though many long-term growth prospects remain attractive.

A further risk lies in wait, in addition to the war and inflation: investors may also have to contend with further weakness in China, because of the country’s zero Covid policy and real estate wobbles. And so, things might get worse. But those who believe the market has already priced in most of the risks and doubt there will be further deterioration could flirt with an increased weighting in European equities and a reduction in less cyclical defensive sectors such as consumer staples. But in our view, it’s too early to take this step.

2.3 Alternatives

Gold is likely to continue to be heavily influenced by the path of interest rates. If the inflation component of nominal interest rates dominates, this helps the gold price; if real interest rates prevail, this depresses the price. Most recently it has been mainly the inflation component that has risen, so that the real interest rate has remained quite stable despite the hawkish Fed. With geopolitical risk having been priced in, we see no clear direction for Gold from this level to trade.

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The oil price is likely to remain very volatile, influenced by a range of factors. The announcement by the U.S. at the end of March that it would release one million barrels a day from its strategic reserve on to the market is putting downward pressure on prices. But the lack of new sales channels for Russian oil as the West tries to look elsewhere is likely to continue to be an upward influence on prices. China is the most commonly cited buyer, but its demand is currently under pressure because of the Covid lockdowns of some cities.

Rising price pressures, especially in construction, are likely to further increase the attractiveness of real estate as a classic inflation hedge, especially for existing properties with partial or full inflation-indexed leases. Infrastructure assets also tend to be well positioned in an inflationary environment, as their monopoly position typically enables them to pass on price increases to their customers, even if this is not already contractually regulated. But we believe cautious selection and careful risk assessment are always necessary in this area.

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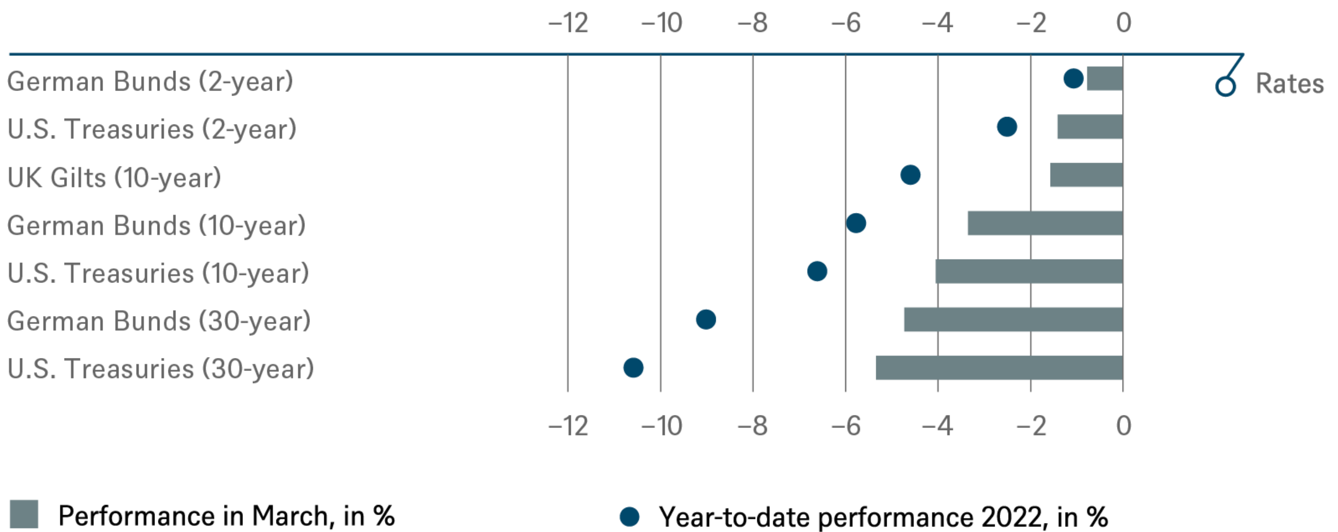
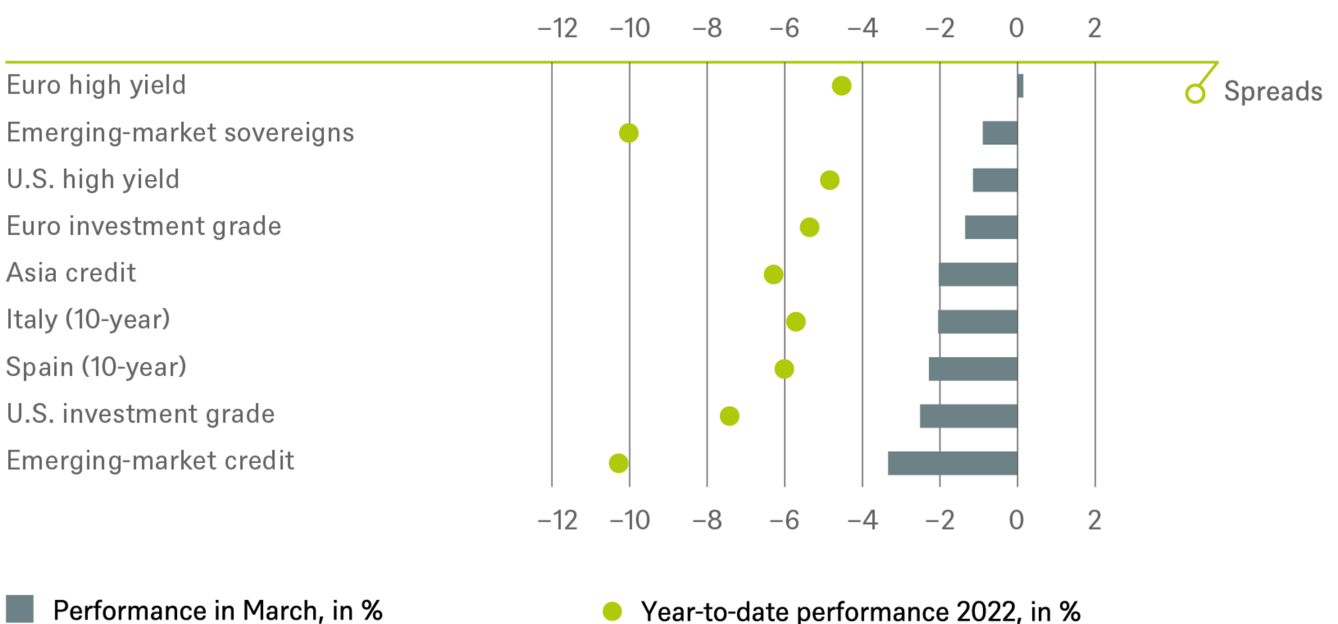
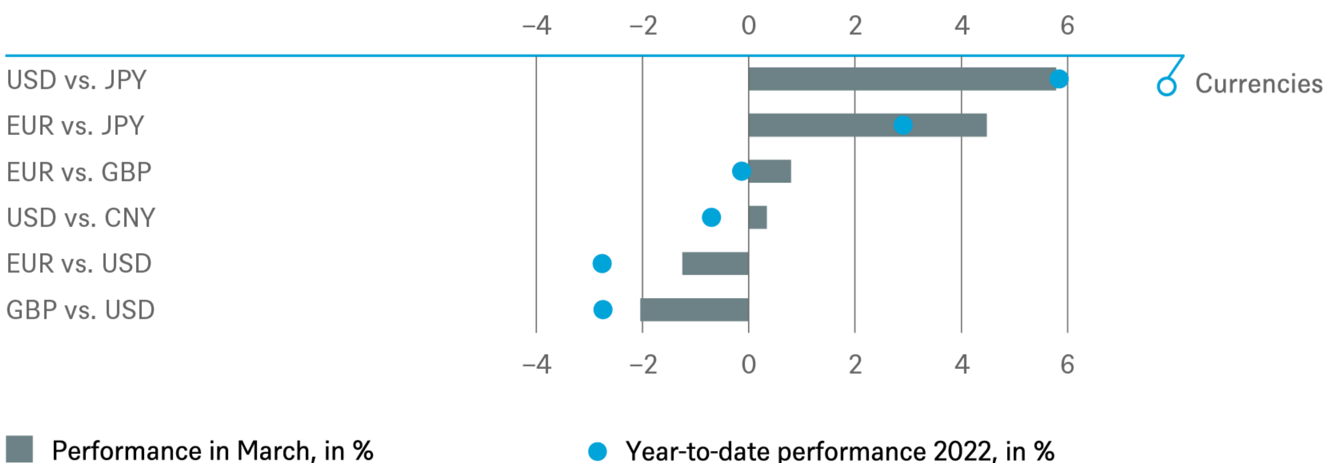
3 / Past performance of major financial assets

TOTAL RETURN OF MAJOR FINANCIAL ASSETS YEAR-TO-DATE AND PAST MONTH







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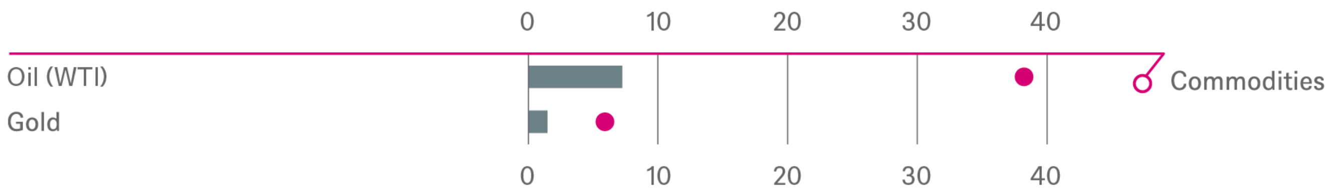

Past performance is not indicative of future returns.
Sources: Bloomberg Finance L.P. and DWS Investment GmbH as of 3/31/22

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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 Mar 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)	🟡	🟡

Spreads	1 to 3 months	until Mar 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	🟡	🟢

Secritized / specialities	1 to 3 months	until Mar 2023
Covered bonds[1]	🟢	🟡
U.S. high yield municipal bonds	🔴	🟢
U.S. mortgage-backed securities	🔴	🟡

Currencies	1 to 3 months	until Mar 2023
EUR vs. USD	🔴	🟡
USD vs. JPY	🟡	🔴
EUR vs. JPY	🟡	🔴
EUR vs. GBP	🟢	🔴
GBP vs. USD	🟡	🟢
USD vs. CNY	🟢	🟡

4.2 Equities

Regions	1 to 3 months[2]	until Mar 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
U.S. small caps[22]	🟢
European small caps[23]	🟢

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	until Mar 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]		🟢

[1] Spread 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

4.4 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 MARCH 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

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GLOSSARY

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.

Consumer staples is a sector of the economy selling essential products.

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

Investors increasingly take environmental, social and governance (ESG) criteria into account when analyzing companies in order to identify non-financial risks and opportunities.

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 27 member states located primarily in Europe.

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

Hawks are in favor of a restrictive monetary policy.

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

The MSCI All Country World Index (ACWI) captures large and mid-cap securities across 23 developed- and 24 emerging-

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markets.

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.

In economics, a nominal value is not adjusted for inflation; a real value is.

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.

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.

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.

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